Olivier Boutellis-Taft
Chief Executive
Accountancy Europe
By email

Tuesday 7 April 2020

Dear Olivier,

Interconnected standard-setting for corporate reporting: A response to the Accountancy Europe Cogito paper from the International Integrated Reporting Council (IIRC)

The International Integrated Reporting Council (IIRC) welcomes the opportunity to respond to Accountancy Europe's Cogito Paper, *Interconnected Standard Setting for Corporate Reporting*, published in December 2019. The IIRC and Accountancy Europe have long shared a vision for a corporate reporting system that focuses on the communication of value creation, critical for the future success of business, society's long-term prosperity and the sustainability of the accountancy profession. We share the view that integrated thinking and reporting present an unrivalled opportunity to reshape the conversation about value and how business performance is measured, accounted for and reported, and assured.

Given the different 'moving parts' and the lack of a single 'owner' or 'sponsor', a system-wide global response is required to resolve the current challenges in the public interest, drawing on all the available expertise, innovation and best practice. We set out in this letter how the IIRC might play its part.

Encouragingly, as an indication of the global strategic support for the IIRC from the accountancy profession, one of our founder organizations and principal supporters is the International Federation of Accountants (IFAC). Your paper refers to IFAC's recent Point of View on *Enhancing Corporate Reporting* which affirmed IFAC's support for integrated reporting as, "a basis for narrative information and metrics that more effectively communicate their ability to create value over time". IFAC encourages regulators and standard setters, "to use the International Integrated Reporting Framework as a foundation for incorporating and organizing information about value creation and impacts, including narrative reporting and metrics from the various standard-setting initiatives. A common framework can facilitate the development of best practices and standardization".

Summary of recommendations

This letter sets out our approach and recommendations in detail. In summary, we recommend:

- A global approach to international standard-setting, which we believe to be essential
- That the International Integrated Reporting Framework is used to develop a comprehensive and interconnected conceptual framework for corporate reporting
- A new roadmap for achieving a global oversight structure with a newly constituted Corporate Reporting Foundation, which has the broad business skills that build on the current attributes of the IFRS Foundation Trustees
- Clearly agreed steps to achieving a single standard setter with milestones
- A commitment to continued innovation, including the use of technology, to ensure ongoing relevance of corporate reporting.

Moreover, the IIRC expresses its willingness to engage with all market participants to secure agreement for a high quality, enduring conceptual framework that will gain the widest possible support from governments, regulators, standard setters, businesses, investors, the accountancy profession and civil society. We believe that the International Integrated Reporting Framework, with its focus on multi-capital thinking, already meets many of the needs of multiple stakeholders and provides the structure to create an interconnected conceptual framework for corporate reporting.

The need for an interconnected conceptual framework for corporate reporting

This recommendation by IFAC is consistent with the observation in the Cogito Paper that the International Integrated Reporting Framework provides, "a useful starting point" for the development of an interconnected conceptual framework for corporate reporting (see Recommendation Two below). We would go further and advance the view that a conceptual framework is essential for elevating a better understanding of the purpose and value of corporate reporting to the governing bodies of organizations (typically company boards) as well as establishing the characteristics of effective corporate reporting in the 21st century, thereby creating the building blocks for decision-useful information both to investors and wider society. Integrated reporting is founded on integrated thinking, providing a cohesive and coherent framework for understanding the business and its value creating process (including the business model, governance and the management of risks and opportunities). In this regard we believe it is essential that corporate reporting plays an explicit role in directing financial capital towards long-term focused and resilient businesses. The current revision of the IIRC's Integrated Reporting Framework presents an opportunity for international coalescence around a set of principles that could form the basis of a globally-agreed and endorsed interconnected conceptual framework for corporate reporting.

A new corporate reporting settlement achieved on a global basis

We endorse the approach taken by Accountancy Europe in encouraging dialogue between stakeholders that will lead to a globally coordinated solution involving many different constituents on an inclusive basis. Regional action can accelerate progress globally and we would encourage the European Union to use its membership of the G20 to lead an internationally-coordinated response. We welcome the European Commission's appetite for innovation in this area and specifically their endorsement of integrated reporting as a 'step ahead' of the current implementation of the Non-Financial Reporting Directive. More broadly in relation to public policy, it is the IIRC's experience that regulatory endorsement is a significant accelerator of adoption and this has been seen in relation to integrated reporting in markets such as Japan and the United Kingdom. The Corporate Reporting Dialogue should continue to be an important driver and enabler of an evolution of the corporate reporting system and the organizations it comprises have already shown dedicated commitment and leadership to create the conditions for deeper and sustained convergence, which can now lead to a new permanent settlement and a model of corporate reporting fit for the 21st century.

An urgent response to economic and societal demands

Changes to the corporate reporting system are being demanded by governments and regulators, investors and companies. This demand for action is driven by two powerful megatrends. First, the risk profile of the world has changed – and permanently. The World Economic Forum's Global Risks Report has tracked this underlying trend over the last ten years, demonstrating the transition from a world dominated by purely financial risks in 2010 (in the aftermath of the Global Financial Crisis) to one where the underlying risks relate to climate, inequality and political polarization. Critically, these risks are interconnected and therefore require new tools, including ways of measuring, reporting and assuring the processes and information that is produced to hardwire resilience into our business models and economic decisions. It would be impossible in this context not to make reference to the current global health pandemic. While it is far too early to draw conclusions, a consensus is building that, "businesses that invest in strategic, operational and financial resilience to emerging global risks will be better placed to respond and recover", (Richard Smith-Bingham and Kavitha Hariharan, Marsh & McLennan Advantage Insights)

The second megatrend is the shift in our understanding of value as intangibles, such as intellectual and human capital, become better indicators of future financial performance – factors that are difficult to account for using traditional financial reporting methods exposing an information and governance gap. Our corporate reporting system, which is critical for ensuring trust and transparency, must adapt urgently to these powerful forces that have transformed the global economy and society.

An interconnected and integrated global approach is needed

These changes to the global economy have left the corporate reporting system incomplete. It is a system focused around a small number of standard-setters for financial and non-financial information. The International Integrated Reporting Framework provides much needed coherence to this system by connecting financial value creation with value creation across other types of capital for multiple stakeholders and over different time horizons (the short, medium and long-term). While there is an order to the system, the perception is one of competing standards, an issue the Corporate Reporting Dialogue has been addressing through collaboration and alignment. This confusion is driven by different demands placed on companies (e.g. new standards and surveys) and the lack of a cohesive regulatory and assurance structure. This shift towards greater convergence needs to be accelerated, a point highlighted by the Cogito Paper and a recent report by the International Business Committee (IBC) of the World Economic Forum.

With respect to information beyond current financial reporting the picture is incomplete, especially in the areas of intellectual and human capital which make up a significant proportion of value creation today. The voluntary nature and inconsistency allow its legitimacy to be questioned, which has real economic outcomes in terms of an inefficient and unproductive capital allocation. The evidence shows that integrated reporting supports how company boards think about and manage their businesses over the short, medium and long-term. The IIRC stands for both financial stability and sustainable development as simultaneous global goals. We have therefore been working as a coalition in our own right, and as a participant in the Corporate Reporting Dialogue, to advance greater alignment, convergence and completion of the corporate reporting system.

An interconnected and integrated global approach is therefore vital. **Of the options presented in the Cogito paper the IIRC would support Approach Four for the standard-setting structure.** We believe dialogue should begin immediately to help build consensus for a single international 'non-financial' reporting standards board. We do believe language and common definitions are also a critical feature of finding a global solution and we welcome the work being undertaken by the Impact Management Project (IMP) in this area.

A shift to the lexicon of value creation over different time horizons is needed to normalize new behaviours

A specific example relates to the distinction between 'financial' and 'non-financial' information, which is both false and damaging to providing a cohesive suite of decision-useful information to enable providers of financial capital to make optimal long-term judgements. A matter that may seem like a low-risk 'non-financial' concern today (for example, a fall in employee morale) will emerge in the cashflows of the business over a different time horizon. By falsely segmenting these buckets of information we are distorting our understanding of what is material to the long-term success of the business, contributing to a market failure. This is a very similar concept to that identified by Mark Carney who, as Chair of the Financial Stability Board, highlighted the 'tragedy of the horizon' – known future risks that are not being accounted for or disclosed as part of existing financial reporting and risk management. At a system level, this thinking would provide an opportunity to connect with multiple stakeholders, driving a better understanding of material topics for groups such as employees or suppliers, and their impact on an organization's ability to create value. Such analysis is applicable across all forms of value creation but we need a different language to mainstream this thinking.

The concepts of multiple 'capitals' as the principal components of value and the 'connectivity of information' as the guiding principle for creating linkages between these sources of value – critically, over different time horizons - should be better prisms through which to understand business performance and the information required by stakeholders to make useful decisions. A single set of comprehensive metrics would allow companies to report on factors today that will impact future performance. Our common goal should be to break-down, rather than reinforce, silos. Such an approach would capture current *and future* financial information – information that should hold the same status and be subject to the same high level of rigour as financial reporting.

We would propose five specific recommendations.

Recommendation One: A global approach to international standard-setting is essential

The IIRC believes that achieving global consensus, first around the need for a conceptual framework, then developing the standards and oversight necessary to achieve legitimacy, is essential. A local or regional approach, while easier to achieve more quickly, will end up being inefficient, confusing and, ultimately, counter-productive. A global approach, on the other hand, would assist trade and the transparency of complex global supply chains. It is also vital that the global momentum in tackling climate change is not lost. In the current context the risk of polarization and nationalism persists, something as a global movement we should resist. We would therefore encourage the involvement of supranational bodies in this discussion as a matter of urgency, for example The World Bank, Financial Stability Board, United Nations institutions and IOSCO – organizations that are already represented on the IIRC's Council to ensure a level of international discourse and a route to global endorsement. This would enable local and regional innovation, but within an overall framework of international coordination and action.

Such oversight would help to bring to fruition the valuable addition of a "Corporate Reporting Foundation" for ensuring that all material information to support the efficient and productive allocation of capital is provided and that the information needs of market participants are kept under review. The system should be responsive to ensure relevance. It should oversee both the conceptual framework and standard-setting work, including the development of new standards and alignment.

Recommendation Two: Integrated Reporting Framework used to develop a comprehensive and interconnected conceptual framework for corporate reporting

As we argued at the start of this letter, an interconnected conceptual framework for corporate reporting will have multiple benefits, including providing an essential link between corporate reporting and governance. It should help to provide greater standardization both of definitions of key corporate reporting terminology as well as explain the purpose of corporate reporting. It will help regional and local regulation and standards, enabling greater consistency, comparability and speed of adoption.

We support the Cogito Paper's analysis that the International Integrated Reporting Framework provides, "a useful starting point" in developing a conceptual framework. Furthermore, we believe such a framework is essential and that the IIRC Framework represents the best chance of achieving the required buy-in from stakeholders in a timely way. The process for drafting the International Integrated Reporting Framework was robust and we are applying the same rigour to its revision.

In the ten years since the IIRC was founded, an increasing number of companies and regulators are viewing the International Integrated Reporting Framework as the global conceptual framework for corporate reporting, evidenced by the number of regulators signposting to the Framework or including a recommendation in corporate governance codes. The Framework has the advantage of being principles-based and comprehensive, with the six 'capitals' encompassing all the principal dimensions of value creation.

In 2020 the IIRC is reviewing the International Integrated Reporting Framework, first released in 2013. This review presents an opportunity for all stakeholders to engage in this process and use the Framework as the basis for building global consensus on the components of an interconnected conceptual framework for corporate reporting. Such a framework must be inclusive, taking account of developments across the reporting landscape, including the existing financial reporting standards under IFRS and US GAAP.

Recommendation Three: A roadmap towards achieving global oversight is needed

While it is straightforward in principle to achieve agreement to move towards a system of global oversight, in practice there are different ways of putting it into practice. The IIRC's Council is a global corporate reporting coalition, created ten years ago, and includes representation from across the broad constituencies with an interest in advancing improvements in disclosures and corporate governance. We would encourage the use of existing multilateral structures, such as the IIRC's Council, either to inform an expanded role for the IFRS Foundation or to create a new body that would require structures and processes that gained widespread acceptance. While a new corporate reporting oversight structure, focused on convergence of the system, will require broader business skills to be embedded within the qualities of the leadership of the Corporate Reporting Foundation, we believe the IFRS Trustees have many of the attributes necessary to take on this role and that an alternative structure would be more difficult to put in place to gain the necessary legitimacy.

Furthermore, endorsement by the global financial reporting standard-setting bodies, and the emergence of a Corporate Reporting Foundation, could have a significant positive impact on ESG disclosure and value creation internationally.

It is of great importance that the Corporate Reporting Foundation develops agreements with standard setters, including FASB, to enable a truly global solution. The IIRC could act as an Advisory Council to inform this process and act as a link between the different organizations.

We believe it is important to initiate a dialogue about this structure and the IIRC Board and Council will decide its own position as a priority in the coming weeks.

Recommendation Four: Clearly agreed steps in achieving a single standard setter

The IIRC welcomes the simplicity of the oversight model outlined in Approach Four, but we believe the current system of standards is incomplete, with significant gaps in areas such as intangibles, human and intellectual capital and quantifying and valuing impacts. We do welcome the goal and believe consensus is required to create a high quality, comprehensive system of global standards. We would anticipate that the Corporate Reporting Foundation would invite existing standard-setters to address the current gaps in the system.

The issue of sequencing needs to be addressed. We would propose that, first, agreement on the need for a global solution is achieved; second, the Corporate Reporting Foundation should be established, leading to the development of the remaining standards needed; and, finally, a move to comprehensive and integrated oversight of the system.

We believe the current IASB Management Commentary project is critical for ensuring that wider information, and especially the link between financial reporting and the management report, is viewed as part of mainstream accounting and reporting, providing more forward-looking information.

Once the Corporate Reporting Foundation is established, we would expect it to take on broadly the following core functions, critical to establishing authority and legitimacy:

- A conceptual, principles-based corporate reporting framework
- Agreements with individual standard-setters to provide the metrics providing the context for comprehensive corporate reporting
- Identifying the need for, and commissioning the development of, new standards and ensuring that existing standards are fit for purpose
- Strong and effective stakeholder engagement
- The identification of effective and efficient processes for corporate reporting, maximizing the use of technology
- Ensuring the system provides the basis for effective external assurance.

The Corporate Reporting Foundation would need to be independent from political interference and have the governance, resources and funding to be effective and trusted in delivering its mandate.

Recommendation Five: Innovation in corporate reporting will ensure its future relevance

In a fast-moving global economy, it is vital that corporate reporting keeps pace with the megatrends that influence business and investor decision-making, governance and trust. Corporate reporting should be a tool for better decision-making both within the business and by external stakeholder communities.

Any corporate reporting structure – including standards and oversight – should encourage innovation to support decision-making for boards and stakeholders and to enable a comprehensive reporting system to be completed (e.g. through new standards). It should also initiate thought leadership so that reporting can play its part in the achievement of, for example, the SDGs, as well as encouraging a role for technology to aid the connectivity of information and the accessibility of decision-useful data and board insights.

The broad eco-system of organizations seeking to bring about convergence, through better measurement of externalities, benchmarking and embedding a multi-capital mindset in core business and investment decisions, has expanded significantly. The IIRC strongly endorses the vital role of the Value Balancing Alliance, World Benchmarking Alliance and Impact Management Project in strengthening the case for integration and achieving the political mandate necessary to create system change.

Thank you again for the opportunity to take part in this vital consultation. We look forward to further constructive engagement with Accountancy Europe as your work develops in the months ahead.

Yours Sincerely,

Charles Tilley

Charles Tilley
Chief Executive
Sent on behalf of the IIRC Board of Directors