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Agenda paper 8

# Connectivity in financial reporting

IFRS Advisory Council meeting  
April 2023

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# Agenda

- What is ‘connectivity’?
- Deep dive into one aspect of connectivity—the role management commentary and integrated reporting can play in facilitating connectivity between general purpose financial reports
  - Introduction to management commentary and integrated report
  - The current state of play
  - Similarities and differences between the *Management Commentary* Exposure Draft (MC ED) and the *Integrated Reporting Framework* (IR Framework)
- Blue sky thinking
- Discussion questions

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# Discussion questions

## Plenary session

- Do you have any questions or comments on the meaning of ‘connectivity’ in relation to the work of the IASB and ISSB?
- Do you have any questions or comments on the initial analysis of similarities and differences between the MC ED and the IR Framework?

## Breakout sessions

- What role could management commentary and integrated report play in facilitating connectivity?
- Do you think that the IFRS Foundation should work together with local regulators and other stakeholders in this area? If yes, what steps would you envisage? If no, why not?
- How would you approach further alignment between the MC ED and the IR Framework?

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## A note on terminology

### General purpose financial reports

The term refers to financial information that is useful to primary users in making decisions relating to providing resources to the entity. The term does not refer to a ‘location’ of information, but to a set of disclosures that are clearly identifiable and distinguished from other information. A report can be a standalone report or part of another report.

### General purpose financial reporting

The term refers to the process of provision of information that is useful to primary users.

### Management commentary / Integrated report

‘Management commentary’ or ‘integrated report’ forms part of an entity’s general purpose financial reports. In practice, an integrated report can be used to meet information needs of a broader group of stakeholders.

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# What is ‘connectivity’?



# Feedback from consultations



- Stakeholders expressed strong support for IFRS Foundation’s creation of the ISSB in part because of opportunity to have both boards within the same organisation
- The opportunity this provides is reflected in the Constitution:
  - *These **complementary sets of IFRS Standards** are intended to result in the provision of high-quality, transparent and comparable information **in financial statements and in sustainability disclosures that is useful to investors and other participants in the world’s capital markets in making economic decisions.***
- But stakeholders also noted the importance of both boards' pursuing their own work on a timely basis

## What do we mean by 'connectivity'?



Matters related to connectivity between financial statements and sustainability-related financial disclosures are part of the ISSB's foundational work and the IASB's work plan. There are other 'connections' (such as between the general purpose financial reports and broader reporting). We are using this term to focus on the connections in the boards' work.

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# Why is connectivity important?

## For preparers

- Increasingly the same individuals are involved in preparing financial statements and sustainability-related financial disclosures. They will benefit from Standards that work well together.

## For users

- Financial statements and sustainability-related financial disclosures share the same audience
- Users need to understand how sustainability-related matters translate into an entity's financial performance and financial position for the reporting period and over time
- They also need to understand connections in the information provided in the financial statements and in the sustainability-related financial disclosures

# The broader reporting landscape



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## Examples of connectivity

### ***Connectivity in process***

- Chairs of the boards have strategic responsibility for connectivity and Vice-Chairs have operational responsibility
- Regular updates during board admin sessions
- Joint staff team for digital reporting
- Integrated Reporting team has joint reporting lines to Vice-chairs
- Sharing of technical staff (for example, for the drafting of S1)
- Knowledge sharing at staff level

### ***Connectivity in product***

- The ISSB has built on concepts included in IFRS Accounting Standards
- The ISSB has learnt from the IASB's Digital Taxonomy
- The IASB plans to build on IFRS S1 and IFRS S2 in its work on climate-related risks in the financial statements
- The IASB and ISSB considered each other's work on commercially sensitive information

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# Introduction to management commentary and integrated report

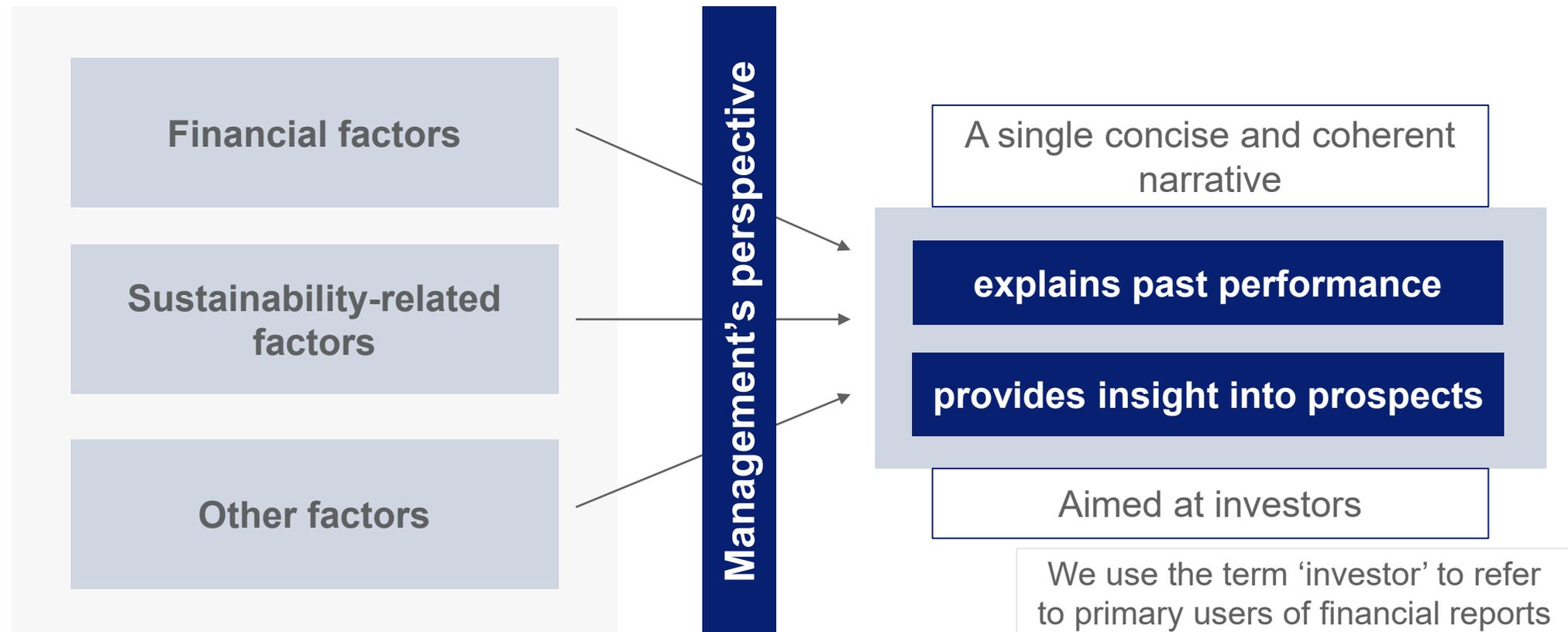


# Deep dive

What role can management commentary and integrated report play in facilitating connectivity between general purpose financial reports?



# The role of management commentary



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# What is integrated report(ing)?

An ***integrated report is a concise communication*** about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation, preservation or erosion of value over the short, medium and long term.

***Integrated reporting*** is a ***process*** founded on integrated thinking that results in a periodic integrated report by an organization about value creation, preservation or erosion over time and related communications regarding aspects of value creation, preservation or erosion.

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# Regulatory landscape

## Financial statements

IFRS Accounting Standards adopted in 145 jurisdictions.\*

## Management commentary / Integrated report

Subject to local laws and regulations on management commentary or a similar report.  
IFRS PS1 *Management Commentary* is being overhauled.  
The role of the IR Framework differs across jurisdictions.

## Sustainability-related financial disclosures

The ISSB is developing a global baseline for capital markets that is interoperable with local requirements and broader sustainability reporting requirements.

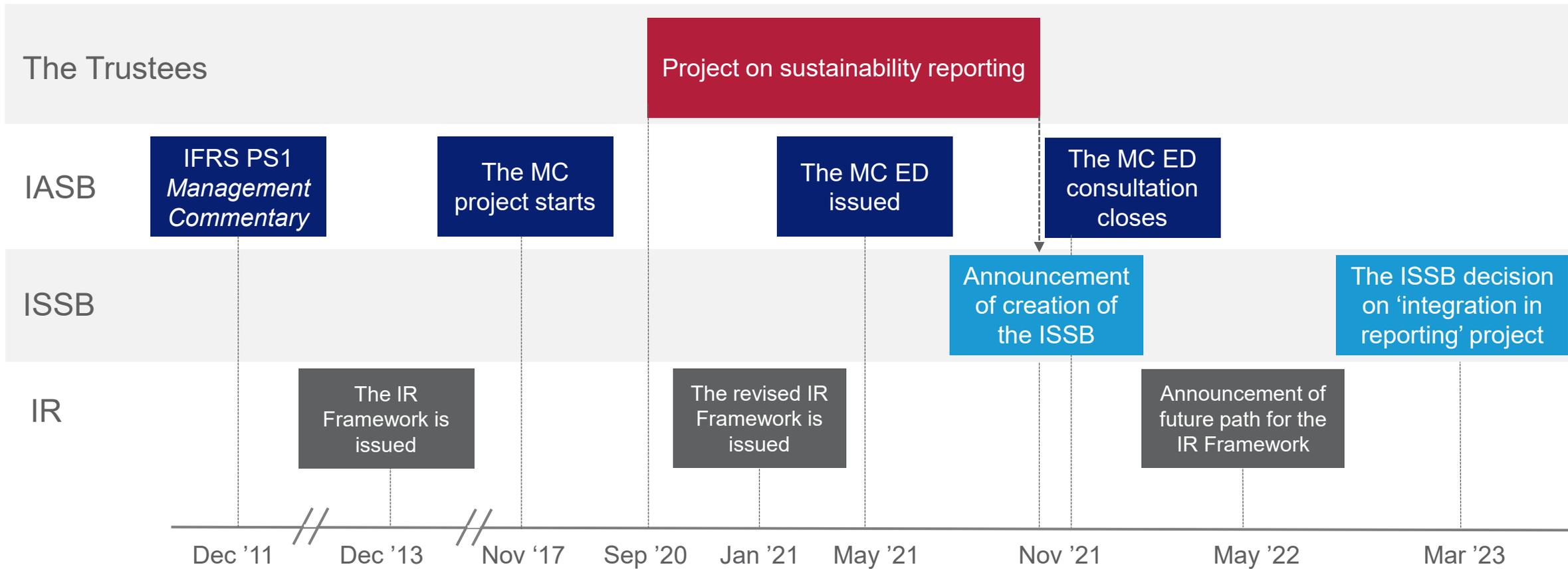
\*Source: [IFRS Foundation website](#), accurate as of March 2023

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## The current state of play



# The journey so far



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## Recent highlights

The Chairs of the IASB and ISSB have acknowledged that there are similarities and differences between the MC ED and the IR Framework and committed to consider opportunities to address that

Stakeholders highlighted the need for connectivity and asked the IASB to collaborate with the ISSB on the Management Commentary project

The ISSB has decided to seek feedback in its Consultation on Agenda Priorities on its priorities and a potential project on integration in reporting

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## Comparison between the IR Framework and the MC ED—the essentials



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## Key observations from the initial analysis



Management commentary and integrated report have **similar objectives**, providing investors with insights for assessing an entity's prospects. Sometimes integrated reports are adapted to meet information needs of other audiences.



The MC ED and the IR Framework incorporate **similar principles and notions of value creation**. An entity's '**resources and relationships**' or '**capitals**' play a prominent role in both documents.



The requirements specified in the MC ED and the IR Framework should result in **similar information** being provided in the reports\*. However, the way in which the requirements are specified can be different.

\* The IR Framework includes additional requirements for information about an entity's governance.

# Complementary approaches



## IR Framework

Principles-based design,  
emphasising the **key notions  
to be applied**

Reporting requirements are  
specified by reference to **high  
level questions about the  
entity the report must answer**



Similar report content



## MC ED



Principles-based design,  
specifying the **types of  
information to be provided**

Reporting requirements are  
specified by reference to **investors' information needs,  
including the assessments  
investors need to make about  
the entity**

# Main features of reports

## IR Framework

## MC ED

Responsibility	Those charged with governance (which may include executive management)	Management (which may include members of a governing body)
Audience	Primary audience is providers of financial capital. All stakeholders interested in value creation benefit.	Aimed at needs of investors and creditors. Other stakeholders may find the report useful.
Purpose of the report	Explain how the organization creates, preserves or erodes value over time	Enhance understanding of financial statements and provides insights into factors that could affect ability to create value over time

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## Comparison between the IR Framework and the MC ED—value creation and related concepts



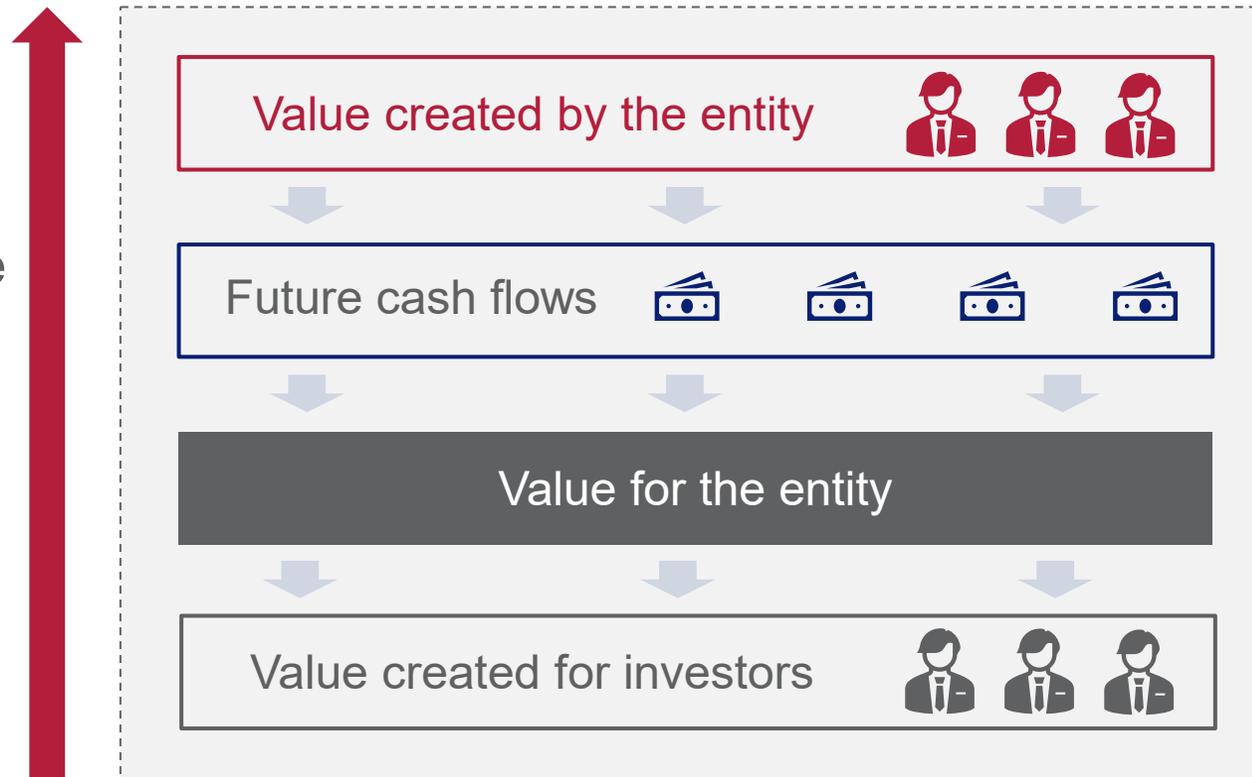
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## Value creation, preservation and erosion

- Both documents focus on the entity's ability to create value for ***itself***, and its impacts on ***others*** to the extent those impacts affect that ability
- The IR Framework emphasises the link between ***value created or eroded for others*** and value for the entity. The document defines value creation, preservation and erosion in terms of ***changes in the capitals***
- The MC ED emphasises that an entity's activities create value if the enhance or preserve the present value of the entity's ***future cash flows***

## Illustrating the complementary perspectives

**IR Framework**  
emphasises the link between value for the entity and value for others



**MC ED**  
emphasises the link between value for the entity and cash flows

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## ‘Capitals’ and ‘resources and relationships’

- **Prominent role** in both documents.
- In the IR Framework, ‘**the capitals**’ is as a **fundamental concept** linked to value creation\*. The document describes six forms of capital that organisations depend on for their success: financial, manufactured, intellectual, human, social and relationship, and natural.
- In the MC ED, ‘**resources and relationships**’ forms an **area of content**. The document requires information on how entity manages the resources and relationships that are fundamental to its ability to create value.

\*The ISSB has used these concepts as a foundation in S1 underpinning the information required to be provided about sustainability-related risks and opportunities for investors.

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# Stakeholder relationships

- Both documents require information about the *nature and quality of stakeholder relationships*
- In the IR Framework, stakeholder relationships is a **guiding principle** emphasising the **link** between value created or eroded for others and value for the entity itself
- In the MC ED, stakeholder relationships forms part of the ‘resources and relationship’ **area of content**

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# Progress, outcomes and impacts

- Both documents require information (including quantitative) about ***how an entity is managing its resources and relationships***
- The IR Framework requires information on the ***outcomes for the capitals*** where this information is needed to understand the value created for the entity
- The MC ED requires information about ***progress in managing the entity's resources and relationships*** and information about ***impacts*** if those impacts affect the entity's ability to create value

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## Comparison between the IR Framework and the MC ED—materiality and other principles



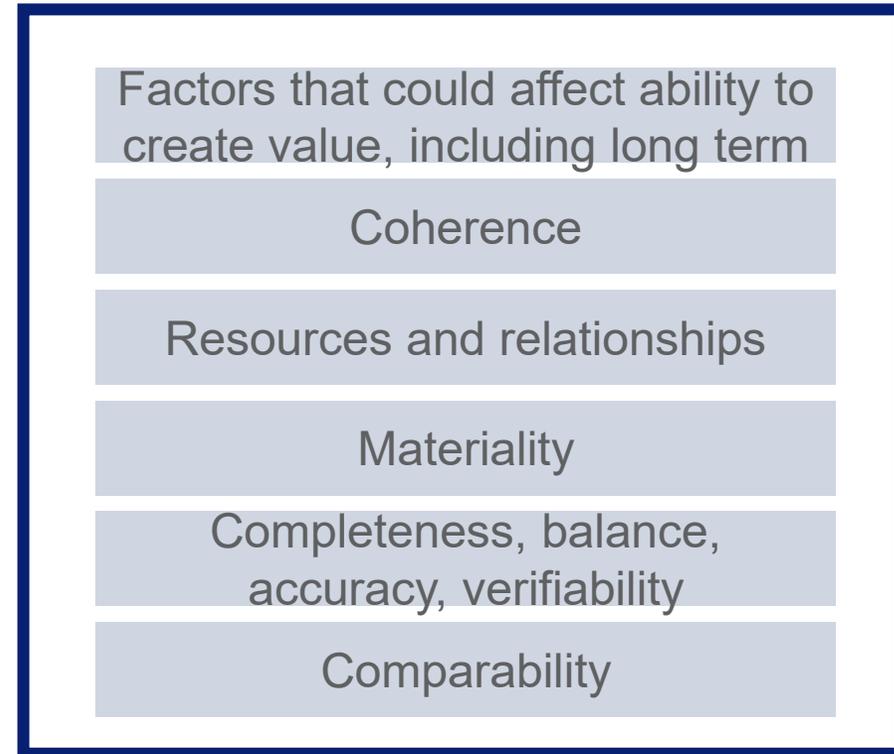
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# Guiding principles and their equivalents

## IR Framework



## MC ED



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# Identifying material information

- In theory, the concepts of materiality should result in the **same information** due to the **investor focus** and the anchor in **value for the entity**, but differences can arise in practice due to different approaches
- The definition in the MC ED is based on the *Conceptual Framework*: information is material if it could **influence investors' decisions**
- Close alignment between '**material matters**' in the IR Framework (those that could substantively affect the ability to create value) and '**key matters**' in the MC ED (those fundamental to the ability to create value)

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# Connectivity and coherence of information

- Both documents emphasise the need for connection between:
  - ***elements within the report***; and
  - the report and ***other sources of information*** (specifically ***financial statements*** in the MC ED)\*
- IR Framework specifically addresses ***trade-offs between capitals***

\*Building on these concepts, S1 requires that information be provided about connections between information in the financial statements and the sustainability-related financial disclosures and that consistent assumptions be used to the extent possible (in accordance with applicable GAAP)

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## Comparison between the IR Framework and the MC ED—content elements



# Content requirements compared

	Key similarities						Key differences	
IR Framework	Business model	Strategy and resource allocation	Risk and opportunities	Org overview & external environment	Performance	Outlook	Governance	Basis of preparation
MC ED								
Business model	✓						<div style="background-color: #d9e1f2; padding: 10px; text-align: center;"> <p>✗ Not an explicit requirement of the MC ED</p> </div>	
Strategy		✓	✓		✓	Addressed in each MC ED content area		
Risks			✓			Specified as an objective in the MC ED		
External environment				✓*				
Financial performance and financial position					✓*			
Resources and relationships	✓ Addressed by the IRF 'capitals' concept							

\* Similar, but some differences

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# Information about governance

- The IR Framework has governance as a ***separate content element*** and requires information on how an organisation's governance structure supports its ability to create value
- There is ***no separate area of content*** for governance in the MC ED. Many respondents to the MC ED suggested adding more explicit requirements on governance

S1 and S2 require that information be provided about the governance of sustainability (climate) related risks and opportunities

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# Design of disclosure requirements for areas of content

## IR Framework

Requirement to answer a question about the organisation

Guidance for applying the requirement

## MC ED

headline objective

assessment objectives

specific objectives

examples of information for each specific objective

## Example—requirements for business model

### IR Framework

*An integrated report should answer the question: What is the organisation's business model?*

Guidance on describing the aspects of the business model:

- inputs
- business activities
- outputs
- outcomes

### MC ED

Investors need to understand...

Investors need to assess...

Investors need to understand...

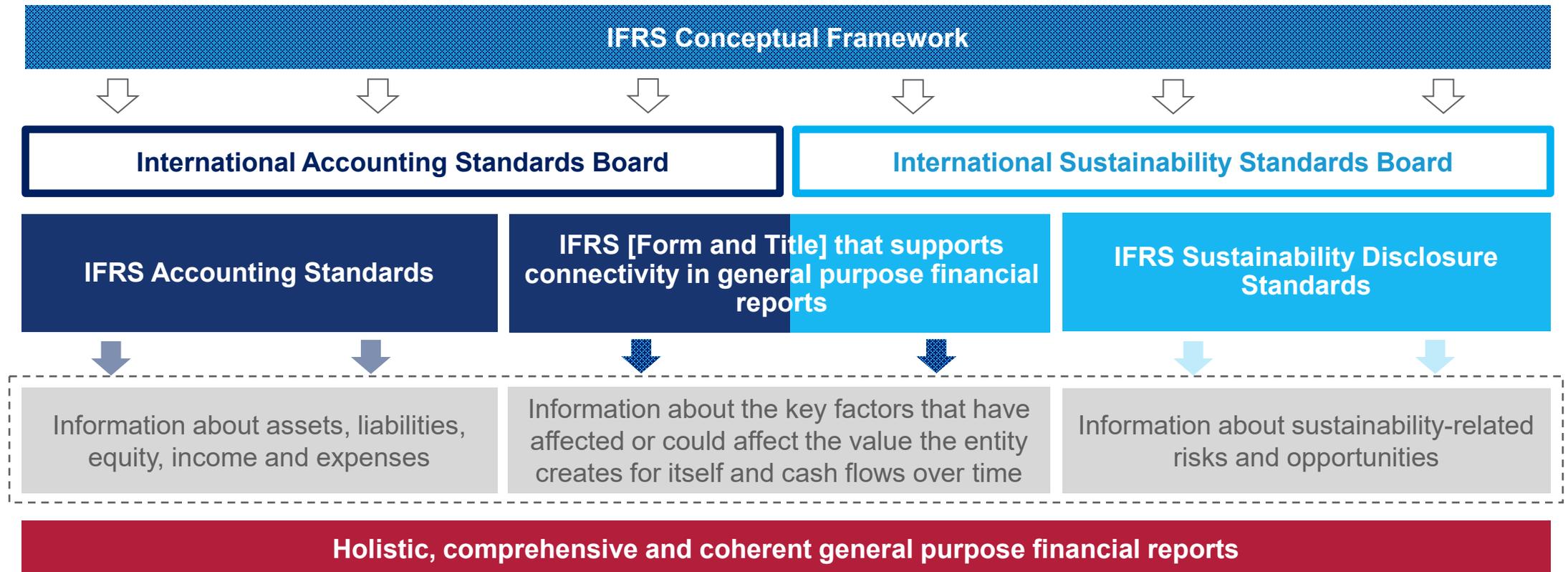
- how the company's business model creates value
- how effective the company's business model is
- how scalable and adaptable it is
- how resilient and durable it is
- the range, nature and scale of the entity's operations
- the cycle of creating value
- impacts of the company if relevant to ability to create value
- progress in managing the company's business model

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## Blue sky thinking



# Staff's view of one possible long-term IFRS outlook



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## Discussion questions



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