XBRL

By Brad J. Monterio

Integrated Reporting and the Potential Role of XBRL

Management accountants should take notice. On April 16, 2013, the International Integrated Reporting Council (IIRC) issued its "Consultation Draft of the International Integrated Reporting Framework" (the CD) as a proposed framework for how to create an integrated report and what to include in that report. Integrated reporting (<IR>) brings together *material* information about an organization's strategy, governance, performance, and *prospects* in a way that reflects its *commercial*, *social*, and *environmental* context. It's intended to be a stand-alone, concise communication that's linked to additional reports and details for stakeholders who want that detail.

One goal of integrated reporting is to provide insight into a company's sustainable performance, value, and impact today and its prospects for the *future*. This places an emphasis on creating future value over the short, medium, and long term, not merely looking back on historical results. This is a forward-looking discussion that focuses on what opportunities a company sees to build value over time. Integrated reporting is also about presenting a *balanced* view—it looks at the business and economic models as well as social and environmental information.

The release of the CD is an important milestone in the evolution of corporate reporting and may also represent an opportunity for eXtensible Business Reporting Language (XBRL) technology to enable a streamlined, more efficient, interconnected reporting process.

The IIRC is accepting comments about the CD until July 15, 2013, and they will be posted on www.theiirc.org. To submit a comment, visit www.theiirc.org/consultationdraft2013.

The CD proposes the latest in a line of recent related frameworks that help companies disclose information that investors, analysts, and regulators indicate they want. Recent predecessor frameworks cover sustainability reporting for an organization (see the G3, 3.1, and 4 Frameworks from the Global Reporting Initiative) as well as environmental reporting (see the Carbon Disclosure Project's Framework). The GRI and CDP frameworks have underlying XBRL "taxonomies" (i.e., agreed-upon, standard definitions of terms) associated with them to help companies create digital, computer-readable sustainability and environmental reports that investors, analysts, regulators, and other stakeholders can easily consume. The IIRC proposed framework doesn't include an XBRL taxonomy yet—it's too early in the process for that. But Section 5 of the CD makes reference to the possible use of XBRL in integrated reporting.

The Basics

Principles-based approach. The CD proposes a principles-based framework—rather than a more rigid, rules-based approach—that allows companies flexibility to tell their unique stories while reporting on several elements (referred to as Content Elements in the CD).

Value creation. The IIRC recognizes that value isn't created by or within an organization alone. Rather, as the CD explains, it is:

◆ *Influenced* by the external environment (e.g., economic conditions, technological change, societal issues, environmental challenges), thereby creating the context within which an organization operates;

◆ *Created* through relationships with others (e.g., employees, customers, suppliers, business partners, local communities); and

◆ *Dependent* on the availability, affordability, quality, and management of various resources.

Six capitals. A model included in the framework illustrates how a company interacts with its external environment and uses and affects a group of six types of capital to create value over the short, medium, and long term. The capitals—it helps to think of them as resources and relationships—are financial, manufactured, intellectual, human, social and relationship, and natural. It's important to note, however, as the CD explains, companies aren't required to adopt this categorization of the capitals in order to prepare an integrated report. They're shown in this way to serve as a benchmark to help ensure that companies don't overlook any of them.

An integrated report leads to a broader explanation of performance than more traditional corporate reporting by "describing, and measuring where practicable, the material elements of value creation and the relationships between them. In particular, it makes visible all the capitals on which value creation (past, present and future) depends, how the organization uses those capitals and its effects on them."

Inputs, outputs, and outcomes. According to the IIRC's CD, the capitals are stores of value that become *inputs* to a company's business model. They can be increased, decreased, or transformed through the activities and *outputs* of the organization. How are they transformed? They are enhanced, consumed, modified, destroyed, or otherwise affected by these activities and outputs. Examples: An organization's financial capital is increased when it makes a profit, its intellectual capital is enhanced when it develops patents, and natural capital is improved when it reduces water consumption in the production cycle. These capitals aren't static—they change through the activities and outputs of the organization. It's also important to understand how the outputs affect *outcomes*—the results of the outputs. Example: A pharmaceutical company may develop a vaccine to prevent a particular disease (the output); a healthier population and an eradicated disease are the resultant outcomes.

Guiding Principles for content and presentation. An important part of the CD covers several Guiding Principles for developing an integrated report. They provide guidance on content for the report and how to present that content. The Guiding Principles covered are:

A. Strategic focus and future orientation,
B. Connectivity of information,
C. Stakeholder responsiveness,
D. Materiality and conciseness,
E. Reliability and completeness, and
F. Consistency and comparability.

Of particular interest to me is materiality—where organizations report on material risks to the business. A strong engagement and communication effort with all stakeholders will help companies gain insight into material factors from the "outside looking in." They will better understand what external *stakeholders* are concerned about, not just their own internal management and boards.

Content Elements point to what to report. An integrated report includes the following Content Elements:

A. Organizational overview and external environment,
B. Governance,
C. Opportunities and risks,
D. Strategy and resource allocation,

PERSPECTIVE FROM THE IIRC

I sat down with Lisa French, head of External Relations (the Americas) for the IIRC, to talk about integrated reporting after the webinar she led for IMA on May 7, 2013, about the draft framework.

B: What is the relevance of integrated reporting to the broader economy?

L: With its focus on encouraging integrated thinking and behavior within the business, integrated reporting leads to a better communication of value, a better relationship between the business and its providers of financial capital, and, once it becomes widespread, a more resilient global economy. Integrated reporting leads to greater market stability by promoting longer-term investment. It leads to robust and resilient business and investment, identified as a major flaw in creating the financial crisis. A recent report from the Enhanced Disclosure Task Force of the Financial Stability Board highlighted the direct link between the investor's understanding of corporate strategy and business model and the value of the business. The cost of capital will also be reduced if investors have visibility over the management's understanding of key risks and likely future performance and prospects. A successful and well-functioning global economy relies on flows of capital that combine with business activity to create and deplete value. This depends on information from the business to make investment decisions, and, in order for those decisions to be efficient and productive, this information must be concise and relevant.

B: What makes you believe that mainstream investors want information other than the financials?

L: The evidence from the 50+ institutional investors that are directly involved in the IIRC is that they are looking to integrated reporting to provide them with information that will aid better decision making. The composition of the market value of a business has changed substantially over the last 40 years, demonstrating that we live a more complex business environment today. Ocean Tomo research showed that in 1975 approximately 83% of the market value of the U.S. S&P 500 could be accounted for in company accounts. There was a high degree of visibility for investors. By 2010, just 20% of a company's market value could be seen through the lens of the financial statements. The majority of a company's value is composed of capitals—including patents, people, copyrights, and trademarks that are not easily visible or accessible through traditional financial reporting. A Financial Stability Board's Enhanced Disclosure Task Force report illustrates the point: Banks and other financial institutions were concerned that their market values were falling below book value and wanted to explore whether improved quality risk disclosures could have an effect. The investors informed the Task Force that in many cases they did not understand the strategy and business model of the financial institution, and, therefore, they couldn't properly assess the risks and future value proposition.

B: Surely most people just want a financial return?

L: Yes, they do want a financial return, but they want the short-, medium-, and long-term report. Apart from day traders and very short-term investors, most people want a good financial return measured over several years, including today. Evidence from the Bank of England's Director of Financial Stability Andrew Haldane shows that the average length of time U.S. institutional investors hold stock has fallen from seven years in the 1940s to just seven months at the start of the financial crisis. This increasing short-termism in the markets creates volatility and contributes to financial instability that erodes long-term value. To make decisions over the short, medium, and long term, providers of financial capital need to have an understanding of, and confidence in, the business model as well as greater visibility, historic and future, over how the business creates value over time.

B: Why would businesses open themselves up to the risk of liability by publishing forward-looking information?

L: Current practice in reporting is skewed toward compliance, meeting the demands of regulators and standard setters rather than the needs and expectations of the users of reports. Integrated reporting rebalances reporting in favor of fostering a more meaningful dialogue between businesses and providers of financial capital. Key to this is ensuring the information available supports capital allocation decisions. Users need a clear understanding of the business model, its strategy, performance, and prospects, and that is what integrated reporting seeks to achieve. Reporting that focuses too heavily on past performance at the expense of future prospects risks feeding short-term behavior, leading to financial instability.

B: Is integrated reporting just the latest in a long line of initiatives in corporate reporting, all of which failed to become widespread?

L: <IR> is different from many other initiatives in three key ways. First, it is market-led—it is business and investor driven, and we have over 80 businesses and 50 institutional investors involved in our work. Second, <IR> evolves the whole corporate reporting landscape, not just one part of it. Third, it is global. We have businesses and investors engaged in our work from Singapore to Spain and from Belgium to Brazil. Corporate reporting is in a state of continuous evolution. In the last 20 years we have seen the introduction of a global financial reporting language, IFRS, which is now practiced in over 100 countries, and sustainability reporting has become best practice for the world's largest businesses. In three years the IIRC has built international momentum behind the concept of integrated reporting, and, with the launch of the framework in 2013, widespread implementation will follow.

B: Is it going to substitute sustainability reporting?

L: Sustainability reporting enables a wide audience of readers to access information about a business's environmental and social performance, which is an important transparency measure. Integrated reporting does not seek to substitute, nor add to, the disclosures businesses make. Instead, it seeks to catalyze a change in thinking and behavior that results in a concise communication of value.

E. Business model,
F. Performance, and
G. Future outlook.

The CD goes into detail about each element that includes a specific question the IIRC feels should be answered in order to cover the elements adequately.

Additional disclosures. The proposed framework document adds that an integrated report should also disclose:

◆ The organization's process for determining materiality,

◆ The governance body with oversight responsibilities for integrated reporting,

◆ The reporting boundary and how it has been determined,

◆ The nature and magnitude of the material trade-offs that influence value creation over time, and

◆ The reason why the company considers any of the capitals identified in the framework to be immaterial given its particular circumstances, if that is the case.

Use of technology like XBRL to enable integrated reporting. As part of its guidance to help companies implement the Content Elements and Guiding Principles in an integrated report, the draft framework discusses the role of technology to enable report production. The IIRC encourages companies "to use technology platforms to increase connectivity within an integrated report and to information outside of the report, and also to facilitate comparisons between reports."

XBRL is mentioned explicitly in this section of the CD as a possible technology platform for integrated reporting as it is used around the world by regulators and agencies as the standard for structured digital disclosures of financial information. It's beginning to be used for structured digital disclosures of nonfinancial information (e.g., environmental, social, and governance information). And XBRL is a logical consideration for providing similar benefits to integrated reports that combine financial and nonfinancial information. According to the CD, "XBRL improves the way information is created, processed, distributed and analyzed by providing standardized definitions, labels, calculations, references and contexts applicable to individual numbers and narrative text. Beneficial characteristics of XBRL that improve connectivity are consistent semantic definitions of, and explicit relationships between, information in an integrated report. Capturing an integrated report in machine-readable format also allows the intended report users to more easily compare integrated reports of various organizations." Music to my ears!

XBRL could bring many opportunities and benefits to integrated reporting because it:

◆ Makes integrated reporting data easily consumable by software applications, Web browsers, and other tools;

◆ Ensures data is computer or "machine readable";

◆ Allows data to be reused over and over;

◆ Virtually eliminates data errors by eliminating rekeying of information and manual calculations;

◆ Preserves data structure and context;

◆ Embeds more complex business rules within data;

◆ Preserves data integrity;

◆ Enables data to be comparable; and

◆ Helps build trust in and credibility around data.

XBRL Challenges

XBRL must overcome some challenges if it is to become widely used and support an integrated reporting framework. Important efforts that should be undertaken include:

◆ Agreement to develop an XBRL taxonomy and agreement on the taxonomy elements;

◆ Harmonization with other related XBRL taxonomies, including those from the International Accounting Standards Board (IASB), GRI, CDP, Sustainability Accounting Standards Board (SASB), and others as they are developed;

◆ Testing of the XBRL taxonomy;

◆ Development of an abstract model for software engineers and development of software tools capable of XBRL tagging integrated reports;

◆ Development of tools for analyzing data;

◆ Development of XBRL reporting guidance for integrated report preparers; and

◆ Creation of comprehensive education and awareness-building programs to help preparers understand how XBRL can be used in integrated report preparation and to help users understand how XBRL can assist in analysis and benchmarking.

Collectively, these efforts would help the market more easily adopt XBRL for integrated reporting and streamline progress needed to take place among both preparers and users of integrated reporting data.

What's Next?

Once the IIRC considers the comment letters, any changes to the proposed framework will be included in version 1.0 of the framework, currently projected to be released at the end of this year. Management accountants need to be aware of integrated reporting and the potential impact on corporate disclosure. Follow the latest developments through IMA® and the IIRC, with one eye toward the types of enabling technologies like XBRL that can make this reporting possible. **SF**

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