



Australian Government

Financial Reporting Council

What Do We Mean by the Term ‘Financial Reporting’, Especially in Relation to Integrated Reporting?

Prepared by the Financial Reporting Council (FRC) Integrated Reporting Task Force on 11 September 2012

Revised by the FRC Integrated Reporting Task Force on 18 February 2013

Introduction

In its 15 December 2011 submission to the International Integrated Reporting Council (IIRC) on its Discussion Paper titled *Towards Integrated reporting – Communicating in the 21st Century*, the FRC agreed that the development of integrated reporting could assist organisations to better explain their value creation process. The FRC stated that development should respect what has been achieved thus far in financial reporting, and what is being aimed for. It also indicated that the FRC believed that integrated reporting should aim to complement, and not substitute, financial reporting.

Clearly that submission of the FRC was based on a distinction between integrated reporting and financial reporting.

In Professor Mervyn King’s 14 March 2012 response to the FRC’s position, he stated:

“...the annual report will be the annual Integrated Report; the Integrated Report will, as the discussion paper indicates, show how the financial has impacted on the non-financial and vice versa but it does not replace the financial report; the Integrated Report does not change the financial statements; the Integrated Report should replace certain forms of reporting but not financial reporting. For example, the Integrated Report may result in there being no need for a Chairman’s report and/or a Chief Executive’s report. A lot of information which may have been contained in the management commentary could be in the Integrated Report.”

“There are excellent standards in financial reporting such as the IFRS.”

So it also seems that the dividing line between financial reporting and the annual integrated report is clear in Professor King’s thinking.

However, the terms financial reporting and financial reports are used both in general parlance and in technical/legislative environments, but with differing degrees of precision and meaning. Sometimes people use financial reporting and annual reporting interchangeably. This seems to be very loose usage of the terms. To further complicate matters the definition of financial reporting, as used in accounting standards, is a conceptual issue of some complexity and one not firmly resolved. The one thing that can be said with confidence is that the scope of financial reporting will change over time. It is conceivable that some aspects

of such change will embrace matters currently perceived to fall outside financial reporting and possibly within aspects of integrated reporting.

An example of where the dividing line is under active consideration by the Australian Accounting Standards Board (AASB) is performance reporting. The AASB envisages that some aspects of performance reporting would go beyond the scope of financial reporting and possibly coincide with aspects of integrated reporting (for example, matters to do with macro community issues such as achievement of policies on providing equal opportunity employment), whilst other aspects would be directly within financial reporting (for example, the cost of delivering services). The AASB does not think that a distinction between financial and non-financial information is particularly helpful – as financial reporting already incorporates both and not-for-profit reporting will almost certainly see more examples of this. You cannot evaluate the bottom line of a charity without relating it to the achievement of the entity's objectives or of a mining company without information about reserves.

So the important issue for the FRC, and for the AASB, is to be conscious of the margin between the two forms of reporting and to ensure that overlap and confusion are avoided.

Financial Reporting in IFRS and under the Corporations Law

When defining financial report and reporting, the IFRS Conceptual Framework currently equates these terms with general purpose financial reports (GPFRs) and the act of presenting those reports. IFRS itself means International *Financial Reporting* Standards.

Within the standards themselves, 'GPFRs' and 'general purpose financial statements' are treated as synonyms. IAS 1 then specifies the components of such statements to be presented (i.e. balance sheet, income statement, changes in equity, cash flows, notes, and comparatives).

Auditors take their cue from this and make the general purpose financial statements the subject of their opinions. They read 'other information' (i.e. information outside the financial statements but inside the periodic/annual report) to make sure it is not inconsistent with the financial statements.

The Corporations Law requires a "financial report" and stipulates its contents as including financial statements, the notes thereto and the directors' declaration (S295 (1)).¹ Reports that do not fall within this definition, including the Directors' report (as opposed to the Directors' declaration), and the management commentary are outside of the financial statements and the scope of auditing.

Broadly, financial reporting can be said to be the periodic process of providing information in financial statements (including the notes thereto) about the financial position and performance of a reporting entity to parties (users) external to that entity to assist them in making informed decisions about allocating scarce resources. This is not intended to be a technical or complete definition of financial reporting, but it is one which is consistent with the Conceptual Framework employed in IFRS and Australia and one which can assist in understanding the borders of financial reporting in contrast to other forms of reporting.

¹ ASIC has taken action in the past against people trying to place materials outside of financial statements that belong within them. This action has been prompted because the notes are defined as including any information that needs to be read with the financial statements in order to provide a true and fair view.

It is hoped that the definition of financial reporting will receive further attention when the International Accounting Standards Board (IASB) revises the current conceptual framework (as it plans to do).

The Place of Financial Reporting in Integrated Reporting

On 4 February 2013, the International Accounting Standards Board (IASB) and the IIRC signed a Memorandum of Understanding which formalised the cooperation between the two organisations to improve the quality and consistency of global corporate reporting to deliver value to investors and the wider economy.

This agreement demonstrates the IASB's support for integrated reporting as the future of global corporate reporting. The FRC considers this a positive development for corporate reporting, and supports the continued dialogue between the IASB and the IIRC.

What does the FRC believe is the place of Integrated Reporting and how does integration occur?

The basic approaches to integrated reporting are either:-

- (a) adding complementary information to that provided by the financial report (statements) to arrive at a holistic view of the entity, for example social, and environmental disclosures. Financial information used to give this holistic view would be sourced from and cross referenced to this financial report; or
- (b) re-mastering all information provided in a single report that serves multiple purposes.

The FRC's view is that (a) is the preferred approach for both conceptual and practical reasons. We believe the IIRC shares this view.

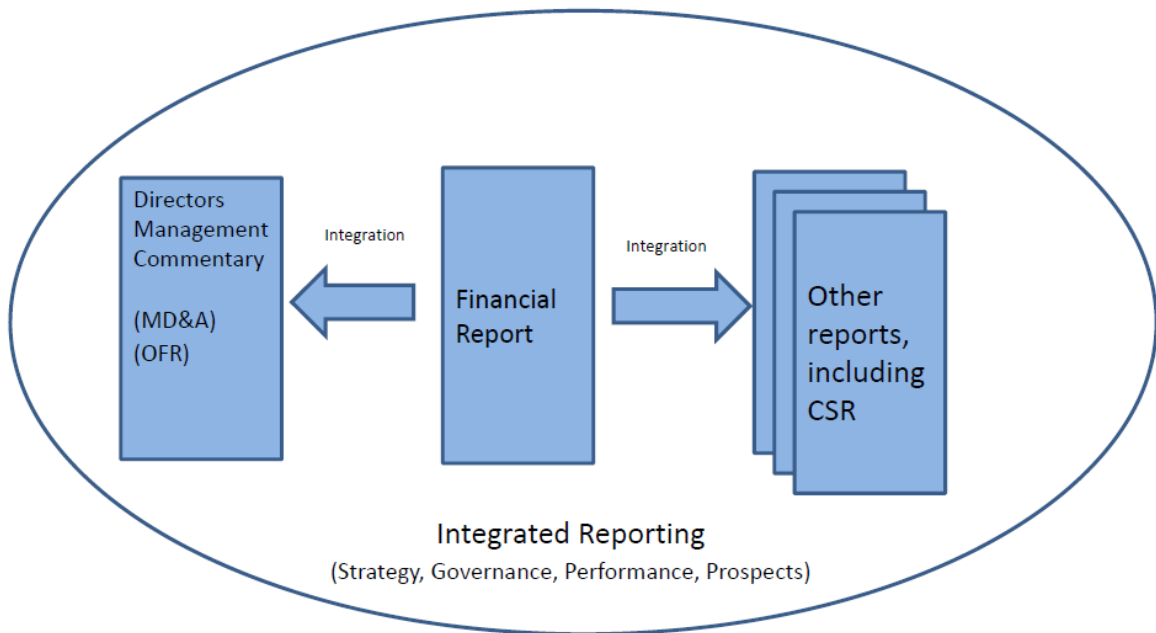
What practically does this translate into?

Integrated reporting demonstrates the linkages between a business's strategy, governance and financial performance and the social, environmental and economic context within which it operates.

The Annual Report should become the vehicle for integration. The Annual Report will contain the financial report, other reports such as the corporate and social responsibility report (CSR), the management commentary (MD&A/OFR), and the remuneration and governance reports.

Why will this be more than consolidation and be an Integrated Annual Report?

Any financial information used in management commentary and/or other reports would be sourced from the financial report and cross-referenced. In time the management commentary (MD&A or OFR) will then merge with other reports. It may be easier to understand this better from the following schematic:



This high level framework does the following:

- (a) preserves the integrity of the financial reporting that is subject to IFRS;
- (b) ensures the integrity of financials used in other reporting such as CSR and operational reporting as they will come from the financial report;
- (c) any action proposed in a social or environmental direction can be seen in the financial report or explained where the impact will be seen in future financial reports. This may require some expansion of line items in a financial report; and
- (d) allows for the development of integration over time within the overall Annual Integrated Report.

Conclusion

Integrated Reporting can be achieved within the framework of an Annual Integrated Report. Integration comes from using financial information from financial reports (consistent measurement methodology) integrating the information in each of the CSR and the OFR. The integrity of the holistic Annual Integrated Report is maintained.

Over time the other reports, including CSR and OFR could merge to be one management commentary that covers operations, financial highlights, strategic direction, corporate and social responsibility, i.e. all aspects of a sustainable business.