Regulatory standards vs. non-regulatory guidelines: Financial stakeholders' perspectives on the appropriate route to effective integrated reporting

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Executive Summary

There is widespread recognition amongst financial stakeholders of Australian organisations that current (annual/financial) reporting requires some changes. There is less agreement that integrated reporting is necessarily the best way forward, and little agreement about whether regulatory standards or non-regulatory guidelines are most effective at driving change.

Central to the problems of current reporting is that existing standards have not kept pace with new drivers of value creation and company performance. Issues include, but are not limited to, environmental, social and governance considerations and their impact on organisations. The flow-on effect is some uncertainty about how new types of reports (including integrated reports) should address established principles of accounting – especially materiality and comparability – to ensure company reports are fit for purpose.

Inevitably some trade-offs will be required in agreeing to a new reporting framework. It will be necessary to reach some compromise to ensure reporting meets the communications objectives it is increasingly assuming, while still providing the type of data that is concrete and standardised to ensure the integrity of the financial system.

The next steps in the development of Integrated Reporting should be to consider the main problem it is seeking to address, and the audience for corporate reports. These issues are more important than new iterations of a framework. Addressing these problems will assist in making sense of new materiality protocols and comparability challenges. While it is too early to move toward new regulatory standards, regulatory reform will be necessary to reduce divergent practice and to eliminate escalating complexity. These regulatory shifts need to be taken in line with the requirements for an Operating and Financial Review (OFR) and Recommendation 7.4 of the Australian Stock Exchange Corporate Governance Council's Principles & Recommendations. These requirements have credibility amongst the financial community, and are becoming institutionalised as part of good practice.

In the immediate future, regulatory consideration needs to be given to audit and assurance standards, and clarifying which organisations should produce an integrated report. While there is some scepticism about the liability that directors face in issuing forward looking statements – some regulatory guidance seems necessary to remove this barrier to reporting reform. In the medium term, a multi-stakeholder approach is recommended to initiate a proper review of reporting protocols.

Introduction

Integrated Reporting (<IR>) is the latest development in a long line of reporting frameworks that have attempted to 'reform' corporate reporting. Unlike other approaches, <IR> has moved quickly to gather widespread support from credible global organisations, standard setters and regulators. It represents an important international movement that promises to "catalyse a more cohesive and efficient approach to corporate reporting" (IIRC, 2013b, p8) than what prevails. While there is growing global demand for <IR>, approaches for mainstreaming are subject to debate. For example, South Africa has mandated <IR> for publicly listed companies; the International Integrated Reporting Council in its various public pronouncements about <IR> Framework have stressed its principle-based market-led, and thus non-mandatory character[1], while the Sustainability Accounting Standards Board in the United States is devising the first sustainability accounting standards to support US public corporations in their compliance with Regulation S-K and 10-K filing requirements under US securities regulations. Stubbs & Higgins (2014) study into early adopters' experiences of <IR> identified the lack of standards/guidelines as a major barrier to undertaking <IR>. The issue of regulatory and non-regulatory approaches to <IR> standards/guidelines has implications for business and accounting practice, standard-setters and industry bodies.

The aim of this study is to explore the role of regulatory and non-regulatory approaches to ensuring the effective adoption and spread of <IR> in Australia. It involves interviews with a wide range of stakeholders who have an interest in corporate reporting and IR. This study offers a unique perspective by focusing on the *users* of integrated reports (rather than the preparers) and it interrogates some of the assumptions associated with the demand for integrated reports.

This study finds little appetite for mandatory integrated reporting. It does find, however, competing views about what is most likely to drive its effective adoption and implementation. While the majority view voluntary, principles-based approaches as most appropriate for driving change – there is recognition that this approach comes with risks. Some leverage can be gained from the recent guidance for an Operating and Financial Review (OFR) required for listed companies by s 299A of the Corporations Act 2001 and the new requirements of the Australian Stock Exchange Corporate Governance Council's Recommendation 7.4 dealing with sustainability risk. These two existing and credible reforms offer scope for addressing some problem areas – but the reform agenda must go

[1] The Executive Summary (page 4) to The International <IR> Framework (2013) does note that "An integrated report may be prepared in response to existing compliance requirements".

further. One key problem is how new regulatory requirements are introduced in an ad-hoc way, creating layer upon layer of reporting burden. This study finds that there is scope for modifications to reporting standards that will assist in encouraging more effective reporting – although it should be noted that reaching agreement on these matters is likely to involve some trade-offs and compromise.

In the section that follows, we provide a brief overview of <IR>, identifying the main issues associated with current reporting. We then discuss our research approach and objectives, before presenting the analysis of our interviews. Our discussion is organised to provide background and the context in which regulatory and/or voluntary approaches to driving the effective implementation of <IR> is considered. We extract some conclusions that form the basis of the recommendations we make.

Background and Literature Review

The International Integrated Reporting Council's <IR> Framework aims to simplify corporate reporting and improve its effectiveness. In contrast to current reporting, <IR> is future-oriented and reflects the interconnections between the financial and non-financial performance factors (Higgins et al., 2014). It is positioned as a consolidating approach, presenting a more holistic view of corporate performance combining different reporting strands, such as voluntary sustainability reports and the annual report (Rowbottom & Locke, 2013). It promises to provide a more cohesive and efficient approach to corporate reporting by bringing together detailed financial information, operational data and sustainability information to focus only on material issues that impact an organisation's ability to create value in the short, medium and long term (IIRC, 2013). The IIRC expects that organisations will no longer produce "numerous, disconnected and static communications" (IIRC, 2013, p2).

The IIRC's International <IR> Framework is underpinned by seven guiding principles that inform the content of the report and how information is presented, and eight content elements (see Table 1). The IIRC recommends that the principles be applied individually and collectively. However, organisations need to exercise judgement, "particularly when there is an apparent tension between them (e.g., between conciseness and completeness)" (IIRC, 2013, p16).

Table 1: Summary of The International <IR> Framework Guiding Principles and Content Elements

Guiding Principles	**Content Elements**
Strategic focus and future orientation	Organizational overview and external environment
Connectivity of information	Governance
Stakeholder relationships	Business model
Materiality	Risks and opportunities
Conciseness	Strategy and resource allocation
Reliability and completeness	Performance
Consistency and comparability	Outlook
	Basis of preparation and presentation

Issues with Corporate Reporting

The IIRC's paper "Towards Integrated Reporting: Communicating Value in the 21st Century" (2011) which discusses the weaknesses of the current corporate reporting regime (pre-<IR> scenario) and the benefits and outcomes of companies adopting <IR> (post-<IR> scenario). This paper, together with the two documents released in 2013 (the Consultation Draft and the International <IR> Framework), provides a basis for analysing the perspective of financial stakeholders in order to understand their expectations of what is communicated by organisations. A comparison of the issues associated with current reporting compared to what is suggested as forming an integrated report is summarised in Table 2.

Table 2: Summary of issues with current reporting approaches and the benefits of integrated reporting

Issues with corporate reporting (pre-IR world)	Benefits and outcomes of integrated reporting (post-IR world)
corporate reporting is not cohesive or efficient	
intangible factors largely ignored in market valuations	more integrated information – full range of issues
reporting provides narrow account of historical financial performance	key risks & opportunities disclosed
reporting is confusing, cluttered, fragmented, disconnected	enhanced sector-specific reporting models; integrate different forms of reporting
key disclosure gaps	access to organizations' most significant info in one concise integrated form
inadequate info on non-financial factors	
reports too long & complex	concise communication
reports focus on compliance not communication	
lack of consistency across jurisdictions => reporting burden; lack of comparability	harmonisation of approaches within and across jurisdictions, leading to reduced 'red tape'
siloed reporting => isolated thinking	makes clear linkages between strategy, governance, financial performance, social / environmental / economic context
focus on financial capital, not all forms	
focus on past performance	greater emphasis on info about future
short-term focus	more effective investment decisions, better

	long-term returns
low trust due to limited transparency	
paper-based	
doesn't promote efficient and productive capital allocation	more effective capital allocation
	economic & market stability (transparency, longer term outlook, risk identification deliver lower market volatility)
	stewardship of common resources

Sources: IIRC (2011, 2013a, 2013b)

While previous research has identified a number of benefits of integrated reporting – it transforms corporate processes (Phillips, Watson & Willis, 2011); it breaks down operational and reporting silos resulting in improved systems and processes (Roberts, 2011); it improves decision-making about resource allocation (Frías-Aceituno et al., 2013a); and it reduces reputational risk and enables companies to make better financial and non-financial decisions (Hampton, 2012) – the meaning of integrated reporting is still widely contested (see, Higgins et al., 2014; Rowbottom & Locke, 2013; Stubbs & Higgins, 2014). Other criticisms have been levelled at <IR>, including: it focuses on financial capital providers to the detriment of other key stakeholders (Cheng et al., 2014); there is a potential lack of "holistic transparency" and a potential for opportunistic use of information by large monopolistic companies (Frias-Aceituno et al., 2014); the subjective concept of six capitals can lead to insubstantial narratives (Cheng et al., 2014); and, there are issues with the assurance aspects of integrated reporting (Burritt, 2012; Cheng et al., 2014).

Previous studies have primarily focused on the early adopters, who have now had several years reporting experience, as evidenced by 78 examples of 'best-practice' integrated reports on the IIRC's website (IIRC, 2014a). However, no research studies have discussed the perspectives of the primary audience for <IR> – the providers of financial capital. It is to this audience that this study is addressed.

Research Objectives

The aim of this study is to explore the role of regulatory and non-regulatory approaches to the preparation, use and spread of integrated reporting in Australia, with particular reference to the needs of financial stakeholders. It builds on the findings of a 2012 study by the investigators that explored the inhibitors and enablers of <IR> in Australia. One key finding was that the lack of standards and guidelines for <IR> is an inhibitor to its implementation and further development – but there was also wariness about the desirability of regulatory rules and standards.

Research Design and Methods

This study involved 22 in-depth semi-structured interviews with corporate reporting and integrated reporting stakeholders in Australia. Of particular interest was the perspective of the financial stakeholders, referred to as the investment supply chain (see Appendix 1). According the IIRC, these stakeholders are the target audience for integrated reporting.

Selection of research participants

Interviewees were identified through our study in 2012 of early adopters of <IR>. We supplemented these with insights from our reading of the academic (Adams & Simnett, 2011; Frias-Aceituno, Rodriguez-Ariza, & Garcia-Sanchez,2013; Strong, 2014) and practitioner literature (Hampton, 2012; Watson, 2013), as well as our monitoring of local and international developments, particularly submissions to the International Integrated Reporting Council's Draft International <IR> Framework. We also used snowballing techniques to identify key stakeholders. Snowball sampling involves using a "group of informants with whom the researcher has made initial contact and asking them to put the researcher in touch with people in their networks, then asking those people to be informants and in turn asking them to put the researcher in touch with people in their networks and so on as long as they fit the criteria for the research project" (Minichiello et al, 1995, p161). Thirty-two people were approached for an interview and 22 accepted. Twenty-one interviews were face-to-face and one was via phone. Table 3 lists the research participants by stakeholder group.

Table 3: Summary of research participants by stakeholder group

Stakeholder Group	*Number invited*	*Number accepted*	*Interviewee code*
Regulators	5	3	Reg 1 Reg 2 Reg 3
Standard Setters •	2	2	SS 1 SS 2
Industry Bodies and Professional Associations representing the financial services industry, shareholders, superannuation funds, company secretaries, company directors and accounting professionals	8	6	IB 1 IB 2 IB 3 IB 4 IB 5 IB 6
Accounting Firms	4	3	AF 1 AF 2 AF 3
Financial Stakeholders including debt providers, asset owners, fund managers, asset consultants, proxy advisors, ESG (Environmental, Social & Governance)	13	8	FS 1 FS 2 FS 3 FS 4 FS 5 FS 6 FS 7

advisory firms and brokers			FS 8
Total	**32**	**22**	

The interviews were 35-65 minutes duration and were recorded and transcribed (with permission). The interviews were guided by the following prompts to explore the participants' perspectives on the role of regulation, standards and guidelines in effective <IR>:

- Shortcomings in prevailing corporate reporting practice;
- The type of information that is necessary to ensure the 'decision-usefulness' of an integrated report, and in what form it should be presented;
- Minimum 'requirements' for an effective and useful integrated report, and why should these be 'required';
- The extent to which regulatory standards are necessary to ensure the 'effectiveness' of an integrated report, and who should be issuing integrated reports;
- The influence of standards in meeting materiality requirements or whether these are best met through voluntary guidelines;
- Elements that can/should be 'discretionary' or 'regulated' and what role these elements play in ensuring the effectiveness of an integrated report; and,
- Which organisations/institutions should be involved in the regulatory process and standard setting?

Analysis of data

Using the NVIVO software package, the transcribed interviews were analysed and coded. Qualitative analysis techniques were used to guide the coding process and draw out key themes (Strauss & Corbin, 1998). Codes were derived from the interview data based on the actual words or terms used by the interviewees (in vivo codes) or by summarising the concepts discussed by the interviewees (constructed codes). Coding included chunks of text at the phrase, sentence and paragraph level. Codes were grouped into categories and then classified into themes as patterns emerged within the data (Neuman, 2003; Patton, 2002). The key themes emerging from the analysis are discussed below.

Results

In this section we first discuss the issues that the Australian investment community experience with corporate reporting – noting the diversity in perspectives about whether the current regime is 'broken'. We then go on to explain the priorities for reform – noting that there is agreement about aspects of these priority areas, but disagreement about some details. Against this background, we explore where regulatory reform may be necessary, and the circumstances in which voluntary guidelines are seen as more appropriate.

Limitations of Current Reporting

The IIRC identified a number of issues with corporate reporting. These include that: current (financial, annual) reporting provides a narrow account of historical financial performance; there are key disclosure gaps; reporting is confusing, cluttered, fragmented and disconnected; reports are too long and complex; there is inadequate information on non-financial factors; and reports focus on compliance not communication (IIRC, 2011, 2013a).

The majority (19) of those interviewed share the view of the IIRC, and identified similar criticisms. There were, however, four [Reg 3, SS 1, Reg 1, FS 3] that were "*not convinced that there is a problem that needs fixing*" [Reg 3] as the "*reporting regime is a well-defined framework*" [Reg 3]. One investor went further saying they "*don't really see the point*" of integrated reporting [FS 3] as the information is already available from existing websites and by talking directly to the company. A regulator believes that there are "*sufficient financial flags and sufficient operational flags*" [Reg 1] in the corporate reporting regime to satisfy its information requirements to enable it to do its job.

Nevertheless, Table 4 illustrates the key limitations of current reporting identified by our interviewee organisations.

Table 4: Interviewees issues with current reports

Issue	Respondents	Explanation
Reports are too complex	FS 2, FS 5, IB 2, Reg 2, IB 5, SS 1, SS 2, IB 1, AF 3, IB 3, AF 1	• Complexity arises from increasing regulatory requirements in response to corporate failures (eg HIH in Australia, Enron in the USA) and economic crises (eg 1990s Asian Financial Crisis and the 2008 Global Financial Crisis)
Reports contain too much information	Reg 1, FS 2, IB 2, IB 6, Reg 2, IB 5, SS 1, SS 2, IB 1, AF 3, IB 3, FS 3	• Increasing layers of regulation where new rules have addressed problems as isolated issues, without considering how they all interact together • Multiple reporting requirements have made reports too dense – requiring too much information to meet compliance requirements • Risk aversion where companies include everything whether or not they need to or whether or not it is material • An assumption about the possibility and desirability of 'perfect information' – in which there have been attempts to provide as much information as possible, irrespective of any demand for it • Concerns for liability and thus over-cautious reporting and disclosure
Corporate reports don't provide the complete story	FS 8, FS 5, FS 7, IB 6, FS 6, Reg 2, SS 1, FS 4, AF 2, FS 1, FS 3	• Reports lack detail about ESG (environmental, social and governance) issues that are important in evaluating companies • Company reports contain information that is 'disconnected' – limiting the ability to make sense of how environmental and social issues impact on economic performance and prospects
Reports are backward-looking	FS 8, IB 6, Reg 2, AF 2	• Inadequate detail provided for assessing future prospects and the quality of management

and don't address connections between strategy, prospects and long-term risks		going forward
Lack of shared vocabulary	SS 2, IB 6, FS 6	• Accountants, sustainability people and financial analysts all have different vocabularies, approaches and requirements for reporting
A lack of rigour and consistency [especially with sustainability reporting]	SS 2, FS 1	• Few agreed standards on what should be reported and how it should be reported, making most existing voluntary disclosures untrustworthy

The essential point is that current reporting fulfils the needs of a small group of stakeholders, but not the majority of stakeholders who use and depend on corporate reports for decision-making. One financial stakeholder went so far as to say that current corporate reporting today is not fit-for-purpose [FS 5].

While there is recognition that corporate reporting needs to be recalibrated and "*go back and look at why we do things and why we request certain information and why we have a financial statement*" [IB 1], requiring a "*periodic review of laws … step back and do a root-and-branch review of how everything is working*" [Reg 2], three interviewees [SS 1, Reg 2, Reg 3] urged caution – the exact nature of the problem has not been well articulated. A regulator warned that you need to be:

> *very clear about what the problem is here that we're attempting to solve, and if we are talking about a disclosure-based solution, let's be very clear about the audience or audiences that we think this disclosure will help because your disclosure should be targeted in a way that's accessible to the audience to whom it's directed [Reg 2].*

Ambiguity about the target audience gives rise to a lack of clarity about the exact role of an integrated report. An industry body argued that "*unless you're highly technically trained, a lot of the disclosures are meaningless to the ordinary retail investor*" [IB 5], but a standard setter countered that there is inherent complexity in some of the information required to be reported and "*we never claimed to be aiming at mum and dad or even some of the directors who seem to be about mum and dad standard, we're trying to be as representationally faithful as we can… For those who just think it's too complex when it is complex, I'd say* *they've got a lot of learning to do*" [SS 1]. One regulator reinforced the perspective that while "*People talk about complexity of accounting standards and the average man in the street not being able to read and understand financial statements … I don't think that's the right test, because the average man in the street is never going to be able to read a financial statement no matter how simple you make it*" [Reg 3]. In another regulator's 15-year experience, retail investors are highly unlikely to read more than about 10 pages of a corporate report, "*so any more than about 10 pages I think you've lost them*" [Reg 2].

Priority Areas for Reporting Reform

Only two interviewees [FS 5, AF 3] explicitly referred to the IIRC's International <IR> Framework when discussing what makes an effective integrated report – but the sentiments of others reflected many of the IIRC's priority themes. One interviewee suggested that "*if you want to call your report an integrated report in accordance with IIRC's framework, you must align to the content elements and the principles. And so it's not bigger than that, it's a very low bar*" [AF 3]. Another two interviewees [IB 2, AF 2] referred to the business model, strategy and governance framework – which touches on one key aspect of integrated reporting.

Five of those interviewed suggested that an effective integrated report is one that streamlines corporate reporting. It will focus on the material issues and "*spend more time on fleshing out the real sort of financial drivers*" [FS 4]. The integrated report will "*sit across the top*" of other reports, such as sustainability reports and annual financial reports, allowing more detailed information to be accessed via these reports if required.

There was reasonably widespread agreement that materiality and comparability are key priorities for reform. Some differences, however, exist in exactly what this means.

Materiality

For nearly half – 11 interviewees – materiality is of upmost significance [FS 4, IB 2, FS 7, Reg 2, FS 5, AF 2, AF 3, FS 2, FS 1, FS 8, FS 3]. Some – two financial stakeholders [FS 7, FS 3] and one regulator [Reg 2] – suggested identifying the material *issues* was of primary importance, while another three financial stakeholders [FS 8, FS 5, FS 2] suggested the materiality *process* was more important.

Materiality raises important challenges that are difficult to address. Materiality is "*very much in the eye of the beholder [because] what a fund manager might think is material and what a super fund, who's trying to be long-term and a universal owner, might think is material is entirely different*" [FS 2] and material issues for companies in the same industry may also be different. Thus, materiality process and "*meaningful discussions*" [FS 7] that "*push companies to provide a rationale for their thought processes*" [FS 5] are important elements of an integrated report for the financial stakeholders. One financial stakeholder explained:

> *if there's two like-for-like companies but they've got completely different business models and operating models then their materiality testing, yeah it might be different, they might be faced with the same external risks but how they manage those might be completely different... but it's very important for them to have those discussions.* [FS 7]

In contrast, an accounting firm didn't think that "*we'll see huge amounts of disparity because I think most organisations, if they're honest with themselves, know what the material issues are*" [AF 2]. This interviewee also thought that pressure from analysts and investors will "*drive that commonality*" [AF 2] and the treatment of material issues "*should be standardised so that everybody who comes and says we have a similar issue have similar ways of measuring and monitoring*" [AF 2].

However, a financial stakeholder pointed to the difficulty in identifying material issues, and opportunities, as "*many of these issues are not financially material until something goes seriously wrong… but notwithstanding I still think it's possible for a company to identify what are the key ESG risks facing its business*" [FS 3]. A debt provider also argued that risk changes over time and the materiality process is "*never going to be perfect*" [FS 1].

Comparability

A similar number and mix of respondents raised comparability as a key issue for <IR> [FS 4, IB 2, FS 7, FS 5, AF 1, IB 5, AF 3, FS 2, FS 8, FS 3] – but there was no general agreement on what comparability meant. For two financial stakeholders, comparability across time – "*historical comparability within a company*" [FS 4] – is more important than across companies or sectors. An accounting firm was more interested in sector comparability "*versus general comparability because of course banking's going to be different to mining*" [AF 1]. One financial stakeholder suggested comparability "*both across time and across the organisation*" is important. Another suggested that sector comparability runs the risk of generating overly-detailed reports "*because they need to be able to be compared to everyone else*", and it's more important to understand how "*each individual company is managing what's relevant to it*" [FS 7].

Several [FS 2, FS 5, IB 2, FS 7, FS 3] suggested that materiality is more important than comparability. It's important to be able to compare year-on-year data where the issue is material across companies but "*you don't want to say to all companies you all have to report this … because water use [for example] might be a huge risk for one company but not for* *another"* [FS 7]. A similar number raised the issue of transparency – with one financial stakeholder suggesting it was more important than comparability, "*in that the whole story is being told and not just sugar-coated*" [FS 2]. They provided an example of a major bank providing direct greenhouse gas emissions without providing the indirect emissions through its lending portfolio: "*you're not getting entirety or full disclosure or honesty or transparency*" [FS 2].

While a small number of respondents hinted at pressure from analysts and investors as the means by which materiality (and perhaps also comparability and transparency) would come to be settled – views were quite mixed regarding the necessity and desirability of regulatory reform in these areas (see below).

The Role and Necessity of Regulatory Reform

Overall, there is little appetite for mandatory <IR>. Only five interviewees held a strong view that <IR> should be mandatory; although eight felt that some level of regulation may be necessary.

In part, interviewees' views about regulatory reform need to be considered in the context of new guidance for the required listed company operating and financial review (OFR) and new corporate governance disclosure requirements issued by the Australian Stock Exchange Corporate Governance Council (ASX CGC Recommendation 7.4).

The OFR and ASX Corporate Governance Council Recommendation requirements

Regulatory Guide 247 (RG247 Effective disclosure in an operating and financial review) for listed entities provides guidance for directors on useful and meaningful information for shareholders when preparing an operating and financial review (OFR, Corporations Act 2001 section 299A) in a directors' report (ASIC, March 2013). Clause 63 states that (p19):

> *An OFR should include a discussion of environmental and other sustainability risks where those risks could affect the entity's achievement of its financial performance or outcomes disclosed, taking into account the nature and business of the entity and its business strategy. For example, environmental risks that may affect an entity's achievement of its financial prospects would be more likely for an industrial entity than for a financial services entity.*

The ASX CGC released the 3rd edition of its Corporate Governance Principles and Recommendations in March 2014. Principle 7 (Recognise and manage risk) states:

> *A listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework.* (ASX CGC, March 2014, p28).

Recommendation 7.4 specifically states that: “A listed entity should disclose whether it has any material exposure to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks.” (ASX CGC, March 2014, p30)

Two thirds of our interviewees maintained that the OFR captures the intent of <IR> and partially covers [IB 5, Reg 2, SS 2, AF 1] or “*picks up on many*” [Reg 2] if not all of the matters addressed by an integrated report [Reg 3, IB 6, SS 1, AF 2, IB 1, KPMH, FS 3] – with one suggesting that the OFR covers 95 per cent [Reg 3] of an integrated report. The OFR provides a “*primary vehicle*” [SS 1] for companies who want to *experiment* with <IR> as it offers “*all the framework you need*” [AF 3]. However, others viewed the OFR as a “*stepping stone*” [SS 2] to address most aspects of an integrated report: “*there is quite a sustained view that if you do a really good OFR, you’ve actually met many of the IR framework; they’re not directly comparable but there’s a lot of similarity in terms of what you’re trying to get to*” [IB 5]. All 16 [SS 1, SS 2, Reg 3, IB 2, FS 7, Reg 2, IB 1, FS 5, AF 1, AF 2, AF 3, IB 5, IB 6, FS 6, FS 8, FS 3] thought that the existing guidance from ASIC and ASX was the *right place* [IB 5] for <IR> (see below). Two interviewees, [FS 8, IB 2] however suggested that the OFR and Recommendation 7.4 did not go far enough – and are currently too narrow in scope, covering only certain aspects of <IR>. One financial stakeholder believed it would be better to:

> *bin the principles and start again around an integrated reporting framework, rather than just adding another layer on top… a collaborative stakeholder approach to try to build a new standard, and picking up some of the bits from the old that were helpful and useful but recognising that actually this is a step change, it's not an incremental change… the potential danger with integrated reporting [is] we just wind up with yet another Band-Aid solution that just adds more confusion and noise and is seen as just another burden by companies rather than being seen as an opportunity to better communicate with their stakeholders and particularly their investor stakeholders.* [FS 5]

Voluntary, Principles-Based Approach

Outside of the OFR and Recommendation 7.4, and specifically in the context of <IR> – a cross section of our interviewees – including industry bodies [IB 1, IB 4, IB 6, IB 5], regulators [Reg 2, Reg 3], standard setters [SS 1, SS 2] and financial stakeholders [FS 2, FS 6], believe that <IR> should remain a voluntary principles-based approach.

Too early for regulation and it's politically unpalatable

Some were not convinced that there is a case to be made for mandatory <IR> as there isn't "*a pressing market failure or regulatory problem at the moment that requires an urgent need to introduce integrated reporting*" [Reg 2]. Others [Reg 3, SS 2, IB 5] suggested it was too early to consider a regulatory approach as the IIRC framework was only released in December 2013. A regulator, for example, stated that the framework has "*a long way to go before it's going to be appropriate to recommend that listed companies across the board adopt it*" [Reg 3]. A number of interviewees [IB 4, Reg 3, FS 2, IB 5, SS 1, SS 2] felt, especially given its early stage of development, that mandatory reporting would increase the reporting burden. One regulator saw it as "*an extra reporting layer on top of an incredibly onerous statutory reporting layer*" [Reg 3], and layer of mandatory standards, which would inhibit the benefits:

> *we feel that the very thing that you want to achieve with it – which is in a sense integrated thinking, that's a cultural shift – if you impose it as a compliance burden at this point, you won't get that benefit of people talking through how we approach this. [Pilot company] say that it's been the greatest benefit; that it had all these disparate internal stakeholders having to talk to each other for the first time and we see that as one of the greatest benefits and we think if you mandate it, that gets lost*. [IB 5]

A lack of appetite for regulatory reform also rests on differing views about how to bring about change in reporting activity. Regulation was seen as politically difficult – it would be *counterproductive* as it would just get companies and directors *off-side* [SS 2]. It was better – in the view of one industry body – to let the process *unfold* [IB 5]. Three interviewees – including regulators [SS 2, SS 1, IB 1] referred to a market-based approach as the best way forward: "*just let the market take this up rather than having a backlash*" [SS 2].

Voluntary approaches can be more effective

Those advocating for a voluntary approach placed faith in letting things take their course – a standard setter claimed that many more companies would be using the framework "*five years down the track*" but also leaving open the possibility for some subsequent regulatory reform: "*it would be nice to think down the track you would end up in a mandatory regime*" [SS 2]. Indeed, one regulator suggested that the OFR was already working, as it had observed "*quite a degree of improvement around the operating and financial review as a result of the guidance*" [Reg 2] – and thus there was probably little more that was needed at this stage.

Integrated Reporting <IR> – as a framework – was largely seen as having the *capacity* [FS 4] to "*steer companies on their reporting journey*" [FS 7], and can provide direction and consistency to:

> *tell a much more coherent story about value creation for the company over the short, medium and long term… so it should help to hopefully cut through some of the noise and focus attention on what the long-term value creation story is as opposed to getting lost in the cacophony of other stuff that's being pushed out of companies.* [FS 5]

Others maintain it can provide clarity about "*what's going on at that board level with the strategy and where they're really allocating the best resources for the best businesses*" [IB 2]. As a principles-based framework, there is "*inherent flexibility*" [SS 2] to tailor it to a company, particularly regarding materiality, which will reduce complexity. An industry association believed that one result of the process of developing the framework, is a "*commonality of language*" [IB 5] and stakeholders are agreeing on key concepts. Voluntary experimentation is best as <IR> "*needs to be seen in practice*" [FS 7].

But some caveats were also identified – the flexibility inherent in the IIRC's guidelines and the adoption of a voluntary, principles-based approach can lead to different interpretations of the concepts: "*you will end up with each and every organisation coming up with what they feel value is*" which "*makes it complicated*" [AF 2]. Some questioned, for example, whether the six capitals created more complexity or resulted in more effective corporate reporting. One regulator thought the IIRC "*just went down the wrong path on that* issue" as "*no business is going to say, for example, well, our people aren't material to our business. So what are we then reporting about in terms of human capital?*" [Reg 3] One financial stakeholder argued that the six capitals are "*just restating what we already know*" and concluded that "*it's just form over substance*" [FS 3]. However, one industry body reinforced that "*it's up to you to decide of the six capitals what's material and how you're going to report*" [IB 5] so the framework can reduce complexity and the volume of information. Seven interviewees [IB 2, SS 1, FS 4, IB 1, IB 3, FS 3, IB 6] raised issues of the *cost of reporting*, *another overlay of reporting*, *the extra work*, *additional complexity, additional requirements*, and reporting *becoming quite burdensome*. According to an industry association, the outcome is that directors question the value of integrated reporting:

> *I think for directors that are sitting around a boardroom table that are either having discussions with their auditors or have seen this framework, consider where the value proposition is for you as an organisation. I don't think it's a quick fix, I think it takes time to prepare an integrated report and I think it takes a commitment that would probably be a lot greater than many companies are prepared to make at this point in*

> *time. I think a lot of them would struggle to see the value today. And I think it is a journey. I think that there aspects that are quick wins but there are other parts of that, if you go down into the detail and you look at how you would disclose it, I think it would take a couple of reporting cycles to be able to achieve what I think the IIRC does envisage as what an integrated report should look like.* [IB 1]

Thus, while most expressed some faith in the voluntary approach being taken, several did acknowledge that <IR> is not the "*cure for corporate reporting*" [IB 6], and while it will help address the issues with corporate reporting [IB 5, IB 6], it becomes problematic if "*we just add disclosure on disclosure on disclosure on disclosure*" [IB 5]. Six of those interviewed [Reg 3, IB 5, AF 3, IB 1, IB 3, FS 3] referred to the onerous requirements for remuneration reporting that resulted in "*what is seen as largely incomprehensible 30 page remuneration reports*" [IB 5] which sounds a warning for <IR>. One financial stakeholder [FS 7] noted that many companies didn't adopt the Global Reporting Initiative's Sustainability Reporting Guidelines because it was too onerous. Another financial industry stakeholder added that they had reviewed the integrated report of a company participating in the IIRC Pilot Programme and "*based on my own desktop analysis of what I would I consider to be the key risks, I then looked at the integrated report to see if they were commented on in that report, and some of them weren't*" [FS 3].

There was, therefore, some degree of realism amongst those interviewed – two acknowledged openly that <IR> was "*not a panacea*" [FS 5, IB 4], and that "*the biggest thing is proving the business case and I think the jury's probably still out*" [IB 6].

Regulatory Reform

As outlined above, there was little support for mandatory <IR>. There was, however, five that did support regulation [FS 8, FS 2, IB 2, FS 7, FS 4], and another six [IB 4, FS 5, FS 6, IB 3, AF 1, FS 1] who thought aspects of the reporting process required some regulatory change. The issues appeared to coalesce around what was necessary to bring about improvements in company reporting, and some clarity on some ambiguous issues. Nevertheless, there was a high level of uncertainty about the regulator's role, as <IR> is still emerging and evolving.

Regulation is necessary to drive change

In terms of change, regulation was seen as a way "*to keep the pressure on*" [FS 2] as "*if there is no regulation or guidelines on it I don't think it will happen any time soon*" [FS 4]. Eight interviewees [IB 4, FS 8, FS 5, IB 2, FS 6, IB 3, AF 1, FS 1] thought that for <IR> to be successful, and to "*get that consistency*" [IB 3], there needs to be "*a level of mandating*" [IB

4] and “*regulation has an important part to play*” [FS 6]. One justified this because of their experience with sustainability reporting, where listed companies claim “*we’re too small … ESG issues aren’t really relevant for our business”*, even though “*you have investors like ourselves and other investors who ask for it”* [FS 4]. One regulator suggested that until there were standards that can guide people, there was little benefit in <IR>.

Regulation can clear up lingering issues

Regulatory reform was seen as desirable for providing some clarity around materiality. One financial stakeholder maintains that while they “*don’t want to be prescriptive in what they should report or how much they should report; [it was necessary to ensure companies] know what the risks are that face their company and how these things impact their company*” [FS 7]. In other areas, clear changes are needed to the number of standards. For example, “the IFRS versus the US GAAP-type consolidation” [FS 5] is an issue, as well as the complexity of accounting standards “*which keep on changing constantly, yet you end up with still the same answer in a sense*” [AF 1]. In some cases, regulation had not kept pace with reporting changes underway. A standard-setter argued that it is “*reasonably well accepted, I think, that the current standards don’t go far enough in terms of dealing with things [such as] the narrative information, forward-looking information, a combination of financial and non-financial … so there is a need to actually put some rigour into how you go about doing these kind of assignments*” [SS 2].

Regulatory reform could also extend to clearing up elements of existing regulations that were now no longer necessary. Information that changes little, such as the governance charter, could be *taken out* [IB 2] of the mandatory requirements. Reform was necessary where existing standards were proving to be inadequate [IB 4, FS 5, IB 2, SS 2, AF 1].

The most contentious issue raised about integrated reporting and regulation is that of director liability for forward-looking statements, as described by one regulator:

> *The issue with the director community in this country is around the long-term focus and the requirements for longer term disclosures which then give rise to concerns about liability for forward-looking statements under our law and the fact that directors are civilly liable if they mislead someone with a forward looking statement. And until that issue is resolved with legislative change there will be a major pushback from directors on adopting the integrated reporting framework in the way it's expressed at the moment around longer-term reporting.* [Reg 3]

While four interviewees [Reg 3, IB 2, IB 5, IB 1] thought this was a real barrier to the adoption of <IR>, seven [FS 8, FS 5, FS 7, Reg 2, IB 6, SS 2, AF 3] thought the concerns "*may be overstated*" [Reg 2]. Indeed, two financial industry stakeholders thought the issue was *overblown* [FS 5, FS 8] and questioned the motivation for seeking a safe harbour provision:

> *There may be an essence of a problem in there somewhere that maybe does need to be addressed. I'm open to the idea that there needs to be a change to the law but the problem's not clear yet and I think that integrated reporting is just the latest wedge in the argument about directors' liability rather than it being about integrated reporting.* [FS 8]

A regulator pointed to similar concerns with the OFR: "*I've heard views expressed by Bob Austin, a former member of the bench, that in fact it's not an issue, and in particular it's not an issue because the requirement basically, as set out in the guidance, simply requires a narrative discussion about what the future prospects of the company are"* [Reg 2]. According to this person, forward-looking statements are more of an issue for financial projections or financial forecasts than a narrative about future prospects.

Issues of assurance also require some regulatory consideration [SS 2, IB 1, IB 4, IB 6], with seven interviewees stating that there is a need for an assurance standard [FS 5, FS 7, FS 4, AF 2, SS 2, AF 3, AF 1]. An industry body [IB 1] argued that directors and boards would be looking for "*some form of rigour*" to be able to sign off an integrated report, which requires a level of assurance. The IIRC has called for an assurance debate and released a discussion paper in July 2014 to seek input on whether assurance is necessary and consider its benefits and challenges. One standard setter pointed to the complexities involved:

> *so materiality; the boundary of the report; does the framework constitute suitable criteria to form the basis of the assurance engagement; forward-looking information; and the ability and willingness of practitioners to provide assurance on that. Do they come back and just talk about assurance on the process of preparing the report, which is pretty meaningless in my view? If you're not going to do it on the report itself then I'm not sure why you'd bother.* [SS 2].

The interviewees did point to the complexity in creating an assurance standard over "*the quality of the narrative*" [AF 3]. One financial stakeholder questioned "*What particular part of the report would we have assured when they're all reporting on a host of different issues*?" [FS 7]. Another suggested that it should be focused on the *process* rather than the data, to ensure that "*the statements that they're making and the risk management frameworks and materiality assessment frameworks that they've used are there and exist and that there's rigour around them*" [FS 5]. But as a regulator pointed out, "*it's a lot easier to audit numbers than it is to audit narrative*" [Reg 2], which was reinforced by an investor who argued that "*descriptions of how a company's managing a particular risk, I don't know how that could be audited*" [FS 4]. A standard setter floated the idea that had been raised in an industry forum, that "*rather than launching into an assurance standard on integrated reporting, we look at a standard or standards on narrative reporting, forward-looking information and combined financial and non-financial information*" [SS 2].

Regulatory clarity was also needed around who should be issuing integrated reports. No participants suggested that all incorporated companies should provide integrated reports as OFRs (operating and financial reviews)[2] are only required for listed companies. Several [Reg 3, FS 5, FS 7, Reg 2, FS 4, AF 2, AF 3, AF 1, FS 3] suggested that listed companies should produce integrated reports, but there wasn't general agreement on the coverage of the ASX-listed companies. An accounting firm [AF 3] considered that all ASX-listed companies could produce a report, but this wasn't a widely supported view. Another accounting firm qualified the all-encompassing view by suggesting an "*if not why not*" approach and "*those mid-cap companies can then say they're not going to and they can give the basis for why*" [AF 2]. Four of the financial stakeholders "*only care about listed companies*" [FS 4]. For one, this was "*down to ASX300*" [FS 4], but the others suggested the ASX100 [FS 5] or the ASX200 [FS 3, FS 7]. Two interviewees thought that "*it's not impossible to have it as some kind of listing requirement. I mean if you're going to be listed and you've got to disclose an annual report every year or issue an annual report, why couldn't there be a listing requirement for this too?*" [FS 4]

Many of those interviewed [SS 2, IB 2, IB 4, IB 6, IB 5, AF 3, FS 6, FS 1] thought that listed companies was too narrow. An industry association argued that some public sector organisations "*have more money and more impact on society through what they do than some of the people in the ASX200*" so should be producing an integrated report. This was reinforced by a standard setter, "the *public sector has pervasive influence on community… why wouldn't they do this as well?*" [SS 2] Two people associated with the investment markets [FS 6, IB 2] pushed the case for fund managers, or "*other parts of the supply chain*" [FS 6], to produce integrated reports as they manage large investments yet, according to one, "*we don't understand what they're on about and some of their governance to me looks somewhat suspect*" [IB 2]. A debt provider needs "*that information more broadly*" [FS 1]. They argued that in the developing world, financial regulators are "*starting to say to banks,*

[2] An OFR, which is not auditable, is the management commentary of annual reports and forms part of a listed entity's annual report. The objectives of the OFR are "to provide shareholders with a narrative and analysis to supplement the financial report and assist shareholders in understanding the operations, financial position, business strategies and prospects of an entity" (ASIC, 2013, p5).

either through guidelines or mandatory requirements, we require you to look at ESG risk; that's going to then drive pressure to everybody to report so people can get their hands on the information to do that ESG risk assessment".

The Way Forward

Four people [FS 8, IB 2, FS 5, AF 1] referred to a *middle ground* that has a "*combination of regulatory change and* guidelines" [AF 1] but leaves "*as much to discretion as is possible*" [FS 5]. No-one could provide a view of how this would occur as "*it's really hard to nail down what should be rules and what should be principles, that is your challenge, I imagine*" [FS 6].

When asked who should be involved in determining whether and how <IR> should be regulated or voluntary, most people did not have a strong view. Three people [FS 4, AF 2, AF 1] suggested that a *broad range* [AF 2] of stakeholders need to be involved, while others referred to standard setters [SS 2, IB 4], regulators [IB 4, FS 2], industry bodies [FS 2], Treasury [IB 2] and the ASX Corporate Governance Council [FS 5]. However, it was not a question that people had put a lot of thought to. An industry body suggested that Australia could follow the lead of the UK with its Financial Reporting Lab, where the regulator, investors and preparers identify potential disclosure changes to address issues with corporate reporting: "*So I think that mechanism which then uses key stakeholders within that supply chain and looks at pragmatic and market-based solutions could be a mechanism to bring about change in corporate reporting … it's about being innovative and thinking differently*" [IB 1].

Conclusions

This study was about financial stakeholders' perspectives on the appropriate route to effective <IR>. Of particular interest was whether regulatory standards or non-regulatory guidelines offered the best potential to bring about necessary reporting reform.

While not the focus of our study, the views of the financial community regarding the overall desirability of <IR> provides important context. The majority of those we interviewed share the concerns of the IIRC about the limitations of current (annual/financial) reporting – but there is less agreement that <IR> is the solution to those problems. Current reporting is seen as meeting the needs of only a small number of stakeholders and users of corporate reports.

In this context, the role of corporate reporting is changing. Some of our interviewees were of the view that regulatory standards, designed to ensure careful reporting of a company's activities, are not necessarily designed to be simply about communication – and thus the conversation around <IR> is misguided. The majority, however, felt company reports today have a variety of purposes – and reform is necessary to ensure they keep pace with the increasing number of stakeholders who rely on company reports to aid their decision-making. In this regard, considerations regarding materiality, comparability and transparency require revision.

Against this backdrop, our study points to the following conclusions regarding regulatory standards and non-voluntary guidelines:

1. There is little appetite for regulation around <IR> – partly because of the recent development of Regulatory Guide 247 (which requires companies to produce an Operating and Financial Review – the OFR) and the ASX Corporate Governance Council's Recommendation 7.4 of their Principles & Recommendations. These are seen as adequate for moving reporting activity towards key disclosures that influence stakeholder assessment of company value and prospects.
2. Resistance to regulatory intervention rests on political and pragmatic views about effecting change. Regulation was viewed as potentially getting directors and managers 'off-side', and would lead to resistance amongst the business community. Many felt regulation, at the current stage of development, would be premature.
3. Voluntary, non-regulatory guidelines tended to be seen as more productive for bringing about change, although this came with the risk of divergent activities and that key issues would remain unresolved. Voluntary, practice-led developments also had the potential to raise complexity and confusion rather than reducing it.
4. While requiring companies to produce an integrated report is not seen as desirable, some areas of regulatory reform are necessary, including: reducing duplication and unnecessary reporting regulations, clarifying who should produce an integrated report, some standards around assurance of non-financial and narrative information, and clarifying materiality (process vs issues) and comparability (sector vs historical) requirements. Consideration needs to be given to clarifying directors' liability over forward-looking statements.

Recommendations

The findings of our study, and the conclusions we draw, leads to a number of specific recommendations for those concerned with reform of reporting activity:

1. The Australian reporting community needs to explore areas of complementarity between the OFR, ASX Corporate Governance Council's Recommendation 7.4 and <IR>. Existing regulatory developments are seen as going some way towards meeting the needs of financial stakeholders – and the recent developments are seen as credible and legitimate. <IR> is perceived as being less so. We recommend that desirable elements of <IR> are rolled in to subsequent revisions of the OFR and Recommendation 7.4.

2. Trade-offs are going to be necessary – especially regarding materiality, comparability and transparency. There are also likely to be compromises necessary regarding audit and assurance. It is unlikely that the perfect reporting framework is able to be developed. While there are limitations with current reporting, there will be limitations with any framework that replaces it. The national (and global) conversation needs to move on to address trade-offs that will meet most stakeholders' needs. It is by addressing these trade-offs that priority areas for simplifying corporate reporting will progress. This discussion must recognise that the needs of the users of corporate reports have changed.

3. More financial stakeholders need to be involved in the conversation about change processes, regulatory reform and the necessary trade-offs. There is a distinct lack of credible leadership in this space in Australia. While there is a reluctance to rely on Government to drive regulatory reform, the voluntary space is dominanted by some stakeholders that lack credibility and are not seen as entirely partial. In the context of recommendation (1) some leadership and considered process is necessary. We recommend that Australia follows the lead of the UK's Financial Reporting Lab, in which stakeholders collaborate to fully investigate the types of regulatory and market-based trade-offs and reforms that are possible.

4. The Government should act on areas of regulatory reform where there is agreement, and act on the findings of a national conversation about regulatory changes in select areas. While there is little desire to mandate <IR>, areas of regulatory reform are necessary. Reforms are needed to reduce onerous reporting requirements – including duplications – where existing requirements are no longer fit for purpose, but also in areas that provide certainty around who should report, materiality, comparability and transparency. Regulatory reform will also be necessary for audit and assurance standards.

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Appendix 1 Australian Investment Supply Chain