Comments on the Consultation Draft of the International <IR> Framework

Ministry of Economy, Trade and Industry, Japan

We share IIRC's view that "corporate reporting needs to evolve to provide a concise communication about organization's value creation over the short, medium and long term."
We hope that an international framework of integrated reporting will promote companies' integrated thinking and function as a catalyst to improve overall communication between companies and their stakeholders.

We appreciate that the Consultation Draft presents important elements which would help lead corporate reporting to integrated thinking. In the meantime, we found several points to be improved both from the viewpoint of concept and practicality in order for the Framework to be well understood and used by companies and users of the reports.
We first start with providing general comments and then individual comments on several headings will follow.

General comments

1)
We understand and agree on the basic idea presented in "Objectives" and "Integrated Thinking" in Chapter 1. With regard to "Audience for <IR>" and "Interaction with other reports and communication," however, we recommend that the contents and expressions should be reviewed after reassessing the contents of the other chapters including fundamental concepts and guiding principles.

2)
The scope of "Audience for <IR>" depends on the definitions of "Fundamental Concepts" presented in Chapter 2, such as "capital", "value", and "outcome" and their relation to each other. Reconsidering those definitions would naturally raise questions as to how these concepts should be understood and who should evaluate values and outcomes of organizations. We, therefore, recommend that the scope of "Audience" should be reconsidered according to the way those fundamental concepts are to be (re)defined.

3)
"Interaction with other reports and communication" is one of the crucial points where the essential role of this Framework would be questioned. We share the idea that "the <IR> process is intended to

be applied continuously to all relevant reports and communications" presented in Chapter 1. On the other hand, an "integrated report" is characterized, in the current Consultation Draft, as a link to other detailed or separated reports without clear mechanism of reviewing or modifying the other existing reports.

This suggests the possibility of integrated reports, with the limited scope of users (providers of financial capital), would merely serve as a convenient "index" of other existing reports. If this were what was really intended, items to be included in integrated reports (presented as the Content Elements) should be very limited. In addition, the necessity of introducing unique "Fundamental Concepts," the concepts which may not be used in other reports and existing reporting frameworks would be greatly lessened.

On the other hand, if integrated reports are intended to either integrate other reports or be positioned as impetus forcing or motivating the other reports and frameworks to be revised based on <IR> framework, certain processes and mechanisms for that purpose should be clearly described in every part of this Framework.

4)

We appreciate the fact that the Framework defines a broader range of capitals as important "input" for value creation of organizations in Chapter 2.

Among the fundamental concepts presented in this Chapter, however, there are things to improve from the logical/conceptual as well as practical points of view. In particular, definitions of key concepts such as capital, value, and outcome as well as their relation to each other present a problem to be solved in order to ensure understandability and usability for companies and users.

5)

First of all, the definition of value, the most important concept, would cause fundamental problems in understanding and applying the Framework. It may raise a serious question as to in what respect (or for whom) value should be evaluated. In this Framework, value is defined as follows; "**Value** is created for an organization and its stakeholders as a result of the increase, decrease or transformation of the **capitals** (2.37)." Capital, on the other hand, is defined as follows; "The **capitals** are stores of **value.**" It essentially makes a tautology where value and capital define each other.

We recognize that the Framework describes categorization of capitals such as "financial capital", "manufactured capital" and "intellectual capital." According to the Framework (2.19), however, organizations do not necessarily have to adopt these categories, thus they should be considered as indicative list of possible forms of capitals. While we understand this approach to the categorization, it would make the concept of value hard to describe as being theoretically underpinned.

Largely because of this tautology without clear anchor of the concept of value, questions as to in

what respect or more precisely for whom (either for companies, providers of financial capital, or other stakeholders, or all of them) value should be evaluated would arise. This, together with the concept of outcome, would become a stumbling block to practical application of the Framework for making and using integrated reports.
We recommend, therefore, that the definition of value itself, avoiding tautology, as well as the viewpoint from which value is evaluated should be clarified.

6)
From a practical viewpoint, partly because the definition and meaning of the term "capital" used in this Framework is different from those adopted by companies and their stakeholders in corporate reporting, companies would find it difficult to relate them with existing reports in practice. For example, the meaning of the term "capital" provided in the International Financial Reporting Standards is totally different from those of "capital" and "financial capital" in this Framework. With regard to "intellectual capital", "human capital" and "relationship capital" are contained as its subsets in the existing international standards regarding intellectual capital.
We recommend that the definitions of capitals, especially that of the intellectual capital, should be reconsidered and clarify how they relate to those used in international financial accounting standards when considering categories of capital.

7)
Secondly, for certain category of capitals, difference from and relations with "external environment" or "factors affecting the external environment" are not clear. Those categories include "social and relationship capital" which companies do not necessarily have exclusive ownership and those "manufactured capital" or "natural capital" which have characteristics of public goods. (e.g., infrastructure)　In particular, "factors affecting the external environment" is described as something "that affects the organization's ability to create value in the short, medium and long term," which may effectively overlap with the concept of capital. We are concerned that such unclearness would hinder companies' understanding and use of the Framework. We recommend clarifying the differences and relationships between these terms.

8)
Among the fundamental concepts, "Outcome" is the concept that is very difficult to understand both theoretically and practically and may become inconsistent with the goal of the Framework.
As seen in 2.35, outcome is defined as "internal and external consequences **for the capitals".** In practical application, organizations are most likely to evaluate each outcome separately for each category of capitals. These segmented evaluations, coupled with unclearness of whom the value is

for (see above comment 5), may go against the goal of organizations' reporting about their performance based on integrated thinking.
Suppose "outcome" is to be evaluated against "value (change in capital)" for primary users of integrated reports, namely providers of financial capital. Since their interest rests on "financial return" as in 2.38, assessing outcomes for capitals other than financial capital has little relevance and materiality even if other outcomes "may ultimately affect financial returns." (2.42)
Although it is worthwhile to take account of a variety of capitals as input, we have certain concerns to define "outcome" as "consequences for the capital."

10)
In general, Guiding Principles are expected to help organizations making their reports and communication with their stakeholders based on integrated thinking. From this viewpoint, we suppose that the items listed in Chapter 3 are well selected in a balanced way. In particular, we agree that "Materiality and conciseness" is an important principle. However, we would like to see a revision of making "conciseness" the foremost principle. Only through pursuing and focusing on truly necessary information based on the principle of conciseness, can organizations, in their integrated report and other communications, find and convey their material information. In this respect, "In achieving conciseness, an integrated report can be linked to additional detailed information (3.29)" is not appropriate based on the purpose of this principle since it simply tries to shift the responsibility onto other reports.

11)
With regard to other principles, we value them as generally well-balanced guiding principles although there is still room for improvement individually. (Discussed separately)

12)
Whether "Content Elements" in the Chapter 4 are appropriate or not will depend largely on the expected role of integrated reports as discussed previously in 4). If the integrated report is merely an index of other previously provided reports, much of "Content Elements" should be omitted.

13)
We appreciate that most Content Elements are reasonably derived from the overall structure of the Framework. However, some contents found in External environment (4A), Governance (4B), and Strategy (4D) seem to appear in a rather abrupt manner and not integrated into the Framework structure. (Individual content will be discussed later.) They may negatively affect organizations' reporting and understandability of stakeholders by encouraging ticking-box style reporting which

may conflict with the principle of connectivity, materiality and conciseness.

14)

With regard to performance (4F), it is a prerequisite to sort out relations of External environment (4A) with certain capitals as discussed previously in 8) as well as clarify the definition of “outcome” as mentioned in 9).

15)

As stated in the summary of the Framework, Chapter 5 is supposed to have “no additional requirements.” However, there are some items which practically necessitate additional requirements or could lead to such requirements.

For example, “Involvement of those charged with governance (5D)” talks about a statement regarding the report being “in accordance with” the Framework. Also “Credibility (5E)” mentions “performance certification” and “compliance assessment (5.19)” and “independent external assurance (5.20).” It is neither necessary nor appropriate to provide, even as indicative lists, this kind of explanation in light of the Framework’s characteristics and the overall unclearness of requirements.

16)

With regard to “reporting boundary (5G),” “financial reporting entity” can be understood in practice. However, “opportunities, risks and outcomes”, which is described as the “second aspect of determining the reporting boundary”, has an unclear definition and would be extremely hard to be identified in practice. Even Figure 7, supposed to help organizations’ understanding about mapping of stakeholders and reporting boundary, would make such difficulty visible. For example, employees are placed as stakeholders outside the organization while it does not include providers of financial capital, who are primary users of the integrated report, as a stakeholder. We recommend that the Framework should provide practical guidance rather than theoretical idea for determining the reporting boundary.

17)

In “Use of technology (5I),” it is recommended to take advantage of technology platforms such as Web-based media and XBRL in order to increase connectivity. We do not mean to deny the usefulness of these platforms. What connectivity should truly suggest, however, is that corporate management understands their unique value creation story in an integrated manner and communicates material information concisely. If management and users of reports take merely searching or linking existing data as a tool of connectivity, it is not only different in essence from the true nature of connectivity but could even go against the principle.

From this reason, although associating the use of such technologies with comparability could be reasonable, relating it with connectivity is considered inappropriate. This is also relevant to 3.12.

18)

Chapter 5, supposed to provide not concepts or requirements but practical guidance, needs a close reassessment as to whether the content is realistic and practical enough to be understood and used in light of actual corporate practices and contents of the reports in order to ensure the usefulness of the guideline.

End

Comments for individual items

(1.13)

It is appropriate that senior management is responsible for understanding the corporation's value creation and exercising judgment to determine which matters are material.

(1.18)

See previous general comments 3).

(2.1) and Figure 2

Difference and relations are unclear between external environment and capital.

Figure 3

We understand that a variety of capitals are considered as important input for value creation. However, evaluating an outcome (separately) for each different capital is not appropriate.

(2.12)

See previous general comments 7).

(2.13), (2.19) and (2.37)

See previous general comments 6).

(2.25)

"Material trade-offs" has no definition and is an unclear notion, which would need to be clarified if it is meant to be used as criteria.

(2.28)

"Input" is a concept of flow and capital is a concept of stock. However, there is no clear definition of "input" and no indication at all in the following paragraphs where examples of capitals (as a stock) are provided. Therefore, clarification of this important concept, "input", not just as "transformation of capitals" is required and clear examples should be given.

(2.31)

"Initiative", a key term to this paragraph, is unclear in its definition and positioning. Conceptually, its relations with both "transformation of capitals" and "business activity" are vague. Therefore, a clearer definition should be provided.

(2.35)-(2.37)
See previous general comments 9).

(2.45)
“Value driver” fails to provide its definition and is hard to place in this Framework. The given examples, either mixes up causes and effects (the first example), lacks clarity in its relations with capital (the second example), or, includes value in itself (the third example). “Value driver” in the current form, is a concept difficult to be included in this Framework.

(3.11)
A clearer definition of “financial information” and its relations with the overall concept (including capital) should be provided. This is relevant to general comments 7) as well.

(3.12)
See previous general comments 17).

(3.23)
See previous general comments 10).

(3.29)
See previous general comments 10).

(4.4)
We value the idea that an integral report provides a concise communication. However, it should not only be linked to other reports but also function as a proactive catalyst for other reports being more concise and integrated as well. The Framework should provide clear mechanism or processes for realizing this dynamism.

(4.5)
Requirement of disclosing the reasons why the organization considers any of the capitals to be immaterial is an unnecessary requirement because this has little to do with the organization’s own business model and value creation story. It would also conflict with the fact that the organization does not necessarily have to adopt the capital categorization (2.19).

(4.9)

We understand that this shows mere examples and should not be used as a checklist. This point should be clearly mentioned here.

(4.11)
To make it clear that items provided are examples, the expression should be revised into something similar to that of (4.9) such as “An integrated report may provide insight about such matters as:”

(4.12)
This heading is neither necessary nor appropriate to place here since it goes against the goal of integrated reports and requires unreasonable disclosure of specific information. If the intent is to examine overall governance, examples shown in (4.11) will suffice.

(4.20) and (4.22）
A description of competitive advantage found in both items is redundant. One solution is to take out the second paragraph of 4.20, revise it and replant it into the second paragraph of 4.22.

(4.23)
The content presented in this item is related to presentation, thus, inappropriate to be included in Content Elements. If this content is really necessary, it should be moved to the Chapter 5.

(4.30)
Although we recognize the intent of this sentence, it is hard to understand why this has to be provided here as part of disclosure of performance.

(4.31)
“Relevance”, “consistency”, “connectivity”, and “materiality” given in this item are all discussed as guiding principles in the Chapter 3, making it hard to justify listing them up again here in a slightly different manner. Rather, we think it is better to quote here in particular materiality and connectivity as defined in the previous chapter.

(5.18) and (5.19)
See previous general comments 15).

(5.29)
See previous general comments 16).

(5.35)-(5.41)

See previous general comments 17).