Integrated Corporate Reporting Approach and Relevant IAS/IFRS in the Context of CIMA’s Strategic Case Study Exam. on an Imaginary Entity “WODD”

Background

After disillusion of Soviet Union in 1991, communism era ended. Now, capitalist era is passing as a unipolar economic philosophy in the world. But, due to its extreme profit making motive, it has already created acute discrimination in distribution of wealth and in quality of living standard within the country and among the countries. According to Oxfam’s study G20 countries represent around 90% of global national products and 80% of world trade. It also says half of the global wealth held by the 1% population. Many economic philosophers believe that capitalism has already reached at its ripping stage and a paradigm shift is waiting for capitalism.

In the context of present world economic scenario, United Nations summit adapted 17 Sustainable Development Goals (SDG) and 169 targets for next 15 years in its 69th general assembly session with a aim of transforming the world through ensuring end poverty, healthy lives, inclusive and quality education, reduce inequality within and among countries, sustainable use of resources etc., which will starts its journey from 1st January 2016.

In the context of WODD, an imaginary forestry management company, SDG15 “Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss.” is relevant.

On the contrary, in corporate arena, an ever-greater number of companies and other organizations are recognizing the need to make their operations more sustainable simultaneously governments, stock exchanges, markets, investors, and society at large are calling on companies to be transparent about their sustainability goals, performance and impact. In light of this, two world organizations, International Integrated Reporting Council (IIRC), UK based a global not-for-profit organization and Global Reporting Initiatives (GRI), Netherland based a global not-for-profit organization, has been working to set framework, guidelines, regulations for sustainability and integrated reporting system.

International Integrated Reporting Council (IIRC)

In 2013 IIRC published framework incorporating following seven guiding principles and eight content elements that govern the overall content of an integrated report:

Guiding Principles

1) **Strategic focus and future orientation:** Provide insight into the organization’s strategy, and how it relates to the organization’s ability to create value in the short, medium and long term, and to its use of and effects on the capitals.

2) **Connectivity of information:** It shows a holistic picture of the combination, inter-relatedness and dependencies between factors that affect the organization ability to create value over time.

3) **Stakeholder relationship:** It relates to the nature and quality of the organization relationships with its stakeholders.

4) **Materiality:** An integrated report should disclose information about matter that substantively affects the organization’s ability to create value.

5) **Conciseness:** An integrated report should be concise.

6) **Reliability and completeness:** An
integrated report should include all material matters without material error.

7) **Consistency and comparability:** An integrity report should be presented on a basis that is consistent over time and in a way that enables comparison with other organizations.

Content Elements

1) **Organization overview and external environment:** What does the organization do and what are the circumstances under which it operates? Who are the major stakeholders? How is it structured and what external events will it affect most? Mission statement, stakeholder analysis, organogram and PESTEL analysis would be relevant for this element.

2) **Governance:** What’s the organization’s governance structure and how does it support the organization’s ability to create value? Organogram, Stakeholder analysis and code of corporate governance are relevant for this element.

3) **Business model:** What is the organization’s business model, and to what extent is it a resilient one? Business model is the system of transforming inputs through business activities into outputs and outcomes that aims to fulfil the organization strategic purpose and create value. Value chain analysis is relevant for this element.

4) **Risks and opportunities:** What are the key opportunities and risks that the organization faces and how is the does the organization tackling them? SWOT analysis is relevant for this element.

5) **Strategy and resource allocation:** Does the organization intend to develop new products, set new factories or expand to new market? Porter’s generic strategies, Ansoff’s matrix, Value Chain and method of growth are relevant for this element.

6) **Performance:** How has the organization performed against its strategy, what are the key outcomes in term of the capitals? Balanced score card and GRI published KPI are relevant for this elements.

7) **Outlook:** What challenges and uncertainties is the organization likely to encounter and what are the potential implications for its business model and future performance? PESTEL and Porter’s five forces analysis are relevant for this element.

8) **Basis of presentation:** How does the organization determine materials matters on their characteristics like KPIs as presented in the integrated report? Balance scorecard, critical success factors and GRI published set of relevant KPIs are applicable for this element.

The Multiple Capitals Model

As organizations draw from multiple capitals or resources that interact with each other to form a unique value proposition and access to the capitals may be controlled by the organization or by society and local communities, sustainable development requires a balance between economic progress, social advances and environmental protection, which is the foundation of the new value creation vision intrinsic to integrated reporting. The new capitals are:

1) **Natural capital:** Water, fossil fuel, solar energy etc.

2) **Social and relationship capital:** Ties to the community, government relation, customers’ relation etc.

3) **Intellectual capital:** Copyrights, patents, organizational system etc.

4) **Human capital:** Skills and know-how of an organization’s professionals as well as their commitment, ability to lead etc.

5) **Financial capital:** external finance, internally generated cash.

6) **Manufactured capital:** Buildings, equipment etc.

Performance Indicators

Sustainability reporting is a non-exhaustive journey with an aim to continuous development and it makes abstract issues tangible and concrete, helping organizations to set goals, measure performance, and manage change. Report should cover all aspects that reflect the organization’s economic, environmental and social impacts. It is not the option of one-size-fits-all. Company like “WODD” biodiversity is an issue, impacts related to this aspect could be associated with the organization’s own operations, or to entities outside the organization. So, considering material aspects, boundaries, connectivity and interdependency among primary objective, financial drivers, core non-financial drivers, key metrics and ESG factors, a set of relevant time bound Key Performance Indicators (KPIs) including financial metrics, Environmental, Social and Governance (ESG) indicators need to be selected.
Connectivity among primary objective, financial, non-financial and ESG factors for measuring performance under dimension of integrated reporting

B) Principles for defining report quality
1) Balance
2) Comparability
3) Accuracy
4) Timeliness
5) Clarity
6) Reliability

Global Reporting Initiatives (GRI)
In 2013 GRI published forth version of sustainability reporting guidelines offer reporting principles, standard disclosures and an implementation manual.

Reporting Principles: The principles are divided into following two groups:

A) Principles for defining report content
1) Stakeholder inclusiveness
2) sustainability context
3) Materiality
4) completeness

B) Specific Standard Disclosures
1) Disclosure on management approach
2) Indicators
   i) Economic
   ii) Environmental
A change in fair value of a biological asset should be included in net profit or loss for the period in which the gain or loss arises. (41.26)

An unconditional government grant related to a biological asset measured at its fair value should be recognized as income only when the grant becomes receivable. If the government grant is conditional, an entity should recognize the grant in the profit or loss when the conditions attaching to the grant are made. (41.34, 41.35)

One method recognizes the grant as deferred income that is recognized in profit or loss on a systematic basis over the useful life of the asset. (20.26)

The other method deducts the grant in calculating the carrying amount of the asset. The grant is recognized in profit or loss over the life of a depreciable asset as a reduced depreciation expense. (20.27)

Under this standard, Key issues are the exchange rates, which should be used where the effects of changes in exchange rates are recorded in the financial statements.

At the end of each reporting period foreign currency monetary amount should be reported using the closing rate. Non-monetary items measured at historical cost should be reported using the exchange rate at the date of transaction. (21.23)

Exchange differences arising on monetary items are reported in profit or loss in the period except the differences arising on net investment in foreign operations which are shown as component of equity. They are recognized in profit or loss on disposal of the net investment. If any gain or loss on a non-monetary item recognized in the equity, any foreign exchange gain or loss element is also recognized in equity.
When preparing group accounts, the financial statements of a foreign subsidiary should be translated into the functional currency. And goodwill and fair value adjustments are treated as assets and liabilities of the foreign entity, and therefore translated in each reporting date at the closing spot rate.

Exchange differences on intra group items are recognized in the profit or loss, unless there a result of the translation of the entities net investment in foreign operation when it is classified as equity.

Dividend paid in foreign currency by a subsidiary to its parent firm may lead to exchange differences in the parent's financial statements. They will not be eliminated on consolidation but recognized in profit or loss. When a foreign operation is disposed of, the cumulative amount of exchange differences in equity relating to foreign operation is recognized in profit or loss when the gain or loss on disposal is recognized.

**IAS 39: Financial Instruments: Recognition and Measurement**

The performance of an entity can be greatly affected by financial risk. For instance, due to price volatility and/or adverse movements in interest rates and exchange rates. This could have a major detrimental effect on a business.

When an item in an entity's statement of financial position or future cash flow is exposed to potential volatility, the entity may enter into hedging transactions to offset any losses and thus reduce financial risk. This is the area of hedge accounting and is governed by the accounting standard, IAS 39.

A hedged item is an item that exposes the entity to risk of changes in fair value or future cash flows and is designated as being hedged.

A hedging instrument is a contract whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item. Hedging instruments are normally a type of financial instrument known as a derivative. Derivatives often require no initial investment, or one that is smaller than would be required for a contract with similar response to changes in market factors; and are settled at a future date.

An example of a derivative is a forward contract. Forward contracts are contracts to purchase or sell a specific quantity of something, e.g. a commodity, or a foreign currency at a specified price determined at the outset, with delivery or settlement at a specified future date.

Another example of a derivative is a futures contract. These contracts are similar to forwards but whereas forward contracts are individually tailored, futures are generic and are tradable in a market. Futures are generally settled through an offsetting (reversing) trade, whereas forwards are generally settled by the actual delivery of the underlying item or cash settlement.

In essence the principle of hedge accounting is that it seeks to reflect the substance of why the hedging instrument (the derivative) has been entered into. To that end hedge accounting is trying to match any loss (or gain) on the hedged item with the gain (or loss) on the hedging instrument. In a perfect world hedging would work so that no net gain or loss arose.

Effectiveness is the extent to which the instrument offsets changes in fair value or cash flows attributable to the hedged risk. A hedge is highly effective if that offset falls within a 80-125% window. Hedge effectiveness has to be assessed both prospectively and retrospectively. All hedge ineffectiveness is recognized immediately in the statement of profit or loss (including ineffectiveness within the 80% to 125% window).

A fair value hedge is defined as a hedge of the exposure to changes in fair value or cash flows attributable to the hedged risk. A hedge is highly effective if that offset falls within a 80-125% window. Hedge effectiveness has to be assessed both prospectively and retrospectively. All hedge ineffectiveness is recognized immediately in the statement of profit or loss (including ineffectiveness within the 80% to 125% window).

A cash flow hedge is defined as a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognized asset or liability (such as all or some future interest payments on variable rate debt)
a highly probable forecast transaction and could affect profit or loss.

The portion of the gain or loss on the hedging instrument that is determined to be an effective cash flow hedge is recognized in other comprehensive income and creates a reserve in equity. If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, any gain or loss on the hedging instrument that was previously recognized directly in equity is recycled from reserves into the statement of profit or loss in the same period(s) in which the financial asset or liability affects profit or loss.

Reference:

Pre-seen materials on Strategic Case Study exam - November 2015 published by CIMA
Zero Marginal Cost Society by Jeremy Rifkin
Building Social Business by Muhammad Yunus
Oxfam media briefing published by Oxfam
Sustainable Development Goal, published by United Nations
The International Integrated Reporting Framework published by International Integrated Reporting Council
Integrated reporting, Elevating value published by Ernst & Young
An introduction to G4 published by Global Reporting Initiative
G4 Sustainability reporting guidelines published by Global Reporting Initiative
Translating ESG into sustainable business value, Report from an international workshop series of the WBCSD and UNEP FI
IAS 20 Accounting for Government Grants and Disclosure of Government Assistance published by IASB
IAS 21 The Effect of Changes in Foreign Exchange Rates published by IASB
IAS 39 Financial Instruments: Recognition and Measurement published by IASB
IAS 41 Agriculture published by IASB
In the last week of July this year, I attended the Global Management Accounting Summit held at Colombo. I procured Subroto Bagchi’s *The Professional* there. Being a professional accountant, I was attracted by the title of the book. While starting reading the book, I was fascinated with the way Mr. Bagchi presented a true professional in his first ‘short subsection of ideas’ titled “Burial of the Dead”. He has introduced the idea of who a professional is through Mahadeva, an uneducated man from Bangalore, whose life is dealing with unclaimed cadavers as an outsourcing agency of a hospital. Mr. Bagchi has described Mahadeva as “the high performer, and a true professional” mentioning two qualities that he has which differentiate a professional from someone who is professionally qualified: one, the ability to work unsupervised and, two, the ability to certify the completion of one’s work (p. 5). In the words of Mr. Bagchi, “In most work environment, people who produce anything of economic value usually need supervision. A person who needs supervision is no professional. He is an amateur, maybe even an apprentice” (p. 6).

The book has seven parts and fifty-five short subsections of ideas. The author has suggested readers not to read the book any way the reader wants. Rather the reader should “read the parts sequentially, in the order in which they are presented” to serve the purpose of the book and to get the benefit from its reading.

Parts of the book have been preceded by a title-less page covering the dictionary meaning of the word ‘profession’, its origin, and some criteria to fulfill for being a professional as perceived in general and as articulated by the author in the book with an initial message: “being a professional is nothing short of a religion” (p. xxi). Seven parts of the book sequentially cover “Integrity” (Part I), “Self-Awareness: Where Competence Ends and Professionalism Takes Over” (Part II), “Professional Qualities” (Part III), “Managing Volume” (Part IV), “Managing Complexity” (Part V), “New World Imperatives” (Part VI), and “The Professional’s Professional” (Part VII).

According to the authors, first three parts of the book are “foundational pillars on which every individual must build his life’s work”. Part I begins with the topic “integrity” which is “the keystone of the arch of professionalism.” Part I has six short subsections: Burial of the Dead; The Day Justice Was Murdered; Integrity Is Personal; Doctor, Heal Thyself; The Many Shades of Grey; and Firing the Star Salesperson. While stating the idea “Doctor,
the life’s work of an individual (which was discussed in first three parts), the author has discussed how a professional with the enhancement of experience will have to deal with two things-volume of work (Part IV) and complexity (Part V).

Nine short subsections of Part IV have discussed on how a professional can manage volume of work. The ideas here include: The Power of Vision; Affective Regard; Commitment to Commitment; Be Prepared; Ask Pertinent Questions; Intent Listening; Human Beings First and Foremost; The Rewards of Transparency; and The Responsibility of Dissent. The author believes that one’s capacity to deal with increasing volume of professional load is directly linked to the size of one’s vision and how the person relates to his/her values. From Part IV, to me, the most important idea a professional should follow is "The Responsibility of Dissent" (pp. 138-142). The author has discussed here the reasons of the collapse of Satyam Computers, the Indian fourth largest software exporter in 2008. Above the reasons such as inclusion of a retired income tax official in the board, payment of unofficial perk to employees, and failure of Satyam’s Chairman RamalingaRaju in differentiating entrepreneurship from ownership, the author has identified that this is the failure of professionals working in Satyam in discharging their 'responsibility of dissent'. Because through this process, a group’s decision making process is shifted from the urge to agree to doing the right thing and thereby avoiding the Abilene Paradox (groups of professionals who work together take a trip to Abilene-non-committal agreements emerge/projects get kick-started-things begin to fall apart-everybody disowns idea of going to Abilene).

Part V deals with the professional qualities top management requires to deal with organizational complexity and critical situations in personal lives in seven short subsections: Three Disasters, Three Great Professionals; Logic or Emotion?; Multiple Intelligences; Three Levels of Knowledge; The Five Minds of the Future; Critical Questioning; and Dealing with Personal Pain.

In Part VI (New World Imperatives), five important, emergent concepts have been presented in five short subsections: Inclusion and Gender; Crosse-Cultural Sensitivity; Governance; Intellectual Property; and Sustainability. These were written in 2009, but still they are issues of high
importance and adaptation. For developing economies going global, these issues are upcoming in many cases and hence ‘new world imperatives’.

The concluding part (Part VII: The Professional’s Professional) is for a different level of professional attributes, which have been delineated in one short subsection: A Yen for Professionalism. In this Part, the author has enumerated the top ten attributes of a professional (based on a feedback received from asking a number of eminent men and women): (1) Integrity, (2) Commitment and ownership, (3) Action orientation and goal seeking, (4) Continuous learning, (5) Professional knowledge/skills, (6) Communication, (7) Planning, organizing and punctuality, (8) Quality of work, (9) A positive attitude, approachability, responsiveness, and (10) Being an inspiring reference to others; thought leadership (p. 206). As professional accountants, are we OK?

After the final part, as an epilogue, the author has added two additional issues: The Unprofessional; and Return of the Dead. Here the author has given a list of top ten markers of unprofessional conduct: (1) Missing a deadline, (2) Non-escalation of issue on time, (3) Non-disclosure, (4) Not respecting privacy of information, (5) Not respecting "need to know", (6) Plagiarism, (7) Passing on the blame, (8) Overstating qualifications and experience, (9) Mindless job hopping, and (10) Unsuitable appearance (pp. 209-2015). As professional accountants, how far we are conscious about these?

In our authoritative literature, a profession is distinguished by certain characteristics including: (i) Mastery of a particular intellectual skill, acquired by training and education; (ii) Acceptance of duties to society as a whole in addition to duties to the client or employer; (iii) An outlook which is essentially objective; and (iv) Rendering personal services to a high standard and performance. But the completion of task as necessary without supervision and self-certifying the completion of task in such a way that no one can raise a question, are not included here as Mr. Bagchi has presented. In view of Warren Edward Buffett (1930-), in looking for people to hire, one should look for three qualities: integrity, intelligence, and energy; and if one doesn’t have the first, the other two will kill the hirer. Thus, instillation of integrity (which is "personal" according to Bagchi; see pages 12-17) can make a professionally qualified person a true professional or professional’s professional.

Mike Brewster (2003) has, referring to the collapse of Enron in late 2001 due to Arthur Andersen LLP, mentioned that the accounting profession has forfeited what was nearly unconditional respect from the public and after Andersen’s incidence, most Americans stereo-type accountants: good shredding skills, Ebenezer Scrooge (it’s timeless), and Al Capone. Revivification of the profession is a must. Then going through The Professional might be of very good help. To be a true professional accountant, I suggest my fellow accountants to take a periodic mental shutdown and read this book.

[The Book is Reviewed by: Dr. Swapan Kumar Bala FCMA, Professor, Department of Accounting & Information Systems, Dhaka University, and Managing Director, Dhaka Stock Exchange Ltd.]

"Climbing to the top demands strength, whether it is to the top of the Mount Everest or to the top of your career. To succeed in your mission, you must have single-minded devotion to your goal."

- Dr. APJ Abdul Kalam

---

3. A character in Charles Dickens’ novella A Christmas Carol (1843), who is a mean, callous, selfish, money-loving, or miserly person (https://atkinsbookshelf.wordpress.com/tag/origin-of-ebenezer-scrooge/).
4. Al Capone (1899-1947) was an American gangster who attained fame during the Prohibition era (1920 to 1933) as the co-founder and boss of the Chicago Outfit. His favorite responses to questions about his activities were: "I am just a businessman, giving the people what they want"; and, "All I do is satisfy a public demand." He did not even have a bank account, but always used Western Union for cash delivery, not more than $1,000 (https://en.wikipedia.org/wiki/Al_Capone).