

ANALYSIS OF FRAMEWORK

CHAPTER 2: FUNDAMENTAL CONCEPTS - THE CAPITALS (Section 2B)

Question 5 and 6: The Framework describes six categories of capital (paragraph 2.17). An organization is to use these categories as a benchmark when preparing an integrated report (paragraphs 2.19-2.21), and should disclose the reason it considers any of the capitals as not material (paragraph 4.5).

5. Do you agree with this approach to the capitals? Why/ why not?
6. Please provide any other comments you have about Section 2B.

NOTE: This objective analysis includes only the most prevalent, significant or controversial issues as far as they relate directly to the content of the Consultation Draft of the International <IR> Framework¹, for the attention of the Working Group and therefore not all matters raised in submissions are referenced in it.

Drafting this analysis involved considerable judgment in deciding how to categories comments into issues/themes and how to summaries the underlying positions. Statistics have been included to provide a snapshot and starting point for analysis. Although the statistics indicate the prevalence of different views, due consideration will be given to the substance of all positions expressed.

In total the IIRC received 359 submissions to the Consultation Draft. 352 are included in this analysis. The remaining 7 submissions (of which 6 were late and one was in too complex for collation) are being reviewed separately.

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A – OVERVIEW

- A1 Of the 352 respondents to the Consultation Draft, 303 answered Question 5 and 162 answered Question 6. Table 1 summarises the number and proportion of respondents who agreed, agreed with minor qualification, disagreed/provided a major qualification, and those that did not respond to Question 5. Table 2 then summarises the themes canvassed discursively by each of the 303 respondents to Question 5, noting that multiple themes could be identified in many responses (see Appendix A). Table 3 presents a similar summary with some slight variations for the themes identified by the 162 respondents to Question 6 (see Appendix B).

¹ <http://www.theiirc.org/consultationdraft2013/>.

Questions 5 and 6 – THE CAPITALS

Table 1: Levels of Agreement with Question 5²

QUESTION 5	Report preparers	Providers of financial capital/analysts	Policy/Reg/Std-setter	Accounting/assurance	Consultants	Others	Total
FULLY AGREE WITH POSITION IN CD	16 (5.3%)	9 (3.0%)	0 (0%)	7 (2.3%)	9 (3.0%)	17 (5.6%)	58 (19.1%)
AGREE WITH MINOR QUALIFICATION	70 (23.1%)	23 (7.6%)	14 (4.6%)	42 (13.9%)	23 (7.6%)	42 (13.9%)	214 (70.6%)
DISAGREE/ MAJOR QUALIFICATION	9 (3.0%)	4 (1.3%)	1 (0.3%)	2 (0.7%)	3 (0.99%)	12 (4.0%)	31 (10.2%)
TOTAL NUMBER OF RESPONDENTS TO Q5	95 (31.4%)	36 (11.9%)	15 (5.0%)	51 (16.8%)	35 (11.6%)	71 (23.4%)	303 (100%)
NO RESPONSE	14	3	4	4	7	17	49
TOTAL NUMBER OF RESPONDENTS TO CD	109	39	19	55	42	88	352

A2 Some clear trends emerge from these analyses. First, 70.6% of the respondents to Question 5 agreed with minor qualification with the Framework's approach to the capitals. A further 19.1% endorsed the Framework's approach to the capitals without qualification. Thus there were 10.2% of respondents that disagreed or had a major qualification with the capitals approach. This suggests that there is significant support for the IIRC's approach to the capitals, although many stakeholders would like to see minor improvements to the current approach.

- In particular, respondents to Question 5 raised concerns about lack of clarity in Section 2B 195 times (as indicated above, this is not 195 of the respondents, as a respondent may have mentioned more than one of the lack of clarity issues). Recurring issues include: (a) the language/terminology used in the Framework to describe the capitals is unclear/unsuitable (73 times); (b) the linkages/interactions between the capitals are unclear (46 times); and (c) more information/guidance is needed (76 times).
- The second most common group of issues, which were raised 89 times (20.9% of the issues raised) related to implementing the Framework's approach to the capitals, with the most common concern being issues of metrics, quantification and monetization (raised 41 times).
- The third main theme, which was raised 69 times (16.2% of the issues raised), related to how prescriptive the IIRC should be in relation to requiring organizations to report on all six capitals and providing justification if they did not disclose information relating to one more capitals. Most of these respondents supported the idea of flexibility in relation to which capitals organizations choose to report on, and believed that it was inappropriate to require organizations to justify why they were not reporting on a capital they did not believe was material.

A3 In relation to Question 6:

- The issue of lack of clarity in the Framework was noted even more frequently than in Question 5, with 130 instances of this concern being raised. The most common theme was the lack of clarity regarding the boundaries/interactions between the capitals.
- As with Question 5, the other key theme that arose from responses to Question 6 was practical implementation issues (65 times), with 45 comments indicating a concern about issues of metrics, quantification and monetization of the capitals.

A4 The discussion that follows will provide further detail about the most salient themes raised by respondents in relation to questions 5 and 6. As respondents raised issues aligning with similar thematic strands in both questions, the discussion of the issues raised in each question will be combined, however, the differences in number of responses and proportions between the questions will be noted. Although the responses of different categories of respondents are reflected in summary Tables 1, 2 and 3, they will only be referred to where there is noticeable skewing of responses by category.

² The percentages reported in this report relate to the number of respondents that answered each question, rather than the overall number of respondents to the Consultation Draft.

B – FIRST KEY THEME: LACK OF CLARITY

B1 As noted above, concerns about lack of clarity regarding the approach to the capitals in Section 2B were raised a number of times (this issue was raised 195 times in response to Question 5 and 130 times in response to Question 6). It should be remembered that this does not represent the number of respondents, as a respondent could raise multiple issues under Question 5 and again under Question 6. In both questions, a significant number of comments (35 for Question 5 and 32 for Question 6) indicated concern about the lack of clarity regarding the boundaries of, and interactions between, the capitals, including in relation to the trade-offs between them. These responses included concerns that the boundaries between certain capitals were indistinct and could cause confusion (see also the discussion of the boundaries of intellectual capital in B3 below), and that the trade-offs between capitals may be more complex than the examples given in the CD, such as when an increase in the stock of one capital accompanies a decrease in another.

B2 A related sub-theme related to comments on Figure 4 (12 comments in response to Question 6), most of which suggested this Figure's implicit message that there is a hierarchy of capitals, with natural capital as the central, underpinning capital for the others, was either confusing or inappropriate. However, a small minority of respondents expressed support for the inclusion of this diagram. The following comment from a provider of financial capital from Western Europe³ reflects the general tenor of comments in relation to Figure 4:

"We regard figure 4 on page 13 as confusing. The figure seems to suggest that creating financial capital also directly increases natural capital as well. The figure also shows a hierarchy of the capitals and then the note to the figure describes 'it is not intended to describe a hierarchy that must be used for <IR>'. This diagram unduly removes the focus from explaining the interconnectedness of the capitals, to a for [sic] investors less interesting question whether a capital could, from a more philosophical point of view, be regarded as being part of another capital. We worry that preparers may interpret this diagram as a hint that the Framework asks them to find a hierarchy in the capitals, and describe why they reverted to their specific hierarchy. ..."

B3 A significant number of comments in relation to Question 5 (26 in total) expressed general concern about the capitals terminology, with a significant number of respondents preferring alternative terms such as "resources" to "capitals". A related sub-theme was the appropriateness of the terminology and boundaries of intellectual capital, with six comments in relation to Question 6 indicating that the IIRC's definition of intellectual capital did not align with generally accepted academic understandings of this concept and its application in practice. As a consultant from Western Europe observed:

"Our prime recommendation to IIRC is to readjust the term "Intellectual Capital". "Intellectual Capital" is - in accordance with established academic sources (Journal for Intellectual Capital) and applied experts (Amidon, Adams, Bontis, Choo, Edvinsson, Guthry, Lev, Roos, Starbuck, Steward, Sveiby, ...) - the category-name or topic title that includes Human, Structural and Relational Capital. "Intellectual Capital" includes three major categories. Two of them ("Social and Relationship Capital" and "Human Capital") are part of the consultation draft as it is. So our second recommendation to IIRC is to add "Structural and Organizational Capital" as the third category of intellectual capital."⁴

B4 A third strand of responses under the rubric of 'lack of clarity' related to respondents' desire for more information and guidance in relation to Section 2B in general, with important sub-themes being requests for greater clarity in the definitions of the capitals (31 comments in response to Question 5 and 15 comments in response to Question 6), and the inclusion of more practical examples (11 comments in response to Question 5 and 10 comments in response to Question 6).

B5 As a proportion of the issues raised by each respondent category, lack of clarity was identified as a greater concern for the policy/regulatory/standard-setting group of respondents.

³ Submission 35: Eumedion.

⁴ Submission 257: Intangible Assets Consulting GmbH.

C – SECOND KEY THEME: IMPLEMENTATION ISSUES

- C1 As previously noted, 89 (20.9%) of the comments made in response to Question 5 and 65 (25.9%) of the issues raised in response to Question 6 indicated concerns about the practical implementation of the Framework's approach to the capitals. In both questions, the sub-theme that recurred with greatest regularity in respondents' comments was the difficulties associated with developing metrics for the capitals, and quantifying and attaching a monetary value to them (41 comments in response to Question 5 and 45 comments to response to Question 6).
- C2 These concerns were raised relatively uniformly across the different groups of respondents in response to Question 5 (they were of slightly less significance for the policy/regulatory/standard-setting group of respondents for question 5, but were raised most frequently by report preparers in response to Question 6). The following comment from a report preparer from Asia is indicative of these types of responses:

*"The concept of capitals is acceptable. The difficulty is envisaged in measurements and quantification of capitals as "input" and as "output". Further difficulty will be "monetizing" the value created. If standard methods are established which are globally acceptable it will help comparison "year on year" and also with other organizations."*⁵

D – THIRD KEY THEME: PRESCRIPTIVENESS OF THE IIRC

- D1 The issue of how prescriptive the IIRC should be in terms of requiring organizations to report on all the capitals, and justifying the reasons it considers one or more of the capitals as not material was addressed in both questions. It was raised most frequently in Question 5 (69 comments which represents 16.2% of the total comments in response to this question, as well as in 18 comments (7.2% of total comments in response to this question) to Question 6. Although some respondents thought it was appropriate for the IIRC to specify that all capitals will need to be reported on or else an explanation regarding materiality provided, most respondents preferred flexibility to a 'comply or explain' approach.
- D2 Report preparers (20.2% of comments from this group of respondents) and those from the accounting/assurance profession (21.3% of comments from this group of respondents) discussed this theme in responding to Question 5. Internal inconsistencies in the Framework's position on these issues were also noted, as the following response from a non-government organization from North America exemplifies:

*"While the concept of the capitals set out in the draft provides useful guidance for organizations in determining whether they have considered all matters that are significant to strategy and performance, many organizations will find that the capitals as indicated in the draft are inconsistent with their approach to actually managing the business. Accordingly we do not believe that organizations should be required to use all of the six categories but rather select those that are most relevant to their business. This approach is another example of the "comply or explain mentality" - there should be no need to explain why any of the six capitals are not discussed in the IR. This is also an example of one of the internal inconsistencies in the draft - paragraph 2.19 indicates that organizations are not required to adopt all of the categories in the Framework, paragraph 2.29 states that the IR does not need to include an exhaustive list of the capitals and yet paragraph 4.5 seems to require that all of the capitals identified in the Framework be used or detailed explanations are required to explain why they were not considered material and thus not disclosed in detail."*⁶

- D2 In a related sub-theme, 22 comments in relation to Question 5, including 10 from the accounting/assurance profession, indicated a preference for organizations being able to choose their own categories of capitals and/or align the reporting of information related to the capitals with another reporting framework.

⁵ Submission 151: Kirloskar Brothers Limited.

⁶ Submission 266: FEI Canada.

E – FOURTH KEY THEME: THE FRAMEWORK’S APPROACH IS FLAWED/INAPPROPRIATE/INCOMPLETE

E1 Fifty comments in relation to Question 5 (received from 31 respondents), and 15 comments in response to Question 6, some of which may have reflected similar sentiments to those that the same respondents expressed in relation to Question 5, indicated that the Framework’s approach to the capitals is flawed, inappropriate, or incomplete. Of the 50 comments on this issue in relation to Question 5, 15 questioned the suitability of the Framework’s focus on the providers of financial capital as the primary audience of integrated reports, and/or whether the proposed Framework will meet the needs of these report users. A further 25 comments in response to Question 5 expressed respondents’ preferences regarding the addition or subtraction of one or more categories of capital, and/or a preference for attaching different weighting/importance to some of the capitals. For example, a professional body from the Oceania had the following to say on these issues:

“... [We are] not supportive of the notion of multiple capitals. We are of the view that the concept of capitals will not be intuitive for a significant proportion of an organisation’s stakeholders and as such we would recommend that the IIRC de-emphasize these capitals. We are of the view, that the integrated report should be written in a language that an unsophisticated investor or other interested party would easily be able to understand and we are not convinced that the multiple capital model enables that communication effectively. We have found that organisations currently already disclose this information rather successfully in broad terms and are not limited to just the financial aspects. ...”⁷

E2 As indicated in Table 1, the major group who found the framework to be flawed were “others” (12 of 71 (16.9%)), followed by financial capital providers/analysts (4 of 36, 11.1%). The group that commented the most were the financial capital providers (15 comments), who commented mostly on whether the Framework was suitable for them as the primary audience.

F – CONCLUSION

F1 In summary, there is widespread support for the approach to the capitals outlined in Section 2B. However, significant proportions of respondents have requested greater clarity in the terminology and explanations in this Section, more guidance regarding issues of implementation, and have expressed preferences for the IIRC to adopt a flexible rather than prescriptive approach to the capitals. Other thematic issues that were raised by five or more respondents, but due to insufficient numbers were only recorded in the Appendices and not analysed in detail above, include concerns about: (1) the approach to the capitals being too academic/theoretical; (2) how the capitals will relate to other reporting approaches (reflected in themes 5 and 6 in Tables 2 and 3); and (3) other miscellaneous issues for Question 6 (reflected in theme 7 in Table 3).

⁷ Submission 164: Australian Institute of Company Directors.

Questions 5 and 6 – THE CAPITALS

Appendix A: Table 2: Themes Identified in Responses to Question 5⁸

<i>QUESTION 5 Themes</i>	Report preparer	Financial capital Provider analyst	Policy/Reg/ Std-setter	Accounting/ assurance	Consultant	Other	Total
1) Implementation issues	5	0	2	1	2	4	14
a) For certain types of entities	3	0	0	2	1	2	8
b) Issues of metrics, quantification and monetization	14	10	0	7	3	7	41
c) Issues of value, stock and flow/value over time	3	1	0	1	2	3	10
d) Benchmarks/comparability	2	0	0	3	0	3	8
e) Cost	0	1	1	1	0	0	3
f) Commercial sensitivity/competitive advantage	1	1	0	1	1	1	5
1) Implementation issues total	28 (21.8%)	13 (25.0%)	3 (13.6%)	16 (17.0%)	9 (24.3%)	20 (22.0%)	89 (20.9%)
2) Lack of clarity	0	0	1	0	0	0	1
a) Language/terminology is unclear/unsuitable	5	6	0	2	1	5	19
(i) Terminology of capitals	7	6	3	5	0	5	26
(ii) Does 'capital' include capital the organization doesn't own/control?	1	0	1	3	0	4	9
(iii) Capitals as 'benchmarks'	1	1	0	3	1	2	8
(iv) Definition of intellectual capital	1	2	0	3	1	3	10
b) Linkages/interactions between concepts are unclear	5	0	0	2	1	3	11
(i) Boundaries/interactions between capitals	13	2	2	11	3	4	35
c) More information/guidance needed	12	2	1	6	4	9	34
(i) Definition of capitals	10	0	2	7	3	9	31
(ii) Practical examples	4	1	3	2	0	1	11
2) Lack of clarity total	59 (45.8%)	20 (38.5%)	13 (59.1%)	44 (46.8%)	14 (37.8%)	45 (44.0%)	195 (45.9%)
3) Framework's approach is flawed/inappropriate/ incomplete	2	0	1	2	0	5	10
a) Suitability of providers of financial capital as primary audience	2	8	1	1	0	3	15
b) More/fewer capitals needed	1	2	0	5	2	3	13
c) Different weighting/importance of capitals	2	5	0	2	0	3	12
3) Framework's approach is flawed/ inappropriate/ incomplete total	7 (5.4%)	15 (28.8%)	2 (9.1%)	10 (10.6%)	2 (5.4%)	14 (15.4%)	50 (11.8%)
4) Prescriptiveness of IIRC	2	1	0	1	1	0	5
a) Option to not report some capitals/justification of materiality	20	1	1	9	3	8	42
b) Choice of own categories of capitals/use other frameworks	4	1	2	10	2	3	22
4) Prescriptiveness of IIRC total	26 (20.2%)	3 (5.8%)	3 (13.6%)	20 (21.3%)	6 (16.2%)	11 (12.1%)	69 (16.2%)
5) Too academic/theoretical	3 (2.3%)	0	0	1 (1.1%)	2 (5.4%)	0	6 (1.4%)
6) Relationship to other reporting systems	6 (4.7%)	1 (1.9%)	1 (4.5%)	3 (3.2%)	4 (10.8%)	1 (1.1%)	16 (3.8%)
Total themes identified	129	52	22	94	37	91	425

⁸ There were 303 responses to Question 5, with respondents in total identifying 425 themes. The number of times each theme was reflected in a respondent's comment is summarised in this table, and the percentages reflect the proportion of the 425 themes identified, for each respondent category.

Questions 5 and 6 – THE CAPITALS

Appendix B: Table 3: Themes Identified in Responses to Question 6⁹

<i>QUESTION 6 Themes</i>	Report preparer	Providers of financial capital/analysts	Policy/Reg/Std-setter	Accounting/assurance	Consultants	Others	Total
1) Implementation issues	5	0	1	2	0	0	8
a) Issues of metrics, quantification and monetization	16	3	0	12	4	10	45
b) Issues of value, stock and flow/value over time	0	4	0	1	0	1	6
c) Benchmarks/comparability	5	0	0	1	0	0	6
1) Implementation issues total	26 (40.6%)	7 (20.0%)	1 (7.1%)	16 (27.1%)	4 (15.4%)	11 (20.8%)	65 (25.9%)
2) Lack of clarity	1	1	0	1	0	0	3
a) Language/terminology is unclear/unsuitable	2	0	1	6	1	5	15
(i) Does 'capital' include capital the organization doesn't own/control?	0	0	1	0	1	4	6
(ii) Definition of 'intellectual capital'	3	0	2	1	0	0	6
b) Linkages/interactions between concepts are unclear	3	5	0	2	0	2	12
(i) Boundaries/interactions between capitals	8	5	3	8	3	5	32
(ii) Problems with Figure 4	1	5	1	4	1	0	12
c) More information/guidance needed	5	4	1	3	2	4	19
(i) Definition of capitals	3	2	0	4	2	4	15
(ii) Practical examples	3	0	0	2	2	3	10
2) Lack of clarity total	29 (45.3%)	22 (62.9%)	9 (64.3%)	31 (52.5%)	12 (46.2%)	27 (50.9%)	130 (51.8%)
3) Framework's approach is flawed/inappropriate/ incomplete	1	2	0	1	1	1	6
a) Suitability of providers of financial capital as primary audience	0	1	0	1	0	3	5
b) More/fewer capitals needed	0	0	1	0	2	1	4
3) Framework's approach is flawed/inappropriate/ incomplete total	1 (1.6%)	3 (8.6%)	1 (7.1%)	2 (3.4%)	3 (11.5%)	5 (9.4%)	15 (6.0%)
4) Prescriptiveness of IIRC	0	0	1	1	2	2	6
a) Option to not report some capitals/justification	2	0	1	5	1	3	12
4) Prescriptiveness of IIRC total	2 (3.1%)	0 (0.0%)	2 (14.3%)	6 (10.2%)	3 (11.5%)	5 (9.4%)	18 (7.2%)
5) Too academic/theoretical	0	0	0	0	0	0	0
6) Relationship to other reporting systems	2	1	1	1	1	1	7
	(3.1%)	(2.9%)	(7.1%)	(1.7%)	(3.8%)	(1.9%)	(2.8%)
7) Other	4	2	0	3	3	4	16
	(6.3%)	(5.7%)	(0.0%)	(5.1%)	(11.5%)	(7.5%)	(6.4%)
Total	64	35	14	59	26	53	251

⁹ There were 162 responses to Question 6, some of which canvassed multiple themes. The number of times each theme was reflected in a respondent's comment is summarised in this table, and the percentages reflect the proportion of the 162 responses that raised each theme.