KIRTANE & PANDIT

INTEGRATED REPORTING

AND THE FUTURE OF FINANCIAL REPORTING

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He has hands-on experience in carrying out and supervising audits of large, listed companies across sectors such as manufacturing, auto-components, chemicals and engineering.

He has led IFRS, US GAAP and Ind AS translation assignments for several large and mid-sized companies.

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BACKGROUND

Integrated Reporting (IR) refers to the reporting framework that organisations can use when communicating information to stakeholders on how organisations create or erode value over the short, medium and long term (generally through annual reports). In this report, we examine the adoption of IR by Nifty 200 companies in their financial reports for the years from FY2022 to FY2024. Also, refer *https://www.kirtanepandit.com/reports-and-publications?page=4* for our earlier report on adoption of IR by Nifty next 50 companies.

AI, Blockchain, Automation, technology enabled audits, data visualisations, ESG and enhanced and wholistic stakeholder messaging are key areas that Finance functions are grappling with in the changing business landscape. The last part of this report examines key questions that CFOs and Management need to ask to evaluate their preparedness for the future of financial reporting.

WHAT IS IR?

IR includes a combination of financial and non-financial data to demonstrate how business targets and wider goals are achieved through use of various capitals within the context of the environment that the organisation operates in. IR provides valuable insights to stakeholders about the value creation process of enterprises and provides a framework to management to articulate and specify the sources of value that are most material and relevant to their organisations.

The International Integrated Reporting Council (IIRC), now part of IFRS Foundation, has prescribed six capitals that are available to organisations – these capitals form the crux of integrated reporting. The six sources of capital available to organisations as per IR framework are: Financial Capital, Manufactured Capital, Intellectual Capital, Human Capital, Social Capital and Natural Capital. Refer Annexure for details of each of the capitals and relevance to different industries.

Integrated Reports seek to co-relate the financial information in a cohesive manner across the annual report. For example, if technology inventions by a Company were earlier reported in the Board Report and Management Discussions and Analysis, then under IR, reporting of such initiatives would also be included as part of description of the Intellectual Capital available to an organization, for example, including information on number of new patents filed and granted to the Company. Furthermore, under IR, the value that the organisation derives or expects to derive from new technology and research would also be elaborated, with specific numbers and description.

REGULATORY REQUIREMENT

While the IFRS Foundation which is the primary body for development of global reporting standards, encourages the adoption of IR by organisations, the reporting in India is driven by the regulatory norms issued by The Securities and Exchange Board of India ('SEBI').

SEBI vide circular SEBI/ HO/ CFD/ CMD/ CIR/2017/10 has permitted companies who are required to submit Business Responsibility Report to report under the integrated reporting framework (top 1000 companies by market capitalization). Accordingly, reporting under IR is recommendatory in nature for large companies.

FORMAT OF REPORTING

As per the IFRS Foundation, an integrated report may be either a standalone report or be included as a distinguishable, prominent and accessible part of another report or communication. For example, it may be included at the front of a report that also includes the organization's financial statements.

In India, IRs are generally included as part of Annual Reports and have overlapping elements with Management Discussion and Analysis and the Financial Statements. The separate disclosure of financial statements (within annual reports) with notes as prescribed by accounting frameworks and board and other reports as per SEBI regulations would continue to be published in formats prescribed by the MCA/SEBI even after adoption of IR.

STANDALONE OR CONSOLIDATED INFORMATION

A question arises whether integrated reporting should include components of standalone financial performance or consolidated financial performance. As the IR seeks to communicate value creation by an organization (as a whole), the Integrated Report would include all relevant parameters of business performance across the entire group of entities such as subsidiaries and others.

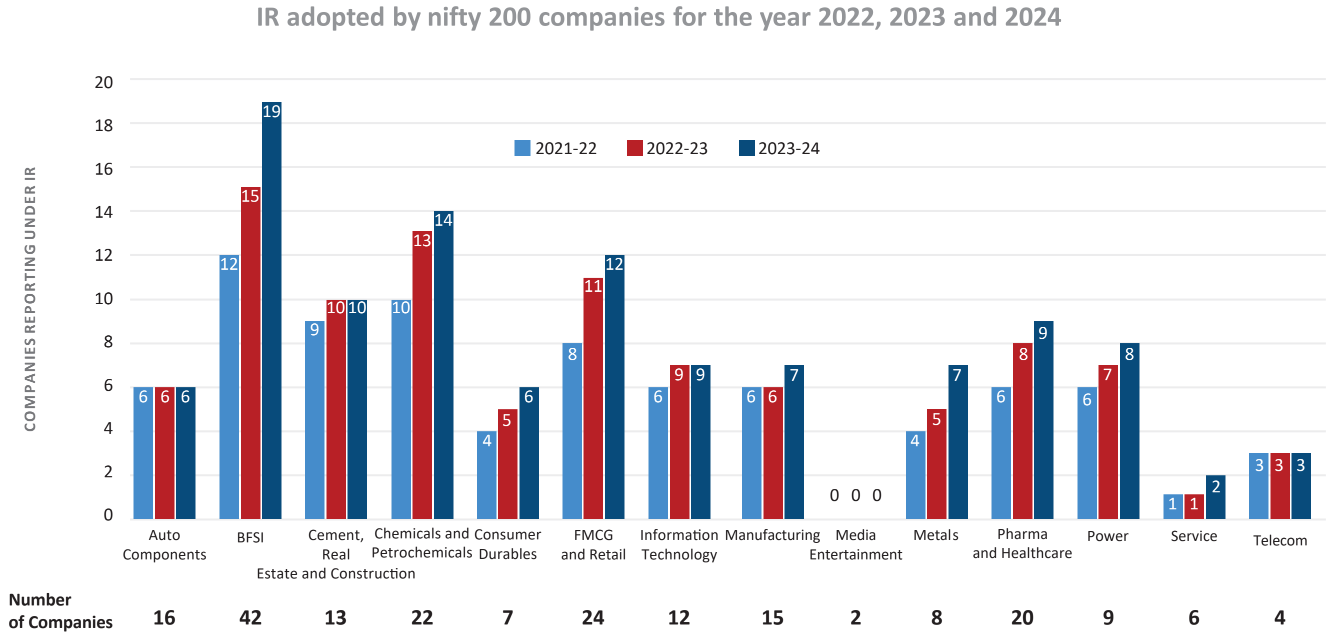
Therefore, IR should cover the performance of entities represented in the consolidated financial statements. The weightage to be placed on disclosure of each business line in the IR would depend on the contribution of that business segment or subsidiary/associate to the organisations value creation process.

The segment or business information that management includes in the IR can provide valuable insights into the importance of each business segment to the governing body of the organization. For example, the IR of a large Indian conglomerate, includes key elements from its different businesses such as number of retail stores for the retail business, spectrum available for the telecom business and refining capacity for the petro-chemcials business.

STATUS OF ADOPTION

STATUS OF ADOPTION OF INTEGRATED REPORTING BY NIFTY 200 COMPANIES - EVOLUTION FROM 2022 TO 2024

109 companies of the **Nifty 200** companies have adopted IR in their annual reports for FY2024.
The sectoral adoption of IR by Nifty 200 companies is presented below. **Adoption of IR by Nifty 50 companies is much higher (35 of 50 companies report under IR).**



BFSI – the segment has seen maximum adoption of IR by companies in last three years with number of companies reporting under IR increasing from 12 to 19 (of 42 companies).

Chemicals/Petrochemicals – the segment has seen strong adoption of IR with number of companies reporting under IR increasing from 10 in 2022 to 14 in 2024 (of 22 companies).

Telecom, Power, Cement/Real Estate/Construction segments have shown high adoption rates with 75%, 89% and 77% of companies in respective sectors reporting under IR.

Industries considered pioneers in adoption of technology and best practices such as IT, Pharma/Healthcare, Media and Auto/Auto-components are surprising laggards in adoption of IR.

Is this a reflection of lower value perception of IR reporting or simply a matter of priority for management?

BENEFITS OF INTEGRATED REPORTS

Adoption of IR is expected to provide benefits to the organisation as well as others engaged with the organisation. Some of the possible benefits of IR are:

- Re-alignment of KPIs – IR focuses on value creation by organisations in context of the internal and external environment of a Company. The IR reporting journey can assist CFO's and Board of Director's in identifying and fine-tuning the most relevant KPI's.
- Improved decision-making as non-financial sources of capital would be formally considered and emphasized upon in addition to traditional emphasis on financial and manufacturing capital. In the technology driven world, non-financial and non-manufacturing capital such as social capital (network effect), intellectual capital (patents, know-how, technology) and human capital (quality of workforce) are significant contributors to business value compared to tangible assets.
- Improved reputation and stakeholder relationships – adoption of IR can signal management's emphasis on enhanced communication with shareholders and others. Stakeholders are provided a broader view of the organisations strategies and sources of capital, enabling better decision making.
- Employees and consultants would be able to better understand the Company's operations and their role within the organisation. This provides clarity to the employees on their contribution to the overall business and operations.
- Clarity on the organisation's strategy and place (in the business world) to all parties.

In our view, organisations that benefit most from IR are those that incorporate IR into their operations, internal processes and MIS reporting rather than restricting IR only to the year end activity of financial reporting/annual reports.

Organisations also need to revisit the reporting framework each year based on changes in internal and external environments to ensure their IR reports are dynamic and reflect the changed business environment rather than merely repeating the initial IR assessment.

STEPS IN ADOPTING INTEGRATED REPORTING IN ANNUAL REPORTS

Eligible companies in India that are planning to report using IR framework would need to start preparation well in advance given the overarching nature of reporting under IR which comprises all aspects of performance, operations, networks, resources and external environment and more importantly the inter-play between these elements. Annual reports under IR are visibly different from non-IR reports and require adequate thinking prior to adoption.
Key steps in preparing for IR reporting comprise:

- Deciding what to communicate through dialogue with stakeholders within the Company and the Board. This first step would be an internal meeting to discuss the objectives and strategy of the Company and an explanation of the six capitals prescribed by the IR reporting framework.

- Assigning responsibility for implementation of IR framework. While the bulk of the work would be led by the Investor Relations and Finance team, other departments such as HR, R&D, Production and Sales would need to be involved. An inter-departmental committee responsible for implementation of IR is required to actively track progress.

- Benchmarking with reporting by other companies in the sector. This will help understand and conceptualise the differences in the value creation process of the Company and its competitors.

- Identification of additional information required for reporting such as the relationship between different sources of capital and outcomes that may not have been specifically reported earlier. Setting timelines and responsibilities for gathering such information.

- Preparation of draft IR or a shorter version of the annual report so that internal feedback can be collated and obtained.

- Roll out of the first Integrated Report by the company.

Managements and teams preparing IR should consider the risk of divergence between what is being said in the IR and the other parts of the annual report, i.e., the narrative of value creation should be uniform and cohesive across the entire annual report.

The first-time adoption of IR requires careful consideration of and alignment with other sections of the Company's communications including investor presentations and analyst conference calls.

The second year of integrated reporting poses a different challenge as entities would need to ensure that changes in the environment, resources and value creation are reflected in the annual report with new or different disclosures rather than a mere updation of factors identified in the first year.

FUTURE OF FINANCIAL REPORTING

AI, Blockchain, Automation, RPA, technology enabled audits, data visualisation, ESG and enhanced and wholistic stakeholder messaging are key areas that Finance functions are grappling with in the changing business landscape.

In addition to Integrated Reporting, companies, CFOs and Board members need to consider the road map of their accounting and financial reporting processes over the next few years to incorporate all or some of these elements. This will enable the Finance function to remain relevant and support growth objectives of business.

Questions that managements need to ask to prepare their organization for the next few years:

1. Are our Integrated Reports communicating the value that was originally envisaged or has the quality and content of reporting divulged from the realities of the business?
2. What is the level of use of software used for reporting activities of the enterprise, in addition to ERP, for example related to contract management, complex calculations under Ind AS, payroll processing, attendance and performance evaluation and regulatory compliance?
3. Does the Company have a data map indicating key sources of data creation and maintenance within the company? What are the gaps in the process of internal and external data collation?
4. Has the organization evaluated opportunities available to deploy blockchain in the financial reporting/reconciliations process?
5. The number of AI agents or RPA's that are used in the Finance function. Target areas where such agents could be deployed, such as three way match of invoice, purchase order and goods received note or analysis of compliance with GST rates and claims across classes of transactions. In case of mid-sized companies, the cost of purchasing AI agents may be significant, hence management would need to perform a cost-benefit analysis prior to deployment.
6. Risk assessment – How dynamic is the risk assessment process. For example, were the possible scenarios emerging from US elections or global geo-political factors considered in the Management's sensitivity analysis?
7. Opportunity Assessment – Risks by default are negative in nature as they focus on what could go wrong. Opportunities in contrast are positive and growth oriented. Does the organisation's financial reporting process highlight business opportunities as they emerge or are the processes reactive in nature?
8. Has the Finance function grown organically or has it been designed to the needs of the organisation? Is there a need to reassess the finance function?
9. Is Internal Audit process reactive in nature with a lag in reporting? What are the key parameters that could benefit from embedded internal audit software that highlights exceptions and deviations as they occur?
10. ESG and business responsibility reporting is only expected to expand over the years, despite temporary pushbacks. Are different functions and employees aware of the Company's climate/ESG/net zero reporting initiatives or is the responsibility for the same centralized. Are the company's ERP systems able to meet reporting requirements under BRSR?

ANNEXURE

CAPITALS AS PER IR FRAMEWORK

The IR framework describes six sources of capital available to organisations.

Capitals per framework	Coverage	Information and disclosure in Annual Reports	Sector relevance
Financial capital	Funds used in production of goods/services	Information on debt and equity capital, working capital and value generated, value retained and net value creation. Credit rating of debt.	Relevant for all companies as source, deployment and returns on capital are key matrices for all.
Manufactured capital	Manufactured physical objects such as machinery	Information on number of factories, project sites, manufacturing output and linkage to overall strategy to provide insight to stakeholders on importance of manufactured capital in the value creation by a company.	Relevant for manufacturing companies including those that outsource manufacturing.
Intellectual capital	Intellectual property such as patents, licenses, rights and organizational procedures and knowledge	Total patents owned, new products developed through R&D, awards for innovation. Ongoing research projects or products under development that could significantly impact future value creation.	Technology, pharma companies though industry 4.0 requires innovation by all companies irrespective of sector.
Human capital	People's competencies, capabilities, loyalties and experience. Motivations to innovate and improve processes	Number of employees of which qualified employees such as engineers or PHDs. Attrition data. Training initiatives and hours trained. Commentary on diversity and inclusion.	Relevant for all companies. People dependent sectors such as IT, outsourcing, pharma expected to provide greater details.
Social, relationship capital	Institutions and relation-ships within and between communities, groups of stakeholders and other networks.	CSR spend and number of MSME and other vendors indicating how organisations engage with and develop communities.	Relevant for all industries given high focus on CSR initiatives and overall stakeholder value creation rather than only shareholder value creation.
Natural capital	Company's understanding of scarcity of natural resources, climate change strategy, carbon emission, water consumption and recycling.	Water and carbon usage and strategy towards reducing emissions. Sustainability initiatives undertaken by the organisation. Use of renewable energy and controls over hazardous materials.	Relevant for all industries given high focus on sustainability by stakeholders. Chemical, Mining companies would need to explain how use of natural capital is incorporated in overall strategy.

Organisations are required to use these six sources and their inter-relationships to describe how value is created through delivery of products and services.

Non-financial resources such as IP, human capital, natural capital and relationships provide a wider prism for reporting under IR.

ANNEXURE - ILLUSTRATIVE MAPPING OF EXISTING REPORTING IN ANNUAL REPORT TO CAPITALS PER IR FRAMEWORK

Capital as per IR Framework

DIRECTORS' REPORT TO THE MEMBERS

Board's report on conservation of energy, technology absorption and foreign exchange earnings and outgo, management discussion and analysis

INPUT

- 100 Million - R&D expenditure
  10 - Employees in R&D

OUTPUT

- 10 – Patents and trademarks filed
  5 - Patents granted
- 5 - Research publications
  5 - Design patents filed
- Amount (in Million)

BUSINESS RESPONSIBILITY REPORT

INPUT

- Energy Utilised
- Water utilised
- Materials utilised
- Oil, Wood, Sand, Steel

OUTPUT

- Recycling achieves (tonnes)

MANAGEMENT, DISCUSSION, AND ANALYSIS

The Company has 3 Manufacturing units, locations in India

EMPLOYEES SECTION

- 500- Employees
- 1000 Million - Total employee benefit expenses
- 500 hours - Learning and development
- 700 hours - health and safety training

CORPORATE SOCIAL INITIATIVES

- 50 – Distributors
- 10 Million - CSR expenditure
- 100 vendors including 18 MSME vendors

Financial capital

Intellectual capital

Natural capital

Manufactured capital

Human capital

Social Capital

Financial statements in Annual Report

	2023	2024
Balance Sheet		
Equity and liabilities		
Shareholders' funds	Xx	xx
Non-Current liabilities	Xx	xx
Current liabilities		
Assets		
Non-current assets	Xx	xx
Fixed Assets	Xx	xx
Intangible assets	Xx	xx
Current assets	Xx	xx
Total	Xx	xx
Statement of Profit and Loss		
Income		
Revenue from Operations	Xx	xx
Expenses	xx	xx
Employee benefits expense	Xx	xx
Depreciation, impairment and amortisation expense	xx	xx
R&D expenses	Xx	xx
CSR expenses	xx	xx
Net profit	xx	x

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