INTEGRATED REPORTING

More Than A Sum of Parts

The publication of an Integrated Reporting Framework marks a significant step on the road towards more transparent and meaningful communication by companies to their stakeholders, as **Brendan Sheridan** explains.

Despite all the changes in recent years, the Annual Report remains the primary document telling a company's story.

A survey of UK Corporate Reporting , with a focus on over 100 UK listed entities[1], found that where companies have tended to fall down in the quest to make their reports truly comprehensible to stakeholders is in linking different parts of their story.

The Corporate Governance Code calls for financial reporting which is fair, balanced and understandable and the Financial Reporting Council has recently renewed its call for improved transparency of reporting in line with this principle.

INTEGRATED REPORTING

The International Integrated Reporting Council (IIRC) believes that corporate reporting must evolve to communicate the full range of the factors affecting an organisation's ability to create value over the short, medium and long term.

Three fundamental concepts underpin integrated reporting:

- Value creation for the organisation and for others;
- The capitals;
- The value creation process.

The primary purpose of an integrated report is to explain to providers of financial capital how an organisation creates value over time.

An integrated report should be a designated, identifiable communication– based on *Guiding Principles* which underpin the preparation of the report dealing with *Content Elements* which are key categories of information to be included in an integrated report, presented as a series of questions – rather than a prescriptive list of disclosures.

The IIRC's vision is that integrated thinking and integrated reporting will become the norm, with the concepts of integrated reporting thoroughly embedded in every form of communication by an organisation to stakeholders.

The integrated report (IR) should include a statement from those charged with governance that meets particular requirements, including an acknowledgement of responsibility for the report and an opinion on whether the IR is presented in accordance with the framework.

In summary, the aims of the IR are to:

- Improve the quality of information available to providers of capital;
- Promote a more cohesive and efficient approach to corporate reporting;
- Enhance accountability and stewardship for the broad base of capitals;
- Support integrated thinking, decision-making and actions that focus on creation of value over the short, medium and long terms.

Table 1: Development of Integrated Reporting

August 2010	Formation of International Integrated Reporting Council (IIRC)
October 2011	Initial organisations participating in the IIRC Pilot Programme announced
November 2012	Prototype of the International Integrated Reporting Framework
April 2013	Consultation draft of the Integrated Reporting Framework
December 2013	Integrated Reporting Framework published

INTEGRATED THINKING

The IIRC's long term vision is a world in which integrated thinking is embedded within mainstream business practice in the public and private sectors, facilitated by IR as the reporting norm.

Integrated thinking is described in the *Framework* as *the active consideration by an organisation of the relationship between its various operating and functional units and the capitals that the organisation uses or affects*.

Many of the entities in the IIRC pilot programme are starting with integrated thinking by applying the concepts of integrated reporting internally to adapt internal information systems and decision-making, before producing external IRs.

The Pilot Programme Yearbook 2013, (available at www.theiirc.org) brings integrated reporting to life through stories and case studies by participants about the application of integrated thinking in their reporting process which they see as key to developing relationships with stakeholders.

Table 2: Integrated Reporting Fundamental Concepts

Value creation for the organisation and for others	interactions and relationships, outputs and outcomes
Capitals	resources and relationships used and affected by the organisation – financial, manufactured, intellectual, human, social and relationship, and natural capital
Value creation process	an entity's business model, drawing on various capitals, and by using the entity's business activities, creating outputs and outcomes

Table 3: Integrated Reporting Guiding Principles

- ➤ Strategic focus and future orientation
- ➤ Connectivity of information
- ➤ Stakeholder relationships
- ➤ Materiality
- ➤ Conciseness
- ➤ Reliability and completeness
- ➤ Consistency and comparability

Table 4: Integrated Reporting Content Elements

- ➤ Organisational overview and external environment
- ➤ Governance
- ➤ Business model
- ➤ Risks and opportunities
- ➤ Strategies and resource allocation
- ➤ Performance
- ➤ Outlook
- ➤ Basis of preparation and presentation

Businesses are stepping up communications that are not directly financial, to provide long-term investors with potential leading indicators for future financial performance. Describing the company's business model is seen as one of the most crucial elements of an IR because it helps investors to understand performance. For some participants, integrated thinking has led to changes in management and governance structures.

Recent studies show that 80% of an organisation's value is 'hidden' in non-financial assets not showing up in traditional financial reports. This increases the need for corporate reporting to provide stakeholders with a more in-depth understanding of their business. Integrated thinking and resultant reporting requires an integrated business strategy that creates value by balancing short-term gains with long-term strategy and investment.

CORPORATE GOVERNANCE

An IR in compliance with the *Integrated Reporting Framework* requires those charged with governance to acknowledge their responsibility for ensuring the integrity of the IR; that they have applied their collective mind to the preparation and presentation of the IR; and to state their opinion or conclusion about whether it is presented in accordance with the *Integrated Reporting Framework*.

The provision of such a statement is considered by many to be the single most contentious issue confronted by the IIRC in finalising the *Framework*. The principle argument against came from respondents in countries like Japan where there is currently no requirement for such a statement in relation to financial statements and there is no evidence that this has caused investors to look less favourably on Japanese stocks.

The IIRC will have to carefully manage the challenge of potential resistance in this regard.

QUESTIONS FOR DIRECTORS

Questions for directors to ask include:

- ➤ How well do we, as a board, and as an organisation, understand integrated reporting?
- ➤ Have we considered how it may benefit the board and management in understanding our organisation and how well our strategies and business models are creating longer-term value?
- ➤ What are our shareholders' and other stakeholders' expectations for a clearer, longer-term picture of our organisation and its ability to create value?
- ➤ If our organisation provides a sustainability report, how effectively do we integrate it with our financial reports?
- ➤ Do we understand how the full adoption of integrated reporting might affect the board, including the liability of directors and officers?

Boards should consider how integrated reporting can help build stronger relationships with stakeholders.

What counts is whether or not a report reaches the target audiences and can help create value through better explaining the activities, value system, and behaviour of the operating company. It is key that the report provides the information that captures all of the organisation's relevant business sustainability issues.

CONCLUSION

Trust in an organisation is achievable through transparent behaviour and is a key success factor for the business to operate, innovate and grow.

Integrated reporting promotes the need to answer important questions around long-term value creation and in a world where economic instability and long term sustainability threatens the welfare of society, this further push towards improved corporate transparency must be welcome.

The *Framework* will be used to accelerate the adoption of integrated reporting across the world. It is currently being trialled in over 25 countries, 16 of which are members of the G20. The pilot programme, referenced as the 'Innovation Hub' by the IIRC, will run until September 2014, allowing participants time to test the *Framework* during another reporting cycle.

Some consider that integrated reporting should not be a goal in itself, but rather that the ultimate goal should be to motivate disclosure that better informs investors and other stakeholders, with tangible step changes towards more concise and informative financial reports including reporting on intangibles. There is some concern that any mandatory introduction of integrated reporting may not achieve the desired objective.

There is little doubt but that improved disclosure and transparency of reporting is high on the agenda. Integrated reporting is a major step in the right direction. ■

[1] *A New Beginning* – Deloitte UK, October 2013

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