

# SPECIAL GAAP REPORT

## ‘Integrated Reporting’

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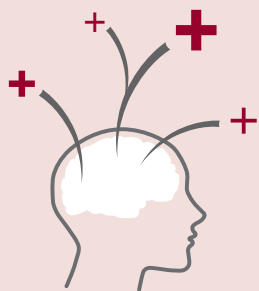
## You need to know that... ‘Integrated reporting’ is gaining ground

### How we can help your firm improve its reporting

**LET’S NOT** over-complicate integrated reporting, which the International Integrated Reporting Council (IIRC) wants to denote by <IR>. As firms and their boards and senior executives become more aware of what it is, its basic premise gets obscured. To avoid the added corporate responsibilities it entails, the temptation to turn the idea into things it isn’t becomes irresistible.

At base, it’s a relatively new but powerful idea: ‘integrated’ reporting – either in annual or periodic reports – aims to give a complete picture of a firm’s activities and, based on these, reasonable projections about the firm’s future. In other words, integrated reporting aims to provide investors, shareholders and those interested in a business entity with a comprehensive picture of it. Its aim is to increase investment in better companies.

An ‘integrated’ report aims for simplicity, stating clearly and in well-written prose (that is easily understood by even non-specialists) where a firm fits in society – especially its management methods, and how it reacts to environmental and social responsibilities. Usually accompanying a firm’s financial statements, this inclusive style of reporting also nominates goals in short, medium and long terms.



*“<IR> is a process founded on integrated thinking that results in a periodic integrated report by an organization about value creation over time and related communications regarding aspects of value creation. An integrated report is a concise communication about how an organization’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term.”*

#### Some recent developments

In July, an <IR> working group of the International Auditing and Assurance Standards Board (IAASB) said there was a growing awareness among organisations of all sizes that they must broaden the base of the information they give to stakeholders.

In a brief report, *Exploring Assurance on Integrated Reporting and Other Emerging Developments in External Reporting*, the group said that relevant non-financial information that might be included in corporate reports should be called ‘external reporting’. It was monitoring the ‘developing demand for assurance engagements designed to enhance the credibility of integrated reporting ...’ Businesses of all types and sizes needed to recognise the ‘interdependence’ of factors that made up their ‘non-financial performance’.

The working group was investigating the ‘demand for professional services and activities’ that would be needed ‘to enhance the credibility of external reporting’ and how ‘assurance practitioners’ were addressing it.

PricewaterhouseCoopers defines ‘assurance’ in the widest sense as the ‘process of establishing the integrity and validity of disclosures – including statements and reports’. How integrated reports might be comprehensively ‘assured’ is probably the most complex and worrisome aspect of integrated reporting’s adoption.

For all that, there clearly appears to be growing acceptance that, in future, entities of all types will have to ‘assure’ not just their financials.

The IAASB’s report coincides with an IIRC ‘overview of feedback and call to action’ *Overview of Feedback and Call for Action*. It noted that internal systems for handling <IR> were ‘far less mature’ than counterparts for ‘financial’ information. The 26-page report, which concentrated on the role of assurance in <IR>, stated that ‘innovation and experimentation (were) necessary’ if comprehensive assurance of integrated reports was to succeed. It summarised the feedback from roundtables on <IR> that had been held around the world.

In a CPA Australia report released in December last year, Colin Higgins and Wendy Stubbs argued that while stakeholders believed reports needed to change there was less agreement that <IR> was 'necessarily the best way forward ...'. How new types of reports, including <IR>, should address 'established principles of accounting' was uncertain.

Drs Higgins and Stubbs wrote: 'The next steps in the development of (<IR>) should be to consider the main problem it is seeking to address, and the audience for corporate reports'. Addressing these problems would help to make sense of 'new materiality protocols and comparability challenges'.

<IR> has been a huge hit among 66 organisations that took part in an IIRC pilot program. After having published at least one 'integrated' report, 87 per cent of them believed investors better understood how they went about their businesses. Seventy-nine per cent of them reported improvements in decision-making, and 78 per cent thought their boards were thinking better about goals and targets. They also thought they better understood risks and opportunities.

PwC, one of the firms taking part in the pilot program, found that 80 per cent of investors thought that the quality of a company's reporting affected their opinions of its management. Sixty-three per cent believed that how companies reported affected the cost of their capital.

So, why is there a temptation to over-complicate integrated reporting? Why, in Australia, are firms slow to take it up? Because to implement it requires management courage and rigour, and skilled English. An integrated report bares a company's soul ... It's an honest effort to come clean. And for some firms, this can be threatening and time-consuming. The less they reveal about their activities the better.

### A brief history

Formally and informally, improved company reporting has been mooted for more than half a century. But only in the 1990s in South Africa did it really take hold.

In 1993, South Africa's Institute of Directors asked Mervyn King, a former judge of the Supreme Court of South Africa, to chair a committee on corporate governance. The committee's first report (King I) was produced in 1994, and a revised edition (King II) was released in 2002. A third edition (King III) was released in 2009. From March 2010, the Johannesburg Stock Exchange required listed companies to adopt the King III principles. Known as 'integrated' reports, South African annual reports are required to demonstrate a company's leadership, sustainability, and good corporate citizenship. In King III, integrated reporting is referred to as a 'key challenge for leadership' in which 'sustainability issues' are 'mainstream'.

It notes that 'strategy, risk, performance and sustainability have become inseparable'. Hence, the best company reports are 'integrated'. While reporting on none of these attributes is legally enforceable, they are mandated through regulation. King is director of the Global Reporting Initiative (GRI), which lobbies worldwide for the introduction of integrated reporting.

In 2009, the Prince of Wales convened a meeting of investors, companies, accounting bodies and United Nations representatives, which included GRI representatives, to form the International Integrated Reporting Committee (IIRC). In 2012, it was renamed the International Integrated Reporting Council. Chaired by Mervyn King, it describes itself as a global coalition of regulators, investors, companies, standard-setters and NGOs that leads the way in steering the world's business entities towards reporting more broadly on their activities.

As early as 1999, PricewaterhouseCoopers created a 'value reporting' framework, now known as the Corporate Reporting Framework, which identified information common to all industries and businesses: market overview, strategy and structure, managing for value, and performance.

In 2002, Novozymes, a Danish manufacturer of industrial enzymes, produced what is thought by many to be the first 'integrated' report. Its annual reports remain models of the style. And over the past decade, major accountancy firms and consultants have contributed to refining the idea of integrated reporting.

The IIRC makes the pace, though. In 2011, it set up an integrated reporting pilot program involving scores of companies worldwide; four are Australian. And last year it released an International Integrated Reporting Framework, which details 'principles and concepts that are focused on bringing greater cohesion and efficiency to the reporting process ...'. In other words, it helps businesses decide how to go about integrated reporting. The document is to be used to 'accelerate' the adoption of integrated reporting worldwide, it says. For all that, it is difficult to determine from the IIRC's website who funds it or where it is based. It has a board, a council, a working group, a 'technical taskforce' and staff and 'ambassadors' throughout the world. Deducing from the national telephone code '44', its HQ appears to be in the UK. Its website is poor – the writing quite abstract and obscure, the opposite of transparent. It does not appear to say how the organisation is funded. The IIRC's definition of integrated reporting, for instance, is: 'A process founded on integrated thinking that results in a periodic integrated report by an organisation about value creation over time and related communications regarding aspects of value creation'. Jargon and rhetoric, in short. The organisation's overarching aim, however, is admirable: it would like to see capital better targeted and more productive.

### A working definition

The following bullet-point summary goes some way to outlining integrated reporting's attributes. Integrated reporting is:

- A relatively new concept in Australia
- A better way of reporting a company's activities
- A more transparent and attractive way of reporting
- A way of revealing a company's value over and above its financial activities
- A way of detailing more comprehensively a company's activities, especially its environmental, social and governance (ESG) performances

### Guiding principles for integration

1. Strategic focus and future orientation
2. Connectivity of information
3. Stakeholder relationships
4. Materiality
5. Conciseness
6. Reliability and completeness
7. Consistency and comparability



- A way of demonstrating good corporate citizenship
- A way of showing in plain English how a company's activities beyond profit-taking contribute to its short-term, medium-term, and long-term goals
- A way a company can appeal more to its stakeholders, investors, and those simply with an interest in it
- A way of attracting investment
- A way of revealing a company's style and character as well as its financials
- A way of eliminating large chunks of jargon from company reports
- A concept likely to be implemented as smart companies see fit – it is unlikely in Australia to be imposed on them by governments and regulators
- A concept approved by many of the world's biggest companies. Several are members of the IIRC's 'business network'. They included PepsiCo, HSBC, Hyundai, National Australia Bank, Unilever, and Deutsche Bank

**Integrated reporting in Australia**

ASIC believes integrated reporting should be adopted on a voluntary basis, and it is unlikely that Australian governments of any shade will make legislative changes to oblige companies to adopt the method.

Directors' liabilities are strict in Australia, and there is little wiggle-room when shareholders act on business predictions that go wildly awry. Hence, ASIC's position allays the fears of many boards. But what kinds of guarantees can companies dare to give in integrated reports? This is a key cause for concern, and, as the IIRC maintains, it's a 'trending' discussion. The buzzword is 'assurance' – in other words, how much can we tell stakeholders without our business risks being unmanageable? A well-run, judicious firm shouldn't have problems sorting this out, and to clog integrated reporting with a long-term 'assurance' debate will simply slow down its adoption.

Another cause for concern among Australian companies is answered to some degree in ASIC's Regulatory Guide 247. The guide discusses the concept of, and exemptions for, 'unreasonable prejudice' – where a competitor might gain a commercial advantage from what is divulged in a report. Confidentiality is also discussed.

One of the biggest challenges facing integrated reporting is the degree to which stakeholders can rely on what they'll read.

IR's major goal is to improve the quality of information available to providers of financial capital. Its supporters know that if this information is to be 'investment grade' it must be reliable. Assurance is key to achieving that level of trust.

Part of 'assuring' an integrated report is expected to be an independent conclusion on whether the report represents an organisation's strategies, governance, performance and prospects according to the IR framework.

Therein lies the rub. At this stage, the framework contains several components that pose difficulties for the assurance provider. Some critical issues are:

- Integrated reporting is future-oriented. Will an assurance practitioner be able to gather appropriate audit evidence?
- Many aspects of integrated reporting deal with management aspirations and/or strategies rather than historic facts.

- The framework might not be able to demonstrate 'suitable criteria', which is an essential element of assurance.
- There is a potential shortage of skilled and experienced assurance practitioners to conduct the work.
- Will the cost of gathering sufficient appropriate audit evidence outweigh the benefits?
- If 'limited' assurance is the only practical result, will that satisfy those who use integrated reports?

The IIRC is acutely aware of these and many other assurance issues and have responded with two papers: *'Assurance on <IR> - An Introduction to the Discussion'* and *'Assurance on <IR> - An Exploration of Issues'*.

Key stakeholders – including government, investors, non-government organisations (NGOs) and the public – are interested in a company's future performance and its impact and contribution to environmental and social issues. A single 'integrated' report might be pressed to fulfil all stakeholders' information needs. It can reduce, however, complexity in reporting and improve communication. Long-term strategies, and past and future performances will also be exposed.

Ideally, a good integrated report is not simply a combination of figures and a demonstration of corporate social responsibility. It will focus on key strategies and communicate them in a timely and effective way.

Encouraging companies to report on their environmental performances does not necessarily mean that they should satisfy investors' moral or ethical interests in a firm. Rather, a comprehensive integrated report will reveal the risks and opportunities a company faces and how they will be managed.

**How GAAP Consulting can help**

GAAP Consulting aims to help your firm use integrated reporting in a way that will most benefit you, your firm's investment potential, and your stakeholders. We have the technical firepower to advise you on financial aspects of integrated reports – what should and shouldn't be revealed. And we have the writing power to convert your reports into powerful, crisp, comprehensive and grammatically-correct documents.

Our <IR> team is Sonya Sinclair (reporting), Justin Reid (assurance) and Stephen Downes (clarity in communication). Don't hesitate to contact us for more information.

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Stephen Downes is a prize-winning writer and journalist. He has covered a war for the French news agency and an insurrection for *The Age*. Three of his books have been translated into a total of five languages. For 11 years he contributed a weekly column to *The Australian Financial Review*, and the subject of one of his many feature interviews for *The Age* was C. Northcote Parkinson, the father of modern business consulting. He holds a science degree from Melbourne University and a Certificate IV in assessment and workplace training.

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