Integrated Reporting: Closing the Reporting gap

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There's a gap between what investors need to know about business plans and long-term strategy and what corporate reports are telling them. This reporting gap makes it harder for investors to discern the true drivers of value creation in a business. Reporting requirements continue to evolve, with regulations looking to help reporters create better and more concise communications, but the issue still remains that reporting is financially and historically biased.

Research shows that over 80% of the market value of leading organizations is not currently reported on in traditional financial statements. The 80% is made up of intangible assets that are not recognized by accounting standards and so not captured on balance sheets. Often the term 'non-financial is applied to the underlying drivers of this element of market capitalization. However, the reason such a high proportion of market value is attributed to the 'non-financial' element is because it has such a significant impact on long term cash flows. Disclosing information about the 80% will clearly improve reporting as then the reader is being informed about the whole value creation proposition rather than just 20% of it.

In a recent PwC survey of investment professionals, nearly two-thirds believed that the quality of corporate reporting could have a direct impact on its cost of capital, with nearly 90% feeling that clear links between a company's strategic goals, risks, key performance indicators and financial statements would help their analysis. Yet they perceived a substantial gap between the importance of these topics and the effectiveness with which companies report on them. Integrated reporting would help to bridge these gaps and so better meet the needs of investment professionals.

Investor would like to see corporate reporting that effectively and credibly links performance measures both to strategy and the drivers of business value. Integrated Reporting is an ideal tool to help companies describe their businesses and to find measures that reflect all aspects of their ability to create value.

What is integrated reporting?

There is no universally agreed definition of what constitutes integrated reporting. Most definitions refer to the integration of financial and non-financial information into a single document. However, there are considerable differences of opinion over the underlying rationale; the type of non-financial information that should be included and how the latter should relate to financial data; and the audiences that such a report should address. Acknowledging these challenges, the International Integrated Reporting Committee (IIRC) was established in August 2010 to develop a reporting framework that would command the support of interested parties. The IIRC includes representatives from the corporate, accounting, securities, regulatory and standards-setting sectors and builds upon work

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previously undertaken by the Global Reporting Initiative and the Prince of Wales' Accounting for Sustainability project.

An integrated report is a concise communication about how an organization's strategy, governance, performance and prospects lead to the creation of value over the short, medium and long term Integrated reporting refers to representation of the financial and non-financial performance of a company in a single report. This helps in providing a greater context to the non-financial data such as how the company performs on environmental, social and governance (ESG) parameters, how sustainability is embedded in the core business strategy etc. Integrated Reporting focuses on the inter-connectivity of strategy, corporate objectives, performance measurement, risk assessment, resource allocation and governance.

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Drivers for integrated reporting

Drivers for adoption of integrated reporting comprise of both pull and push factors. Stakeholder groups such as investors, customers etc. can demand greater level of disclosure and encourage companies to adopt integrated reporting. On the other hand, regulations and compliance standards such as those by stock exchanges, government regulatory bodies etc. can act as another driver for adoption of integrating reporting.

Why use Integrated Reporting

Integrated Report demonstrates how organisations really create value:

- It is a concise communication of an organisation's strategy, governance and performance.
- It demonstrates the links between its financial performance and its wider social, environmental and economic context.
- It shows how organisations create value over the short, medium and long term.

Increasingly, businesses are expected to report not just on profit, but on their impact on the wider economy, society and the environment. Integrated reporting gives a 'dashboard' view of an organisation's activities and performance in this broader context, which will:

- Enable more effective decision making at board level.
- Improve the information available to investors.
- Encourage more integrated thinking and business practices.

Guiding Principles of IR

The following Guiding Principles underpin the preparation of an integrated report, informing the content of the report and how information is presented:

- **Strategic focus and future orientation:** An integrated report should 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.
- **Connectivity of information:** An integrated report should show a holistic picture of the combination, interrelatedness and dependencies between the factors that affect the organization's ability to create value over time.
- **Stakeholder relationships:** An integrated report should provide insight into the nature and quality of the organization's relationships with its key stakeholders, including how and to what extent the organization understands, takes into account and responds to their legitimate needs and interests.
- **Materiality:** An integrated report should disclose information about matters that substantively affect the organization's ability to create value over the short, medium and long term.
- **Conciseness:** An integrated report should be concise.
- **Reliability and completeness:** An integrated report should include all material matters, both positive and negative, in a balanced way and without

material error.

• **Consistency and comparability:** The information in an integrated report should be presented: (a) on a basis that is consistent over time; and (b) in a way that enables comparison with other organizations to the extent it is material to the organization's own ability to create value over time.

Content Elements of IR

An integrated report includes eight Content Elements that are fundamentally linked to each other and are not mutually exclusive:

• **Organizational overview and external environment:** What does the organization do and what are the circumstances under which it operates?

• **Governance:** How does the organization's governance structure support its ability to create value in the short, medium and long term?

• **Business model:** What is the organization's business model?

• **Risks and opportunities:** What are the specific risks and opportunities that affect the organization's ability to create value over the short, medium and long term, and how is the organization dealing with them?

• **Strategy and resource allocation:** Where does the organization want to go and how does it intend to get there?

• **Performance:** To what extent has the organization achieved its strategic objectives for the period and what are its outcomes in terms of effects on the capitals?

• **Outlook:** What challenges and uncertainties is the organization likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?

• **Basis of presentation:** How does the organization determine what matters to include in the integrated report and how are such matters quantified or evaluated?

Challenges of integrated reporting

Though a beneficial concept, integrated reporting has many challenges associated with it, especially considering the fact that very few companies across the world have actually adopted it, though the number is growing progressively.

• **Assurance:** The biggest challenge facing integrated reporting is the question of providing assurance for the reported data by the third parties.

• **Materiality:** All disclosure indicators may not be material for all firms. Materiality will differ depending on the industry the company operates in.

• **Diverse beneficiaries:** Both financial and sustainability reporting serve multiple and diverse stakeholders such as investor, employee, government, community etc. Though some of these stakeholders overlap, integrated reporting may not appeal to all stakeholders

SEBI Circular regarding Integrated Reporting

The Securities and Exchange Board of India (SEBI), by way of its circular issued on 6 February 2017 (Circular), advised the top 500 listed companies in India to adopt Integrated Reporting on a voluntary basis from the financial year 2017-2018. Prior to that, such companies have been required to submit a Business

Responsibility Report (BRR) that pertains to areas such as environment, governance, stakeholder relationships, and the like. Since the Circular does not mandate preparation of Integrated Report (IR), a company may voluntarily opt to prepare IR. In such a case, the company has to provide cross reference in its IR to information that has already been disclosed in accordance with any other national or international requirement / framework.

Looking forward

Corporate reporting will continue to evolve with the changing business environment and stakeholder expectations. Adding integrated reporting to management's agenda and to board strategy sessions may help companies determine how to meet these evolving expectations. The integrated reporting concepts may provide companies a useful framework when considering how to best disclose environmental, social, and governance matters that they have decided to report. Companies may also improve their access to capital, achieve greater influence internationally and achieve strategic business benefits from integrated thinking.