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Integrated Reporting- A Potent Tool for Value Creation

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Abstract: *The integrated reporting is a new standard for corporate communication, and helps to complete financial and sustainability reports taking into account financial and non financial. Integrated reporting <IR> is a "process that results in communication, most visibly a periodic "integrated report", about value creation over time. 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." It means the integrated representation of a company's performance in terms of both financial and other value relevant information. Integrated Reporting provides greater context for performance data, clarifies how value relevant information fits into operations or a business, and may help embed long-term value creation into company's decision making.*

Keywords: *Integrated reporting, value creation, the International Integrated Reporting Council*

What is an integrated reporting?

Integrated reporting is a concept that has been created to enhance the presentation of the broader range of measures that contribute to long-term value and the role organizations role in the society. It's necessary to identify what are the pivotal factors in addition to financial performance which contributes to overall increase in organisations value. There are many factors such as reliance on the environment, social reputation, human capital skills and others which leads to overall increase in the value creation. This value creation concept is the backbone of integrated reporting and this certainly is the direction for the future of corporate reporting. Value creation is the process that results in increase, decrease or transformations of the capitals caused by the organization's business activities and outputs.

To create value over time, today's organizations need to actively manage a wider range of resources. Intangible assets such as intellectual capital, research and development, brand value, natural and human capital have become as important as tangible assets in many industries. However, these intangible assets are not universally assessed in current financial reporting frameworks even though they often represent a substantial portion of market value. A range of issues combined with intangible assets influence competitiveness. Examples include: regulation or deregulation, technology innovation, finite resources and consumer sovereignty, and compliance and legislation. Creating sustainable value for organizations depends on two things:

1. Adapting to change and the challenges and opportunities in their environments

2. Effectively managing intangible assets, which can represent a substantial portion of market value.

Background

The concept of integrated reporting was introduced in South Africa in 2009 through King III, the code of corporate governance. The Johannesburg Stock Exchange adopted King III, and all listed companies are now required to "apply or explain" the King III principles, of which integrated reporting is one. Regulatory requirements around the world and some listing requirements in different parts of the world are heading in the same direction. Requirements are emerging to increasingly disclose non-financial performance, such as:

• In Germany, German Accounting Standard 15 (GAS 15) includes disclosure requirements with respect to context, KPIs (Key performance indicators), risks and opportunities, forward-looking statements and corporate governance

• In France, Grenelle II stipulates the inclusion of externally assured non-financial information in annual reports

• In Spain, a regulator's taskforce is working on proposals for a new management report format

• In Brazil, the Sao Paulo Stock Exchange requires listed companies to report non-financial KPIs on a "comply or explain" basis

• In the UK, the Companies Act 2006 (strategic report and director's report) extends the scope of mandatory non-financial reporting obligations for listed companies

The IIRC, set up at the end of 2010, aims to create the globally accepted integrated reporting framework. Ultimately, an integrated report should explain the reporting entity's interrelated financial, environmental, social and corporate governance information. It should be presented in a clear, concise, consistent and comparable manner. And disclosure should be retrospective and prospective to better match investors' needs. By doing so, organizations could improve their ability to access capital.

REPORTING ITEMS IN THE INTEGRATED REPORTING

In addition to financial capital, integrated reporting examines five additional capitals that should guide an organization's decision-making and long-term success — its value creation in the broadest sense.

In the Framework of International Integrated Reporting Council (IIRC), the six capitals are categorised and described:

A) Financial capital – The pool of funds that is available to an organization for use in the production of goods or the provision of services

B) Manufactured capital – Manufactured physical objects (as distinct from natural physical objects) that are available to an organization for use in the production of goods or the provision of services. Manufactured capital is often created by other organizations, but includes assets manufactured by the reporting organization for sale or when they are retained for its own use.

C) Intellectual capital – Organizational, knowledge-based intangibles

D) Human capital – People's competencies, capabilities and experience, and their motivations to innovate.

E) Social and relationship capital – The institutions and the relationships within and between communities, groups of stakeholders and other networks, and the ability to share information to enhance individual and collective well-being

F) Natural capital – All renewable and non-renewable environmental resources and processes that provide goods or services that support the past, current or future prosperity of an organization.

Its recommend that organizations take into account the guidance of the International Integrated Reporting Council (IIRC) when carrying out an integrated report.

Sustainable organizations create value by combining a broad range of resources controlled by the organization or third parties. They are increasingly expected to generate positive outcomes for society that go beyond returns for their shareholders or investors — outcomes that can be instrumental in improving an organization's long-term financial performance. Understanding this co- creation and shared value process is fundamental to integrated reporting. Other considerations include:

1. An organization's value creation potential depends on its ability to identify all of the resources available to it, whether tangible or intangible, owned by the organization or third parties, and to align them with its corporate strategy

2 .Any value created, including that which benefits society as a whole, has the potential to impact on the organization's value and profitability

3. An organization that communicates its strategy to the market and quantifies this broader contribution may well be stimulating value creation in itself. However, to increase stakeholder confidence the information must be credible.

We can safely assume that the only layer of value currently measured consistently by organizations till now is financial capital — usually through the annual report and accounts. This value is translated into dividends for shareholders or stock price gains. The second layer encompasses shared value that benefits stakeholders directly related to the organization (employees, customers, suppliers, public treasury, etc.). Shared value depends extensively on factors such as employee performance, operating permits and consumer confidence. The third layer describes the value that an organization generates for society at large, even if it's not directly linked to its business purpose. These externalities, as they are known, may be either positive or negative. An integrated report is broader than traditional approaches in terms of scope and time horizon. It should tell each organization's unique value creation story for each of these areas and include how:

•It creates value and for whom

• It measures and quantifies the layers of value

• It identifies the value created at each level and how it may affect future performance.

To tell a comprehensive value creation story, integrated reporting requires organizations to identify the interdependency between all elements — internal and external — that materially affect their ability to create value over time. Seeing this connectivity requires integrated thinking as opposed to "silo thinking." All the operating and functional units of an organization, as well as the capitals that it uses to create value, must be considered. This leads to integrated decision-making and actions. The integrated report is the product of the processes of connectivity and integrated thinking in the organization. Integrated reporting is therefore not just about the report, but about the process of the organization's unique approach to value creation. To translate integrated thinking into integrated reporting the organization should convey a holistic view of strategy, governance, performance and prospects. The integrated report should also bridge time horizons. Therefore integrated reporting can be used as a governance tool for performance-oriented management.

USING THE GUIDING PRINCIPLES FOR THE PREPARATION OF INTEGRATED REPORTING

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. The report should clearly show the linkages between strategy, risks and opportunities, current performance, as well as future outlook and targets.

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. The report should highlight the connection, for example, between past, present and future performance, between financial and non-financial information, and between qualitative and quantitative information.

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. A focus on materiality should assist in avoiding irrelevant and detailed information from cluttering the report. The integrated report is a high-level, concise report that contains only the most material matters and information affecting the organisation and its ability to create value over time. Additional information can be placed in supporting reports.

RELIABILITY AND COMPLETENESS

An integrated report should include all material matters, both positive and negative, in a balanced way and without material error .Integrated reporting requires that consideration is given to both good and bad news and performance. Furthermore, both the increases and reductions in the value of the important capitals should be reflected. Where the information is not perfectly accurate, estimates should be used and appropriate processes in place to ensure that the risk of material misstatement is reduced.

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. The use of industry benchmarks, indicators of best practice, and ratios are tools that can improve reporting consistency and industry comparability

PLANNING THE PREPARATION PROCESS

Planning for an integrated report should ideally start at the beginning of the reporting period. Setting clear instructions with firm timelines will ensure the smooth running of the reporting process. When planning timelines, it helps to work backwards from the date on which the report has to be released and the timetable should include dates for the governance approval procedures. It's important to consider how the existing reporting processes and reports (such as internal reports, sustainability report and financial statements) will fit into the integrated reporting process to avoid duplication and overburdening resources. Planning by the integrated reporting team should cover all aspects of the preparation process.

Strategy and key performance indicators

Strategy formulation should describe the process and tools designed for the creation of value for shareholders and other stakeholders, specifically customers, suppliers, employees and society as a whole. The value created for the community is the result of the production of positive and negative externalities. The strategy should maintain a balance between two things: first, short-term financial performance; second, the sustainable creation of value in the medium and long term. It's important to distinguish the time horizons framing decisions regarding the allocation or consumption of the capitals.

The value of intangibles depends on the extent to which they link with the organization's objectives — or in other words, value creation through connectivity. Any increase in their value may eventually materialize by improving financial performance through interrelated links. This alignment and these interactions are key since the measurement of the value of an intangible can be cost-based, but it can also rely on other performance indicators. Intangible assets have a value potential that depends on how the organization defines its strategy and how those assets contribute to the organization's value creation goals. An intangible asset unaligned with the organization's strategy may have no value. The success of a strategy depends, above all, on execution.

KPIs measure financial and non-financial performance against targets and long-term value creation goals. They can also indicate what the organization's outcomes are in terms of tangible and intangible value as well as value for society. KPIs can be used to measure performance and outcomes resulting from the use of tangible and intangible assets as well as capitals the organization doesn't own. They relate to the organization's critical value drivers and track the organization's performance in the short, medium and long term.

With correct KPIs the management team can focus on monitoring material matters, and investors can assess value creation. Creating KPIs enables organizations to understand how they can minimize negative externalities and maximize positive ones. For example, take KPIs related to waste reduction generated in manufacturing. The reduction of waste may indirectly measure the creation of external value through enhanced environmental performance. The improvement could result in an improved brand image. This in turn enhances customer loyalty and, by extension, customer relations (an intangible asset).

Finally, communication is a crucial component of strategy and the value creation story. Naturally, it's vital that the entire organization is aligned with the organization's strategic targets. However, it's also true that the market will only tend to recognize an organization's intrinsic value to the extent that it receives sufficient information. Moreover, reporting how an organization creates intangible value and a value for society may create additional intangible value as long as the communication is credible and consistent. Integrated reports should disclose the measurement methods used by management to calculate KPIs. This information is relevant to enable comparisons between organizations and provide a clear understanding of the organization's performance.

Risk and opportunity management

Integrated reporting takes a broader approach to risk and opportunity management than traditional frameworks. As a consequence, a strategy that includes the identification and mitigation of risks against the integrated reporting six capitals has a direct impact on performance. It also has an impact on reducing the gap between its market and intrinsic values. Risks can be placed into four major categories according to the Committee of Sponsoring Organizations of the Treadway Commission (COSO) : strategic, financial, operational and compliance. Risks related to natural resources such as scarcity and risks envisioned for the future fall into the category of strategic and operational risks. Enterprise risk management is seen as important to guaranteeing the viability of any corporate strategy and, by extension, the value creation process. Material risks that could have a significant impact on the execution of the organization's strategy and its value creation goals should be incorporated into the decision-making process with the aim of reducing uncertainty with respect to achievement of operating results. Empirical studies show that organizations with advanced risk management systems create more value in terms of revenue, operating profits and results against equity. With risk management a clear-cut value driver, it's important to communicate it properly to the organization's various stakeholders and relate it to its corporate strategy. Investors, regulators, shareholders and suppliers, among other stakeholders, are increasingly calling on organizations to enhance their risk management disclosures. Control over reporting and communication of risk management information can help maximize value creation. Internally, it's important that the organization understands and is familiar with existing risks and stringently applies the related controls. This process should be overseen by its board of directors and audit and control committee. Externally, it's vital that third parties understand the key characteristics of the risk management model and how the organization responds to the most material risks. Decisions regarding what should be communicated, and how, need to be handled by management.

Conclusion

Integrated reporting has become the need of the hour and it should be adopted expeditiously by all the organisations to enhance their accountability towards various stakeholders. Since it has numerous advantages, their merits easily outweighs the cost involved in the integrated reporting. 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 and achieve strategic business benefits from integrated thinking.

Some of the benefits of integrated reporting cited by experienced South African reporters are listed below:

- Increased internal awareness of key environmental, social and governance matters.
- Breaking down of internal silos and promoting sharing of information in the organisation
- Improved knowledge-management processes
- Focused integration of key performance indicators (KPIs), risks, and strategic objectives within the context of the six capitals
- Clear depiction of the business model articulates and increases understanding of how value is created over time
- Greater alignment of internal and external reporting, i.e. one version of the truth
- Succinct and connected reporting which is easier to interpret and analyse
- Improvement in balanced reporting and transparency through:
- Inclusion of both positive and negative information
- Addressing both historic performance and future outlook
- A strategic focus
- Improved quality of communication between the organisation and stakeholders

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