Leading companies pull FURTHER AHEAD IN REPORTING

Integrated reporting represents a major shift from traditional annual and/or sustainability reporting. Telling the value creation story is replacing ticks in compliance boxes. How can we tell? Because the annual EY Excellence in Integrated Reporting Awards are starting to reveal a gap between the reporting pioneers and the majority of followers who have yet to fully grasp the IR concept. Here, we look at how leading companies are applying the principles of integrated thinking and reporting.

Integrated reporting (IR) is the latest, and possibly most significant, effort to persuade a company's board and executive leadership to consider how non-financial issues impact on their company, especially in the medium to long term, and how their company intends to compete effectively using the assets, or 'capitals', at its disposal. The International Integrated Reporting Council (IIRC) calls this telling the value creation story.

This is a different approach from earlier compliance-led approaches – such as ticking boxes against Global Reporting Initiative (GRI) issues or King III principles – which have dominated reporting since the sustainability report was introduced to account for corporate behaviour around 15 years ago.

How do we, as the lay reading public, gauge the quality of any particular annual report? Even if we suspect that a particular report is not worth much more than the paper it is written on, what pressure is being brought to bear on the industries or on individual companies to up their game and save us from another meltdown?

Rewarding IR excellence

Enter the EY Excellence in Integrated Reporting Awards.

Now in its third year, the Excellence in Integrated Reporting Survey is conducted by the University of Cape Town (UCT)'s College of Accounting. It assesses the top 100 companies by market capitalisation on the Johannesburg Stock Exchange (JSE) and ten State-owned companies (SOC). The adjudicating team comprises associate professor Mark Graham, head of UCT's College of Accounting; Goolam Modack, deputy head of UCT's College of Accounting; and Professor Alexandra Watson, member of the South African Integrated Reporting Committee Working Group.

Each company is rated against a markplan that mirrors the IIRC IR framework guidelines. They are then ranked within five categories: top 10, excellent, good, average, progress to be made.

The number of companies ranked as excellent increased to 35 from 28 last year, and 64 were ranked as excellent or good. The other companies have yet, in the eyes of the adjudicators, to make an effort at producing an integrated report. It is interesting to note that the best reporters in

TOP PERFORMERS IN THE EY EXCELLENCE IN INTEGRATED REPORTING AWARDS 2014
Top 10
Royal Bafokeng Platinum
Standard Bank Group
Sasol
Truworths International
Gold Fields
Aspen Pharmacare Holdings
Kumba Iron Ore
Liberty Holdings
Clicks Group
Exxaro Resources
Excellent
Altron (Allied Electronics)
Anglo American Platinum
Anglo American
AngloGold Ashanti
ArcelorMittal SA
Barclays Africa Group
Barloworld
British American Tobacco
Growthpoint Properties
Harmony Gold Mining Company
Illovo Sugar
Intu Properties
Lonmin
MTN Group
Murray & Roberts Holdings
Nedbank Group
Oceana Group
Omnia Holdings
PPC
Redefine Properties
SABMiller
Sappi
Tsogo Sun Holdings
Vodacom Group
Woolworths Holdings

2014 have solid track records for reporting over the years: seven of the top 10 were also in the top 10 last year.

Positive trends

Mark Graham, who headed up the board of adjudicators, sees definite improvement in IR. "Companies are certainly getting better at explaining their strategies and how their strategy integrates with their risks," he observes. "More companies are using key performance indicators [KPI] to evaluate strategies and show us where they are going. Many of the reports have been endorsed by the board or the audit committee and in some cases by both. The layout and structure is also improving. We are delighted that companies are using the concept of the six capitals, which is something that was fairly strange when it first came out."

Reports are also becoming more concise, though the improvement from an average of 172 pages in 2012's integrated reports to 159 pages in reports produced in 2013 suggests there is still a long way to go. Much of the improvement is down to 46 companies including summarised financials, compared with 35 in the previous year. As Graham notes, crisp and concise remains the cornerstone of a good integrated report. This means moving away from long narratives to tables, graphs and short explanations of strategy, risks and other key areas. It also means that different parts of a business need to work together when contributing to a report rather than working in silos.

End-to-end integration remains a challenge

Nearly a third of the companies in the survey made no attempt to produce an integrated report. The adjudicators were particularly critical of traditional annual reports with a sustainability section bolted on at the back.

The journey towards reporting primarily on issues that are material to their medium- or long-term sustainability remains a challenge for many companies. By reporting on what they think people might be interested in rather than their material issues, notes Graham, many companies could simply be greenwashing their integrated reports.

Another area for improvement involves making the connection between strategy, risk, performance and executive remuneration. When talking about its strategy, it is essential for a business to explain how it is going to measure progress towards its strategic goals in concrete terms, and to identify the KPIs. It should report on how well it performed against previous KPIs. Ideally, KPIs should be followed right through into the section that deals with directors' remuneration, especially the variable portion of their remuneration.

The IIRC's long-term goal is to see a behavioural change in thinking at leadership level from a focus on operational and financial drivers to a more holistic, integrated approach to managing the company. While this may be happening, the judges saw limited evidence of integrated thinking in this year's reports. The continued use of the traditional reporting layout may be a factor that inhibits integrated reporting. But, according to Graham, producing a good integrated report will always be extremely difficult if the board and management are not thinking in an integrated way.

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THE MARK PLAN AT A GLANCE

The mark plan developed by the adjudicators of the EY Excellence in Integrated Reporting Awards is largely based on the Consultation Draft of the International <IR> Framework. The fundamental concepts of <IR> Framework require that a report comprises a concise discussion of the various capitals that an organisation uses and affects, as well as an explanation of the business model and how value is created over the short, medium and long term.

Six guiding principles

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

Six content elements

1. Organisation overview and external environment
2. Governance
3. Strategy and resource allocation
4. Opportunities and risks
5. Performance
6. Future outlook

The judges looked for how well reports gave the reader a sense of the issues that are core to the operations and how well these were dealt with. Crisp information highlighting relevant facts counted for more than content that ticked the boxes.

Restricted by structure

As Graham points out, many companies are still stuck in old patterns when it comes to structuring their reports. The standard reporting framework used to look like this: a message from the chairman followed by a message from the CEO and the financial director's report, then a governance report. This structure cannot easily accommodate the IIRC IR framework. Most reports still retain this basic structure, simply expanding the body of the copy to incorporate the IR framework. This, says Graham, leads to repetition. "We would like to see more innovative thinking," he emphasises.

Ultimately, however, Graham and his fellow adjudicators want to see companies following the IIRC IR framework now that it has been formally adopted as the standard framework. This should help significantly, not only with structuring reports, but also with telling the value creation story logically and clearly.

Addressing both shareholders and society

That said, companies need to think carefully about who their report is aimed at if they are going to take the IIRC IR framework seriously this year. The framework is clear in its guidance: reports should be aimed at capital providers. In South Africa, however, King III recommends that reports should be aimed at all stakeholders. Treading a safe line in between, the Institute of Directors issued a practice note in 2014 recommending that companies should apply whichever approach is the most appropriate to them.

The EY Excellence in Integrated Reporting Awards found only 13% of companies aim their report at investors. Disconcertingly, it was not clear where most of the other companies were aiming their reports. While there is much debate at an academic level about whether to address shareholders or society, it is not difficult to reconcile the two approaches.

For most companies, making a return on shareholders' investment is a fairly obvious value driver. If the shareholder takes an enlightened long-term view, then the report should take into account and address all stakeholders, ranking issues for discussion in the report according to their impact on the organisation as well as society. In pursuit of long-term profit, managers are forced to take the concerns of wider society into consideration.

For most industries, this concept is easy to understand. A retailer may serve society, but ultimately its goal is to buy and sell for a profit. Likewise, a mine seeks to make a profit out of extracting and refining minerals taken from the earth. However, even organisations that serve society more directly have capital providers who call the tune – usually a tune that requires financial sustainability.

Paul Druckman, CEO of the IIRC, recommends a simple solution to the shareholder versus society debate: write the integrated report through the lens of an investor, but write it for everybody.

Presenting financials

How to treat the company's financial statements in its integrated report is another concern. The tide is definitely turning away from including full financial statements as part of the report, with 46% of companies surveyed producing summarised versions, most of these following the IAS 34 interim financial reporting standard.

Graham would like to see this trend taken even further. "I'm not sure any of the financial statements should be in the integrated report, not even IAS 34 summaries," he argues. Instead, reporters should make the effort to tell the value creation story using the information in the financial statements to help connect the key elements. By adopting this approach, companies are more likely to apply their minds to extracting material information from the financials, rather than burying information that is sometimes highly relevant in a note towards the back of the report.

Best versus the rest

Meanwhile, the EY Excellence in Integrated Reporting Awards are beginning to reveal a real difference between companies that take the concept of integrated thinking seriously and those that either do not or simply have not yet figured out how to present their thinking.

For example, Royal Bafokeng Platinum, this year's winner, added intellectual capital to its reporting story, revealing an effort to think in

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a more integrated way about the connections between the six capitals and its value creation story. Standard Bank's integrated report was also a leading example of how to demystify a complex business and write a clear value creation story. The report's excellence was exemplified by the financial director's review, one of the best ever seen by the judges.

Others also excelled. Sasol, placed third, revealed the benefits of its status as a pioneer in the non-financial reporting arena. The judges particularly appreciated the maturity of the company's performance indicators. These show three-year performance against targets and are informatively represented through various useful infographics.

Integration demands leadership

Until now, companies could hire practitioners to fill in the various forms required to get onto the JSE Socially Responsible Investment (SRI) Index, apply King III or comply with the GRI's list of issues. By and large, they could achieve this without disturbing the main board's deliberations. According to Graham, those days are now over. This year, the board of adjudicators would like to see reporting reflect integrated thinking from the company's leadership.

Indeed, one of the EY Excellence in Integrated Reporting Awards' most significant contributions is to distinguish those companies that get it from those that do not. Companies whose leaders makes a concerted effort to tell their value-creation story using the IIRC IR framework will find themselves looking at their business in a more holistic and integrated way – a way that may very well find favour with investors who are committed to long-term value creation.

INTEGRATED THINKING

The South African Institute of Chartered Accountants (SAICA) released a new survey on 12 March 2015, exploring the concept of integrated thinking: understanding the connections between resources and relationships, and how they connect to the different functions, departments and operations in the company. In the survey, which was conducted with representatives from 33 JSE Top 100 companies, more than three quarters of respondents acknowledged integrated reporting as a driver of integrated thinking, although there was circumspection around just how enthusiastically integrated thinking is being embraced in organisations.

The report can be downloaded at www.saica.co.za.