INSTITUTE OF DIRECTORS
SOUTHERN AFRICA

Integrated Reporting

Sustainable Development Forum

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1. EXECUTIVE SUMMARY

Organisational survival in a world marked by multiple global crises requires different strategies and new ways of assessing and building value for stakeholders. Recent history has taught us that corporate governance and knowledge of an organisation's risk profile, and transparency on these matters, are as important. Social and environmental risks and opportunities could profoundly impact on an organization's markets, its customers and its future so it is critical to know that these have been addressed by the Board alongside their evaluation of financial performance and prospects.

The Integrated Report is seen as one means of providing investors and other organisational stakeholders with the kind of information they require to evaluate the sustainability, or long-term viability, of a reporting entity. Integrated reporting refers to an underlying process and more frequent engagement with and communication to stakeholders on material issues.

Financial reporting is governed by regulation, such as the Companies Act, International Financial Reporting Standards, as well as the listings requirements of the JSE, and this paper has taken as its departure point that most organisations are well versed in the requirements of financial reporting. It is a commonly held view that reporting on other issues and the integration of those issues in an overt and consistent manner lags somewhat, and this view was reflected in the King III code on corporate governance. Sustainability reports have generally been stand alone reports that do not fully reflect the impact of sustainability issues (both risks and opportunities) on the organisation or give an adequate view of the impacts caused by the organisation.

This Paper explores and discusses the challenges of achieving integrated reporting and seeks to demonstrate that integrated reporting:

- Builds on the principles of both financial and sustainability reporting such as those of materiality, completeness, accuracy.
- Must reflect the integration of environmental, social and governance (ESG) considerations into a company's way of doing business, its decision making, and its strategy formulation, alongside its focus on financial performance.
- Can only be achieved when it reflects integration at strategic business level. Strategy should not be formulated only when the communication process is embarked upon.
- Requires reporters to provide a view of how directors and executive management have applied their minds to risks and opportunities that could protect, create or destroy value within the reporting entity.
- Goes beyond the mere inclusion of some sustainability data in the annual report.
- Is not a uniquely South African concept.
- Implies a journey or process, rather than an annual event. It is not expected that reporting entities will achieve full integration immediately. However there is a need for an immediate paradigm shift to start the journey. It is expected that entities articulate the strategic steps they have taken towards this goal.
- Integrated reporting will not reduce the statutory financial reporting requirements until further changes to the companies act are brought into force.
- Integrated reporting contains both performance reporting (historical) and strategic intent (forward looking) as well as a focus on short and long term goals.

The paper draws a distinction between sustainability, or long-term viability, and sustainability issues, which is the common terminology to describe the so-called "non-financial" aspects such as environmental, social, governance and economic factors. Sustainable development has a specific focus on achieving sustainability through development processes that consider economic, environmental and social factors.

2. INTRODUCTION

It is no longer sufficient to view the performance of any organisation only through the prism of profit. As has been illustrated by the global financial crisis, past financial performance does not necessarily mean future success. Changing geopolitical trends, major environmental events like the oil spill in the Gulf of Mexico or natural disasters which leave communities further impoverished, can all impact on an organisation's survival.

Companies also create or contribute to impacts beyond their operational boundaries and should be taking steps to ensure that others don't pay the price of their activities. The King III report on governance in South Africa (King III) states that "it is unethical for companies to expect society and future generations to carry the economic, social and environmental costs and burdens of its operations". One of the purposes of the Companies Act, 2008 is stated as promoting the company as a vehicle for economic and social advancement. Companies which act as responsible corporate citizens contribute to building more sustainable futures and environments within which they can continue to flourish and provide ongoing economic value to stakeholders. Both King III and the 2008 Companies Act consider these to be duties.

Integrated reporting will enable stakeholders to determine whether an organisation is acting responsibly and whether it has adequately addressed factors outside of its own control which may impact on its value.

Due to their relative wealth, power and resources companies have a significant impact, which often extends beyond those who stand to benefit directly from a share price. It has therefore become necessary for companies to operate cognisant of its key stakeholders. To do this they need to test core strategies against economic, social, environmental and governance considerations and report material aspects in a transparent manner.

A company's formal means of communicating with stakeholders is reporting. Financial reporting provides an important, but limited, view of company performance. It does not satisfy the requirements of all stakeholders who wish to see the board assess the organization's future viability against environmental, social and governance criteria as well.

The other shortcoming of traditional financial reporting is that it is historically focussed. Integrated reporting takes a forward looking approach and asks that those charged with governance agree that the company has assessed its strategy and performance against the most material issues identified in conjunction with its stakeholders. In this way economic, social and environmental reporting are integrated to provide stakeholders with a more holistic and balanced view of the company's performance.

Integrated reporting is NOT simply the integration of information from sustainability departments into a financial report, or vice versa. Integrated reporting implies that the material financial, governance, environmental, social and economic aspects for the organization, its geographic location and its sector have been identified, managed and reported on. It requires that the board satisfies itself that the associated impacts are factored into future strategies and action plans.

3. BENEFITS OF INTEGRATION

The requirement for integrated reporting or issuing an integrated report (IR) has been set by King III and adopted by the JSE Disclosure Requirements on an "apply or explain" basis. The question is what value integrated management and reporting would add to an organisation and why they should strive to achieve true integration as opposed to "reporting as usual"?

The anticipated benefits are:

- A more informed strategy and operational plans to support this strategy, based on an understanding of core value drivers;
- A true reflection of effective management of the opportunities and risks associated with sustainability considerations;
- Accountability of internal management for their performance;
- A platform for strategic communication and conversations with stakeholders that provides a meaningful account of performance, builds trust and helps inform future strategy;
- Unlocking "value" from stakeholders and the market, through engagement on key issues
- A wider view of the organisation's impact beyond financials, which can reveal valuable opportunities for value enhancement;
- Increased internal awareness about corporate social responsibility; and
- Increased trust, confidence and support by transparent reporting about the full societal impact;

The integrated report is the opportunity for effective reporting and disclosure to stakeholders. It should be supported with other interventions that contribute to better reporting and disclosure practices, for example, stakeholder briefings and customer forums.

4. ACHIEVING TRUE INTEGRATION

An integrated report describes how a company has made its money and contextualises financial results by reporting on the positive and negative impact the company's operations have had on its stakeholders. It provides a view on an organization's ability to mitigate and manage risks.

Strategy, governance and sustainability are inseparable and in order for a company to give a complete and integrated presentation of its financial and sustainability performance - as required by King III – it is necessary to integrate its approach to sustainability and financial issues before it begins to report on them. Integrated reporting can only be meaningful if it is a result of this integration process.

Defining factors

- Firstly, it is about reporting on the company's impact. This is a two way relationship in terms of:
  - -how socio-economic and environmental issues impact on core value drivers and the company's growth strategy, and
  - -how the company has a material impact on socio-economic and environmental issues, and where the company has leverage to effect change.

  On impact issues the company should report on what has happened in the reporting period, as well as taking a forward-looking perspective in terms of anticipated impacts (and associated business opportunities) and its strategic approaches to managing these.

- Secondly, it is about understanding what this means for organisational competencies.
  Stakeholders that are interested in the company would want to know what capacity and competencies the company has to be agile in the context of anticipated turbulence. Currently most sustainable development reports focus primarily on impact issues, and typically with a backward looking lens without a link to long term strategy.

Therefore, in making the transition, it is recommended that at the outset at least a detailed roadmap is published indicating to readers what implementation and reporting targets have been set to achieve integrated reporting and assurance best practice, within a defined timeframe.

This speaks to King III's overriding principle of "apply or explain". Notwithstanding levels of reporting maturity, companies will be expected to demonstrate continuous improvement in managing and reporting on sustainability in subsequent reporting cycles.

5. INTEGRATION IS A JOURNEY AND LONGER-TERM PROCESS

It is important to note that integrated reporting cannot be treated as a matter to be addressed at the end of the financial year. The integrated report is the end-result of an implementation process and strategy that consider the long-term viability of the company relative to its financial, economic, social and environmental impacts. Sustainability principles must be integrated into all aspects of organizational strategy. The company's integrated report should then be a document which allows all executives and stakeholders of the company to evaluate the performance of the company (including strategic and operational performance) and the risks its strategy represents for the business and for society.

If the company begins its strategic process knowing that it will be required to report on an integrated basis, this will enable it to articulate the impact of its operations on its stakeholders. This in turn, obliges companies to have upfront the appropriate conversations about the drivers and key measures of performance.

5.1 Steps to be taken

The process to achieve integrated reporting involves the following:

1. Connecting business strategy, governance and sustainability	1.1	Identify the financial, social, environmental, governance and economic issues that are most relevant to the organisation, the sector and markets in which it operates.
	1.2	Determine those issues that are material to the organisation's performance. Materiality must be determined in conjunction with key stakeholders and the Audit Committee should agree on the process and outcome.
	1.3	Describe the process of determining which issues are material. This should explain why issues that are generally considered significant at sector, national or international levels are not considered material for disclosure by the business.
2. Key Performance indicators and actions taken	2.1	Identify the actions taken to address each of the material issues (risks and opportunities) resulting from 1.2.
	2.2	Establish the intended outcome for each action
	2.3	Set out how progress towards outcomes will be measured, identifying key performance indicators (KPI) for each material issue, as relevant.
	2.4	Agree of targets for each KPI and supporting performance measures.
	2.5	Identify the relationship between selected KPIs and financial or business performance, where possible quantifying the relationship in terms of impact on revenue, expenditure, investment, cash flow or measures of operational performance.
	2.6	Align management performance appraisal and incentive structures with selected KPIs, based on time horizons over which outcomes can be measured.
3. The integrated report	3.1	Ensure appropriate information collection processes are established to provide complete, accurate and consistent information.
	3.2	Report on the actual performance achieved in the reporting period with reference to: • Agreed targets; • Reporting baseline; • Performance in prior years; • Peers, industry and national averages or other benchmarks.
	3.3	Report related financial or business performance measures alongside KPI's, providing a clear indication of the relevance of sustainability performance to the business results.
	3.4	Describe clearly: • The actions taken in response to each material issue; • How these will achieve the intended outcomes; • The KPI's which demonstrate performance, highlighting the connection with the strategic direction of the • The governance arrangements in place to incentivise and reward behaviour contributing to the delivery of intended outcomes.

6. THE INTEGRATED REPORT

Integrated reports convey information about the operations of the company and the associated social, environmental and governance issues pertinent to its business, as well as its financial results, in a holistic and integrated manner.

The Integrated Report will require a deeper strategic analysis compared to most of the current sustainability reports, to explain the relationship between the company's short and long term business goals and the environmental, social and corporative governance impacts.

6.1 One or two reports

A truly integrated report should reflect all of the material issues in a single report. However, as outlined in chapter 9 of the King III report, it can be presented in more than one document. Where this is done, however, the documents should be made available at the same time and disclosed as an integrated report. The practice of issuing a financial report in one volume and a sustainability report in a separate volume is not integrated reporting, even though it may provide stakeholders with important information.

As is implied by the title of this paper integrated reporting is a process which is more responsive to stakeholder needs than the annual production of a single report. It is recognised, however, that reporting is a resource intensive process and it can be expected that the transition to integrated reporting will not be achieved by most companies in a single step.

Regardless of the number or format of the reports, the information provided on the company's environmental, social and governance performance should be sufficient in relation to and integrated with the company's financial performance. Simply combining information into one document is not sufficient – integrated reporting will need to demonstrate the analysis of basic performance data across all areas into a meaningful view of the organisation's current performance and where its strategic intentions.

The report should ideally not be voluminous and it should focus on the most material issues. Further detailed performance data and additional material can be made available to stakeholders in additional documents or via websites. What is critical is that Integrated Report should in itself be a full and fair reflection of the key issues. However, it is important to note that until further changes in the Companies Act allow the publishing of summarised financial statements, companies will be required to fulfil their existing statutory financial reporting requirements.

6.2 Integrated reporting

The integrated reporting process should not only be focused on once-off annual disclosure, but on ongoing reporting and communication. It should be a part of a two-way communication process which engages stakeholders and is different in that it is the link to strategy and to issues which have often in the past been discounted as "non-financial issues".; Additional means of communicating, such as websites, focus groups and additional documents can be used to package the information for special target audiences.

6.3 Substance over form & reporting on the positive and negative

One of the challenges with an integrated report is that notwithstanding the progress that has been made regarding the standardisation of reporting, it is still a complex issue. Unlike financial reporting, where rules are reasonably clear about what should be reported and how, with integrated reporting, especially with regard to economic, environmental and social performance, the matter is much more complex.

Reporters therefore need to apply their minds to matters that are material and should be disclosed to stakeholders. The information provided in the integrated report, particularly on sustainability issues, should result in the inference that the company has a sustainable business.

The integrated report should provide sufficient information on the company's positive and negative impact on its material stakeholders in the past year and on how it plans to improve the positive impact and eliminate or reduce the negative impact in the following year.

6.4 Guidelines

The GRI G3 Guidelines is the current internationally accepted framework offering guidance for companies on the sustainability reporting process, including guidance in each step of the reporting process, with particular focus on materiality and the process of determining what is material. The GRI's framework offers guidance for beginners, as well as for experienced reporters. When starting to prepare an integrated report, this guidance can be very helpful. The GRI guidelines have also been formally adopted by the United Nations Environment Programme's finance initiative, the UN's Global Compact and as an effective means of reflecting progress against many other international initiatives, such as ISO 26,000 the new standard on corporate social responsibility.

The GRI Guidelines also describe principles for the reporting process, very similar to the ones presented in King III – materiality, completeness, timeliness, relevance, balance, accuracy, honesty, accessibility and comparability.

At the moment, the GRI is working with a large number of organizations to be able to offer even more specific guidance and metrics, that will assist in explaining the relationship between the company's short and long term business goals and environmental, social and corporate governance issues.

King III recommends using the Global Reporting Initiative's (GRI) G3 Guidelines and the JSE Socially Responsible Investment (SRI) Index criteria as a framework to achieve transparent disclosure of sustainability issues as envisaged by King III.

6.4.1 Recent developments

An International Integrated Reporting Committee (IIRC) was established in August 2010 to respond to the need for a concise, clear, comprehensive and comparable integrated reporting framework, structured around a company's strategic objectives, its governance and business model and integrating both material financial and non-financial information. At present a range of standard-setters and regulatory bodies are responsible for individual elements of reporting. No single body has the oversight or authority to bring together these different elements that are essential to the presentation of an integrated picture of an organization and the impact of environmental and social factors on its performance. In addition, globalisation means that an accounting and reporting framework needs to be developed on an international basis.

At present, there is a risk that,as individual regulators respond to the risks faced, multiple standards will emerge. The role of the IIRC is to raise awareness of this issue and develop a consensus among governments, listing authorities, business, investors, accounting bodies and standard setters for the best way to address it. The IIRC will also facilitate the development of an overarching integrated reporting framework setting out the scope of integrated reporting and its key components. (Press briefing by THE PRINCE'S ACCOUNTING FOR SUSTAINABILITY PROJECT, August 2010)

In South Africa, a local Integrated Reporting Committee and working group was similarly established with the same purpose but directed at the South African context. The hope is that at some future point the IRC and the IIRC will be able to align their outputs to meet the challenges around a uniform framework for sustainability reporting. The committees are multi-stakeholder in nature and include both financial and sustainability reporting experts.

6.5 Assurance – financial and sustainability information

An independent assurance process increases trust in the information and therefore the value of the report Assurance should cover all material issues, whether they are financial, environmental, social or governance issues and, both quantitative and qualitative in nature. The requirements for assurance over a company's financial reporting, has not changed.

Assurance assists in improving the robustness of internal systems, controls, and processes and hence ensures better quality information throughout the year to allow management to make informed and reliable decisions.

The board is responsible for the integrity, accuracy and completeness of the company's integrated report. King III recommends that the board should delegate the oversight of sustainability issues in the integrated report to the audit committee, which should ensure that the information is reliable and that no conflicts arise when integrated with the financial results.

The audit committee should seek external assurance of material data and should also evaluate the independence and credentials of the external assurance provider.

6.5.1 *Standards for assurance on financial information*

International Standards on Auditing (ISA) are the professional standards for the performance of financial audit of financial information. These standards are issued by International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB).

6.5.2 *Standards for assurance on sustainability information*

King III refers to AccountAbility's AA 1000 Assurance Standard (AA1000AS) and the International Auditing and Assurance Standards Board's International Standard on Assurance Engagements (ISAE 3000) in this regard. While AA1000AS usually aligns the assurance process to material concerns of stakeholders in terms of the report as a whole, ISAE 3000 concentrates on the accuracy and completeness of information through a process of verification of data, systems performance assessment and evaluating compliance within the company's defined scope. King III therefore recommends that:

- 'sustainability' assurance is an ongoing, integral part of the integrated reporting cycle; and
- ISAE3000 and AA1000AS methodologies are used in combination to ensure the needs of the stakeholders and those of the company are met in a single process.

To the extent that reports are subject to assurance, the name of the assurer should be clearly disclosed, together with the period under review, the scope of the assurance exercise, and the methodology adopted.

7. Conclusion

Reporting entities are at different levels of maturity in their reporting of sustainability issues. Some may have already begun the process of integrating strategy and governance with risks, opportunities while others are just at the start of this process. The scope, extent and format of financial reporting are well bedded down internationally but the same cannot always be said of sustainability reporting. International and local work on integrated reporting hopes to contribute significantly to the understanding and guidance in this regard.

At its very core, however, integrated reporting should be a reflection of a balanced and integrated approach to performance, strategy, governance and long-term viability as influenced by each company's unique circumstances.

Ultimately, the test of effective reporting is not only what is reported but how well stakeholders are able to understand the vision, strategy, risks and performance of the company and the broader impact of these leadership choices on society.

8. References

- *The 'King Report on Governance for South Africa', The Institute of Directors in Southern Africa, 2009 (King III).*
- *GRI G3 Guidelines – "GRI Sustainability reporting Guidelines",*
  The Global Reporting Initiative. For download at: www.globalreporting.org.
- *Accounting for Sustainability – Connected reporting, a practical guide with worked examples.*

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