

Just over a decade has passed since South African companies started to prepare integrated reports. This document outlines the benefits and drivers of better quality reporting. Impediments to high quality reporting are also covered.

# Integrated report quality

A review of South African-specific research

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## TABLE OF CONTENTS

1: DEFINING INTEGRATED REPORT QUALITY .....	2
2: DOES HIGH QUALITY REPORTING MATTER? .....	3
3: DRIVERS OF INTEGRATED REPORT QUALITY .....	4
4: IMPEDIMENTS TO HIGH QUALITY REPORTS.....	6
5: SUMMARY .....	7
CONTRIBUTIONS AND ACKNOWLEDGEMENTS.....	9
REFERENCES .....	10

## FACTORS ASSOCIATED WITH BETTER QUALITY INTEGRATED REPORTS

In 2011, South Africa released the world's first discussion paper outlining the nature and objectives of integrated reporting. Almost ten years since companies started preparing integrated reports, it is useful to reflect on the current state of South African integrated reporting and the factors associated with higher quality reports.

### 1: DEFINING INTEGRATED REPORT QUALITY

The *International <IR> Framework* (the IR Framework) does not define 'quality'. On the other hand, it details Fundamental Concepts, Guiding Principles and Content Elements which, when applied as part of an integrated thinking philosophy, result in:

'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 over the short-, medium- and long-term' [1].

Figure 1 summarises features of high quality reports based on technical reviews of South African integrated reports. A list of commonly used quality indicators from some of the academic research is also provided.

**Figure 1: Features and indicators of high quality integrated reports**

Quality features	Quality indicators
<ul style="list-style-type: none"> <li>• A complete and succinct explanation of the value creation process over the short-, medium- and long-term</li> <li>• Explanation of the relevance of different capitals</li> <li>• Coverage of the Content Elements in the context of the organisation's value creation process</li> <li>• Reporting on outputs and outcomes</li> <li>• An appropriate balance between positive and negative consequences of an organisation's business model on the capitals</li> <li>• An appropriate balance between historic and forward-looking information</li> <li>• Connectivity of information in a report, which provides a holistic and clear account of the value creation process</li> <li>• Stakeholder-centric reporting</li> <li>• Evidence of integrated reporting informed by integrated thinking</li> </ul>	<ul style="list-style-type: none"> <li>• Coverage or 'density' of disclosures</li> <li>• Content integration</li> <li>• Absence of repetition</li> <li>• Language and tone</li> <li>• Ease of interpretation (including conciseness)</li> <li>• Presentation of information (including use of graphs, tables and images)</li> <li>• Emphasis on policies and actions</li> <li>• Methods/processes for identifying and engaging with stakeholders</li> <li>• Number of stakeholders accessing and engaging with the company on its integrated reports</li> <li>• Balance between positive and negative information; forward-looking and historical information; narrative and qualitative disclosures</li> <li>• External assurance and other sources of internal assurance</li> <li>• Rankings in independent reviews/competitions</li> </ul>

(developed from sources [2-14])

## 2: DOES HIGH QUALITY REPORTING MATTER?

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South Africa has a mature capital market supported by sophisticated codes on corporate governance. It is regarded as a pioneer in integrated reporting [15, 16] and provides an excellent 'case study' for testing the benefits of this type of reporting.

Briefly, higher quality integrated reporting<sup>1</sup> is associated with:

- lower costs of capital, higher valuations, better forecast accuracy;
- improved investment and capital allocation efficiency;
- more sophisticated accounting systems, internal controls and reporting processes;
- a detailed understanding of value creation at the executive and managerial level;
- informed internal decision-making including evidence of reporting on value creation informing changes to strategy, risk mitigation and operating practices;
- pro-active engagement with social and environmental issues as part of a drive for sustainable development;
- a better understanding of the materiality of social and environmental issues for generating sustainable economic returns;
- comprehensive reporting to stakeholders which avoids empty rhetoric;
- reduced instances of impression management;
- greater stakeholder confidence in organisations and
- a sense of credibility, continuity and, ultimately, legitimacy.

(developed from sources [17-27])

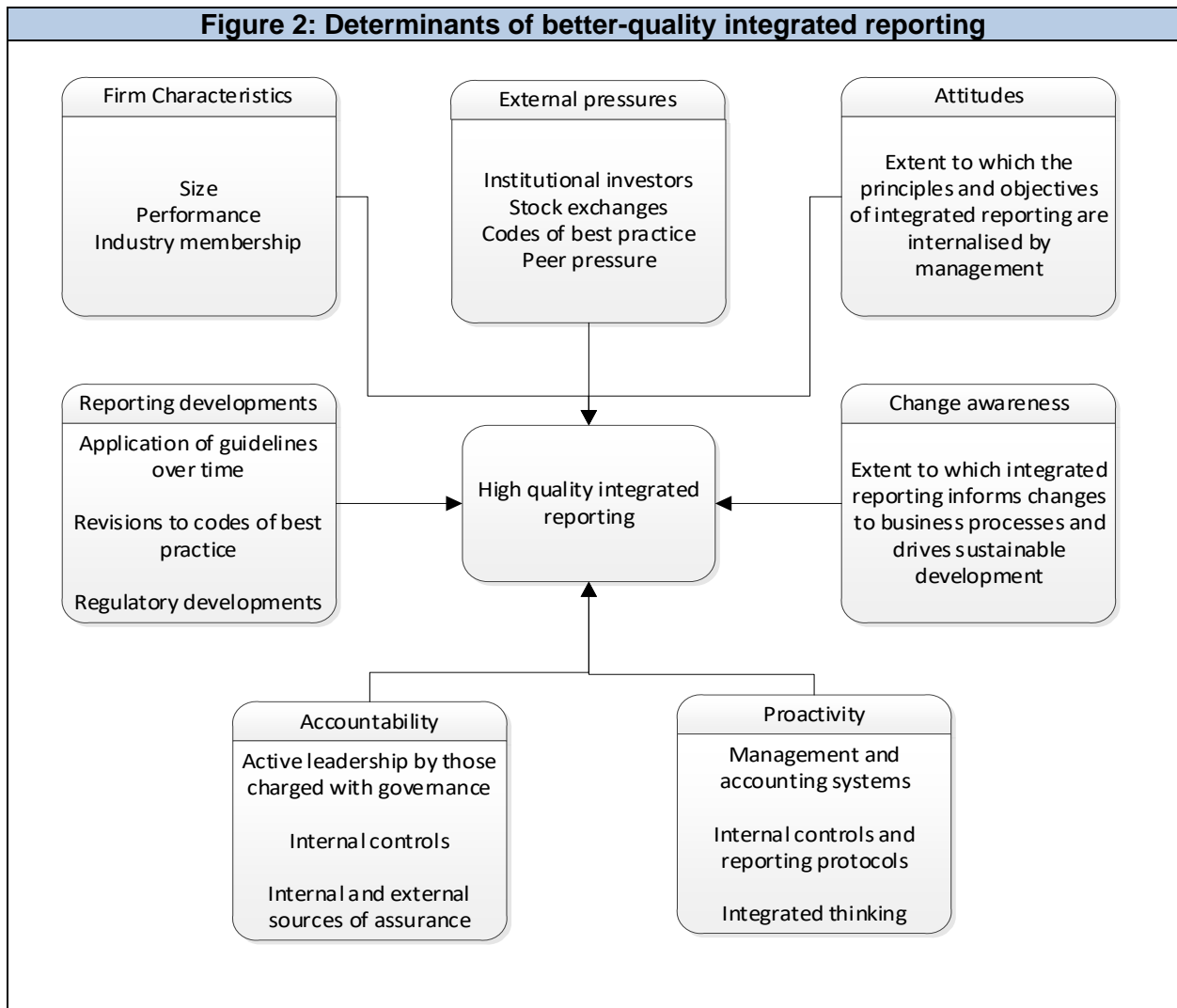
It is difficult to prove that integrated reporting results in the above in every instance. Integrated reporting is not without challenges [28] with some critics arguing that it does not do enough to promote a genuine commitment to long-term sustainability [29, 30]. It must also be pointed out that academic findings must be tested over time before definitive conclusions can be reached, especially when different studies do not reach consensus. Nevertheless, the academic research provides high, but not absolute, assurance on the benefits of integrated reporting. The research to date points to integrated reporting as more than simply an amalgamation of financial and so-called 'non-financial' disclosure. There is also some evidence that integrated reporting is having a positive impact on how companies manage and report on the six capitals used to create and sustain value and reduce negative outcomes of their business model for stakeholders. In this context, an integrated thinking approach may be beginning to take hold as part of the broader and more holistic business management and corporate governance environment [see 22, 31, 32].

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<sup>1</sup> A distinction can be drawn between the relevance of an integrated report itself and the underlying reporting and internal management processes. This report only provides a high level summary of the academic research and does not distinguish between integrated reports and the relevance of integrated thinking which informs the preparation of those reports.

### 3: DRIVERS OF INTEGRATED REPORT QUALITY

Possible drivers of higher quality integrated reports are summarised in Figure 2.



#### ***Firm characteristics***

Larger organisations and those with a material social and environmental impact are subject to greater scrutiny by, and have more information to report to, their stakeholders. As a result, they can be expected to prepare integrated reports which explain how the different capitals are being managed to generate sustainable returns [17, 33]. Companies may use their integrated reports to detract from the negative outcomes of their business model [28, 30, 34]. At the same time, companies which are committed to pro-actively managing economic, environmental and social capitals in the interest of sustainable performance will prepare integrated reports which reflect an integrated thinking philosophy [19, 35-37].

## ***External pressures***

In South Africa, integrated reporting is not mandated by statute. However, findings from an in-progress research project suggest that King-III, King-IV and the JSE's Listing Requirements have a positive influence on reporting practices. Whether intended or not, they have become institutionalised standards which define the minimum levels of expected reporting quality. Peer pressure, including the publication of integrated report awards and technical guidance by the Integrated Reporting Committee of South Africa, is an additional consideration [see 4, 14]. Some of South Africa's most prominent companies are investing in high quality integrated reports [4, 7] and set the minimum standards for integrated reports. The demand for better quality integrated reports from South African companies is also in line with a shift internationally towards integrated reporting and integrated thinking among leading multinational companies, as demonstrated from studies by KPMG and Black Sun, for example [38, 39]. As the responsible investment movement grows, external pressures to provide more relevant and reliable integrated reports will only grow.

## ***Attitudes and change potential***

Not all companies choose to prepare an integrated report and, when they do, there is no guarantee that the reports will be of high quality. In general, companies which have truly understood, internalized and embedded the importance of social and environmental metrics for their business models value creation and long-term sustainability prepare better quality reports.

Factors influencing the attitudes to integrated reporting and an awareness of its ability to inform how businesses are operated include:

- whether integrated reporting is imposed on an organisation by a limited number of individuals or develops 'organically';
- the level of support and strategic direction provided by those charged with an organisation's governance;
- external or internal 'shocks' which reveal weaknesses in the business model and highlight the need for action;
- the pressure to differentiate the organisation from its competitors;
- formal training in sustainability, integrated reporting and value creation;
- the extent to which innovation is encouraged and change is accepted as part of the organisation's broader management processes;
- affirmation of the benefits of integrated reporting from influential stakeholders;
- the embedding of material economic, social and environmental issues into the heart of the organisation's value creation model and
- an integrated approach at the centre of the organisation's systems of internal control, risk management and governance philosophy.

[19, 22, 28, 40, 41]

## ***Proactivity and accountability***

High quality reporting is only possible if organisations have clearly articulated policies for guiding how the IR Framework should be interpreted and applied and the processes and systems which

need to be put in place to ensure relevant and reliable reporting to stakeholders<sup>2</sup> [42]. As part of this, the 'accounting infrastructure' must be improved to collect and analyse different types of information which are material for managing and reporting on value creation. Charts of accounts must be supported by reporting policies which outline how the accounting system supports strategy development, risk assessment, core operations and stakeholder engagement [17, 33]. Well trained staff, including the use of external reporting experts, will also be essential for preparing high quality reports.

Clear lines of authority for the nature and extent of information collected and reported should be developed. Internal controls for ensuring the integrity of the data collected and used for management purposes or reporting to stakeholders are paramount. The governing body must play a proactive role in reviewing the integrated report disclosures, driving improvements to the report and ensuring that integrated reporting informs changes in how the organisation is managed [22]. A combined assurance model which optimises the use of internal and external sources of assurance can assist with improving internal controls, promoting accountability and ensuring relevant and reliable integrated reports [42-46].

The objective is for integrated reporting to be informed by integrated thinking defined by the IR Framework as:

'the active consideration by an organization of the relationships between its various operating and functional units and the capitals that the organization uses or affects. Integrated thinking leads to integrated decision-making and actions that consider the creation of value over the short, medium and long term' [1, p. 2].<sup>3</sup>

### ***Reporting developments***

The IR Framework is principles-based. How it is interpreted and applied by companies will change over time, leading to the development of uncodified rules of thumb and generally accepted practices. Integrated reporting and the IR Framework will continue to change<sup>4</sup> as codes on corporate governance are refined and new external regulations emerge.

## **4: IMPEDIMENTS TO HIGH QUALITY REPORTS**

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While South Africa has played a significant role in championing integrated reporting [16, 31] not all companies are investing in the preparation of high quality reports. The academic research identifies several impediments to integrated reporting in South Africa. These include:

- the imposition of integrated reporting on individual preparers by governing bodies leading to the legalistic or superficial application of the IR Framework;

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<sup>2</sup> As explained by the IRBA (2018), this will also be essential for any external assurance engagements performed on an organisation's integrated report.

<sup>3</sup> In this report, integrated thinking is included as part of proactivity because it informs the methods, systems and processes used to collect and analyse data for internal decision making and reporting to stakeholders. It may also be understood as an integral part of 'element' in Figure 2. In the interest of brevity, this is not shown.

<sup>4</sup> In early 2020, the IIRC initiated a call for comments on an update to the IR Framework.

- a continuing focus on market imperatives and short-term financial gains which result in social and environmental issues being framed as ancillary rather than as an integral part of how organisations should be managed;
- doubts about the relevance of integrated reporting, especially if institutional investors either disregard or are perceived to be disregarding integrated reports (however, research has asserted the decision usefulness of integrated reports to South African institutional investors [18, 20, 26]);
- limited examples of stakeholder activism when companies fail to prepare high quality reports and the difficulty of holding governing bodies responsible for the negative outcomes of an organization's business model and process;
- the difficulty of holding governing bodies responsible for integrated report quality allowing for the fact that integrated reporting does not enjoy the direct force of law;
- concerns that more detailed reporting will attract unwanted scrutiny;
- continuing uncertainty about what and how to report to stakeholders, including the practical difficulties of determining whether or not the information is material and how accounting and management systems need to be redesigned to support more holistic reporting;
- over-reliance on consultants which leads to integrated reporting being seen as something separate from the organisation's core activities;
- a lack of formal training, especially considering the ongoing emphasis on traditional finance and accounting by local accounting bodies;
- the ongoing use of integrated reporting as an impression management tool;
- the practical challenges encountered when trying to gauge the quality and impact of an organisation's integrated report
- the challenges of determining materiality of social and environmental matters;
- uncertainty about the systems, processes and controls which can be used to improve report quality including, for example, monitoring and review by those charged with governance, the use of internal auditors and the appointment of external assurance providers
- challenges faced by assurers when testing forward-looking, social and environmental disclosures

[7, 20, 25, 28, 34, 47-50]

## 5: SUMMARY

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There is no definite measure of integrated report quality or a single method for gauging how integrated reporting is changing over time. Features of high quality reports have been identified in technical reviews. They include, for example, the application of the Guiding Principles in the IR Framework and the way the Content Elements are presented in an integrated report [e.g. 7, 51]. The academic literature provides additional quality 'proxies', such as the readability of the reports, the level of detail being provided and evidence of impression management.

A consensus has not been reached but the research provides strong evidence in support of integrated reporting. In general, a commitment to high quality reporting is associated with improved financial value, lower levels of risk and better internal management and decision-making. More broadly, integrated reporting contributes to greater stakeholder confidence in organisations and a commitment to responsible corporate citizenship. This reinforces South Africa's legitimacy as a pioneer in good governance and value-adding corporate reporting. Perhaps most important is the mutually reinforcing relationship between integrated thinking and



reporting which results in improved communication to stakeholders *and* a more holistic approach to how businesses are managed.

Determinants of better quality reporting identified by academic research include:

- social and environmental impact and performance;
- external pressures exerted directly or indirectly by stakeholders;
- an organisation's attitude to and awareness of the need for a multi-capital approach to value creation;
- investments in the accounting infrastructure required to support high quality reporting and
- the functioning of effective combined assurance models.

South Africa's integrated reports have developed over the last ten years [4, 7, 16, 52]. Driven by a context-specific and principles-based framework, further developments can be expected as organisations respond to growing economic, environmental and social challenges which require innovative solutions and a genuine commitment to sustainable development.

Reflecting on the challenges arising from COVID-19 and the impact of the ongoing crisis on organisations in South Africa (and globally) integrated reporting presents an ideal opportunity for communicating interdependencies among the different capitals in a meaningful manner. When informed by integrated thinking, integrated reporting provides an approach to strategy development, risk management and value creation which embeds the complexity of interrelated social, environmental and economic factors which are becoming ever more important as the world grapples with climate change, overpopulation and emerging illnesses. Health and safety of employees, business continuity, ecological risk factors and biodiversity can all be assessed and reported using an integrated thinking and reporting approach [48, 49, 53, 54].

## CONTRIBUTIONS AND ACKNOWLEDGEMENTS

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