REPORTING BY THE ACCOUNTANTS TODAY EDITORIAL TEAM

INTERPRETING IR

At this early stage in the **INTEGRATED REPORTING (IR)** game, preparers and auditors are still figuring out the salient issues.

WHAT came through loud and clear at the recent CFO 2014 Dialogue - which included a panel session on 'Epitome of Integrated Reporting' - is that the still-nascent process of Integrated Reporting (IR) is provoking intense interest.

One point that earned consensus was that accountants and CFOs will be key players in driving IR, while IR will be a useful tool in painting the "big picture of business" that stakeholders demand today. The caveat is that the business-as-usual CFO who controls numbers and produces quality metrics must be able to morph into a strategist and integrated thinker. "CFOs must have a deep understanding of the business model, the business risks that go with it, and crucially, the bigger business picture, and be able to "connect the dots" across the business," said Charles Tilley, Chief Executive of CIMA,

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-Datuk Johan Idris, President of MIA.

at the conference which was jointly organised by the Malaysian Institute of Accountants (MIA) and the Chartered Institute of Management Accountants (CIMA). "They need to provide an understanding of how the different parts of the organisation come together to create value, and crucially, where the trade-offs are. Integrated reporting is a tool for this."

Meanwhile, as reporters of performance and accountability, "the accountancy profession has an extremely important role to play in reporting and assuring integrated reporting and information," said Datuk Johan Idris, President of MIA.

Professor Mervyn E. King, Chairman, International Integrated Reporting Council (IIRC) concurred with this and said that "the accounting profession has a critical role and moral duty" to capture value accurately and record the actual resources being used to arrive at a product or service. This will be the way to what he termed "sustainable capitalism."

"Things have changed. Value is now seen as the impact of how companies make money financially, socially and environmentally. Companies with negative impacts on environment and society could be destroying value, for example, when textile producers pollute the environment through their fabric dyeing process by not treating toxic chemicals before putting them down the waste."

"When you buy a hamburger, what are the costs that go into making that hamburger? It's subsidised by resources and society, and historic financial reporting doesn't tell the whole story," said King. The accounting profession has got to make corporate reporting relevant and not just focus on historic financial value.

Members of the panel: Charles Tilley, Dr. Noel Tagoe, Prof. Mervyn King, Dato' Mohammad Faiz & Ainol Yaacob

He remarked that limiting corporate disclosure to historic financial reporting is "not the way of the future. You might as well be driving a car with a rear view mirror but no windscreen."

WANTED: CLARITY, BALANCED REPORTING AND UNIFIED MESSAGES

The principles-driven framework of IR may make it difficult for companies which are used to compliance-driven reporting.

For IR to achieve its goals of promoting transparency and credibility through integrated thinking, businesses have to improve their ability to integrate information, as well as the quality and quantity of reporting and disclosure. "To be accountable, you have to be understandable. Current financial reports are very difficult to understand. IR can make reporting easier to understand by stakeholders," said King.

Importantly, since "people are the providers of capital, make sure that people understand the state of play in a company." But don't confuse transparency with telling all. "Being transparent does not mean being naked. You don't have to disclose confidential information. It means balanced reporting." said King.

Reporting should be balanced between the positive and negative, and avoid jargon and verbosity. "There is a natural inclination to highlight the positive and to downplay the negative. This is misinformation. Provide balanced information and use clear, concise and simple language to enable comprehension and informed decision-making," he continued.

It is also very important to ensure that messages are consistent and aligned across all channels and media,

ASSURANCE AND CREDIBILITY

As expected, there was keen interest in how the non-financial and narrative information of IR might be validated to improve credibility.

Faiz remarked that eventually, assurance standards will be created for IR because "we auditors love to apply standards. However, the flexibility and wide scope of IR makes it difficult to achieve the required level of comfort."

Rather than relying on external assurance, King advised preparers wanting to embark on IR to depend more on internal auditors. "Seek assurance on issues like sustainability and supply chains from internal auditors. Internal auditors are able to provide assurance on a range of issues, whereas the external auditor gives assurance according to the IAASB standards which are focused on financials. "

advised Dato' Mohammad Faiz Azmi, Chairman of MIA's Capital Market Advisory Committee and Executive Chairman, PwC Malaysia. "There has to be internal and external alignment. Typically, in companies, accountants control numbers while corporate communications produces annual reports and another group does the sustainability reports. How do you align these messages and ensure that the sustainability report doesn't contradict the financial reports, for example? Are you singing the same tune?"

Faiz also raised the issue of valuations for intangible assets, such as for talent and the quality of staff, and indicated that IR's narrative and non-financial reporting principles might be a means to recognise and communicate these values.

Explain these in clear and simple language so that the user can make an informed assessment of whether this organisation will sustain value creation in the short, medium and long term.

Panellists highlighted materiality, which is not just salient to IR but also to GRI G4 principles for sustainability reporting. "How do you decide what information is relevant out of all the data that you have?" asked King. "What is the process of thinking involved to arrive at that conclusion that certain information is material?"

King advised boards to invest more time into looking at detailed reports to identify the material issues, and analyse the significant impacts and outcomes of their organisation's products on the economy, society and the environment. "Explain these in clear and simple language so that the user can make an informed assessment of whether this organisation will sustain value creation in the short, medium and long term."

REGULATION HOT POTATO

While it was agreed that accountants and CFOs are the logical people to drive IR, other issues such as regulation were avidly discussed – and equally divisive. As expected, IR regulation was a hot potato. Regulators such as Bursa Malaysia and Securities Commission have previously indicated that IR will be encouraged but not made mandatory.

Taking the opposite view, Faiz said that, “We cannot rely on self-regulation and thus governments must come in to regulate and mandate IR.” As a precedent, Faiz cited local banks and their general reluctance to implement best practice Equator Principles for socially responsible lending, despite recording good performance. “If you want companies to buy into this, then you cannot run away from the role of government, because companies by their nature are very geared towards profit making.”

However, King is staunchly against regulation. “There is a huge traction and uptake in IR throughout the world. What terrifies me is that, as a result, regulators are becoming interested. There can be nothing worse than regulating IR where regulators will say: “You have to do it this way. We could then have a checklist approach. Rather a regulator says apply IR or explain why not.”

Instead, King believes that the responsible investment movement will drive demand for IR. As investors become more enlightened, they will measure corporate behaviour against investment criteria for ethical behaviour and social and environmental responsibility, using tools such as ESG (Environmental, Social and Governance) indices. “Financial trustees of investment and pension funds can deploy responsible investment criteria, which takes into account how companies deal with social and environmental issues, and these can extend all the way down into supply chain codes of conduct, for example.”

“This is much more effective than relying strictly on mandatory reporting,” King insisted. Asked about South Africa’s IR regime, King explained that public-listed companies are required to either apply or explain why they didn’t do an IR to the Johannesburg Stock Exchange.

At the end of the day, said King, “It makes good sense for hard-nosed capitalists to engage in integrated reporting because it will enable companies to borrow and attract capital more cheaply. It’s enlightened self-interest.” ■