BY MAJELLA GOMES

ASSESSING VALUE THROUGH IR

Is the move towards integrated reporting (IR) just an overload of compliance, or a revolutionary means of measuring and communicating value?

WILL thick annual reports finally become more user-friendly and transparent and fit-for-purpose with the trend towards integrated reporting (IR)? And will reporting companies be able to save more trees by producing thinner integrated reports ?

"Annual reports (ARs) tend to be focused on historical financial information, but things are changing," said Pauline Ho, Assurance Leader for PwC Malaysia. "In their present form, ARs are not very helpful to investors because the information is

not timely, nor articulates clearly how the company is achieving its strategies. Therefore there is a need for companies to supplement with other forms of communication."

Neither does historical financial information give an accurate representation of how valuable the business is, whereas using the IR framework will enable a company to communicate information consistently and provide an insight into the future prospects of the company, said Ho at the recent Public Practitioners Forum 2014 on the subject of Integrated Reporting – revealing hidden value or compliance overload?

Comparing IRs to ARs, she said that ARs tended to be prepared by pulling together information from various divisions resulting in information being "silo" in nature and not linked back to strategies, priorities and outcomes. "The IR Framework, on the other hand, which was launched in December 2013, established guiding principles and content elements that govern the overall content of an IR. It was also market-tested prior to launch," she explained.

Why does all this matter? It's a matter of outcomes. "A company which is sustainable, or wants to be, will need to create good outcomes for all its stakeholders," Ho said. And that means not just for its shareholders, employees and suppliers, but for the community it operates in as well.

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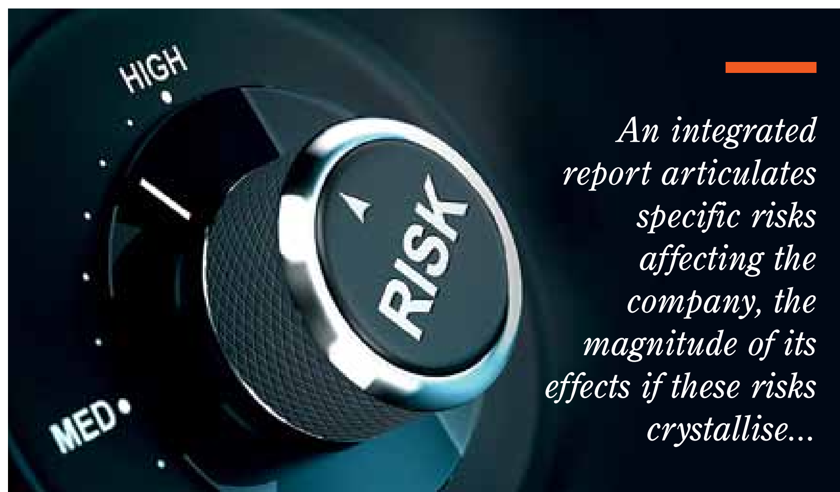
BEING COHESIVE AND CONCISE

It is also a question of stakeholders, not just shareholders – and the stakeholder voice is growing louder. Companies can be asked, publicly, if they have contributed to the degradation of the environment – and if they have, what they intend to do about it. This cannot be ignored, as it is directly connected to what the company hopes to achieve. "Very often, the traditional CEO's Report and the Chairman's Message do not necessarily link to the rest of the AR," Ho admitted. "IR brings together material information about a company's strategy, governance, performance and prospects in a way that reflects the commercial, social and environmental context that it operates in. It's a process that results in clear communication

of how a company creates value over time."

Increasing regulatory requirements have resulted in AR being more compliance oriented. "When IFRS (International Financial Reporting Standards) were first implemented, AR became a more extensive document," Ho said. "There is a lot of work involved, and costs of producing an AR have also increased in addition to cost of compliance. But one pilot company has shared that it was possible to reduce the number of pages of an AR through being more concise and covering only material information that is relevant to the stakeholders."

At this early stage, there is not much hard evidence linking IR clearly to increasing the valuation of companies. However, 98% of the companies in the International Integrated Reporting Council (IIRC) pilot programme which responded to a survey carried out by Black Sun in 2012 agreed that IR will lead to a better understanding of how the organisation creates value. 93% said it helps them to overcome "silos" within the organisations. As more in-depth information is gleaned from the various departments to produce the integrated report, a better collaborative relationship develops between the departments, leading to a greater understanding of their own business model and giving them the opportunity to focus on the right Key Performance Indicators (KPIs).



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CAPTURING RISKS

"The principal risks associated with achieving the company's goals usually do not appear in annual reports," remarked Ho. "There is a lack of communication on the future outlook of a company and how the risks affect the ability of the company to create long-term value. There is also no mention of the company's risk appetite. An integrated report articulates specific risks affecting the company, the magnitude of its effects if these risks crystallise,and steps taken to mitigate or manage these risks. Another area that is lacking is the description of a company's business model. What are the key resources and relationships that the company is dependent upon to create long-term value?"

One example of a good description of a business model, she added, was Coca Cola. The information was simply presented, and linked the inputs to the business, the various business processes, and outcomes to the various stakeholders. A survey of Malaysian companies revealed some telling surprises. "We benchmarked the annual reports of the Top 30 Bursa Malaysia companies, and found that while a high percentage (93%) described the process by which risks are identified, only 27% identified their principal risks," said Ho. "Similarly, while 90% discussed market trends, only about 20% linked their discussions to their strategic choices. About 43% made references to their business models, but only 7% linked their business models to value creation. Having said that, these companies have not adopted the IR framework and hence, it is like getting the results for an exam they did not sit for."

"Companies can no longer rely solely on their financial performance as an indicator of their overall performance," Ho said, adding that to start on the journey of preparing an IR, there are three main steps: defining value creation within the context of the company, deciding how to measure it, and making a plan and executing it. "Take-up of IR among Malaysian companies is currently low, and companies which embark on this journey will find that as they progress, they will need to refine or make changes to the way they communicate," she concluded. "But they will also see how using the IR framework allows a company to articulate very effectively the way the company can bring sustainable value creation to their stakeholders." ■