Discussion Forum
presented by
Standard Life and Standard Life Investments
in conjunction with the Royal Society of Edinburgh

Integrated Reporting: Benefit or Cost?

20 February 2013

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In the aftermath of the financial crisis, questions have been asked of current financial reporting. Advocates of integrated reporting (IR) believe it offers a better way forward by providing organisations with a concise means of explaining how their strategy, governance, performance and prospects combine to create value for investors. Critics fear it may simply become another administrative burden. The forum provided an opportunity for Scottish business to hear the arguments for IR and discuss its potential. The speakers were Paul Druckman, Chief Executive Officer, International Integrated Reporting Council (IIRC), Russell Picot, Group Chief Accounting Officer, HSBC plc and Jan Bebbington, Professor of Accounting and Sustainable Development, St Andrews Sustainability Institute, University of St Andrews. The session was chaired by Jackie Hunt, Chief Financial Officer at Standard Life.

Introducing the event, Ms Hunt said no one looking back to the start of the financial crisis could say that financial reporting had been effective. Today's financial reports are large, complex, technical, and mainly geared towards meeting compliance requirements. They have become less effective at communicating a broad picture of an organisation's long-term value.

From an investor's perspective, Ms Hunt said she was always keen to see better reporting. This allows investments to be made in a way that meets clients' objectives and that is both ethical and responsible. A personal concern is that investment decisions have become increasingly short-term.

What is needed is clear communication, greater transparency and a wider view of the value businesses bring to society. The question is how this can be done. Ms Hunt said: "How do we talk meaningfully, and not in a 'by the way' fashion, about what we contribute to the communities in which we operate, and more generally about what is our business model, how sustainable is it and are we still going to be here in another 100 years? The benefit from an investor perspective is clear – better information leads to better decision making and ultimately that will feed through into returns."

Companies are already producing huge amounts of detailed information on everything from financial performance to CSR. Ms Hunt said she was keen to hear ideas about "how do we move this debate forward but without just adding to the burden, size and complexity. How do we do this in a way that is meaningful as opposed to just becoming another framework, another compliance objective?"

Paul Druckman, CEO, IIRC
"If integrated reporting is just more reporting then we have failed, let's be clear from the outset that this is not the idea," said Mr Druckman.

Companies tell stories every day – and these stories affect investors, customers, suppliers, staff and many others. IR will allow companies to tell their story in a concise and effective way. IR will build on financial, sustainability and other reports to represent the strategy, governance, performance and prospects of a company within its full context. Mr Druckman said: "The goal is to give shareholders, and other stakeholders, a truer picture of how a company creates value over time."

The IIRC is working with 87 companies (including Microsoft, HSBC and Tata) in around two dozen countries on pilot projects. It also has an investor network. On April 16th it will launch a 90-day consultation on a new proposed IR framework which can be applied to business across the world.

Mr Druckman gave five reasons why business leaders and investors need to pay attention to IR:

1) Integrated reporting leads to integrated thinking: Smart boards fight silo thinking by encouraging staff to think about the connectivity of business strategy to the whole organisation. IR encourages managers to think in terms of the business as a whole.

2) Investors want better not more information: Companies do a lot of reporting. One problem for investors is that the reporting streams are not connected; another is that they tend to look backwards when the need is to look ahead. "With a sharper picture of both the risk and the opportunity, investors are more likely to provide capital with confidence."

3) Stakeholders are rarely silent: While economic power has become more concentrated in corporations, communications power has shifted to stakeholders. Strategic company leaders know that increased transparency means they must acknowledge problems and solutions in a clear context. IR makes this possible and potentially powerful in mitigating the risk.

4) Brands must be protected: Any company that loses control of its brand is at high risk and IR helps avoid this. Customers want authenticity and for products to genuinely reflect brand values. Confidence in a brand influences our decisions to buy products, believe company claims and make investments.

5) Integrated reporting needs integrated communication: There are few risks greater than losing touch with shareholders, customers or stakeholders. "That's when even a successful business finds itself vulnerable to disruptive innovation, reputational damage and lost value."

IR allows companies to show how all their capitals – financial, manufactured, social, intellectual and other – work combine to create value. The phrase used by the IIRC is "Better reporting for better business". As the momentum towards IR builds, businesses need to decide whether to lead or lag. Given the link between better reporting and greater resilience, Mr Druckman argued that it is best to be in the vanguard.

IR is for all stakeholders, but the investor or provider of financial capital is the primary audience. This reflects the realities of a world where the top 500 fund managers oversee US $42 trillion (with the top ten accounting for a third of this) and 79 of the top 144 economic entities are companies, not countries.

The IIRC is trying to drive the evolution of corporate reporting, and this is a process which is getting support from all across the globe, not just from businesses and investors but also from bodies such as the International Federation of Accountants.

Russell Picot, Group CAO, HSBC

As a preparer for a large international bank with a balance sheet of US $2.5 trillion, Mr Picot says HSBC is "steeped" in work to communicate with the market. Part of this is done through the annual report, which is an unwieldy and increasingly compliance-based document. The 2012 Annual Report and Account will run to over 500 pages.

Regulatory pressure has pushed up the amount of reporting required and many different bodies, such as stock exchanges, also require information. The effect has been to increase the burden on companies. "My team in London produces many checklists, I have a checklist of checklists to make sure I have completed all the checklists."

The HSBC Annual Report has a short statement at the beginning of each section which says what happened during the year, what the impact was, how it affected risk, and what the bank is doing about it. The aim is to be clear and simple. Some reports are not so helpful. Mr Picot said they "tell a story which is 'this just happened to be and management didn't do anything'."

Mr Picot envisages IR as a second report because so much would have to change to allow the annual report to be done differently. It could be a distillation of the content of other reports, with information about what makes the business model sustainable for the long term and how the various capitals at its disposal are used.

Mr Picot is optimistic about the prospects for the future and is proud that the UK is a leader in advancing IR. Voluntary private sector initiatives, such as the Enhanced Disclosure Task Force which has looked at how banks disclose risk, have demonstrated a desire and capacity for change without the need to wait for government action.

IR, which is strategic in its approach, would be a valuable counter to short-termism. It also resonates with the desire for investors to have better, not more reporting. IR drives boards to explain why they believe they will be around in the long term by making them discuss how they will deal with risk. Mr Picot cited the examples of breweries that faced water shortages and manufacturers who use precious metals of which there are finite supplies – investors need to know how the business will adapt. At present, such issues are rarely addressed in a consistent and coherent manner.

The outcome will be improved business practice. Mr Picot said: "There is no doubt that, when directors realise something is going to get published, they start to pay attention. I do think this will drive broader, more balanced discussion and will allow appropriate information to be given to the market."

Mr Picot concluded by saying that he hoped to see IR progress over the next couple of years and that the idea of a second report could point the way to the future.

Jan Bebbington, Professor of Accounting and Sustainable Development, St Andrews

Professor Bebbington offered a conceptual framework within which IR could be understood, stating that the debate over IR is not new, as arguments over the role of organisations within society are perennial. At their heart is often the issue of a social contract – that is, “what is the deal between organisations and society and how do we agree on the deal?”

“Any scandal you care to think of is usually about a social contract having fallen apart in some way, or having been misunderstood by relative parties.” Such arguments afflict everything from policing and healthcare to industrial issues.

Since 2008, one of the big debates has been over the kind of stability and probity that can be expected from banks.

Once the issue of responsibility is agreed, accountabilities and accounts come into play – and have to be fit for purpose. With small organisations, Professor Bebbington said that simple word of mouth can be highly effective in determining if they were responsible. For other bodies, such as large for profits, there is often the need to ascribe formal duties and to create formal accounts about what they have done.

In recent decades, there has been an insistence on accountability and responsibility in a growing number of areas, such as fair employment, economic stability and environmental integrity. Some of these aspects are discussed in separate arenas from financial reporting. Professor Bebbington said IR brings all these relevant aspects together in one place and puts a strong context around the various issues.

Effective accounting is valuable not just for the stakeholder or investor, but for the enterprise itself. Professor Bebbington argued that the relationship between the parties can be far more complex than just their formal contractual arrangements; there are implicit as well as explicit agreements. The latter can be subtle and subject to change – as many firms have discovered in the past.

Indeed, many organisations only find out they’ve got it wrong when it’s in the public domain ... sometimes the social contract changes without firms noticing.

IR provides a mechanism through which organisations can keep the more subtle and fragile aspects of their relationship with the world in view. In doing so, it not only highlights future prospects but can help to secure them.

Questions

● The panel was asked if those taking part in the pilot were from a wide range of industries. Mr Druckman said they had set out to get a broad range of sectors and geographies. The sector split was good; the geographic one took longer to develop.

● Asked if there were plans to educate the sell side as well as the buy side, Mr Druckman said there were and that this would be a major task. They would be working with auditors and many other specialist groups.

● The issue was raised about where the dividing line should be between state and self-regulation and whether the latter would really affect behaviour. Mr Picot said he thinks a code could work and be quicker than waiting for legal intervention. He cited the example of the UK Corporate Governance Code as an example of success. Underlying this may well be the implicit threat of regulation. Prof Bebbington added that many formal regulations are ignored and that sector standards and agreements can sometimes be more binding.

● Asked about the changes brought by IR, Mr Druckman said that organisations started looking at themselves in different ways and discovering new things. The feedback from the pilot projects showed that this is being valued and that companies themselves are becoming the strongest advocates of IR.

● The panel was challenged on whether they would be able to influence less regulated areas of industry. Prof Bebbington said those operating in the business-to-business world can be more difficult to influence than those with higher public visibility. One way to persuade them was through their supply chains – encouraging those who deal with them to apply pressure.

● Mr Druckman was asked how long he expected it to take before IR becomes the norm and how major banks will be brought on board. He responded that a significant number of companies round the world would be doing IR within three to five years. However, it is not just a question of numbers, as the point of IR is better, rather than more, reporting.

● A question was put about whether improved reporting would damage a company's competitive edge by giving away what made it successful. Mr Druckman said that he was recently in Japan, which has a strong tradition of confidentiality, but that business there fully recognises that society and investors want and need to know more. They also realised that transparency about business models attracts customers and investors.

The evening ended with a vote of thanks proposed by RSE President Sir John Arbuthnott.