INTEGRATED REPORTING: WHY, AND HOW, WE MUST EMBRACE IT

Stathis Gould, director of advocacy at the International Federation of Accountants (IFAC), explains why integrated reporting must serve as the foundational framework for global accounting rules that standardise and track ESG disclosures

Momentum has been growing recently for enhancing corporate reporting.

A 2019 McKinsey survey highlighted that 86% of corporations and 88% of investors favour a single or, at the very least, fewer standards for sustainability reporting. The complexity caused by different jurisdictional requirements for corporate reporting, along with the absence of widely agreed standards beyond financial reporting, is doing a significant disservice to the global economy.

To reduce costs to business and better position investors and asset managers to allocate capital toward long-term value creation, there is a strong need for both a standardised approach to reporting on non-financial information, and integrated reporting principles. The development of global standards will enhance the quality of reporting and support robust assurance practices, particularly because assurance is most effective when applied against metrics and disclosures that follow clear best practices.

The standard-setting activities of organisations such as the Sustainability Accounting Standards Board and Global Reporting Initiative, along with more recent initiatives, including from the World Economic Forum, provide the building blocks for delivering comparable, consistent, and reliable environmental, social and governance (ESG) and sustainability data needed by investors and other stakeholders.

The reality, however, is that external reporting alone does not necessarily lead to a change in corporate behaviour. The International Integrated Reporting Framework provides the strategic context and framework for global efforts to develop standards, and ensures alignment between internal thinking and external reporting.

The Integrated Reporting Framework's comprehensive focus on value creation is the foundation for understanding and reporting on multi-faceted drivers based on both financial and non-financial information – and showing the connections between them.

The framework's long-term and forward-looking focus provides investors and others a clear view on purpose, governance, strategy and plans, risks and opportunities, capital resources and relationships, and business models. This approach enables companies to understand and communicate what is driving value creation over time, their prospects for resilience, and their contribution to more sustainable outcomes for business and society.

Stathis Gould, IFAC

Importantly, integrated reporting embeds integrated management thinking in organisations, enabling better decision-making based on interconnected and multi-capital information. This provides clarity on factors that materially affect future cashflows and, therefore, market and intrinsic value, as well as understanding what supports a positive reputation and licence to operate.

ESG FACTORS

At the same time, ESG factors are increasingly important to companies, investors and asset managers in evaluating corporate responsibility. These factors are undoubtedly financially material over time, and need to be incorporated as key value drivers.

In an integrated reporting approach, ESG factors are a critical component of value creation. ESG performance can increase or decrease the expected value of a company's tangible and intangible assets, and lead to positive or negative societal impacts. For example, responsible products can drive revenue; efficient and low-carbon production and processes reduce operating costs; investments in people, talent and diversity improve productivity and innovation; and socially acceptable practices in the supply chain and among communities ensure the business's licence to operate. All these factors enhance brand value and reputation.

Value creation and ESG metrics typically track the entity's performance in terms of gains and losses to value creation rather than broader organisational impacts. Bridging value creation and impacts is an important step for companies in their efforts to optimise value creation and manage trade-offs between the interests of stakeholders and between short and long-term consequences of any decision. It also involves the measurement and valuation of impacts – the monetisation of non-financial information.

Impact accounting is a rapidly evolving area. An increasing number of companies are using impact measurement to help steer their businesses toward value creation, and to communicate to investors and stakeholders as part of their integrated reporting.

Integrated reporting ultimately helps businesses understand and account for their value creation and impacts on society. IFAC's guidance on the role of the CFO and finance function in value creation considers how the finance function can work to track and measure three value perspectives – book, business, and societal value – that reflect current and future value models.

These perspectives incorporate financial and non-financial value drivers, including intangible assets, which are now responsible for over 80% of all business value. All three value perspectives must be integrated into the performance management and external reporting of a business.

By providing relevant insights on all material aspects of value creation, CFOs and their teams can help shift the corporate mindset from short-term shareholder value creation to long-term stakeholder value creation and protection. Through integrated reporting, they can better deliver these insights to boards, CEOs, managers, investors and others – preparing their organisations for long-term success in the process. ■