COMMITTING SOUTH AFRICA TO INTEGRATED REPORTING
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Talk for the KZN Institute of Internal Auditors South Africa (‘IIASA’)
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Good morning ladies and gentlemen

May I begin by thanking Jeanette Englund, and the Institute of Internal Auditors South Africa (KZN Branch) for inviting me to your Regional Conference.
For some of you who know me, it’s seldom that I will miss an opportunity to visit my hometown where the sharks rule!
My topic, ***COMMITTING SOUTH AFRICA TO INTEGRATED REPORTING*** will essential deal with 6 key areas; namely;

1. Brief history on an Integrated Report, what it is and then what’s the difference between an Integrated Report and Integrated Reporting?
2. Why is it so important and who should report?
3. What content makes for a good Integrated Report?
4. Since its inception, has Integrated Reporting in South Africa been successful?
5. Is enough being done?
6. If business is expected to report, should the same apply to Government?

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1. Brief history on an Integrated Report, what it is and then what’s the difference between an Integrated Report and Integrated Reporting?

Brief history on the Integrated Report

Although one cannot be entirely sure of the origins of business reporting perse, what we do know is that during the 19th century, business regulation in the United Kingdom became a huge focus and many business owners were forced to turn to professional ‘accountants’. In 1844 the first British Companies Act was passed, requiring auditors to examine the accounts of all public companies.

By 1862, an updated British Companies Act was passed which required banks to be audited.

By 1925, the American company and accounting laws and regulations had also increased, but it was not until after the Stock Market Crash in 1929 -- which led to the Great Depression and affected economies worldwide -- that financial reporting became mandatory for listed companies in America. As a result of the Stock Market Crash in 1929, the US Congress enacted the Securities Act of 1933 which required listed companies to file financial reports. Following the Stock Market crash, financial accounting and reporting gained momentum as various countries imposed stricter regulations on organisations.

By the 1970’s, the term Corporate Social Responsibility (CSR) began appearing in reports -- often in the form of advertisements and small sections in annual reports – and in many cases this was done in an attempt for organisations to regain popularity after they had suffered some form of reputational damage. Expectedly, these reports were largely unverified and disconnected from the organisations’ corporate performance.

During the 1980s, CSR lost momentum until 1989 when an American company hired a ‘social auditor’ as part of their yearly audit. Since then, social accounting gained momentum worldwide as environmental and social issues gained public interest. As CSR grew in importance, the need for organisations to demonstrate a correlation between their Annual Financial & their CSR reports increased.

So ladies and gentlemen, after some pretty disastrous events circa 150 years ago, there have been significant developments and expectations in company reporting. In the greater scheme of things; these events were most likely the main catalyst for company reporting, and what we now call Integrated Reporting.

So what exactly is an Integrated Report?

Integrated Reporting is a relatively new phenomenon in the world of corporate reporting and it has gained traction across both the corporate and investor community in the last ten years.
For all intent and purpose, an Integrated Report should be a single report which is the organisation's primary report for reporting to the organisation's stakeholders matters which pertain the organisation's strategy, governance and financial performance, including the social, environmental and economic context within which it operates. Interestingly, in some jurisdictions there is a distinction regarding who the readers of the Integrated Report should be?

In respect of those countries who follow the principles of King III strictly, the Integrated Report would be prepared for the organisation's stakeholders (this means shareholders and other stakeholders).
But in other jurisdictions, the target audience is only the shareholder and this is to the exclusion of the organisation's extended stakeholders and supply chain. Indeed, in South Africa there is no hard and fast rule that the Integrated Report should be a single report; in most cases the Integrated Report is in fact a separate report which is complimented by the organisation's set of annual reports.

In the PwC's latest survey of JSE Top 40 Companies' Integrated Reports 2014; only 15% of South African companies have a single Integrated Report.

The remaining companies all offer a 'suite' of multiple reports. Of course it may be argued that singular reports -- assuming they provide the necessary and sufficient information -- make it far easier for any stakeholder to get easier, more rapid access to an organisation's IR information as compared to those who don't offer a single report.

To this point, making this information available via the organisation's website, makes potential investor's investment decisions much easier and hopefully faster too.
In most cases, the Integrated Report is produced once a year. Whilst this report is generally compiled by the company secretariat -- and even sometimes outsourced to a PR agency -- it is strongly advised that in producing this report, all key players of the organisation should be involved in its compilation.

So often this report is simply seen as an irritation and it is passed off to a junior person in the organisation who simply does not understand the critical role this report can play in the promotion of the organisation's activities.
Used correctly, this report has as much meaning to a potential investor, as what it does for any other stakeholder such as an employee or supplier.

Get the contents wrong, and the organisation can get into deep trouble with shareholders, the media, activists and even the various regulatory bodies who use the information, or lack of information, as a tool for further interrogation.

Each element of an Integrated Report should provide insights into an organisation's current and future performance. Indeed, the report must show proper and applied integrated thinking; rather than some slap-dash approach of useless, or even worse, false information.

How does the Integrated Report fit into Integrated Reporting?

By addressing the material issues for an organisation, an Integrated Report should demonstrate in a clear and concise manner an organisation's ability to create and sustain value in the short, medium and longer term.
Integrated Reporting demonstrates the linkages between an organisation's strategy, governance and financial performance and the social, environmental and economic context within which it operates.
Used correctly, the report is not seen as a 'static' document which is parked on a coffee table or posted annually on the website to comply with a 'tick-box'.

This report must be a 'living' document, accessible to all employees and people with a vested interest in the organisation. Besides the usual suspects from the board and shareholders, HR, marketing and all senior management must be 100% familiar and comfortable to use and refer to this report.
By reinforcing these connections, Integrated Reporting can help organisations to take more sustainable decisions and enable investors and other stakeholders to understand how an organisation is really performing.

2. Why is it so important and who should report?

Integrated Reports and Reporting are progressively receiving attention both locally and internationally.
The need for IR stems from a number of important factors, these include;

- the need for transparency and disclosure pertaining all issues that affect the organisation's sustainability
- stakeholder's growing concerns regarding the use of natural resources
- instability of the global economic crises
- ethical leadership and practices at personal and organisational levels
- early warning risk detection or strategy failure
- increased fraud and corruption
- issues of dwindling natural resources and environmental protection
- changing social values

These and other corporate governance factors, influence the on-going sustainability of organisations and play a vital role in the organisation's overall strategy and that of its stakeholder's.
By providing the organisation's stakeholders a clear picture of its existing position and intended future, all the organisation's stakeholder's legitimate needs, interests, concerns and expectations can be effectively managed over the short-to-long terms. Expectedly, this provides stakeholder assurance with the many benefits that usually follow. Of course, when there is 'harmony' amongst all the stakeholders which has been done through design, the organisation's ability to perform optimally, with the support of all the stakeholders, becomes much easier.

Current reporting methods which are not IR orientated have been found to be inadequate and have not provided more forward thinking stakeholders with sufficient information (neither confidence) to make fully informed decisions regarding the organisation. To this point, merely reporting on financial matters only, only gives a one-sided perspective of the organisation. Through IR, organisations must demonstrate to stakeholders that their business is sustainable, both now and in the future, and that it is prepared for the various challenges it will face (both financial & non-financial).

Increasingly, organisations are being held accountable by stakeholders for their impact in many different areas that were considered 'immaterial' in the past. They are expected to be environmentally responsible, actively demonstrating the measures taken to minimise the organisation's impact on the environment.
They are also expected to contribute socially and economically, participating in wealth creation, distribution and in skills development. Integrated Reporting allows organisations to reassess numerous aspects of the business and to steadily grow stakeholder confidence by demonstrating the organisation's strategy for those aspects.

Who should report?

From a South African perspective, only JSE-listed companies are expected to produce an Integrated Report. However, besides the JSE-listed companies, government and state-owned companies, including all private companies with a PIS of 500 or more points should also be required to produce an Integrated Report. Similar to organisations having to produce annual tax clearance certificates for procurement purposes, all organisations for profit or otherwise should be compelled to produce such a report. Of course, the levels of reporting will be different between larger vs. smaller organisations, but the principles of reporting should be exactly the same. That being said, it is my humble submission that all non-profit companies (old S21 companies) should be subjected to the same conditions of reporting. Why should they be treated any differently?

Let's agree that sound governance within an organisation is key to creating and sustaining value. Organisations that establish principles of accountability, transparency and ethical business values, will understand the reasons and benefits of using an Integrated Report to communicate their governance principles and their business practices to their stakeholders. Those who fail to provide such information to their stakeholders will -- over time -- feel the affects of an uneasy, unassured stakeholder. It's worth bearing in mind that one of the International Integrated Reporting Council's (IIRC) principle roles is to get consensus amongst governments, listing authorities, business, investors, accounting bodies and standard setters to align the thinking for this new way of integrated organisational reporting. Organisations who retard their actions, or offer untruthful information, or avoid its intended stakeholder benefits, are simply delaying their future demise.

3. What content makes for a good Integrated Report?

It is imperative that organisations fully understand the appropriate classifications of marking documents. For example, in any organisation what is meant by a RESTRICTED, or a CLASSIFIED, or a CONFIDENTIAL document? Have organisations actually informed their employees of these differences and more importantly, when to apply these classifications? That having been said, what about the use of SECRET, or worse…TOP SECRET?

So where is this leading to? I will pick up on in a moment. But back to the matter of the contents which should be found in a good Integrated Report. Some of the better -- award winning -- reports include clearly articulated, material information which covers inter alia, the organisation's:

- current leadership structure
- current & future business overview
- processes to make strategic decisions
- leadership & business performance
- synopsis of the external environment
- forward looking strategy & resource allocation
- attitude towards risks & opportunities
- governance matters, also mechanisms for addressing integrity and ethical issues
- how remuneration and incentives are linkled to value creation
- stakeholder engagement & relations
- corporate social investment
- environmental & sustainability matters

If Integrated Reporting is about being open and honest, as well as providing accurate information to assist stakeholders to inform themselves; how is it then possible that some organisations mark these documents with various forms of restricted, and sometimes confidential classifications?

In a recent case, I read a completely low key -- fully completed government document -- where senior government officials were talking about public domain information under the auspices of a TOP SECRET document. The point of this illustration is that we need to know and understand <u>what is</u>, and <u>what is not restricted</u>; and then we also need to know what we <u>must</u> be telling the public as opposed to what we <u>should</u> or <u>should not</u> be telling the public.

Indeed, let's also understand there's a fine line in respect of giving away competitive edge for the advantage of others. Clearly, in the Integrated Report, the reporting organisation needs to be judicious in the manner of its competitive positioning, and telling the stakeholders what is actually going on and what to expect from the organisation is an important matter. Then as a final point under this section, organisations who claim their 'decent corporate citizenry' must align their daily behaviour with the contents found within their Integrated Report.

Far too often one sees and hears about the poor governance practices in the media of an organisation, yet the same organisations produce these puffered, expensive glossy reports claiming their fantastic work to improved organisational and stakeholder-value performance. Of course what really needs to happen is a thorough audit needs to be done on each Integrated Report so as to provide the necessary assurances that the information provided in the Integrated Report can be wholly relied upon. In the last few weeks, I recall two incidences with local retailers….

In the one case, the retailer has allegedly not been as honest about their products as the public may have expected. In an open letter written to the CEO of this retail group, the consumer action group believes with good reason that the retailer has mislead the public in respect of the retailer's product labelling.
In this case, the retailer claims a unique 'ethical high ground' with its 'world of difference' slogans which have allegedly increased sales, the retailer's products stand accused of not being able to stand up to scrutiny. This retailer has been criticised previously for the sale of GMO 'Frankenfoods'.

In another case, a family food retailer has associated its brand with a liquor outlet. Whilst the retailer's slogan appeals to their products "being good for you", its liquor outlet who use the same brand imaging advertise single bottles of whiskey at R85,499.00.
Besides the misalignment of the marketing messages in both the cases, one does need to question the following matters:

1. does the daily business practice of the organisation actually align with the message contained in the Integrated Reports?
2. does the Integrated Report marry the organisation's ethical values with the contents of reporting?
3. is there proper management and assurance checks -- from the board and to each (store)manager -- to ensure that management are behaving in such a manner which lives the organisation's values so that this behaviour can knowingly be reported in the Integrated Report?
4. does the reporting instil trust and credibility?

Indeed, perhaps these are isolated cases and such where arguably the one hand did not know of what the other was doing? That being said and notwithstanding, as Warren Buffet said it takes a lifetime to build a brand, but one incident to destroy it.

Following the illustration of these two examples, it also goes to show how important it is for organisations to inform all their employees of the importance of aligning values with practices.

Expectedly, if the Integrated Report is seen as yet another 'necessary evil' which lands on some person's task of duties – with no integrated thinking and collective organisational involvement – the contents presented in the Integrated Report may in fact be far from the real situation at the ground level. In governance and legal terms, such a situation may in fact be construed as reckless behaviour.
Of course, if the intention on the part of an organisation is intentionally meant to mislead, then this is tantamount to fraud, or fronting as it were.

4. Since its inception, has Integrated Reporting been successful?

According to the comments by the UN Conference on Trade and Development (UNCTAD), including the B20 and G20 countries, there is positive progress and Integrated Reporting is gaining traction.
Although Integrated Reporting has the potential to fundamentally change corporate reporting, we still know relatively little about its causes and consequences. Proponents of Integrated Reporting argue that the attraction of long-term investors is a benefit of adopting Integrated Reporting.
While anecdotal evidence has suggested the presence of a link, no empirical evidence to date has been provided to establish such a relation. Specifically analysing data of a recent pilot programme conducted internationally by Harvard Business School on more than 1,000 firms between 2002 and 2010, it was found that firms practicing Integrated Reporting generally have a more long-term investor base and fewer short-lived investors.

In addition, the pilot also revealed that changes in Integrated Reporting led to changes in the organisation's investor base, whilst changes in the investor base did not necessarily lead changes in Integrated Reporting.
In South Africa, according to PwC's latest survey of JSE Top 40 Companies' Integrated Reports 2014, they made some of the following findings. SA companies who provide Integrated Reports:

1. showed a strong focus on strategy and resource allocation
2. but, contrary to point one, companies were reluctant to incorporate any detailed perspective on the future of their markets, and how they planned to operate therein with no or little insight provided into the market drivers

3. whilst there appeared at first to be an improvement in the integration of diverse information, in reality the links between the annual report and the narrative report -- as documented in the IR – showed clear signs of disjointedness
4. showed great efforts to reporting on stakeholder engagement processes, denoting the importance to improve damaged relations with employees, labour unions and civil society
5. whilst only 46% of companies described their customer base, even fewer (20%) provided information on their competitive landscape
6. as some further general comments whilst all the reporting areas should significant room for improved reporting;
    - there was a decline in the effectiveness of risks & opportunities reporting from 2013 (32%)-2014 (26%)
    - there is a clear area for further developing governance reporting which dropped from 2013 (39%)-2014 (28%)
7. but of more concern, is that very few companies (18%) clearly linked governance to the rest of the Integrated Report
    - many companies clearly described their company culture and values and how these drive governance and the tone from the top.

As a brief comment, even though IR may be in its early stages of development in SA, it does seem that – even though IR is mandatory for JSE listed companies -- many companies only provide brief information to comply with the minimum of reporting.

This trend will have consequences upon these companies practicing the minimalistic approach, particularly as foreign investors compare IR reporting of foreign companies against those in SA and find those in SA of a sub-standard reporting nature.

As is evident by the fact that only 8% of companies were willing to clearly distinguish their short term, medium term and long-term priorities; I am most certain this would have a dampening effect upon potential investors who may be doing high-level 'window shopping.'

5. Is enough being done?

In my humble opinion, a lot more should be done by all companies with a PIS of 500. This should not just be for listed companies. As we know, the Integrated Reporting Council (IIRC) has released the IR Framework in December 2013 and this framework provides a clear set of guidelines to assist organisations to report on a basis such where investors – amongst other – now have a reasonable way to assess the performance of organisations on a reasonably comparative and fair basis.

The practice note issued by the IoDSA in June this year provides further detail providing the WHAT & HOW answers to Integrated Reporting.

Considering the fact that the values of people and generations has changed to the extent that it has, and if organisations persist on behaving with a singular dogmatic attitude that profit will be made at the expense of other capital such as Human and Environmental Capital; then these organisations will be taken to task by a need breed of activist informed investor and similar stakeholder groups.

In my mind, IR is a perfect platform that allows all stakeholders to – for the first time – have the opportunity to have good, clear view on what the organisation says it stands for, what it says it will do, how it will do it and the impact it will have on the environment, people and our planet.

Through this knowledge, stakeholders can have a clear consciousness regarding the reasons it supports or doesn't support an organisation. Those organisations who are out of kilter with the new stakeholder expectations and demands will need to shape up or ship out.
This is – in the new age where consumers have been given extraordinary powers to act against unscrupulous operators - long overdue.

6. If business is expected to report, should the same apply to Government?

As government departments are expected to apply the King III code, in my mind there's no reason why we should not fully expect all government and municipal departments and state owned companies to report on exactly the same principles as we expect from JSE-listed companies, including all other privately owned companies whose PIS scores exceed 500 points on an annual basis.
As directors are increasingly being measured regarding the risk management and performance of business, it is my belief that the IR will become an even more important document for which activists and informed shareholders must be equipped. Indeed, risk must be managed in order for an organisation to make profit.
That being said, the same principles would apply to a government department, albeit that the latter may not be measured by profit making, but rather prudent spending. There is no reason why directors and boards should be treated any differently.

If municipalities were mandated to produce a proper IR and on the same basis as a listed company, the IR would not only serve to spot and remedy matters as may be appropriate, it would also allow citizens an opportunity to make informed decisions as to which municipal areas to support and which ones to avoid. This is surely part and parcel of one's democratic right as espoused under the freedom of speech and movement.
Whilst on the note of government and municipalities providing some form of IR, let us not forget about the Batho Pele Principles which have a remarkable resemblance – perhaps with an extra dose of imagination – to the IR principles. The main sections the Batho Pele Principles cover are:

The Batho Pele principles are as follows:

1. Consultation
2. Setting service standards
3. Increasing access to information and services empowers citizens
4. Ensuring courtesy from our government and municipal departments
5. Providing information
6. Openness and transparency
7. Redress
8. Value for money

Of course considering these Batho Pele principles, the SA Governments IR might then include topics such as:

- SA's leadership
- political instability
- governance
- corruption in government: circa 20-25% of state procurement, representing approximately R180bn is lost each year due to corruption
- a largely divided and unequal society
- crime
- education
- inadequate and poorly located infrastructure
- ailing public health system
- poor performance of the failing public service
- ailing economy
- unemployment
- industrial strikes and rolling mass action
- South Africa's growth path
- overly prescriptive regulation & lack of skilled workforce
- electricity supply and disruptions

Given the challenges in SA companies as well as our government….

“As Mark Goyder, founder of Tomorrow’s Company, advises, ‘Don’t claim to be perfect. Tell it like it is. Warn that there aren’t easy choices. Invite the [reader] into the dilemma’.

The audit committee should play a key role in assuring the integrity of the company’s report and should specifically evaluate the significant judgments and reporting decisions made by management which affect the integrated report.”

Thank you ladies and gentlemen for your attention.

ENDS

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