

# The Business Case for Integrated Reporting

By Michael Bray, KPMG in Australia



**Fundamentally, Integrated Reporting is about improving the basis of capital allocation.** The aim of the game is business communication for capital reward. Integrated Reporting will enable the capital markets to better understand a company's strategy, align their models with business performance, and make efficient and forward-looking investment and other key decisions.

Institutional investors, fund managers, analysts, and other capital markets participants who underpin their investment decisions with detailed modelling are also becoming actively involved in the journey to Integrated Reporting. Legislators and regulators, business commentators, investor associations and other stakeholders influencing business reputations and licences to operate are also increasingly interested and involved.

To 'feed' their models and decision-making processes, the markets for the six capitals need the right information to be delivered in the right format at the right time and with content that the markets believe in. Ultimately the aim of Integrated Reporting is about credible communication for capital. It is that simple – and that complex.

#### The six capitals\*

- Financial capital
- Manufactured capital
- Human capital
- Intellectual capital
- Natural capital
- Social capital

#### Our firms' clients and the capital markets have become frustrated with corporate reporting for a variety of reasons:

- The key features of financial performance are often buried in voluminous financial statements. As a result a number of 'workarounds' have emerged, including alternative financial performance measures such as 'underlying profit', and new financial reports such as 'summary financial reports'
- Annual reports containing audited financial statements have become divorced from the time horizon and information requirements of capital markets
- Sustainability reports seldom demonstrate the part that Corporate Responsibility performance plays in the business strategy and value creation, and are often not designed with the capital markets in mind
- The narrative reporting lacks a common framework and so there is little consistency between businesses. The capital markets must compensate for this lack of consistency as

\*The six capitals are explained in the IIRC's Integrated Reporting Discussion Paper 'Towards Integrated Reporting - Communicating Value in the 21st Century'.

best they can, but in doing so the risk remains that the real story of business performance and prospects may not be fully understood.

- Directors are concerned by the need to make continuous disclosures such as profit guidance outside of their 'normal' reporting and assurance processes.

These factors do not make for precise financial modelling and analysis and efficient capital allocation decisions.

Modelling and decision-making becomes weighed down by extrapolation and assumption, makes greater allowance for uncertainty than is necessary and embraces more 'short-termism' than would be the case if all businesses communicated their story to the markets for capital in a consistent manner.

#### The potential benefits of Better Business Reporting

The journey to Better Business Reporting, culminating in an Integrated Report prepared under the IIRC's Integrated Reporting Framework, should be of particular interest to CEOs, CFOs and directors as they face the challenge of convincingly telling their organization's 'story' to the markets so they can obtain capital at a reasonable cost.

The benefits of improved business reporting through Integrated Reporting include more efficient capital allocation, streamlined reporting processes, reduced reporting costs and enhanced organizational clarity in terms of business strategy and the business model.

Early movers on Integrated Reporting concepts are already describing the benefits that they see from better business reporting. They talk of the improved organizational clarity that comes from articulating the business strategy and business model, given that reporting on these matters lies at the heart of better business reporting. They also talk about the business process improvement that comes from consolidating multiple reporting processes for generating different reports into one reporting process for producing all reports, and the significant cost reduction which results.

It is too early to expect empirical evidence about the effects of Integrated Reporting on the cost of capital as the Integrated

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Reporting Framework is yet to be fully implemented. So while it is too soon for anyone to report the 'right-sizing' of their cost of capital through Integrated Reporting, early adopters note positive comments from their investors and they expect their cost of capital will more closely mirror their strategy, performance and prospects over time.

From the decision-making end of the capital markets reporting supply chain, a number of analysts have noted that they need different information from that contained in today's quantitative and narrative reporting to do their work effectively. They note that the Integrated Reporting Framework, being focused on reporting the strategy, performance, and insights into past performance and performance prospects, will let them improve their models and analytical capability.

#### **Enhancing financial reporting as part of the journey**

Businesses can take immediate steps to begin realizing these potential benefits by making business reporting-based improvements to their existing reports and evolving to a more comprehensive reporting strategy over time:

- Enhancing financial statement disclosures allows organizations to communicate to investors on important investment drivers, within the current reporting and assurance framework which has the benefit of adding a greater level of credibility, reliability and consistency to the information disclosed. This is not to argue in defence of retaining lengthy financial statement disclosures in the Integrated Report; rather enhancing the quality of disclosure practices on key investment drivers within the mandatory financial reporting framework, ensuring that messages communicated in both the financial statements and narrative reporting are consistent. This allows unnecessary disclosures to be eliminated and narrative reporting to be more succinct and focused upon interpretative guidance through the eyes of management.
- Linking the strategic and interpretive material in the narrative reporting to information in the financial statements can achieve greater clarity and provide consistency over time and across sectors.
- Reporting on the risks that are critical to the business is also important. Most companies use financial instruments (for example a derivative contract) to decrease or minimise a risk exposure. Reporting only the financial instrument risk generally does not provide a complete picture of the risk exposure for the business, or how well management is managing risks.

#### **Enhancing sustainability reporting as part of the journey**

The potential benefits to businesses, particularly CFOs, but also CEOs and Boards, of enhancing sustainability reporting are many. If the capital markets can fully understand a company's strategy, including how Corporate Responsibility elements 'fit' with the financial aspects, they will have greater insight into how these matters affect performance and business value. Some sectors of the capital markets are already using Corporate Responsibility metrics as a proxy for management quality. Better reporting of Corporate Responsibility matters can provide greater influence over the capital markets' determination of management quality and performance. This is an opportunity for management to better communicate the underlying strategy and performance of the business.

There is an increasing expectation in the community and in the capital markets that reporting on Corporate Responsibility factors will become mandatory, if not by law, then by dictums of best practice and corporate reputation. Enhancing sustainability reporting now will ensure that your business is capable of identifying and reporting on Corporate Responsibility matters before it becomes a statutory obligation or a market imperative.

#### **Automating business reporting as part of the journey**

Current developments in business reporting automation include those made possible by technological innovations such as XBRL, web-based and real-time reporting. There are benefits from these developments, including efficiencies arising from automated information gathering and reporting systems, but there are also potential challenges around how to establish the credibility of the new information incorporated into the expanded business reports they make possible.

Progressive automation of existing reports is driving improvements in the collection and storage of basic financial data. The automation of process is a small step towards real time reporting, which can provide improved data integrity and timely access to information.

**As the broader picture unfolds, there is an opportunity today for businesses to achieve cost savings, and financial reporting and information integrity benefits through the automation of reports using technology such as XBRL.**

### In brief:

- Users and preparers have become frustrated with the volume and lack of transparency of current corporate reporting
- Capital markets need the right information to be delivered in the right format at the right time and with content that the markets believe in
- Integrated Reporting allows capital markets to better understand a company's strategy and performance 'story'
- Additional potential benefits include greater organizational clarity and streamlined reporting processes, at a lower cost
- By taking the first steps towards better business reporting, companies can bring greater clarity, consistency and reliability to their corporate information.

### Key questions

- Do you have a comprehensive business reporting strategy, and is it delivering immediate benefits?
- Are you communicating consistent messages in both your financial statements and narrative reporting?
- How much time and effort do you invest in reporting information that is required by investors, management or regulation?
- Are you taking full advantage of the potential efficiencies to be derived from automated information gathering?

### Getting Started

Not every organization will be ready or able to commit to the full Integrated Reporting journey. For those that aren't there are some simple practical actions to get started:

- Undertake a diagnostic analysis of existing financial reports and supplementary capital markets communications, sustainability reports and report automation
- Use this analysis to develop a fit-for-purpose reporting strategy focused on improving the basis for capital allocation, streamlining reporting processes, reducing reporting costs and improving organizational clarity as to the business strategy and business model
- Businesses can experiment internally with the Integrated Reporting Framework, XBRL business reporting taxonomy and industry KPI libraries as they calibrate their internal reporting processes and systems to deliver integrated reporting to the board and executive teams

- Such reporting can be delivered externally in enhanced existing reports and then in an Integrated Report when the capital markets are judged to be ready to use it effectively in their decision making
- Over a period the reporting strategy will become 'business as usual' through the ongoing reporting process and a development of a reporting team with the knowledge, skills and competencies to execute the reporting strategy effectively.

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