Integrated Reporting – a concept whose time has come

Mervyn E King SC

The history of accountancy establishes that changes to reporting standards and practices occurred as a result of global events or crises. It was said that one of the causes of the Great Depression of the 1930s was the value of assets on the basis of mark to market. This type of valuation was consequently abandoned in some jurisdictions, but was retained in others. The great depression also resulted in the implementation of generally accepted standards of accounting in the United States. It also led to stock issues as a leading method of financing expansion. As stockholders, rather than bankers, became the primary audience of financial statements, the income statement began to take centre stage over the balance sheet. Other factors, such as income taxation and cost accounting, shifted the focus to revenue and profit.

In the late eighties, the BCCI and Maxwell scandals led to the Cadbury Report on the 'financial aspects of governance', which was its remit. In 2001, the Enron and WorldCom disasters resulted in the Sarbanes-Oxley Act of 2002. In 2008, we had the global financial crisis. As in the past, this has led to comments on some financial reporting practices.

But the global financial crisis is not the only crisis that we face at present. There is the climate change crisis and the crisis of ecological overshoot. These sustainability crises speak for the fact that we have used the natural assets of planet earth faster than nature can regenerate them. In short, we have three crises which companies cannot ignore in their long-term planning.

These crises have brought to light the importance of business incorporating environmental, social and governance factors into fundamental corporate analysis and business planning. They have compelled directors to rethink the basis for sustainable economic performance.

The false assumptions of the last 150 years of there being a planet with limitless resources and having an infinite capacity to absorb waste are at an end. There is a realisation that the planet is in crisis. Reporting influences behaviour. If the company reports on the impacts which its operations have on society, the environment and financially, the company has to ensure that the users of the report will find the company's conduct justifiable in the context of it being a decent global citizen, as it is operating in a flat, borderless electronic world.

The customer of today is not the customer of yesterday. The customer of today is aware of the fact that there are three crises: financial, climatic and ecological. The great multinational companies of today have economies greater than those of governments. The influence and the impacts which these companies have on society and the environment are enormous. Corporate reports can no longer be in corporate legal and accounting jargon as the providers of capital today are the citizens of a country, simply because, from a beneficial download of a share register, one finds that the majority shareholders today of MNEs are financial institutions and the majority of those are pension funds. Their trustees have a very onerous duty to make an informed assessment of the sustainability of a business before investing their ultimate beneficiaries' money in the equity of a company.

It is generally accepted that in the context of this new economy in which we find ourselves, trustees cannot discharge their duty simply by looking at the balance sheet, the profit and loss statement and the related notes. Trustees need to know how the operations of the company are impacting on society and the environment and that the business is a sustainable one in the context that business cannot continue to be conducted as usual and companies have to strategise about making more for a growing world population, but with reducing natural assets. Hence, the creation of stewardship codes for trustees of pension funds. How does the non-financial impact on the financial and the financial on the non-financial? Further, institutional investors want to know the traceability of input products because, for example, a supplier who is breaching human rights could adversely impact on the reputation of an investee company.

It is this context of crises concerning the 'take, make, waste' economy on which business decisions have been made and companies have been built, that led to the meeting in London in July of 2010 when the International Integrated Reporting Committee (IIRC) was formed.

Disparate bodies met. The Big Four, represented by their chairmen and/or chief executive, A4S, GRI, IAASB, IASB, IOSCO, UNDP and most significantly, the FASB. The FASB and the IASB, whose boards are debating the convergence project to make IFRS and US GAAP as near to identical as possible who, with the other constituent members, quickly agreed to an identity of purpose. That identity was a general acceptance that financial reporting had to be supplemented by Environmental, Social and Governance (ESG) factors. In short, integrated reporting. The user of a report must be told in clear and understandable language how the financial has impacted on the non-financial and vice versa and that the board and management have embedded the sustainability issues relevant to the business of the company into the fabric of the governance of the company.

The world has started to accept this – Norway, Sweden and Denmark have all passed legislation in regard to integrated reporting. There are requirements in amongst others France, Germany and the United Kingdom, which require corporate reports to go beyond the annual financial statement and a paragraph on prospects for the future.

Corporate reporting is not what it used to be. It has to be in clear and understandable language as to how the company's operations, during the year under review, have impacted socially, environmentally and financially. It should also be able to reveal to the user how the company intends to enhance positive aspects and eradicate or ameliorate negative impacts in the year ahead. Great companies such as Unilever and Procter & Gamble have laid out long term plans to have their factories driven by renewable energy sources and to make their products so that customers will be able to use fifty percent less energy and waste in consuming them.

In 2011, the IIRC plans to have a framework on integrated reporting available for discussion and I am hopeful that the G20 can be persuaded to follow the Danish Financial Statements Act, namely report or explain the impacts which your entity has on society, the environment and financially.

In Geneva in October 2010 and Kuala Lumpur in November 2010, the leading accountants of the world met. They accepted that the accountancy and auditing professions will influence integrated reporting. In Geneva on 12 October 2010, the world's leading accountants and auditors agreed that:

- The accountancy profession has a key role to play in strengthening corporate governance and facilitating the integration of governance and sustainability into the strategy, operations and reporting of an organisation.
- Boards have to focus on the long-term sustainability of their companies' businesses.

The global financial crisis was and is a crisis. Post the 1930s, financial capital was restored. It will be restored again. But natural capital once spent cannot be restored! The issues surrounding current financial reporting cannot be solved by bolting on sustainability. The preparers must clearly report to the user how the collective mind of the board has strategically dealt with the sustainability issues relevant to the business of that company – as water is to the brewer of beer. Current corporate reporting does not tell the user about sustainable performance in the new economy where we have to conduct business as unusual and learn to make more with less.

The formula is simple: No planet, no people, no profit. There are more companies than there are governments. The way companies report will influence their behaviour. Integrated reporting is a step on that ascending path towards making life on earth sustainable. The earth has been lent to us by those who come after us – we are caretakers, not owners.

Integrated reporting does not replace financial reporting. It is an evolution of financial reporting, whose time has come because of the crises of our time. ■

Mervyn King is a founding member of the Arbitration Foundation of Southern Africa and for some eight years was the South African judge at the ICC International Court of Arbitration in Paris. He consults and advises on corporate legal issues. He is recognised internationally as an expert on corporate governance and sustainability.