

Sustainability

Comments on the 'Framework for Integrated Reporting
and the Integrated Report –Discussion Paper'

by

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Introduction

I'm browsing through the news sites, sipping a cup of coffee. Yesterday in the USA, on the 16th of April 2011, tornados caused destruction with 65 people dead. I look outside the window and it is still raining. On record Namibia has never received more rain than this season, three times the average rainfall. Portugal begins debt bail-out talks and Standard & Poor is considering downgrading the US Governments credit rating on long term debt.

Is climate change and poor management causing this... are we sitting on a time bomb or do we still have time to make a turn-around in our stewardship of the earth and in the way we conduct business?

In my mind there is no other option but to manage our businesses according to principles of *sustainability*. To ensure that we add value in all we do in the short, medium and long term. The current efforts towards sustainability are not sufficient in general business practice. We need to do more.

A key concern in the discussion paper on the "Framework for Integrated Reporting and Integrated Report" is: will the purpose be achieved as intended. After the string of corporate collapses during the past decade I agree that we also need to improve our reporting. *Integrated reporting* (IR) makes sense.

I believe the purpose of IR reporting is commendable. To present stakeholders with "One Report" that accurately discloses short, medium and long term strategies, core competencies, business model, risks, opportunities and so forth.

In this response I will play devil's advocate, even though I support the basic tenants of *integrated reporting*.

General comments

The **fundamental concern** I have with the IR is that companies will **use IR to their advantage**, even if they have to misrepresent or leave out material issues. This is to improve their competitive position, gain market share or protect their business against bad publicity.

The reason for misrepresentation to me involves **incentives**. Management produces the IR report and the board of directors reports on it. These two stakeholders have a vested interest in various kinds of incentives and ownership in the business. The better the business performs financially and IR wise, the more investors are attracted. Better performance also leads to improved *incentives* for managers and directors. For this reason management and the board of directors will ensure good IR, even if it is not an accurate reflection of the situation.

The most important stakeholder is the **investor (shareholder)**. Measurement of corporate success historically is creation of wealth for only one stakeholder, the shareholder. To start a business you need investors to provide capital, and to grow a business faster you need more investors. Yet investors will invest in business where the returns and risk are best suited for them. IR will increase cost of business and lower profits. The cost of long term sustainability will be short term profits. Investors will invest in businesses where return-on-investment tend to be the highest and long term sustainability questionable.

I believe most companies will do a reasonable presentation of material issues that are important to stakeholders. My question is: can IR reporting identify and prevent the next BP Deep Horizon oil spill disaster in 2010?

I do not believe so. To support my argument: In 2008 Fortune magazine ranked BP as the 9th out of 10 most accountable big companies. The shocking fact is that the Global Reporting Initiative (GRI) listed BP as a finalist for two categories in the Readers' Choice Awards for sustainability reporting.¹

The IR report intends to supply important information to stakeholders, and of course the **competition** will get hold of the information as well. The reporting on short, medium and long term strategic goals, risks and opportunities is a grey area to me. The question I pose is how are businesses going to report important information that will fulfil the requirements of IR, while not disclosing information that would put the business at a disadvantage to the competition? Businesses cannot afford to disclose information that will be used against them.

One of the aims of the IR is to alert stakeholders to issues and flag companies. The companies that are the most likely to experience **avoidable catastrophic disasters** are the least likely to provide advance warnings. 'Questionable' corporate citizens will use IR reporting to their advantage. It will take prudent stakeholders and investors to read between the lines and make use of **other information** to draw more accurate conclusions about material issues.

Specific comments

Relevance and Materiality

Relevant information can influence stakeholder decisions. As the IR report caters for various stakeholders with various needs, the amount to disclose might become a daunting task.

An item is of material importance if it impacts substantially on, and influences the assessments and decisions of the organisation or its stakeholders. Materiality is a measure or threshold against which information can be evaluated.² Financial materiality is easy to determine using the accounting standards. How are businesses going to **determine materiality** regarding **environmental and social issues**? What level of error or omissions in data will influence the assessment and decisions of stakeholders? Relevance and materiality reporting according to IR framework will be manipulated by companies to their benefit.

¹ Learning from BP's "Sustainable" Self-Portraits: From "Integrated Spin" to Integrated Reporting, Sanford Lewis, Counsel Investor Environmental Health Network; The Landscape of Integrated Reporting

² Discussion paper on the "Framework for Integrated Reporting and Integrated Report"

Faithful Representation

To be useful, the information in an IR needs to be relevant and should faithfully represent the situation and circumstances. The goal of faithful representation is to ensure that the information presented is complete, neutral and free from error.³

Completeness is one of the most difficult concepts to audit and report on financially. With the IR we not only need to ensure completeness, but also completeness for all stakeholders and not only financially but also in other disciplines. An IR report that fulfils this requirement i.e. complete in all material aspects, will be exceptionally long. I doubt that businesses will honestly and completely report on all material aspects that will have or may have a negative impact on their business.

Strategic objectives, competencies, KPIs and comparability

I cannot see any business reporting on core KPI's while not giving away valuable information to the competition. The universal KPI's⁴ mentioned by the GRI are useful in some areas but are insufficient for many companies and industries.

It will also be difficult to compare IR reports between similar companies, where one company is listed and the other is a subsidiary. Example a transport company like VALUE vs. the logistics division of Imperial.

Summary – Theory vs. Reality

IR in **theory** is morally good and beneficial to business and to society. The **reality** is that companies will use IR reporting as “**window dressing**”. As long as companies own and pay for the IR process, the integrity of the report cannot be trusted completely. Companies will become experts in using statistics and carefully framed words to their benefit – ‘greenwashing’. IR will become a new cost of business, an additional set of rules to the game that must be mastered.

My recommendations are that IR reporting should **not try to satisfy the information needs of all** stakeholders in “One Report”. Stakeholders should be limited and clearly defined. Relevance, materiality and completeness should be narrowed down and clearly specified. Do not force companies to do honest reporting on strategic plans, core competencies, opportunities and KPI's that will weaken their position in the market.

³Discussion paper on the “Framework for Integrated Reporting and Integrated Report”

⁴Towards a 21st Century Balance Sheet: The First Three Steps, Toby A.A. Heaps; The Landscape of Integrated Reporting

In addition to IR, the law should require of companies to **disclose penalties and warnings** received by government agencies. This can be done on the IR, but definitely on their website or an official website. This will improve transparency and ensure that stakeholders do not only have to rely on IR.

In time the IR process will evolve. However, we should not put our hope in IR to sort out the 'bad' corporate citizens. Government, external parties, auditors and interest groups should do the **policing, verification, auditing and criticism**. Companies found guilty of misconduct should be heavily penalised in the court of law or by society. Directors and managers should be held accountable where possible.

In my opinion, IR reporting in business will not restore trust lost by society. There will always be offenders, transgressors and lawbreakers in charge of business. Yet I concede that IR will help responsible companies eliminate waste, improve efficiency and seek greener alternatives.

Reference

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