

HOLBOTH BUSINESS SOLUTIONS

Integrated and Sustainable reporting

A review of public and private enterprise
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INTEGRATED AND SUSTAINABLE REPORTING

Introduction

Over the years financial reporting has increased in its complexity and in the information disclosed. Instead of becoming simpler, for all investors to understand, it has become increasingly more difficult to understand. It has come a long way since Luca Pacioli published his text book, “Summa de Arithmetica, Proportioni et Proportionalita” in 1494, which besides being a text book on the mathematics of the time, was the first text book on bookkeeping using the double-entry accounting system and the concept of the income statement and balance sheet.

When I started my accounting career in 1961, the concept of annual financial statements was not much different to that. Both the balance sheet and the income statement were produced on the old T format. The balance sheet reflected Equity and Liabilities on the left hand side of the T and Assets were reflected on the right hand side. The income statement, or Profit and Loss Account as it was then called, reflected expenditure on the left hand side of the T and income on the right hand side. There was no cash flow statement and the notes consisted of half a dozen items on issues such as fixed assets, Directors’ loans, Directors’ emoluments and interest paid. These disclosures were all determined by the Eighth Schedule of the 1926 Companies Act. Together with the Auditors’ Report and Directors’ Report, the total number of pages in the annual financial statements consisted of no more than perhaps ten pages, if a Chairman’s report was included.

This report evolved to including a source and application of funds statements, which later changed to Cash Flow Statement and then with the advent of the 1973 Companies Act more information was added as required by the Fourth Schedule. Accounting statements also started making their appearances and this led to the introduction of GAAP and slowly the size of the annual financial statements increased. However the annual financial statements could still be understood by a reasonably intelligent layman. By the 1990’s the GAAP statements were far advanced and now the annual financial statements were becoming more complicated. I wrote an article titled ‘Financial Reporting in South Africa – Revolution

or Evolution” which was published in Accountancy SA in April 1997, in which I questioned the content of the annual financial statements and raised the questions of who are they prepared for and does the average person even understand the content. Bear in mind that this was even before the advent of IFRS which created a major shift in reporting standards and even more so after the Enron and other major business failures. Transparency became the order of the day and reporting requirements became even more onerous. The question to ask is whether all this information overload has in fact reduced the number of business failures and frauds. I think not because, in my opinion, the annual financial statements became tainted with all sorts of adjustments and requirements so as to make even the reported profit questionable. This is now being recognised resulting in changes to IFRS statements which hopefully will make the annual financial statements more user friendly.

King III and Integrated and Sustainable Reporting

In 1992 the Cadbury Committee, set up in the United Kingdom, published their “Code of Best Practice”. This saw them divorcing the roles of CEO and Chairman and introducing the concept of three non-executive directors on the board and an independent audit committee. This was the start towards the concept of good corporate governance which all companies should have aspired to, although tacitly as there had really been no defined rules on this.

In South Africa we saw the set-up of the King Commission in 1992 which set up Codes for voluntary compliance. We saw the introduction of King I and then King II which was adopted by the JSE Securities Exchange for all listed companies. In terms of King II the principle of “Comply or explain” was introduced. With the introduction of King III in 2009, the principle was changed to “apply or explain” and the Code went even further with the concept of sustainability.

In 2000 we saw the start of the collapse of a number of U.S companies with the collapse of Enron. This was followed by a number of other large companies such as Tyco International, Adelphi, Peregrine Systems and Worldcom. This obviously shook the investment world as billions of dollars were lost by investors. As a result of this the U.S. Federal Government introduced the “Public Company Accounting Reform and Investor Protection Act” and “Corporate and Auditing Accountability and Responsibility Act”, commonly known as Sarbanes-Oxley after its sponsors. This introduced new standards for all U.S. public company

boards, management and public accounting firms. The main principle in Sarbanes- Oxley or Sox is that of “comply or else”. Sox has come in for considerable criticism and in my opinion, having done considerable work for an American multi-national, I believe that the boards of the U.S companies are so busy making sure that they are complying that they do not have sufficient time to run the businesses of the companies. There are very stringent criminal penalties and these boards are spending too much time ensuring that they stay out of trouble and as a result the main purposes for which they were appointed, which was to give direction to the companies and maximise profits, has been lost in the morass created by Sox.

The question to ask is what has King III, Sox and the Cadbury Code of Good Practice brought to business? The answer to this is that they have brought a dynamic change in the way business is now conducted. No longer can we have the dictatorial attitude, with the chief executive officer making all the decisions and ignoring the effects of his decisions. The move has been towards transparency and participation with decisions being made on a participative basis. It has brought about the need for strong controls, laid down guidelines for the boards and subcommittees, stakeholder relationships and it has brought about the move towards Integrated and Sustainable Reporting.

Looking at Integrated Reporting, what do we mean by this?The answer to this is integrating financial information with other business impacting information so as to provide interested stakeholders issues and other factors which could impact on the businesses future performance. King III says “ *The integrated Report,, should have sufficient information to record how the company has both positively and negatively impacted on the economic life of the community in which it operated during the year under review, often categorised as environmental, social and governance issues (ESG). Further it should report how the board believes that in the coming year it can improve the positive aspects and eradicate or ameliorate the negative aspects, in the coming year.*”

It is imposing the responsibility of being good corporate citizens on organisations both in the private sectors and the public sectors. The days of chasing profits with no consideration as to the damage possibly being created to the environment, ecology, community, etc are becoming something of the past. Many of us saw the movie on Erin Brokovich about her campaign against an organisation which had chased profits without consideration for the environment and the subsequent impact on the health of individuals.

Sustainability was defined by KPMG in their 2011 publication “Measuring Up: Improving Sustainability in Consumer Markets” as being the following: -

Sustainability is *“The adoption of business strategies that meet the needs of the enterprise and its stakeholders today while sustaining the resources, both human and natural, that will be needed in the future”*

What does all this mean? Well in simple terms, the financial performances of enterprises are no longer enough. Investors want to know whether these enterprises are good corporate citizens and are acknowledging their responsibilities. They want to know more about the economic issues affecting the enterprise, environmental issues, social issues, Human rights, the enterprise’s role in society, information on product responsibility, political issues and the list can go on.

Every day we read in the newspapers about issues such as slave labour, sweat shops, racial prejudices, pollution, man-made disasters, political issues and their consequences, disease, etc. How are we dealing with these issues or are we dealing with these issues? This is what the stakeholders and investors want to know more about and the impact that these issues have on the financial performances of the enterprises. Are the financial results sustainable taking into account these factors and their potential impact on the future of the company? In addition the investors and stakeholders want to know whether the management have the capabilities to deal with all these issues. Generally the annual financial reports of companies have never dealt with these issues and in that respect they were deficient. Companies chased profits and were happy to report earnings and performance for the financial year but were reluctant to comment on future performances and what were major issues affecting future performances. I came from that background where the directors were, to put it bluntly, scared of giving out all this information as they were mainly concerned about what their competitors would do with the information and that is unfortunately the mindset of many company directors. These deficiencies in annual financial reporting were dealt with by the King Code of Governance for South Africa 2009 where it describes the problem:

‘The market capitalisation of any company listed on the Johannesburg Stock Exchange equals its economic value and not its book value. The financial report of a company, as seen in its balance sheet and profit and loss statement, is a photograph of a moment in time of its financial position. In buying a share on any stock exchange, the purchaser makes an assessment of the economic value of a company. The assessment

considers the value of matters not accounted for, such as future earnings, brand, goodwill, the quality of its board and management, reputation, strategy and other sustainable aspects. The informed investor assesses the quality of the company's risk management and whether it has considered the sustainability issues pertinent to its business."

In an interview published in the Harvard Business Review of the 12th April 2010 by Martha Lagace conducted with Robert G. Eccles and Michael P. Krzus, the authors of "One report; Integrated Reporting for a Sustainable Strategy" they described the benefits of more integrated reporting as follows:

"We see four primary benefits to companies:

- 1. Greater clarity about the relationship between financial and nonfinancial key performance indicators. This will help managers understand and confront trade-offs necessary to balance financial and societal demands.*
- 2. Better management decisions. As noted by the creators of the Balanced Scorecard, HBS professor Robert S Kaplan and Davis P Norton, there is compelling evidence that better measurement, and therefore better information leads to better decision making.*
- 3. Deeper engagement with the broad stakeholder community. First, it will help shareholders focus on more than short-term returns and better understand the investments necessary to ensure long-term viability. Second, other stakeholders will begin to appreciate the need for a company to make a profit if it is to create value over the long term.*
- 4. Lower reputational risk resulting from integrated reporting. Stakeholder engagement leads to better mutual understanding. Clear and consistent communications about a company's financial and nonfinancial performance will be the basis for a constructive two-way conversation.*

Good Qualities of an Integrated and Sustainable report

1. Integrity

The integrity of the report must be beyond reproach. "Tell it as it is" must be the order and not "Tell it as I would like it to be". Too often annual reports have only dealt with the positives and not always the negatives. Very often it is a means of protection for management to avoid the negatives. There is nothing wrong in giving

the positives but very often the negatives are the issues which threaten the sustainability of an entity and by reporting on them it is bringing them to the fore and stakeholders are made aware that management is dealing with them.

2. Standard Disclosures

The Global Reporting Initiative (GRI) suggest the following disclosures in their “Sustainability Reporting Guidelines” :-

- Strategy and Profile
- Economic
- Environmental
- Labour Practices and Decent Work
- Human Rights
- Society
- Product Responsibility

One disclosure which has not been raised and in my opinion is an extremely important one, particularly in South Africa is that of Political issues which could have a significant impact on the sustainability of an entity. This is particularly important in the mining industry where the effect of nationalisation as being espoused by certain sectors of Government must be extremely worrying at this time and until the ANC’s next policy making conference in 2012.

3. Materiality

The information provided in the report should be of a material nature which could have a major effect on the company and would significantly influence stakeholders and investors in their investment decisions and dealings with the entity.

4. Quality

The quality of the information must be able to stand up to scrutiny and should be both favourable and unfavourable.

5. Sustainability

The report needs to deal with the sustainability of the entity’s performance in the wider context of economic, environmental, social conditions, etc. How will these issues affect the entity in the future? Issues such as skills scarcity, limits on pollution

levels, labour unrest in the future should all be dealt with in the report if they affect the sustainability of the entity.

6. Comparability

This is a thorny issue as no organisation likes to give out information which enables competitors the opportunity to compare performances. However we should understand that if every entity of substance is required to do this then no one is giving away any competitive edge and the playing fields are levelled. However from the investor and outside stakeholder, it is important that the information be given in such a way as to enable them to make informed investment decisions, allow rating activities and other analytical surveys.

7. Accuracy

The value of the report is only as good as the accuracy applied to it. The report should indicate where data has been measured or where it has been estimated and the basis of the estimation. As the GRI Sustainability Reporting Guidelines states, *“The Characteristics that determine accuracy vary according to the nature of the information and the use of the information. For example, the accuracy of qualitative information is largely determined by the degree of clarity, detail and balance in presentation within the appropriate Report Boundary. The accuracy of quantitative information, on the other hand, may depend on the specific methods used to gather, compile and analyse data.”*

8. Independent Assurance

In terms of King III independent assurance should be given as to the accuracy of the report in order for it to ensure its integrity. Previously we had the situation where the Chairman’s report dealt with many of the issues now required in the Integrated and Sustainable Report. However the problem with the Chairman’s report was that it was never audited, it generally dealt with the positives and did not always raise the risks or issues which confronted the entity in the future. Having reviewed a number of annual reports which have been submitted by listed companies after 1 March 2010 and who have submitted integrated and sustainable reports as required by the JSE Securities Exchange, not all have obtained independent assurances (See Annexure A).

Listed Companies

With the introduction of King III, in terms of which all listed companies on the JSE Securities exchange must comply, all listed companies are required to submit Integrated and Sustainable Reports as from 1 March 2010. A sample of some of the larger and medium sized companies was taken and their reports were analysed, the results appearing in Annexure A. The manner of dealing with this report varied from company to company. The Global Reporting Initiative Guidelines for Integrated and Sustainable Reporting have been adopted in most cases. Not all companies have gone for independent assurance which is a pity as this could possibly detract from the integrity of the report. The lengths of the reports all differ with some publishing a summary and referring to their website for more information and others not publishing anything in their annual financial statements and instead making reference to their website. I have no intention of saying which is right and which is wrong but my view is that if you are going to publish a detailed report on the website, at least provide a summary in the printed annual report to give those reading it some insight into what is happening in the organisation. I also believe that the integrity of the report is of paramount importance and therefore the independent assurance, which should be undertaken, should be published in order to provide the necessary assurances to the investors and other stakeholders relying on these annual financial statements.

Unlisted Companies

“King III applies to all entities regardless of the manner and form of incorporation or establishment and whether in the public, private sectors or non-profit sectors. We have drafted the principles so that every entity can apply them and, in doing so, achieve good governance” according to the preamble set out in the Introduction and Background to King III.

This means that unlisted companies and private companies should adhere to the principles of King III. Unfortunately there are some very large private companies whose annual reports are not available for general consumption which makes it difficult to police. Just as the listed companies are required to present Integrated and Sustainable Reports, I believe that private companies should produce them and perhaps in the future they should be mandatory for them and made available to stakeholders and interested parties on request. The cost of producing glossies for this purpose is very often prohibitive, but these can be produced

fairly cheaply in house with all the information with all the information needed. It is very often these companies which exceed the bounds of good corporate governance. How often have we read in the press of waste disposal companies disposing of medical waste on vacant ground as it is cheaper than incinerating it? Too often tenders are awarded to such companies who do not have the capacity to do the job properly. There are many more such examples in other areas of industry as well. The issue of medical waste disposal is but just an illustrative example.

Public Sector organisations and Government

I will deal with this together as public sector organisations are generally organs of government, examples being Eskom, Transnet, South African Airways and the South African Broadcasting Corporation. Municipalities and the various Ministries would fall into this as well.

As we all know, National Government, Provincial Government and Local Government are the representatives of the electorate and are elected to provide for the needs of the population and that is why we pay taxes, to pay for these services. In the case of certain organisations such as Eskom etc. they levy fees and charges for their services. As they are effectively responsible to the people, they should be totally transparent in all that they do and want to do. The question one has to ask is, are they transparent in all that they do? I obtained details of the Auditor- General's report published on the 29 June 2011 for the year 2009/2010 on the South African Government Information website and was appalled at the results given. These are set out in Annexure B. However, of the 286 municipalities and municipal entities which underwent audits, only 17 received clean audits. On the 20 January on the same website the Auditor-General reported on government departments as follows: *"Nombembe said he was satisfied that, of the audited national departments, none received the worst audit outcomes – disclaimers and adverse opinions. This is a noticeable improvement from the previous years. There was, however, a regression in clean audits (financially unqualified with no findings on predetermined objectives and compliance with laws and regulations) to 12% (2008-09: 17%)*

On the issues of service delivery, the results as set out in Annexure B speak for themselves. With results like that, we cannot expect them to submit any Integrated and Sustainable report which will stand up to public scrutiny. They more than anyone else, should be forced

to comply by issuing such reports. However the integrity of such reports will be questionable in the extreme. Our public representatives should more than anyone else ensure that the basic requirements of an Integrated and Sustainable Report are upheld and reported on truthfully: -

- Strategy and Profile
- Economic
- Environmental
- Labour Practices and Decent Work
- Human Rights
- Society
- Product Responsibility

In the Bill of Rights Handbook by Ian Currie and Johan de Waal (Fifth Edition) on page 11 they say, "The idea of Constitutionalism is bolstered by the specific entrenchment of the rule of law in the founding provision, s 1 of the Constitution. As originally conceived by the English constitution lawyer A V Dicey more than a century ago, the purpose of the rule of law was to protect basic individual rights by requiring the government to act in accordance with pre-announced, clear and general rules that are enforced by impartial courts in accordance with fair procedures. Put at its simplest, the rule of law requires state institutions to act in accordance with the law." If we look at the Human Rights Report on South Africa, the very organ of state which is there to uphold these rights is itself is one of the biggest abusers of Human Rights.

One could go on about the other areas of the Integrated and Sustainable Reporting requirement and there is no doubt that the responses to this issue will be exactly the same as far as government is concerned

In terms of Sect 40 of the Public Finance Management Act an institution must report on its financial statements and its performance against predetermined objectives as well as other matters that may be prescribed by National Treasury and Sect 40(3) deals with the content of the annual reports and states "information about the institution's efficiency, economy and effectiveness in delivering programmes and achieving its objectives and outcomes" including elements of sustainable reporting.

It is obvious that the public sector is sadly lacking in either corporate integrity or they do not have the capacity to carry out the requirements and demands of the electorate. How do we turn this around? Obviously as the electorate, those in government are answerable to us and we need to ensure that by voicing our objections the government meets its objectives and the objectives of the electorate.

HOW WILL GOVERNMENT RESPOND?

We have already seen the consequences of the electorate's response to non-delivery and the heavy hand of government in denial. We currently have the Bill which has been held back, calling for people to be jailed where information considered sensitive to government is disclosed. The only sensitive information is corruption by government officials. We have a government in denial and they need to recognise their mistakes and the errors of their ways. How one does that is something I will not venture to answer but will leave to those who have the influence to make change happen

CONCLUSIONS

At the end of the day we must realise that the era of Integrated and Sustainable Reporting is still in its infancy and must be allowed to grow and develop. There is no doubt that it has the effect of raising the awareness of management and as such hopefully will ensure that at the end of the day they will give the necessary consideration to it that it deserves. From the private sector, I am of the opinion that they have the necessary skills and the desire to fulfil these requirements transparently and honestly. I think that the private companies need to be educated further and considerable more attention needs to be given to developing this report. Perhaps we need to look at a shortened and more concise version of this report specifically designed for them as it is obviously expensive to undertake for a much smaller audience.

Insofar as the public sector is concerned, I am of the opinion that they should be setting the benchmarks for Integrated and Sustainable Reporting, if they are truly transparent. To date my confidence in their ability to do is extremely low due to their apparent inability to deliver on the basics such as financial reporting which as has been illustrated, leaves a lot to be desired.

During September the International Integrated Reporting Committee issued a discussion paper on a new approach to reporting. The intention is of the paper is *“to forge a global consensus on the direction in which reporting needs to evolve, creating a framework for reporting that is better able to accommodate complexity, and, in so doing, brings together the different strands of reporting into a coherent, integrated whole.”* What do they mean by that? Well as the paper says the world has changed and reporting needs to keep pace. *“It is not enough to keep adding more information – the connections need to be made clear and the clutter needs to be removed.”* What the paper proposes is an International Integrated Reporting Framework which is in line with the introduction of the International Financial Reporting Standards. They are inviting both organisations and investors who wish to participate and experiment with the proposals over the next two years to join the IIRC Pilot Programme. Now there is an opportunity for some of the larger business in South Africa to influence the way Integrated Reporting should move.

ANNEXURE A

ANALYSIS OF A SAMPLE OF INTEGRATED & SUSTAINABLE REPORTS ISSUED BY COMPANIES LISTED ON THE JSE SECURITIES EXCHANGE

	1.Forestry and Paper	2.Speciality Chemicals	3.Beverages	4.Oil & Gas	5.Platinum and Precious Metals	
Strategy & Profile	YES	NO	No	YES	YES	
Economic	YES	NO	YES	YES	YES	
Environmental	YES	YES	YES	YES	YES	
Labour Practices and Decent Work	YES	YES	NO	YES	YES	
Human Rights	YES	YES	NO	YES	YES	
Society	YES	Yes	YES	YES	YES	
Product responsibility	YES	NO	YES		YES	
Length of report	10 pages	18 Pages	4 pages	62 pages	Printed on website	
Independent Assurance	No	Y – On selected information	NO	YES	NO	
General Comments	Prepared in accordance with the GRI Guidelines	Not prepared in a manner which enables the reader to easily see all the suggested disclosures as per the GRI Guidelines.	Not prepared in a manner which enables the reader to easily see all the suggested disclosures as per the GRI Guidelines Detailed report published on the website	Published on their website	Published on their website in accordance with the GRI Guidelines. It is an interactive report with a summarised report at the start and the ability to go into the detail. A lengthy report.	

AUDITOR-GENERAL' REPORT FOR 2009/10 RELEASED ON 29 JUNE 2011

1. 237 Municipalities audited – 7 obtained clean audit reports
2. 49 municipal entities audited – 10 received clean audit reports

Service Delivery

3. 84% of municipalities and municipal entities did not fully comply with regularity requirements.
4. 65% - the performance information was not meaningful or useful.
5. 48% - the reported performance information was not supported by reliable evidence.
6. 24% - the performance information was not received in time for audit purposes

INSTANCES OF HUMAN RIGHTS ABUSE BY THE SOUTH AFRICAN POLICE SERVICES

1. 294 deaths in police custody and 566 deaths as a result of police action
 - 1.1. 479 deaths from shooting.
 - 1.2. 122 deaths due to assault.
 - 1.3. 112 deaths due to suicide.
 - 1.4. 93 deaths from natural causes.
 - 1.5. 27 deaths as a result of being struck by police vehicles.
 - 1.6. 15 deaths as the result of auto collisions.
 - 1.7. 7 deaths as the result of torture.
 - 1.8. 3 deaths from suffocation
 - 1.9. 2 deaths from poisoning.
2. During 2009 the Independents Complaints received 6377 complaints against the police.
3. The conviction rate in criminal cases is 10.3% due amongst other things “inadequate collection of evidence at crime scenes, insufficient investigation of crimes, long trials and ineffective court processes