

Integrated Reporting in practice: **The South African story**

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In brief:

- Companies listed in South Africa now need to adopt Integrated Reporting on an 'apply or explain' basis
- KPMG in South Africa's experience is that many of the most successful implementations have been driven from the board and top management
- Successful Integrated Reporting is not just about reporting, but about co-ordinating different disciplines within the business and focussing on the organization's core strategy
- The businesses which have gained most from Integrated Reporting have spent time and effort in building a continuous reporting approach

The first annual cycle of Integrated Reporting in South Africa shows this has been a rewarding – though sometimes challenging – journey for the listed companies applying it. Through KPMG in South Africa’s involvement with more than 80 companies we can see the positive impact that the entire change in reporting ethos is having on companies’ strategic thinking. Our experience is yielding important lessons for companies already embarking on the Integrated Reporting journey as well as those who simply want to improve the quality of their reporting.

It is clear that the concept is bedding down and gathering momentum.

One year in

Companies listed on the Johannesburg Securities Exchange (JSE) were required to adopt Integrated Reporting from years commencing on or after 1 March 2010. The driver for this was the King Code of Governance Principles for South Africa 2009 (King III) becoming a JSE listing requirement. King III recommends that organizations should adopt Integrated Reporting on an ‘apply or explain’ basis.

There has been a generally positive and pro-active response from JSE-listed companies and a number of State-Owned Entities in South Africa which have embraced Integrated Reporting as part of their King III application programs. The levels of application have varied, depending on the maturity, sophistication and approach by organizations to Integrated Reporting. Reporters typically fit into the following categories (and sometimes more than one): Early adopters & business-case driven; Compliance approach; Wait and see; and Laggards.

It is clear that the concept is bedding down and gathering momentum. Full adoption of Integrated Reporting is a journey and we think it could take most companies up to three years for it to become a fully established way of reporting the business strategy and performance. The journey duration depends on the departure point – the maturity and sophistication of existing reporting systems – and management’s energy and commitment to implementation.

We have had the privilege of working with more than 80 Integrated Reporting organizations. Below we share some of the key learning points observed in the first annual Integrated Reporting cycle, some of the challenges, and how businesses are tackling these.

Peer groups are establishing benchmarks and trends in terms of structure and content.

What have we learnt?

Driven from the top

The more successful Integrated Reporting implementation programs have benefitted from close involvement of CEOs and executive committees. Well organized and committed steering committees and project-management teams are needed to drive the implementation process.

Integrated thinking and management

The key to successful Integrated Reporting implementation is the ability of the business to achieve integrated thinking and integrated management in the organization. This requires getting the different disciplines within the business to work together and break down the silos that are evident in many organizations. Some of the more successful Integrated Reporting teams have included the following functions:

Finance	Performance Reporting
Sustainability (Safety, Health & Environment)	Governance & Regulatory
Risk Management & Strategy	Operations Management
Corporate Communications & Investor Relations	Human Resources
Stakeholder Engagement	Information Technology

These functions can be structured in different ways in each organization but the key challenge for the Integrated Reporting project leader is to get buy-in and ensure involvement from all the main internal stakeholders. There needs to be 'one view' of the business and consensus on one set of material issues that need to be addressed through one combined strategy. For example the days of having a stand-alone sustainability strategy are gone, and we are increasingly seeing this incorporated into the core strategy of the business.

Ad hoc reporting versus continuous process

Given the often pressing reporting commitments and deadlines that businesses face, there needs to be a balance between preparing an ad hoc annual report and establishing an enduring integrated reporting process within the business. Shortcomings in the reporting process (such as reporting of risk management, stakeholder engagement, execution of strategy, performance and remuneration structures) often point management to deficiencies in underlying activities or processes. Management can fall into the trap of 'fixing the report' on an ad hoc basis rather than addressing the underlying issues.

The ideal state is achieved when the internal management reporting is aligned with external reporting thereby focusing on the activities most valued by investors. The story of the business is already understood, analyzed and told before the Integrated Report is prepared. Reaching this state takes away the huge effort typically observed in year-end reporting and moves towards a continuous reporting flow. We have seen businesses actively align their executive committee and board reporting to their Integrated Reporting process, and vice-versa. The result is that what gets reported is managed throughout the year so there are no surprises in the year-end reporting process.

Forward-looking focus

Integrated Reports should include a forward-looking perspective on the business corroborated by a look-back on performance against strategies and strategic objectives. This marks a shift in focus from short-term historical financial performance to providing an understanding of how management is driving the medium to long-term business prospects. The cultural change required from report preparers is substantial.

Business-case driven approach

Implementation of Integrated Reporting has mostly been a positive experience for corporates that have

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established a clear business-case driven approach to the task. Most organizations have built on their existing reporting practices and now are focussing on areas needing improvement.

What do users think?

It is early days and there has not been overwhelming feedback from users – yet. We believe this will take time as users get used to the new approach to business reporting and Integrated Reporting gathers momentum, and as more detailed content is provided around the broader range of issues being identified in the report.

A number of forums and interaction between reporters and stakeholders are taking place on a collective and individual basis. This ongoing interaction and feedback should start the stakeholder engagement that is required to more clearly define users' legitimate requirements and expectations from Integrated Reporting.

But it is not just about the users of the reports. There are clear benefits for underlying businesses adopting Integrated Reporting. Interestingly a lot of positive feedback comes from management teams who are finding that Integrated Reporting enables them to:

- Focus the business on the really material issues
- Achieve integrated thinking and integrated management
- Consider risks and opportunities more widely (including environmental, social and governance, and stakeholder engagement)
- Communicate strategy more effectively
- Enhance performance reporting
- Streamline reporting externally and internally

Where now for South African companies?

This has been a discovery process for the many first-time integrated reporters, and the first annual wave of reports got this project off to a good start. The International Integrated Reporting Council pilot programme is also adding international momentum.

The South African business community has responded positively to something that has been a long time in coming. Most businesses view it as a refreshing way of looking at and managing their businesses and reporting both internally and externally.

Peer groups are establishing benchmarks and trends in terms of structure and content as well as common material issues and performance measures. This has been particularly evident in the mining and banking sectors.

Most first-time reporters have identified areas of their Integrated Reporting process that can be improved, and we expect that report detail will improve as its value becomes apparent and the underlying reporting systems improve. Many of these developments will be addressed in the journey to better reporting that has been adopted and will become evident in new generations of Integrated Reports. Most importantly it should be recognized that Integrated Reporting is a way of achieving Better Business Reporting. It is being driven by businesses and their stakeholders as opposed to being simply another regulatory compliance exercise. The successes and better practice trends being developed as well as continued stakeholder engagement, thought leadership and drive by the business community will ultimately underpin the future success of Integrated Reporting.

The days of having a stand-alone sustainability strategy are gone.

Better Business Reporting in practice: **Challenges found** (and how you can overcome them)

Various common challenges and critical success factors emerged as we worked with clients in South Africa to tackle Integrated Reporting. Leading reports found innovative solutions and are establishing best practice trends in many of these areas, bringing creative thinking to the table. It is clear from the leading reports that Integrated Reporting in these companies was driven by the business – by its objectives, by its strategy, and by the different areas of the business working together to create integrated value across the organization as a whole. Leading companies also demonstrated strong interaction between reporters and stakeholders.

This approach has already started to pay dividends with the results looping back into the different areas of an organization and flowing through to its governance and continuing improvement of long-term strategy. As the Integrated Reporting process continues to mature, this interaction should generate increasing benefits for an organization and its value creation. Here we consider our findings so far on some of the challenges and success factors noted to date.

IFRS reporting in the financial statements remains a safe haven for objective reporting which can be reconciled to the analysis provided by management in the Integrated Reports.

Materiality

Materiality is applied at all levels of Integrated Reporting, particularly in risk and opportunity analysis but also in considering the impact of strategic focus areas and performance reporting and outlook.

Quantitative materiality thresholds can be defined using traditional concepts of reporting materiality but qualitative criteria need to consider issues including reputation, credibility, sensitivity and strategic relevance of matters. The structure of a well-designed Integrated Report provides a natural basis for determining the material qualitative issues.

Reporters who have applied the connectivity principle effectively have found that their report content naturally addresses the most material issues affecting business value.

Additionally, the stakeholder assessments that many companies went through as part of their reporting process has helped them to step back to identify a more complete picture of business challenges and opportunities. In this respect materiality has been much less of an issue than many had originally anticipated.

Assurance

Developing an appropriate assurance process over Integrated Reporting is a significant challenge for many organizations. A focus group has been formed in South Africa to address this challenge and develop guidance in consultation with regulators and other stakeholders.

A combined (internal and external) assurance approach is at the heart of an efficient and effective strategy. The assurance approach needs to combine the following:

- Governance – oversight and approval of the reporting strategy, structures and processes
- Processes – establishment of appropriate processes, systems and controls at all levels of the Integrated Reporting process, including internal audit and external assurance providers
- Data – assurance over quality of underlying data
- Use of judgment – assessments of risk and materiality

The first challenge for reporters is to build appropriate systems of controls over these new reporting areas. The size of this task should not be under-estimated given the volume of qualitative and quantitative data which has not previously been subject to a formal reporting process.

Once this has been achieved we expect that the assurance community (internal and external) will be ready to meet the demand for broader assurance in these areas by building on existing assurance standards for forward-looking and non-financial information.

Logical links and flows

Connecting elements of the report is critical to the success of effective Integrated Reporting. Appropriate structuring leads to good linkage and logical flow. Redundancies and irrelevant

content can be identified through an editing process that links content across the Integrated Reporting elements.

The ultimate test? *If it's not linked, it doesn't belong.*

Regulatory requirements and other reporting

Organizations in South Africa need to continue to meet their regulatory reporting requirements under King III, the Companies Act of 2008, International Financial Reporting Standards and the JSE listing requirements. They may also wish to subscribe to certain non-mandatory frameworks (such as the Global Reporting Initiative, JSE Socially Responsible Index, Carbon Disclosure Project, United Nations Global Compact and Millennium Development Goals).

Many companies have found the most effective way of dealing with additional content that's not material in the context of the Annual Report itself has been by providing explicit links to other documents.

For example, often only abridged financial statements are provided with linkage to a separate document containing the full IFRS financial statements. This approach has worked well where the linkages have been clearly highlighted and are easy to follow.

Stakeholder engagement

Stakeholder engagement is sometimes overlooked or dealt with at a shallow level. Integrated Reports should reflect meaningful interaction and engagement with stakeholders, filtering to material issues and demonstrating responsiveness in the business strategy and ultimately performance.

Leading reports demonstrate that interaction actually took place and specify the issues arising from it rather than using generic stakeholder engagement avenues and themes.

Organizations that have addressed shortcomings in their stakeholder engagement processes find that a wealth of business intelligence lies in meaningful interaction with stakeholders across all spectrums of the business.

Providing a balanced view

Users of reports typically want a clear view of shortcomings and challenges businesses face. Most importantly, they want to understand how management is dealing with these issues.

Businesses tend to think that reporting these challenges can lead to a negative perception of the organization. Those charged with governance have a responsibility to ensure that the Integrated Report deals with all the organization's material issues in an objective manner, providing a balanced view of the organization.

Ultimately most businesses have developed what they consider to be the best strategy to deal with the challenges they face. *They have generally found it preferable to explain how they're managing the issue rather than retreat behind boilerplate disclosure that may leave readers with the impression it is not being addressed at all.* Similarly, organizations may benefit from highlighting the opportunities and competitive advantages they have achieved in successfully executing their strategies.

Stating the business strategy

Many reports only set out generic strategic themes or objectives for the organization. Businesses need to state the underlying strategies clearly so users can understand the essence of these plans and where they will take the organization. Only by understanding a strategy can performance be understood. Articulation of strategy usually requires an outline of the underlying activities, initiatives and processes linking to the associated targeted performance and aspirations.

Selecting the right KPIs

Key performance indicators presented in reports are only effective when placed in context.

It is important to link KPI's to underlying strategic imperatives as well as associated targets and trends that provide the required context. Some organizations have gone as far as benchmarking KPIs with their peer groups locally and internationally.

It is notable that the extractive industries and banking sector have been leaders in providing additional performance information. Peer pressure may be playing a part here, with participants reluctant to risk challenge over the completeness of their disclosures.

Financial performance analysis

Financial results included in Integrated Reports are often limited to summarized financial statements prepared on an abridged basis. Better reports provide analysis of drivers of volatility and sustainability of trends in financial performance and link them to underlying strategic initiatives. This could extend to providing management's perspective on sustainable earnings and identifying what are considered exceptional items in the financial results. *IFRS reporting in the financial statements remains a safe haven for objective reporting which can be reconciled to the analysis provided by management in the Integrated Reports.*

Targets and future performance

The forward-looking orientation of Integrated Reporting necessitates preparers to start providing meaningful insight into management's plans and aspirations. It does not necessarily require management to provide detailed projections or forecasts of financial performance. Ideally the uncertainties and non-controlled factors should be identified and their impact on performance outlined in sensitivity analysis. Management's aspirations and targets should focus on what they control from a strategic and operational perspective.

Reporters can be reluctant to provide targets and future performance aspirations in their external reports. Reasons given revolve around regulatory concerns on providing forward-looking information and creating expectations that may be used against management in future periods. *Often regulatory concerns and commercial sensitivities can be managed through careful presentation.* Without guidance on future performance goals, many users set their own implicit expectations – these can be equally damaging to management if not met.



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