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Corporate reporting: Shifting to the long-term

Last summer, @realDonaldTrump tweeted about changing the reporting requirements of public companies from each quarter to twice a year. It was an idea floated to him by a business leader and it's just one of the many proposals looking to address the pressures put on business and economies by short-term thinking, planning and investing.

A host of groups have launched initiatives in recent years to curb short-termism in capital markets and improve corporate reporting to better serve the needs of investors and facilitate long-term investment.

Among the initiatives gaining global traction is the International Integrated Reporting Framework (<IR> Framework) which provides a holistic picture of a company's strategy, governance, performance and prospects for long-term value creation. While integrated reporting has been embraced in other parts of the world, it has not yet taken hold in a significant way in Canada.

In order to help the Canadian business community better understand the global move to integrated reporting and what it might look like here, on February 6, 2019, CPA Canada convened a group of leading international experts to share what's happening around the world and why. The group included: Richard Howitt, Chief Executive Officer of the International Integrated Reporting Council (IIRC); Lisa French, Chief Technical Officer (IIRC); Vincent Papa, Associate Director of the European Financial Reporting Advisory Group (EFRAG); and Sarah Williamson, Chief Executive Officer (FCLTGlobal).

Here are some of the key takeaways:

Integrated Reporting defined

Formed in the aftermath of the 2008 financial crisis, the IIRC and its <IR> Framework focus on filling in the gaps for investors and others on exactly how companies create value over the short, medium and long-term. This means putting strategy and business model front and centre and taking into account important assets, resources and relationships that are not reflected in current financial reporting (a 2015 Ocean Tomo study found that 80% of the S&P 500 market value was driven by intangible assets).

To do that, the IIRC has identified six "capitals": financial, manufactured, intellectual, human, social and relationship, and natural. "These are the true value drivers," said the IIRC's Richard Howitt. "It's less reporting but better reporting. It's a more concise communication that is more material to the company. It cuts the clutter."

> *"Integrated reporting is not Environmental, Social, Governance (ESG) reporting. Integrated reporting takes a broader and arguably more fundamental look at the business, its model, key relationships, viability, and the connection between the value created for others and the value created for the company and by extension its shareholders. Financial management and financial performance continue to be central themes as do strategic considerations that go beyond ESG, such as cyber security, disruptive and enabling technologies and core infrastructure."*
> *— Lisa French, Chief Technical Officer, IIRC*

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Breaking through: Integrated Reporting around the world

The International Federation of Accountants (IFAC) has stated integrated reporting is the future of corporate reporting. Since its release in 2013, 1,700 companies in 72 countries have adopted the IIRC's <IR> Framework. That said, there is no single path for how to get there.

For example, integrated reporting is already mainstream in Japan and South Africa. In Japan, adoption by the state's pension plan—the largest pension fund in the world—paved the way for other organizations and businesses to follow. In South Africa, integrated reporting is embedded into the King IV corporate governance code and as such is a listing requirement of the Johannesburg Stock Exchange and widely adopted by South African businesses. As of 2018, the European Union's Non-Financial Reporting Directive requires companies there to include non-financial information in their reports to shareholders.

In the United States, 28 large companies including GE, PepsiCo, Southwest Airlines, are all issuing integrated reports. An integrated reporting US Community has emerged to help further advance adoption. A survey by the American Institute of CPAs (AICPA) found 50% of corporate CEOs in the U.S. are on the journey to integrated reporting, and another 34% believe they will be within three years.

Recent research shows that a number of companies in Canada are already putting non-financial information in their annual reports. The interest exists but what needs to happen for integrated reporting to become a leading practice in Canada?

Levers for change: Why integrated reporting is on the rise

Four drivers are advancing integrated reporting around the world: **investor demand** (a study by EY reveals 94% of investors believe integrated reporting is essential or important; 70% say it's essential); the push for **good corporate governance** (the International Corporate Governance Network has recommended in its Global Governance Principles that boards produce integrated reports); the need for **better strategy** in the era of the Fourth Industrial Revolution where technology is blurring the lines between the physical, digital and biological; and the understanding that **sustainable development** and long-term value creation depend on the interconnectedness of the six capitals.

Which of these will work most effectively either individually or in combination to help Canada take the next step towards integrated reporting?

> *"All the evidence shows long-term investors outperform short-term investors. And long-term companies outperform short-term companies and they create more value for society. Why do we have capital markets in the first place? To reallocate investments from long-term savers into new ideas and products. We need to get back to connecting long-term source and long-term use."*
> *— Sarah Williamson, CEO, FCLTGlobal*

What integrated reporting could look like in Canada

The shape of integrated reporting varies depending on where you are in the world. In South Africa, the integrated report is the investor-oriented regulatory report. In Canada, companies are experimenting with elements of the <IR> Framework. For her part, the IIRC's Lisa French sees the core ingredients of a good integrated report in the Management Discussion and Analysis (MD&A) and Annual Information Form (AIF). "We're talking about providing fundamental business information, providing context though narrative. So I see Canada's existing continuous disclosure requirements playing a pivotal role in integrated reporting in Canada."

> *"EFRAG is establishing a corporate reporting lab similar to the UK's Financial Reporting Council that will be a safe space for European investors and companies to come together to engage on key areas of financial reporting. The intent is to influence by moral suasion by showcasing good reporting practices to change behaviours; not regulation change."*
> *— Vincent Papa, Associate Director, EFRAG*

Building consistency and coherence within the corporate reporting space

The proliferation of reporting initiatives and frameworks in the marketplace—the bulk of which are in the environmental, social, governance (ESG) space—has caused confusion for some companies. It shouldn't. Integrated reporting is the umbrella movement under which other reporting strands and their related initiatives sit. They support integrated reporting rather than compete with it.

In order to clarify the roles of individual frameworks, the IIRC formed the Corporate Reporting Dialogue, which brings together several key standard setters and framework developers. Participants have already adopted a Statement of Common Principles of Materiality, developed a Corporate Reporting Landscape Map, and taken a common position in support of the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosure (TCFD). In 2018, it launched the Better Alignment Project that will work on mapping various standards and frameworks to identify commonalities and differences between them and opportunities for aligned disclosure requirements.