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INTEGRATED REPORTING – A SOLUTION FOR THE SUSTAINABLE DEVELOPMENT OF THE CORPORATE SECTOR

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ABSTRACT

The private sector has been dealing with one of the most severe financial crisis in recent history, thus the question of solutions must be tackled. As a result of the need to adapting to a more demanding economic environment, the present business reporting has proven unsatisfactory. Alternatively, an Integrated Reporting system could be the answer: flexible, addressing short, medium and long term time frames, focusing both on the past and future, it analyze s six key types of capitals - financial, manufactured, intellectual, social and relationship, human and natural capital. This paper aims at to introduce the concept of Integrated Reporting with respect to sustainable growth. In the literature review section the progress of Integrated Reporting is reviewed from the perspective of two organizations' - King Report on Governance for South Africa, and the International Integrated Reporting Council in the U.K. Afterwards, the article presents a case study of a successful company which has already issued an integrated report in 2012, combining information on its financial and non-financial performance – SAP AG, to enhance transparency and innovation potential. Therefore, the implications are centred on providing new lines for the business model and underlining the practical importance of interdependencies between categories of reported information.

Key words*: integrated reporting, intellectual capital, human capital, economic crisis, innovation.*

JEL codes*: J24, G01, G32, O16.*

1. Introduction

As empirical research carries more and new studies that bring light over the link between disclosure, especially voluntary disclosure, and growth disclosing has become one of the main concerns of many businesses. However, what should a company disclose? Then more questions must be addressed: financial or non-financial data, what rules should be applied, which shareholders and stakeholders, what are the strategic consequence, and so on. Therefore the best option is to use a framework that has been already engaged in various economic sectors and successfully applied.

This was one of the reasons behind a new concept – integrated reporting. The second has to do more with the changes that are result of economic challenges, such as the economic crisis, and new economic paradigms. One of the contemporary perspectives depicts several types of capitals – financial capital, manufactured capital, intellectual capital, social and relationship capital, human capital and natural capital. Because they are interconnected they should be visualized and analyzed together. Hence, the International Integrated Reporting Council (IIRC) has issued in March 2013 a Prototype Framework as a starting point for companies which want to make use of an integrated report, an instrument useful to communicate periodically to the different shareholders the value creation path the organization takes. Also, it can support the strategy development and financial sustainability (Integrated Reporting Organization, 2013).

Our paper aims to define and present the concept of integrated reporting in connection to the corporate sector, the place where it has started. We also want to evaluate its ability of acting as a speed up factor for recovering of profit organization after an economic crisis (especially by comparison to other frameworks already in use) but also to identify possible implications for the public sector.

Therefore, the literature review discusses the IR (Integrated Reporting) through the perspective of two of the most important organization in this field. First is the King Report on Governance for South Africa (King III), issued by Integrated Reporting Committee of. South Africa (IRCSA). After initiating the first report in 1994, South Africa was the first to impose an integrated report to companies listed on JSE (Johannesburg Stock Exchange) after the King III Report experience. The other is the International Integrated Reporting Council, formed in 2011 by various stakeholders from reporting field, which has assumed the important responsibility of working on the development of an integrated reporting framework that can be internationally acknowledged (ACCA, 2012).

Next, the article studies the six capitals that are employed when carrying integrated reporting, and tries to identify both advantages and disadvantages of this business model. In order to exemplify the intermediary conclusions after the analysis, a successful case study is included: SAP Integrated Report 2012.

Finally, the conclusion and future research section include several examples of companies that have already included IR as a current practice - Vodacom and Wilderness Holdings - public company (Africa), and Smithfield (America).

2. Integrated Reporting concept

2.1 From compulsory to voluntary disclosure

The King Report on Governance for South Africa (King III) is the result of the efforts of Integrated Reporting Committee of South Africa (IRCSA), positioning Africa as a pioneer in the field. The reason is that, even though there are other countries which are trying to implement IR, they are still at a building stage, while King III represented the first national project of this kind. It was introduced in 2010 by the Johannesburg Stock Exchange (JSE), which included IR in accordance with King III Report 2009 as a requirement for companies that wanted to be listed, except for the primarily listed ones. However, this came as a normal development considering that the first King Report was issued in 1994, then focusing on the improvement of corporate governance. This was also, due to the new Act of Companies which entered into force in 2011, a year after IRCSA worked under the coordination of professor Mervyn King on integrated reporting good practice (ACCA, 2012).

Practically, the JSE requires is: "(a) a narrative statement of how it has applied the principles set out in the King Code, providing an explanation that enables its shareholders and potential investors to evaluate how the principles have been applied; and (b) a statement addressing the extent of the company's compliance with the King Code and the reasons for each and every instance of noncompliance." (JSE, 2012). To comply with these obligations, the straightforward way was to require companies to prepare and deliver an Integrated Report. The recommendations concern its periodicity which should be annual, including the proper financial and sustainability performance information, and focus on the content not the form. Disclosure is compulsory, along with the financial reports, the responsibility being delegated by the board to an independent audit committee (King III - Chapter 9: Integrated reporting and disclosure).

At the same time, another structure that has great impact on IR is the International Integrated Reporting Council (IIRC). The organization was founded in 2011 and it brings together various stakeholders such as businesses, accountancy companies, regulators, academics, that are connected to IR (IIRC, 2013).

One of IIRC most significant outcomes is the IR International Framework, which is to be made public in December 2013, after a consultation Draft Period; also, running the IIRC Pilot Programme, that ends September 2014, is a corner stone. The programme involves 100 corporations belonging to different industries across the world, and 35 investors' organizations. Their main objectives are to contribute to developing the IR International Framework and to test it during a reporting cycle (IIRC, 2013).

Another input is building up the multiple capitals theory that is incorporated in IR vision of IIRC: the financial capital, manufactured capital, intellectual capital, human capital, social and relationship capital, and natural capital.

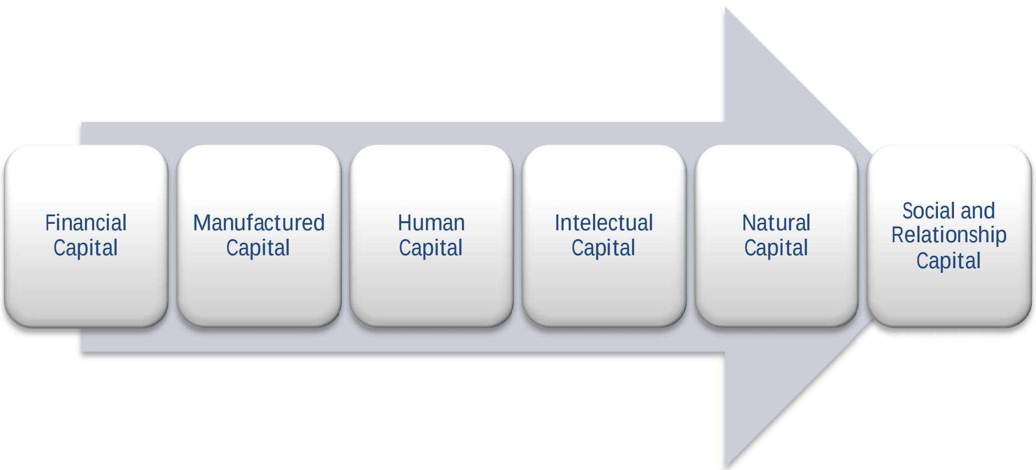
On the other hand there are many other reporting frameworks, codes and guidance systems, like Connected Reporting (Accounting for Sustainability, 2013), which presented the "Connected Reporting Framework" (CRF) – 2007, and the Connected Reporting "how to" guide – 2009, Sustainability Reporting Guidelines (GRI) by the Global Reporting Initiative (GRI, 2013) only to name two of many. The common reticence that forced almost 100 years of waiting until a standardized financial reporting was globally recognized has proved its power for many of these. Still IR has had a better acceptance rate, even in times of economic crisis (Deloitte, 2011).

2.2 Six capitals for a new business model

Introduced as a “stores of value” theory, the six capitals came to answer to the issue of including more than traditionally requested items in the financial reports. The terminology which resulted after consultations carried by IIRC, is still under development; another term for capital is “resources and relationships” (IIRC, 2013).

As the Figure 1 shows, the capitals are interconnected and therefore they are dependent on each other. For example, a decision to invest in manufactured or human capital increases this capital but diminishes the financial capital. Considered as input factors, capitals’ role is to contribute to the future growth of the company. However, depending on the specific activity some of them may be more or less important than others, in which case they add to little to the value creation processes therefore being “immaterial for reporting” (IIRC, 2013)..

Figure 1. The Six Capitals and Integrated Reporting



A significant obstacle when trying to promote and enforce a new reporting framework is the measurement. Used to quantitative indicators and metrics nowadays it has become obvious that this is not enough. For many components of the capitals this is not possible – human capital incorporates experience, reputation or loyalty; can these be monetary evaluated? Others are measured better by accounting their effects and by making use of narratives instead of figures. But IR offers is a benchmark system against which an organization can start evaluating and reporting all its capitals. This means that there will be capitals which are not covered by the six capital theory but can be included if necessary for achieving the goals of an integrated report.

Following we present each type of capital according to a Background paper on IR that aims at detailing the six capitals theory, corroborated with information from Deloitte, Ernst & Young, and ACCA.

Financial Capital represents the “pool of funds” available and used by a company in the production process. It comprises the debt, equity and grants, interacting with the other capitals by the way it transforms itself to value. The financial capital is a means for acquiring other forms of capital – investing in the personnel qualifications by training decreases the financial capital but it increases the value of the human capital. Still the perspective of IR on the financial capital is oriented towards the sources of funding and not on the acquisition process.

Manufactured Capital is defined as "material goods and infrastructure owned, leased or controlled by an organisation that contribute to production or service provision, but do not become embodied in its output" (The Sigma Project), such as buildings or infrastructure. A characteristic is that it combines both tangible elements as well as intangible, which are associated of intellectual capital like patents for a machine.

The next is *Intellectual Capital*, whose definition is still under construction. The notion has most often been defined by its three components – human capital, structural (organizational) capital and relational component, but for reporting purposes this could cause confusion (Human capital and Social and Relational Capital). There are also subtle aspects to be analyzed: intellectual capital has both intangible assets and liabilities (intellectual liabilities) yet unaccounted for; the intangibles must possess certain futures so they can be reported – "durably and effectively internalized and/or appropriated" (IIRC, 2013) by the company. At last, reporting must make the distinction between intellectual capital and intellectual property which are not the same. The latter is only a part of IC over which the company has legal rights.

Because of these reasons the next three capitals are separately reported and disclosed though under debate as they are strongly connected to IC.

Human Capital is represented by individual employees who have the skills, abilities, loyalty and experience, all required for the duties specific to the company for which they work. This implies that the organization is in control as it is responsible for the selection procedure of the human resources.

On the other hand, the *Social and Relationship Capital* is embedded in the networks a firm has, both internal and external ones. Obviously it is linked also to the Human Capital but it refers mainly to social aspects, functioning as a complement to it and to IC. Here are grouped common values, key relationships and social licence to operate (IIRC's Prototype Framework).

Finally, *Natural Capital* includes the natural resources that are vital to performing any economic activity, renewable and not renewable, such as water supplies, soil, minerals or air, all necessary to produce goods and services.

To sum up the Six capitals and IIRC Framework we want to underline that though they seem overlapping with sustainable reporting the two are not the same. The integrated reporting is focusing mostly on a specific category of stakeholders, those who make available of the financial capital, and on the impact of the capitals on the value creation process. On the other hand, sustainable reporting is focusing on financial return, in the case of private entities, and social benefits, well being, goods or services for the public sector, while the motivation varies from legal requirements to political pressure (ACCA, 2010). But is it integrated reporting superior? This remains a tricky question to answer.

3. SAP Group

The research had as first objective to identify the current state of the art on the investigated topic. The second purpose was to analyze reporting principles through a case study, the software company SAP Group, comparative to those included in the International Framework (IIRC, 2013). Finally, the study intended to identify the disclosure reasons behind voluntary IR and the benefits it brings, in particular providing solutions in case of global economic crisis.

To reach these goals a simultaneous approach was required through document analysis and case study (qualitative research methods triangulation) to analyze the information from different perspectives and use diverse documents as data sources. These meant public documents available on the IIRC website and the emerging integrated reporting databases. Another important source was the papers published by professional organizations such as ACCA, PricewaterhouseCoopers, Deloitte Global Services Limited or Global Reporting Initiative (GRI).

It should be mentioned that the research design made use of document analysis because of several advantages: the possibility to work with written records on a topic of great interest at the moment, but on which it would be difficult to collect enough data due to rapid development and changes in the state of the art; it offered the possibility to continue the research in the future for determining the level of change, even in the eventuality of increasing the research sample.

SAP Group (SAP, SucessFactors and Ariba), "the world leader in enterprise software and software-related services", presented the first Integrated Report in 2012 together with its Annual Report. The documents were drawn up in accordance with the reporting and accounting standards – IFRS in the case of the Consolidated Financial Statements, German Commercial Code and German Accounting Standards No. 17 and 20 for the Management Report, including the SAP subsidiaries and the Global Reporting Initiative (GRI) for aspects related to the social and environmental information (SAP Integrated Report, 2012).

To collect information on future development directions as well as challenges on IR, SAP IR Report was investigated in comparison to the general IR trends for the period 2009-2011, for the African companies listed on JSE (ACCA, 2012). The reasoning is connected to the research performed by ACCA which had a sample of companies from different industries, investigation carried by "interpretative/critical approach to analyzing the content of integrated reports and of annual reports", that were issued before the IR became compulsory.

As stated, the "***stores of value***" differ from one company to another. However, considering a framework and clear ***principles*** for determining them simplifies the ***selection process***. In the case of SAP the principles applied were *inclusivity* (the entity assumes responsibility for its actions, and it involves the stakeholders in achieving sustainability), *materiality* (settles on the significance of an item for the entity and its shareholders; an item is material if it influences the course of decision and actions), and *responsiveness* (stakeholders' engagement by cooperating and communicating with them), as presented in the AA1000 AccountAbility Principles Standard (2008) (SAP, 2012).

The great focus on materiality is in line with King III and IRSA as they recommend that only material elements to be subjected to disclosure. But the materiality choice and materiality definition are still under construction notions. According to the International Integrated Reporting Framework the general principles to be applied are *strategic focus*, that is to link strategic objectives of the entity to the creation value process; *connectivity of information* –business model, external factors, and resources and relationships available to the company; *future orientation* so that from the IR can be determined potential perspectives and risks; *responsiveness and stakeholder inclusiveness*, and *conciseness, reliability* and the aforementioned *materiality*.

The next aspect was ***the integration level of information regarding social, environmental and ethical issues***. Though the list varies across companies, it was noticed that most items fall under the "social" category. This is explained by the historical importance given to them in South Africa.

For SAP IR the indicators are grouped in five categories: Financial key performance, Research and Development, Shares and dividends, Employees, Customers and Environmental. Here, the social and environmental indicators are predominant compared to the ethical ones. The number of items per category may vary in the future as SAP rethinks the definition of materiality in 2011. One outcome is the change of vision over risks, opportunities and solutions ; the later ones are currently analyzed as portfolios not only as a specific set of solutions, while the number of tackled issues has been limited to the most significant ones for a more efficient management.

Table 1. Key indicators for SAP Integrated Report 2012, adapted by the authors from SAP Integrated Report 2012, [Online], Available at:
http://www.sapintegratedreport.com/2012/fileadmin/user_upload/2012_SAPintegratedreport/downloadcenter/13_03_27/SAP_AR 2012_en.pdf

Key Indicators	
Financial key performance indicators	Software and cloud subscriptions (IFRS) Non-IFRS adjustments Software and cloud subscriptions (non-IFRS) Software and software-related service revenue (IFRS) Non-IFRS adjustments Software and software-related service revenue (non-IFRS) Total revenue (IFRS) Non-IFRS adjustments Total revenue (non-IFRS) Operating profit (IFRS) Non-IFRS adjustments Operating profit (non-IFRS) Operating margin in % (IFRS) Operating margin in % (non-IFRS) Free cash flow Net liquidity Days' sales outstanding (DSO) Equity ratio (total equity as a percentage of total assets)
Research and development	Research and development expenses Research and development expenses as a percentage of total revenue (non-IFRS) Number of employees in research and development at year-end
Shares and dividend	Weighted average shares, basic in millions Earnings per share in € Dividend per share in € Share prices at year-end in € Market capitalization in € billions
Employees	Number of employees at year-end Personnel expenses per employee – excluding share-based compensation Employee engagement Business Health Culture Index Women Female managers Employee retention
Customers	Net Promoter Score
Environmental	Greenhouse gas emissions in kilotons Greenhouse gas emissions per employee in tons Greenhouse gas emissions per € revenue in grams Total energy consumed in GWh Energy consumed per employee in MWh Renewable energy sourced in % Data center energy consumed in GWh Data center energy per employee in KWh

Without being a compulsory requirement like in the case of King III, the drivers behind IR in Europe are diverse. SAP mentions several of them in a special section of the Report:

- To create a corporate sustainable strategy
- To capitalize on innovation and better business by integrating thinking
- The connection between financial and non-financial performance: it has been acknowledged that ignoring ethical, social or environmental items can impact the financial results.
- Increasing transparency: *"Our four global corporate objectives speak to this need for balance: Two focus on our past financial performance (growth and margin) and two on non-financial measures that capture our ability to perform in the future (customer success and employee engagement)."*
- To develop innovative services tailored to clients' changing needs.

It also must be pointed out the change in *the stakeholders discourse* noticed by the ACCA research. In the case of SAP this aspect cannot be tracked over time as 2012 IR was the first, but in the CEO letter to the stakeholder's deals with subjects as innovation strategy, value of innovation, social resources, without disregarding the link with financial component: "*In 2010, we introduced a highly focused innovation strategy that doubled our addressable market… In 2012, we experienced another four quarters of double-digit software and software-related (SSRS) growth (non-IFRS) – we have now had 12 consecutive quarters of double-digit SSRS growth. (..) Our cloud momentum continued to accelerate, and the annual cloud revenue run rate approached €850 million."*

4. Conclusions and future development

For SAP the importance of integrated reporting is revealed in connection to the exterior risks that the group faces. In the Management Report there are clearly identified risks associated to the economic, political, social and regulatory aspects but out of them we will only discuss the first category. An economic global crisis like the one that has affected Europe these years can decrease the potential investment in the company as well as the profits, financial performance, or unbalance the cash flow estimations.

On the other hand, IR offers the possibility to tackle these risks in an aggregated manner. The Combined Management Report includes a section dedicated to Economic Conditions. Here there are presented the global economic trends and the economic recovery evolution in 2012, followed by an analysis of the IT market (expansion and competitors) and finally the impact of the economic conditions on SAP.

The findings also provide further references for determining the current state of the art in the case of companies that draw up Integrated Reports voluntarily. It can be a starting point for continuing the research in Romania. There is only limited information on companies which implemented IR. One example is ENEL, a multinational company operating on gas and power market that has applied the guidelines of Global Reporting Initiative (GRI), and issued since 2006 a sustainability report, while 2012 was the first year for the IR evaluating also Romanian operations. However, there is still a long way to go. Already many companies abroad have annually IR such as AstraZeneca in the health care industry, Vodacom and Wilderness Holdings- public company from Africa, Smithfield in America, and the list of examples continues [1].

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