Integrated reporting gives better picture of company's worth

by **Kamarul Azhar**
FD@bizedge.com

WITH market value of companies linked more and more to intangible factors rather than physical and financial assets, integrated reporting offers a more comprehensive representation of an organisation, particularly public listed company. Through a concise annual report, a company's strategies, governance, performance and prospects can be presented more accurately.

According to the International Integrated Reporting Committee (IIRC), between 1975 and 2009, the physical and financial assets of S&P 500 companies being reflected by their market values have been declining. While physical and financial assets represented 83% of the average market value of S&P 500 stocks in 1975, it was a mere 19% in 2009.

The declining percentage highlights a concern that not everything that is valuable to a company is captured within the financial data or numbers as they appear, and according to the current framework for financial reporting, said managing partner of PricewaterhouseCoopers Malaysia Sridharan Nair in an exclusive interview with *The Edge Financial Daily*.

"The market is actually demanding more information on non-financial aspects. For many companies only about 20% of their value is actually captured in the balance sheet, in the form of tangible and some intangible assets. So it makes sense to communicate what is not on your balance sheet as well," said Sridharan.

This is because shareholders and investors are not given a clear picture of what the organisation or company really has, especially the intangibles.

With capital market regulations and accounting standards requiring more and more data, the bigger picture and longer-term aspiration of companies are lost in translation amid the financial jargons and terminologies.

"Reporting as it stands today has a lot of bias towards compliance. Companies tend to focus on complying with regulations and standards in their reporting, which is important. But they should also look at ways of communicating what may be useful to shareholders in terms of value creation," said Sridharan.

Integrated reporting is described as linking together the material information about an organisation's strategy, governance, performance and prospects in the commercial, social and environmental context within which it operates, according to the IIRC.

The idea behind integrated reporting stems from the 2008 global financial crisis, as investors were perplexed as to why businesses that had produced financial statements under generally accepted accounting principles (GAAP) could suddenly fail.

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These investors questioned whether there was accurate and adequate disclosure of risks, and whether all assets were appropriately valued.

At the same time, financial reports are becoming more detailed, with numerous financial terminologies used. Companies are also producing an array of other reports, such as on corporate governance and corporate social responsibilities, which target different audiences and readers.

Integrated reporting focuses on the strategy of the organisation and its governance, how these translate into its performance historically and the prospects going forward, said Sridharan. It is reporting in the context of the external environment and the market in which the company operates, and also about communicating how they create value, he added.

The percentage of a company's market value not represented by its financial assets is higher now than it was three decades ago. This shows that investors today need to be presented with an integrated report, which highlights the company's strategies, governance, performance and prospects, in order for them to ascribe a more reflective value of the stock, said Sridharan.

"There is just a lot of financial information being reported, while a lot of non-financial value is not communicated. So integrated reporting is in a way a chance for organisations to define their own story, as opposed to allowing the markets to define the story for them," he said.

In a pilot run organised by the IIRC in April 2013, 95% of the 85 companies from 50 countries involved found that integrated reporting provides a clearer view of their business models. Ninety-three percent of the participants say it breaks down internal silos, while 95% agree that it increases board focus on exactly what the key performance indicators for the business should be.

While the benefits of integrated reporting may not be achieved instantaneously, Sridharan said there is substantial evidence that shows that when companies adopt good corporate governance and better disclosure, there is a level of market appreciation which, over a period of time, translates into the value of the share price.