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INTEGRATED REPORTING AS A MECHANISM OF INCREASING BUSINESS VALUE

The article considers the fundamental concept of an international integrated reporting framework. A number of problems associated with adequate quantitative reflection of changes in the amount of different types of capital are outlined, as well as the impact of such changes on company's business value.

Keywords: *integrated reporting; value creation; financial capital; forms of capital.*

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ІНТЕГРОВАНА ЗВІТНІСТЬ ЯК МЕХАНІЗМ ПІДВИЩЕННЯ ВАРТОСТІ БІЗНЕСУ

У статті розглянуто фундаментальну концепцію основ підготовки інтегрованої звітності. Визначено низку проблем, пов'язаних з адекватним кількісним відображенням змін величини різних видів капіталів і впливу таких змін на вартість бізнесу.

Ключові слова: *інтегрована звітність; створення вартості; фінансовий капітал; види капіталу.*

Табл. 1. Рис. 1. Літ. 12.

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ИНТЕГРИРОВАННАЯ ОТЧЕТНОСТЬ КАК МЕХАНИЗМ ПОВЫШЕНИЯ СТОИМОСТИ БИЗНЕСА

В статье рассмотрены фундаментальная концепция основ подготовки интегрированной отчетности. Обозначен ряд проблем, связанных с адекватным количественным отражением изменений величины различных видов капиталов и влияния таких изменений на стоимость бизнеса.

Ключевые слова: *интегрированная отчетность; создание стоимости; финансовый капитал; виды капитала.*

Introduction. A new stage in corporate reporting development is the emergence of the integrated reporting (IR), which is a consolidation of financial and non-financial information reflecting organization's ability to create and maintain its value in the short, medium and long term. The visible results of IR are short, periodic integrated reports.

The emergence of this kind of reporting was not accidental. The gap between the needs of investors to have a more complete picture of company's value and the information currently contained in financial statements increases. IR is designed to fill this gap by offering a basis for companies to explain how the value creation process affects capital markets. IR can also help users to look beyond short-term results of the companies, to form a clearer outlook on the long-term value of a company.

Literature review. The general issues of integrated reporting were developed by foreign, Russian and Ukrainian researchers: sustainable development problems (Porter and Kramer, 2011), creation of an Integrated Reporting model (Drukman and Martin, 2012; Busco, Frigo, Quattrone and Riccaboni, 2013) and setting up companies' value (Sorokina, 2010; Solovieva, 2013; Kostyrko and Lishycha, 2012; Lokhanova, 2013; Davyduk, 2012) etc.

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Problem statement is revealing topical issues the development of an integrated reporting model, elaboration of financial statements to reflect the increase or decrease in business as a whole, integrated reporting data validation by independent experts.

Results and discussion. The world first integrated reports began to emerge in the mid 2000s. In 2007 by the Prince of Wales initiative "Accounting for sustainability" was presented a document named "Connected Reporting Framework". In 2009, the same organization released another paper – "Connected Reporting "how to" guide. Later all the groundwork were passed to the newly initiated International Integrated Reporting Council (IIRC).

The IIRC was created in 2010, under the aegis of A4S and GRI to develop a unified approach to integrated reporting. All A4S research in integrated reporting was transferred to IIRC, which focused on international standards elaboration. In 2011, the Council issued a document "One step closer to integrated reporting. New approach in the XXI century" defining an IIRC approach to integrated report format.

IR concept is supported by over 90 global companies and more than 50 institutional investors, members of the IIRC pilot program. Among them are Danone, Deloitte, HSBC, KPMG, Microsoft, Coca-Cola, Unilever, Volvo etc. Russian companies participants of the pilot program are: "Rosatom", OJSC "NK Rosneft", OJSC "NIAEP" FC "Uralsib". In Ukraine, integrated reporting issues just started to be discussed by financiers of major domestic corporations, who have their first experience in the formation of sustainable development reporting due to inclusion of their companies into the pilot projects ("DTEK", "Metinvest" Group, FIG "SKM", "Obolon" corporation) (DTEK corportate website,2013).

In December, 2013 an official document was released called "The International Integrated Reporting Framework". A considerable part of IR Framework is devoted to companies' "value creation".

The basis for preparation of integrated reporting rests on two fundamental concepts: 1. Value creation. 2. Categories of capital.

The value creation process in question is based on 7 elements: organizational overview and external environment, governance, opportunities and risks, strategy and resource allocation, business model, performance, and future outlook.

Let us consider fundamental concepts mentioned above in more detail.

Value creation. The main idea is that company value cannot be created by or within an organization alone. The value can vary over time: influenced by external environment or through relationships with stakeholders, as well as depending on the access to various resources.

Therefore, an integrated report should focus on:

- external environment that affects a company;
- resources and relationships used and affected by a company;
- how company interacts with external environment and capitals to create value over the short, medium and long terms.

Corporate reporting discloses the value created directly for the company, and enables financial returns to the providers of financial capital. Integrated reporting includes also the value an organization creates for others – stakeholders and society at large.

Moreover, the ability of the company to create value for itself is linked to the value it creates for others. This happens through a wide range of activities, interactions and relationships:

1. Company operations (business activities results).
2. Relations with concerned parties (customer satisfaction, suppliers' willingness to trade with the company, terms and conditions upon which they do so).
3. Interactions with external environment (legal requirements, company reputation etc.).

When these interactions, activities, and relationships are material to the company's ability to create value for itself, they are included in the integrated report.

Forms of capital. All organizations depend on various forms of capital for their success. "The International IR Framework" address capital categories stated in Table 1 below, though preparing an integrated report is not required to adopt this categorization. It is included in the "Framework" as a guideline to ensure a company does not overlook a capital that it uses or affects.

Table 1. **The capitals**

	Categories of the capital	*Definitions*	*Examples*
1.	Financial capital	The pool of funds available to a company for use in the production of goods or services provision, obtained through financing.	Debt, equity or grants, or generated through operations or investments.
2.	Manufactured capital	Manufactured physical objects (distinct from natural physical objects) available to a company for use in the production of goods or services provision	Buildings, equipment, infrastructure (roads, ports, bridges etc.)
3.	Intellectual capital	Organizational, knowledge-based intangibles	Intellectual property: patents, copyrights, software, rights and licences; "organizational capital" such as tacit knowledge, systems, procedures and protocols.
4.	Human capital	People's competencies, capabilities and experience, their motivation to innovate	Alignment with and support for a company's governance framework, risk management approach, ethical values, ability to understand, develop and implement company's strategy, loyalties and motivation for improving processes, goods and services, including the ability to lead, manage and collaborate.
5.	Social and relationship capital	Institutions and relationships within and between communities, groups of stakeholders and other networks; the ability to share information to enhance individual and collective well-being	Shared norms and common values, key stakeholder relationships, trust and willingness to engage that a company has developed and strives to build and protect with external stakeholders, intangibles associated with brand and reputation.

Continuation of *Table 1*

	Categories of the capital	*Definitions*	*Examples*
6.	Natural capital	All renewable and non-renewable environmental resources and processes that provide goods or services that support past, current or future prosperity of a company.	Air, water, land, minerals and forests, biodiversity and eco-system health.

Source: The International IR Framework (International Integrated Reporting Council, December 2013).

The overall stock of capitals is not fixed over time. There is a constant flow between and within capitals as they increase, decrease or transform. For example, when an organization improves its human capital through employee training, the related training costs reduce its financial capital. The effect is that financial capital is transforming into human capital.

The value creation process. The value creation process is depicted in Figure 1.

As we can see an integrated report includes the following 7 elements: organizational overview and external environment, governance, business model, opportunities and risks, strategy and resource allocation, performance, and future outlook.

External environment, including economic conditions, technological change, societal issues and environmental challenges, sets the context within which an organization operates. Mission and vision encompass the whole organization, identifying its purpose and intention in clear, concise terms.

At the core of organization is its business model, which draws on various capitals as inputs and, through its business activities, converts them to outputs (products, services, by-products and waste). Organization's activities and its outputs lead to outcomes in terms of effects on capitals. The capacity of business model to adapt to changes (e.g., in the availability, quality and affordability of inputs) can affect organization's longer-term viability.

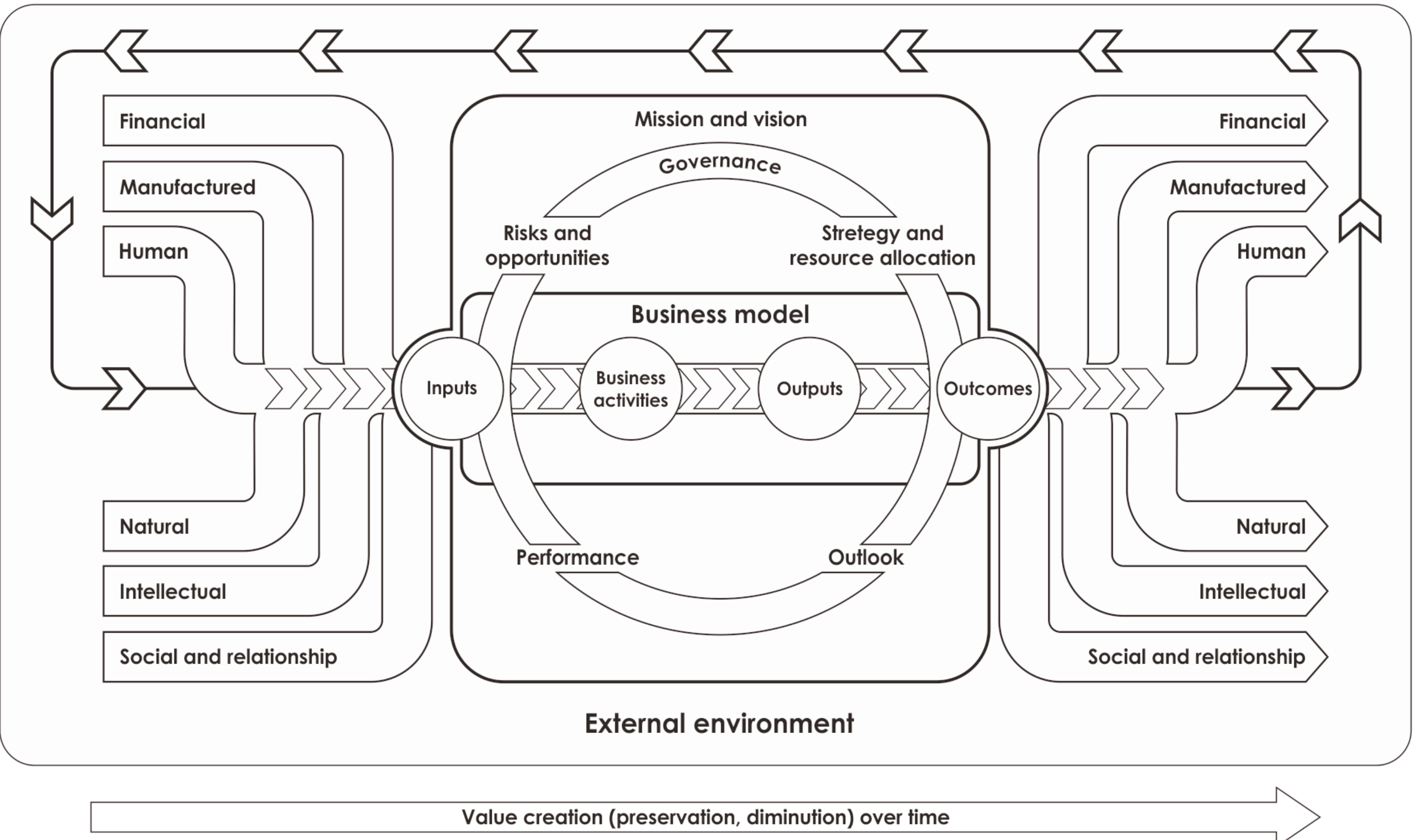
Business activities include planning, design and manufacture of products or deployment of specialized skills and knowledge in services provision. Encouraging the culture of innovation is often a key business activity in terms of generating new products and services that anticipate customer demand, introducing efficiencies and better technology use, substituting inputs to minimize adverse social or environmental effects, and finding alternative uses for outputs.

Continuous monitoring and analysis of external environment in the context of organization's mission and vision identifies risks and opportunities relevant to organization, its strategy and business model.

Organization's strategy identifies how it intends to mitigate or manage risks and maximize opportunities. It sets out strategic objectives and strategies to achieve them, which are implemented through resource allocation plans.

Organization needs information about its performance, which involves setting up measurement and monitoring systems to provide information for decision-making.

The value creation process is not static; regular review of each component and its interactions with other components, and a focus on organization's outlook, lead to revision and refinement to improve all the components.



Source: The International IR Framework (International Integrated Reporting Council, December 2013).

Figure 1. **The value creation process**

Considered fundamental concepts of value creation are certainly innovative and designed to respond to stakeholders' requests on the creation of value over short, medium and long term.

However, it is clear that the development of integrated reporting model raises a number of problems. As noted by K.V. Sorokina (2010) "one of the main issues is how much in detail is it possible to define the information necessary to disclose, for it to be useful". According to the "IFRS Conceptual Framework" (Conceptual framework of financial reporting, 2010) for financial information to be useful, it must be relevant and authentically represent what it is meant to represent (QC4 of "IFRS Conceptual Framework"). Relevant financial information can affect the decisions made by users (QC6 of "IFRS Conceptual Framework"). To be faithful representation it should be complete, neutral and free from error (QC12 of "IFRS Conceptual Framework").

Usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable (QC4 of "IFRS Conceptual Framework").

Information is material if its omission or misstatement could influence the decisions made by users on the basis of financial information on a particular reporting entity – materiality is specific for the organization aspect of relevance (QC11 of "IFRS Conceptual Framework").

Since "IFRS Conceptual Framework" refers to financial performance, is the given judgment applicable to non-financial indicators? Sometimes even executives do not know what specific indicators need to be analyzed and disclosed in the IR as "a lead to success".

Also according (Sorokina, 2010) it seems to be reasonable to disclose success drivers to business. However, a major obstacle in the practical application of this approach is that, although this relationship is intuitively clear, distinctly defined contribution of each driver (which can be numerous) to success and financial performance of the company is very difficult. The effect can be cumulative, i.e., from a few drivers together, to estimate the contribution of each driver in financial statements is quite subjective.

A number of IR problems are outlined in the publication (Lokhanova, 2013). In particular, 4 groups of unresolved issues are stated:

- providing materiality of information, presented in IR;
- balancing necessary but not excessive information, that could endanger economically sustainable development of an enterprise;
- balancing of economic interests in relation to sustainable development and disclosure of relevant information;
- reliability of the indicators used in the preparation of integrated reporting.

And yet still a major problem, in the author's opinion, is adequate, objective, quantitative assessment of business value, what was the main purpose of the integrated reporting model developers. At the same time, according to item 4.53 of the "Conceptual framework of the International Integrated Reporting" (The international IR framework, 2013) quantitative indicators are allowed and even encouraged, in particular some guidelines were issued regarding that.

It is unclear however, how to practically assess the impact of certain capital category on business in general? Is there any correlation between changes in e.g. social capital and company's business value and how to keep track of it? For example, if a

company has financed during the year two social events for more than the last year, will that increase the total company value (with a noticeable and measurable reduction of financial capital)?

It is quite obvious that the measurement and evaluation of the changes impact in one or another form of capital on company's value is a methodical challenge. At first, the indicators have to be developed, the methodology have to be determined for calculating the impact on value, and only then widespread introduction of this integrated reporting model would be possible.

Corporate financial reporting presented by companies (which provide useful information for existing and potential investors to make decisions about providing resources to organization) certainly has some limitations. In particular, in the present model of corporate reporting not enough attention is paid to some factors, such as risk, strategy, supervision and stability of the enterprise business model. Certainly reporting should evolve as there is a need to reflect changes in business, information technologies, and consumers' needs – but should the changes be so revolutionary?

Prospects for further research concern a number of issues:

- theoretical (problems of terminology in the Conceptual framework of the International Integrated Reporting, IR status, scope, purpose, users problems etc.).
- methodological (the process of integrated reporting as a product of the integral accounting system, qualitative, quantitative indicators that measure the value of business, elaboration of the methodology for the integrated reporting model etc.)

Conclusions. Value created by an organization has two interrelated aspects: value created for the organization itself, which brings financial benefits to the providers of financial capital, and the value created for other stakeholders and society at large. Therefore, an integrated report is intended to disclose information about the external environment affecting the organization, resources and relationships used in the company and how organization interacts with the environment and capitals to create value in the short, medium and long terms.

1. All organizations depend on various forms of capital for their success. "Conceptual IR Framework" reckons such capital categories as financial, manufactured, intellectual, human, natural, social and relationship. Capitals are the stocks of value that are increased, decreased or transformed through the activities and outputs of the organization.

2. The value creation process is based on 7 elements: organizational overview and external environment, governance, opportunities and risks, strategy and resource allocation, business model, performance, and future outlook.

3. Building a model of integrated reporting raises a number of problems, including the following:

- whether it is possible to define in detail the information, required for disclosure in the IR, to make it useful;
- to reach the balance of necessary but not excessive information, which could jeopardize economically sustainable development of the enterprise;
- to balance economic interests with respect to sustainable development and disclosure of relevant information.

4. The main problem is the lack of adequate, objective, quantitative assessment of business value, which was the purpose of the developers of integrated reporting model.

5. Estimation and evaluation of the impact of changes in one or another form of capital on the company value as a whole is a methodical challenge. First, indicators have to be elaborated, then methodology for calculating the impact on value is to be developed, before the widespread introduction of this integrated reporting model.

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