Chapter 1

Paradigm Shift in Corporate Reporting

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Additional information is available at the end of the chapter

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Abstract

In this paper, we present the evolution of integrated reporting and organizations playing an active role in this process. As a result of the changes, corporate reports including only historical financial information have become insufficient. It has started to be important for the firms to be sensitive towards environment, social capital and governance. For these reasons, authorities started to search for new reporting types. Their aim was to form a report giving detailed (prospective and retrospective) information about the total performance of the firm. Sustainability reports, the starting point of integrated reporting, were established and Global Reporting Initiative (GRI) standards were formed to increase the popularization. Integrated reports aim to supply full disclosure about the firms' strategies, goals and performances. They also respond to the demands and needs of key stakeholders. In order to actualize the financial stability and sustainability, they are necessary. Integrated reports also put related groups into play. So, decision makers become a participant instead of watching the system from outside. In addition, integrated thinking philosophy provides systematic disclosure of value creation, namely how organizations made resource allocations in the past and how they will create value in the future according to their business models.

Keywords: integrated reporting, sustainability reporting, International Integrated Reporting Council, Global Reporting Initiative

1. Introduction

There have been so many changes because of globalisation, developments in technology, rapid population growth, increases in human needs and in the number of environmentally sensitive people. In connection with all these issues, while machine and labour-based production have decreased, information-based production has increased. Also climate changes in negative direction, social responsibility problems and raw material shortages have been observed. As a result of all these changes, traditional financial reports have not kept pace to surroundings.

As traditional financial reports give information about only firms' historical financial positions, they started to be inefficient. In addition to the financial information request, a demand towards non-financial information has also been seen and financial reports giving only financial information have not been preferred any more. Nowadays, in firm evaluation, people do not deal with profit only. They also want to be informed about the environmental sensitivity, future performance, risks and opportunities of the firm. All mentioned changes have led to differentiations in business world.

In order to meet all needs, financial reports started to possess lot of information. This caused confusion and users of financial reports got lost among a lot of information [1]. They could not obtain items that they wanted to learn from reports. This made financial reports useless. Studies had started in order to overcome these problems. Authorities had searched for financial report types having ideal characteristics and meeting needs. Many different types of financial reports have been established by different standard setters in different period of time. As a result, a common view formed a report possessing both financial and nonfinancial information, lacking unnecessary bulk information, being stakeholders' need oriented should be prepared with a standard framework.

A report, considering happiness and welfare of all living things, thinking about future generations and displaying firms' performance related with environmental, social, corporate governance issues, formed and named as sustainability report. But unfortunately, sustainability reports become insufficient in responding the correlation between the firm itself and its business model, strategy and financial situation [2]. In order to overcome this problem, a new reporting type Integrated Reporting (IR) was formed.

As seen in **Figure 1** which is adopted from EY (2014) report [3], the evaluation of corporate reporting has been changed dramatically over the years. In the 1960s, corporate reports referred to financial statements only. Over time, they have become much more contentful. In the early 2000s, sustainability reports have taken place within corporate reports. Nowadays, integrated reports including financial information, governance and remuneration, management

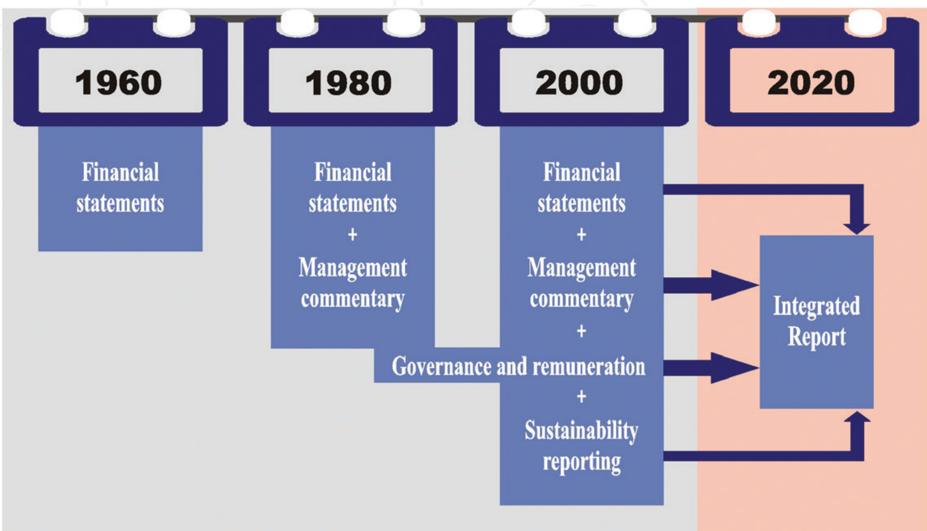

Figure 1. Evaluation of corporate reporting.

commentary and sustainability information become significant in business world. Consequently, it is possible to say that today integrated reports become the pre-eminent form of corporate reports.

In the ongoing sections of this chapter, firstly, sustainability reporting will be subjected as the starting point of IR. Then, the main item IR will be examined in detail with its historical development and its philosophy of integrated thinking.

2. Sustainability reporting

The term of sustainable development was first presented in Brundtland Report of the World Commission on Environment and Development (Brundtland Commission) in 1987. With this term, the importance of guaranteeing the future of new generations was revealed. After that, to be able to respond the changing needs, firms have started to prepare sustainability reports. The important issues about sustainability mentioned in G4 Sustainability Reporting Guidelines are as: "*Sustainability reporting helps organizations to set goals, measure performance, and manage change in order to make their operations more sustainable. A sustainability report conveys disclosures on an organization's impacts—be they positive or negative—on the environment, society and the economy. In doing so, sustainability reporting makes abstract issues tangible and concrete, thereby assisting in understanding and managing the effects of sustainability developments on the organization's activities and strategy*" [4]. Long-term profitability, social justice and environmental protection are the main goals of firms preparing sustainability reports.

With the spread of sustainability, besides financial performance, the importance of social and environmental performances also increased. Therefore, in year 1994, the term "Triple Bottom Line (TBL)" was established by John Elkington regarding to sustainability. TBL consists of three performance dimensions: social, environmental and financial. It has three elements represented as 3Ps. These are:

- People represents the social dimension of TBL
- Planet represents the environmental dimension of TBL
- Profit represents the financial dimension of TBL.

The main goal of TBL is to measure firms' social, environmental and financial performances and to ensure and advance sustainability. The measurement may be actualized by using a shared currency or basing into an index.

The leading organization in the dissemination of sustainability reporting is Global Reporting Initiative (GRI). GRI is an international independent organization that shows the impact of the firms on critical sustainability issues. It has published standards since 2000 in order to form the framework of sustainability reports. The first version of GRI Guidelines named as G1 was published in 2000. In 2002, the second version G2 was published. In 2006, G3 Guidelines was launched. In May 2013, GRI established the fourth generation of Guidelines, G4. Latest revolution of these standards is GRI Sustainability Reporting Standards (or shortly GRI Standards).

GRI Standards are the improved forms of G4 Guidelines. Although there are G4 Guidelines on the basis of GRI Standards, some of the terminologies in G4 have been simplified or changed while passing to GRI Standards. GRI Standards will be mandatory after 1 July 2018. Firms continue to apply G4 Guidelines until that date. Global Sustainability Standards Board (GSSB) is the GRI's independent standard setting body, and it issues GRI Standards. There are three universal standards: GRI 101, GRI 102 and GRI 103. GRI 101 is the starting point and consists of reporting principals.[1] It gives information about how sustainability reports should be prepared according to the standards. GRI 102 mentions the general disclosures related with contextual information. GRI 103 deals with management approach (how you manage).

GRI Standards have also topic specific standards. They have three different main topics as; economic (GRI 200), environmental (GRI 300) and social (GRI 400). They are like bag standards with modular structure and they may be updated, new ones may be added. Firms apply universal standards and in addition to these, they may choose from topic specific standards related with material topics.

In **Figure 2** which is adopted from Chersan study [5], it is possible to see the geographic distribution of reporting according to GRI. While the highest number of reports prepared according to GRI Guidelines is the year 2014 with 3981, the lowest one is the year 1999 with 6.

	Asia	Africa	Europe	S. America	N. America	Oceania
1999	1	0	0	0	5	0
2000	7	3	1	1	2	1
2001	1	1	15	2	6	9
2002	3	8	22	9	31	12
2003	3	2	54	5	31	10
2004	8	22	115	9	47	14
2005	29	23	180	17	50	23
2006	39	25	223	51	70	40
2007	85	24	342	80	27	48
2008	185	51	457	141	38	71
2009	304	54	647	189	83	90
2010	367	55	829	258	66	81
2013	1119	167	1344	613	439	122
2014	1183	167	1443	619	453	116
2015	702	47	940	418	274	24

Figure 2. Geographic distribution of reporting according to GRI at world level.

[1]Reporting principals are stakeholder inclusiveness, sustainability context, materiality, completeness, accuracy, balance, clarity, comparability, reliability and timeliness. These have to be taken into account when preparing a sustainability report.

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In total, Europe has the highest number of GRI-certified reports. The region with lowest number of reports is Oceania with only 24 firms. On the date of 9 March 2017, according to Sustainability Disclosure Database, totally there are 38,969 reports, 26,004 GRI reports and 10,397 organizations whose reports include sustainability reports [6].

3. Integrated reporting

As a result of increasing needs and changing conditions, both business world and authorities started to be in quest of new reporting types meeting the needs. Especially, stakeholders do not want to examine 150–200 pages reports. This is not useful for them because excessive information obscures critical details. They want to possess clear and concise information at short notice. Integrated reports hold all these features and they can respond to the needs of related groups.

IR contributes to the financial stability and sustainable development by integrating both financial and non-financial information. Actually, IR is more than the combination of financial statements and sustainability reports. It gives a holistic view for the related groups. There may be some problems in adopting IR. As it is research intensive, every business cannot apply it. Also, there is a risk of being so much transparent.

It is possible to examine the components of S&P 500 market value from **Figure 3** which is adopted from Ocean Tomo's 2015 Annual Study [7]. There has been a decrease in firms' tangible assets with the decrease in machine and labour-based production. While in 1975, the intangible asset value of S&P 500 was 17%, it showed a dramatic increase between the years 1975 and 2015 and in 2015, the value of intangible assets became 87%. As a result of this

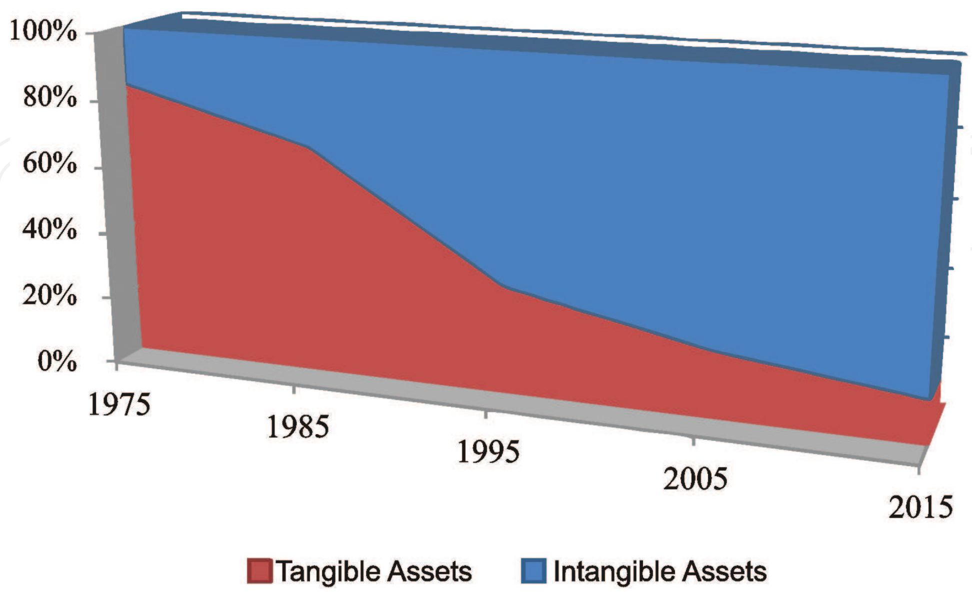

Figure 3. Components of S&P 500 market value.

increase in intangible assets rate, firms understood that they had to give much more information related to intangible assets when compared with past years.

Integrated reporting combines the information referred in traditional financial statements, management commentaries, sustainability reports, governance and remuneration reports and also shows how firms create value in short-medium-long term and the sustaining ability of firms. The term value mentioned here is created for all related groups like stakeholders, investors, government, suppliers, customers, society, creditors etc. The scope of integrated reports differs according to who the value is for. The scope of the report is broader when the value is for society compared with when the value is for investors.

The terms integrated thinking (IT) and IR are interrelated. Integrated thinking is the keystone and philosophy of IR. IT is mainly necessary for an effective IR and it is a kind of broad-minded and prospective thinking. In the study of Churet and Eccles [8], while IR is expressed as the tip and visible part of the iceberg, IT is the below and unseen part. In general, IT understands and interprets how the value creation process will be achieved in short-medium-long term by considering business resources. Long-term thinking, long-term decision making and long-term value creation are actualized by firms started to adopt IT.

Hopwood et al. [9] reveals the benefits of IR as a result of the survey conducted with the pilot enterprises selected in 2010. Eccles and Armbrester [10] and James (2015) [11] are also mentioned that IR avails to firms. On the other hand, Flower [12] and Thomson [13] have negative criticisms related with IR and address the missing aspects of it. Humphrey et al. (2017) [14] builds up a chronological archive data about the development of International Integrated Reporting Council (IIRC) and examines the reasons of high-speed evolution of both IIRC and IR. While Boiral [15] uses the research technique of counter accounting related with sustainability reporting, Rowbottom and Locke (2016) [16] examines the development of IR by using actor network theory. Serafeim [17] mentions that firms producing integrated reports have longer term investors. Chersan [18] examines the firms applying IR standards. He finds that firms implementing IR applications mostly are positioned in South Africa and secondly in European countries. These two regions account for 78% of firms preparing IR in all over the world.

3.1. Historical development process of integrated reporting

In order to understand integrated reporting much better, it is important to examine the historical development process of it as seen in **Figure 4**. In year 1994, King Report on Corporate Governance was established in South Africa in order to encourage firms to report non-financial information. There are also two other King Reports, one of them is King II which was published in 2002 and the other one is King III which was published in 2009. In these reports, the responsibilities of firms clarified as financial, social and environmental issues. Also, issuing annual integrated reports is recommended in King III.

The Prince's Accounting for Sustainability Project was constituted in 2004. Prince of Wales defended that sustainability reports had to be clear, concise and comparable. Prince's idealism was giving the task that saving the planet by the help of accounting [12].

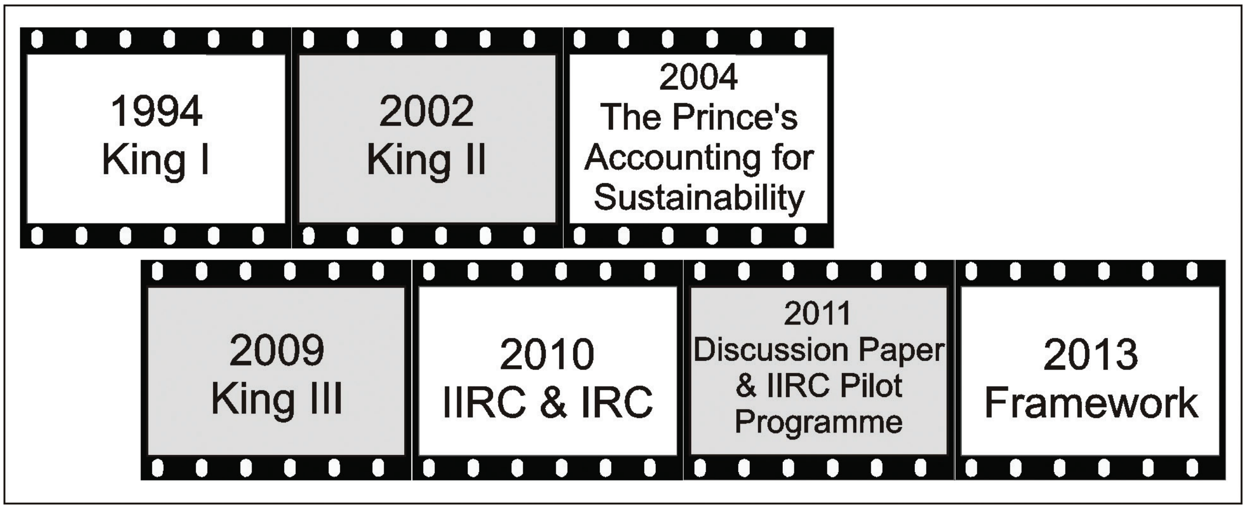

Figure 4. Historical development process of integrated reporting.

International Integrated Reporting Council (IIRC) was formed in August 2010 to actualize sustainability accounting and form a globally accepted framework. IIRC uses social and environmental accounting as a base. There are two leading organizations in the establishment of IIRC: The Prince's Accounting for Sustainability Project and Global Reporting Initiative (GRI). IIRC includes heads of the International Accounting Standards Board (IASB), the Financial Accounting Standards Board (FASB), the International Federation of Accountants (IFAC), the International Organization of Securities Commissions (IOSCO), the CEOs of the 'Big Four' (Deloitte, Ernst & Young, KPMG and PWC), the heads of the major British professional accountancy bodies and the CFOs of major multi-internationals, such as Nestle, Tata and HSBC.

In May 2010, Integrated Reporting Committee (IRC) of South Africa was also formed under the chairmanship of Professor Mervyn King. The main goal of IRC is to provide the best possible practice of integrated reporting in South Africa. The members of the IRC are as follows: Association for Savings and Investment South Africa (ASISA), Banking Association of South Africa (BASA), Batseta (Council of Retirement Funds for South Africa), Business Unity South Africa (BUSA), Chartered Secretaries Southern Africa (CSSA), Financial Services Board (FSB), Institute of Directors in Southern Africa (IoDSA), Institute of Internal Auditors (IIA), Government Employees Pension Fund (GEPF), Johannesburg Stock Exchange (JSE) and South African Institute of Chartered Accountants (SAICA) [19]. IIRC and IRC are leading organizations for the development of IR [20].

South Africa is the first in making the application of IR compulsory (legal obligation) for companies whose shares traded in the stock exchange. In the year 2010, Johannesburg Securities Exchange's (JSE) Listing Requirements were published and companies listed on the JSE either have to issue annual integrated reports (including financial, social and environmental information) or have to explain the reason of not doing so.

In October 2011, IIRC Pilot Programme was announced. This was a 2-year programme and had two parts as Business Network and Investor Network. In Business Network, there were over 100 businesses from 25 countries. They applied IR principles in order to support the development of it. Investor Network, on the hand, had over 35 participants from 12 countries. They were advocators of IR, and they shared their views related with the IR evolution. The IIRC got feedback from this Pilot Programme [21].

In September 2011, Discussion Paper related with integrated reporting was published. After that in 2013, IIRC published the International Integrated Reporting Framework. Framework consists of the guiding principles of integrated reports. These two, especially Framework, shape the integrated reports and are loadstars in the preparation of integrated reports. Shortly, it is possible to mention that King III Report, Discussion Paper and Framework are important references for the ones that will start IR.

In order to increase the importance and application of IR, Memoranda of Understanding (MOU) were signed between IIRC and many other organizations [14]. As mentioned in **Table 1**, it is possible to examine the name of organizations with which MOU was signed and also the signature dates.

3.2. Components of integrated reporting

Integrated reporting has three main components: business model, capitals and value. With all these components, it is possible to imagine IR as a system taking inputs and after operations creating outputs. Business model could be described as: "*Academic research and corporate practice are increasingly addressing the business model as a unit of analysis offering a systemic perspective on how to do business, mainly with the aim of understanding how to improve the ability of companies to create financial value. On the other hand, there is a growing body of literature on business models that provides a range of approaches to characterize their different roles for achieving corporate sustainability*" [22]. Every integrated report has a unique structure. The business model of a firm is extremely important for the integrated report as it shapes integrated report.

The terms referred as inputs and outputs in **Figure 5** [23], are both capitals, second component of IR. When the amount of output capitals is more than the amount of input capitals,

	Name of organization	Signature date
Memorandum of Understanding (MOU) signed between IIRC and	International Federation of Accountants (IFAC)	7 September 2012
	International Financial Reporting Standards (IFRS) Foundation	4 February 2013
	International Financial Reporting Standards (IFRS) Foundation	28 November 2014
	Sustainability Accounting Standards Board (SASB)	17 December 2013
	Carbon Disclosure Project (CDP) and Climate Disclosure Standards Board (CDSB)	18 July 2013
	World Intellectual Capital Initiative (WICI)	15 April 2013
	Global Reporting Initiative (GRI)	1 March 2013

Table 1. Memorandum of Understanding (MOU) signed between IIRC and other organizations.

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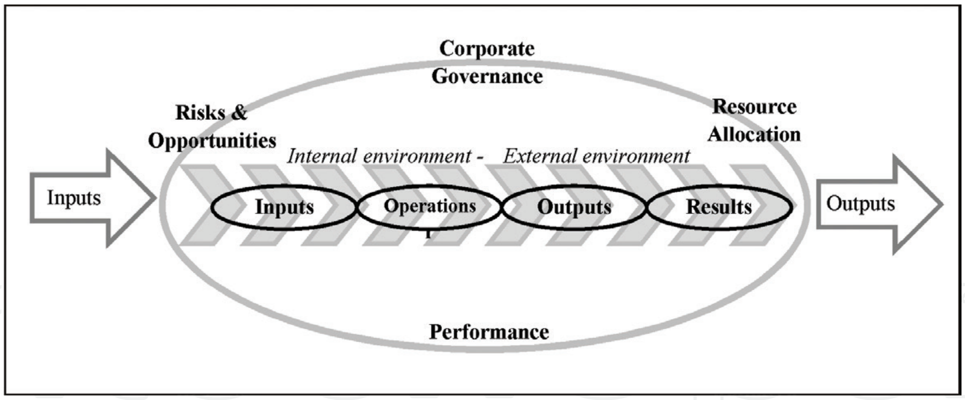

Figure 5. Business model.

we can say that there is a value creation. There are six different categories of capitals. They are financial capital, manufactured capital, human capital, intellectual capital, natural capital and social and relationship capital. Contrary to traditional financial reports, IR does not only take financial capital into consideration, it also deals with other types of capitals. Financial capital can be shortly defined as the pool of funds. Manufactured capital is a kind of human-made capital and machines, buildings, bridges, devices may be good examples of it. Human capital consists of information, skill and ability of employees'. Intellectual capital is a non-physical financial and patent rights, copyrights, licenses, software may be given as examples. Air, water, natural gas, petrol and forests are examples of natural capital. It is necessary to pay attention to the consumption of natural resources especially for future generations. Social and relationship capital is the one constituting well-functioning link, trust and interrelation between individuals and institutions.

Some of the capitals located in integrated report are not owned by the firm. Also, it is possible to make trade-offs between capitals. If the trade-offs affect value creation in a positive manner, then it is rational to do. Let's suppose that there is a decrease in capital X. The firm makes a trade-off from capital X and selects capital Y. As a result of this selection, if an increase in value actualizes, then this means that the firm's decision is right.

Integrated reports have to give information about all capitals affected by the business activities. Briefly, it is possible to specify that firms should report capitals possessed by the firm, influence the firm, controlled by the firm, being both inputs and outputs of the firm.

4. Conclusion

In this chapter, we have tried to show the development process and the paradigm shift in corporate reporting and accounting phenomenon. In today's world, sustainability issues broadly defined in terms of environmental, social and governance gain importance to make effective decisions. Therefore, stakeholders have started to demand summarized corporate reports with comprehensive information that include both financial and non-financial performance. In other words, separate presentation of financial and sustainability information without interconnection has become inadequate in the frame of guidance effectiveness of corporate reporting. In addition, information in order to shape future beliefs has also started to be demanded by stakeholders.

Integrated reporting framework announced in 2013 exhibits the new methodology of corporate reporting to satisfy stakeholders' needs. Its philosophy includes presentation of both financial and non-financial information by providing systematic disclosure of value creation, namely how organizations made resource allocations in the past and how they will create value in the future according to their business models. This new paradigm based on integrated thinking has brought sustainability into the forefront and has redefined the accounting role. Today accounting is no longer simply about producing beneficial financial information. Therefore, accounting as an information system should provide summarized comprehensive information derived by intersection of financial and non-financial performance according to paradigm shift in corporate reporting.

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