

Is Integrated Reporting relevant to SMEs?

The International Federation of Accountants (IFAC)'s policy position is that integrated reporting can bring about a more coherent corporate reporting system, which is currently largely fragmented, complex and compliance-driven. IFAC believes that integrated reporting is an opportunity to focus on long-term value creation and ultimately encourage longer term behaviour in the capital markets. But for many SMEs the capital markets and the views of institutional investors are not relevant to how they do business so does integrated reporting have any relevance to the SME sector?

We need to look at what is involved in integrated reporting and integrated thinking to understand how it can contribute positively to the functioning and growth of an SME just as it can do so for a global plc.

Integrated reporting provides a framework within which we can examine all parts of a company that are involved in value creation and preservation. It encourages integrated thinking which results in a better understanding of the various sources and drivers of value in the short, medium and long term. Ultimately, it should improve board and management information and decision making. It should inform capital providers of key drivers of enterprise value and provide confidence to them and other stakeholders that the company has a strategy for long term value creation considering its own aspirations and plans and how it is responding to changes and uncertainties in the business environment, legitimate stakeholder expectations and opportunity and risk.

According to IFAC, integrated reporting can be applied in a proportionate and scalable manner to all organisations regardless of their size and sector. The International Integrated Reporting Framework was written primarily in the context of private sector and for-profit companies of all sizes. However, as it is a principles-based framework it can be adapted and applied by organisations in the public and not-for-profit sectors. It may in fact be most suitable for charities as it provides a

holistic view of the entire activities of the organisation and how they all integrate to achieve the organisations overall purpose.

Integrated reporting is relevant to established organisations as well as those that are emerging or small and can be particularly beneficial to those building confidence in their business model and needing to attract funding, staff and other resources. Integrated thinking and reporting can benefit SMEs by helping them better understand the drivers of value in their business, resulting in more informed decisions and the implementation of a strategy and business model that will enable growth.

Through an integrated report SMEs can show potential funders how that they are equipped to create value, that they have a detailed understanding of all elements of their organisation and can therefore identify and respond rapidly to risks that could impact on their long-term goals.

IFAC has developed a guide for SMEs implementing integrated thinking and reporting. They state that through using integrated reporting, trust in the business is built by succinctly highlighting what drives value.

Understanding value creation is enabled by what is called integrated thinking, a central theme of integrated reporting, which is based on breaking down internal silos between people and departments



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so that the organisation can collectively better understand the key elements of the business. This includes the governance, strategy, business model and opportunities and risks in the context of trends and issues affecting the business. Integrated thinking also involves an organisation considering the different resources consumed and the relationships it relies on, leaving it in a better position to make decisions that help ensure its viability and resilience over time.

In addition to improving internal management processes, integrated reporting can also lead to other significant benefits including:

- Creating greater trust and credibility with customers, suppliers, other stakeholders and society. This is increasingly important in light of government agencies and not-for-profit organisations searching for commercial partners that can not only supply the goods and services that they need, but also do so sustainably;
- Maximising the potential to transfer, sell or hand over the business by providing a better basis for valuation; and
- Securing financing at a reasonable cost. Among other things, many lenders will want to know how financial capital has been deployed in the past and future intentions, based on a holistic strategy and a well-rounded business plan.

Integrated reporting is an effective way to help an SME better understand and manage how it creates value, as well as reporting on that value creation. More integrated information and thinking should lead the organisation to make better decisions about the key areas that affect its ability to create value that can then be communicated through an integrated report, which demonstrates a compelling business case to providers of finance and others interested in the business. Collectively, the process of creating value and telling the story is integrated reporting.

Multiple Capitals

Through integrated thinking, integrated reporting can help an SME build a better, more concrete understanding of the factors that determine its ability to create value over the short, medium, and long term. It enhances an SME's business planning and development by taking a fully connected, holistic view, including its use of and effect on, all capitals or resources that are important to its business model and future. Integrated reporting uses the term "capitals" and a multi-capital model to recognise the fact that value is not stored in financial capital alone, but in all sorts of capitals.

When these other capitals are properly understood and managed, they can continue to release value over time, while simultaneously growing in their capacity to continue to drive value in the future. The IFAC identifies these other capitals as:

- Manufactured capital, the tangible goods and infrastructure that an SME owns, leases or has access to that are used in the provision of goods or services.
- Intellectual capital, the knowledge, intellectual property, systems and processes that an SME has at its disposal that provide it with a competitive advantage and positively affect its future earning potential.
- Human capital, the skills, experience and motivation that employees and management in an SME possess that provide the foundation for future development and growth.
- Social and relationship capital in an SME's brands and reputation, including its relationships with the community in which it operates, its customers and business partners and others in its value chain, such as various government agencies.
- Natural capital, an SME's access to environmental resources that it can use to provide a return and/or that it affects through its activities or the goods and services it creates.

Integrated reporting involves fully considering the many implications of connectivity between all these capitals, the external environment and internal factors through the lens of the business model.

Integrated thinking encourages the free flow of information within the company which should promote more creative cross functional thinking and a shared understanding of value creation over a longer time frame through a deeper understanding of how the various capitals that impact it affect how value is created and preserved.

The current primarily financial focussed annual reports that most SMEs produce could be significantly enhanced through the use of integrated reporting and the integrated thinking which it requires. Funders and other stakeholders, including customers and employees, are as much interested in other areas, like strategy and business model, that will drive the organization forward to meet its objectives. The integrated reports allow for a broader view of the company by including key financial information alongside significant "non-financial" measures and narrative information. This provides context to current and prospective equity investors, banks and other providers of financial capital who can appreciate "the full picture" of how an SME creates value, and its capacity to continue creating value over time.

Is Integrated Reporting relevant to SMEs? If the SME is concerned with value creation and continued viability into the future then I believe the answer is yes. It is a wonderful tool to assist all enterprises to become fully aware of how they create and can retain value and how to most effectively tell their story. No company is an island. All companies need to ensure that they can communicate their value to the many varied stakeholders which now exist in the business world and integrated reporting is the ideal platform to do so.

Further information on Integrated Reporting and how to apply it can be found on the IFAC website at www.ifac.org.