THE EVOLUTION OF FINANCIAL REPORTING - INTEGRATED REPORTING AND KING IV

Global Public Sector Compliance
ACCA
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Presented by Prof Mervyn E King
Collective mind thinking in silos
Focus on profit in best interests of shareholder
Primacy of shareholders – owners
Ford Motor Co vs Dodge Brothers
Special circumstances in 1992-4
Inclusive vs exclusive
First stakeholder governance model – King I
Incapacity – directors’ heart, mind and soul
COMPONENTS OF MARKET VALUE

S&P 500

Physical and financial assets  Other assets

1975  17  83
1985  32  68
1995  68  32
2005  80  20
2009  81  19

INNOVATIONS IN CORPORATE REPORTING

- Enhanced business reporting
- Balanced score cards
- Triple bottom line
- Sustainability reporting
- Each trying to communicate value creation
- 2002 King II recommended sustainability reporting according to GRI guidelines
INTANGIBLE ASSETS

- Strategy – long term value creation
- Reputation – perceptions of stakeholders
- Supply chain - deforestation
- Human rights – child labour
- Stakeholder relationships – civil society
- Positive and negative impacts on three aspects
- Quality governance of the organisation
- How the company makes its money
BEYOND FINANCIAL REPORTING

- Triple context
- Report in monetary terms
- FR critical but not sufficient
- SR critical but not sufficient
- The two in silos not sufficient
- King III recommended IR
- Geneva
- St James’ Palace
THE SIX CAPITALS

Financial  Manufactured  Human  Intellectual  Natural  Social
AN ORGANISATION’S VALUE CREATION PROCESS

INTEGRATED REPORTING (IR)
VALUE TODAY

- How does the company make its money?
- The positive and negative impacts on the triple aspects of the company’s business model and product
- Enhancing the positives, eradicating or ameliorating the negatives
- Embedding sustainability issues into strategy
- As water is critical to the beverage manufacturer
- Now value is seen through a sustainable lens in a resource deprived world
THE THREE SHIFTS

From ‘Silo Reporting’ to ‘Integrated Reporting’

From ‘Financial Capital Market System’ to ‘Inclusive Capital Market System’

From ‘Short-term Capital Markets’ to ‘Sustainable Capital Markets’
The concept of value

Financial capital to inclusive capital

Short term capital to sustainable capital

Silo reporting to integrated reporting

EU, UK strategic report, Australia OFR

IFAC promotion of IR to the G20, global endorsement for IR in January 2017, the Coalition for Inclusive Capital has approved IR, the ISAR considering IR the way to report on the SDG’s and CIPFA started the IR Public Sector Network in 2014
THE CHANGED WORLD

- Global financial crises
- Climate change crisis
- Ecological overshoot
- Radical transparency
- Greater expectations from stakeholders
- Population growth
- Digital and net generation era
- Fourth Industrial revolution
- Cannot carry on business as usual
- Have to learn to make more with less
KING IV REGIMEN

- Prism of value creation process and inclusive capital
- Process is inputs to outcomes
- Inputs, practices, outputs, 16 principles, 4 outcomes
- Ethical culture and effective leadership
- Adequate and effective controls/oversight
- Value creation (performance) in a sustainable manner
- Trust and confidence, good reputation and legitimacy
- Apply and explain 16 basic principles
THE PUBLIC CITIZEN

- Feels disempowered
- Distrust in governments
- Public bodies need to engage with the stakeholders they serve
- Public Sector adopts financial reporting standards such as IFRS or International Public Sector Accounting Standards
<table>
<thead>
<tr>
<th>VALUE FOR MONEY PUBLIC SERVICES</th>
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<tbody>
<tr>
<td>◆ Value creation in a sustainable manner – private sector</td>
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<tr>
<td>◆ Value for money in a sustainable manner – public sector</td>
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<td>◆ CIPFA has identified IR as being applicable to the public sector</td>
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<td>◆ Clear, concise and understandable communication with the public</td>
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<td>◆ Public sector changed world</td>
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<td>◆ Aging population</td>
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<td>◆ Erratic economic growth</td>
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<td>◆ Less or diverted funds available for public sector spending</td>
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<td>◆ PPP’s in the public service</td>
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<td>◆ Blurring the boundaries between public and private sectors</td>
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CIPFA appreciates that the accountant of today has a different role

- Professional and ethical competencies
- Strategy and development in a digital world
- Good communicator with stakeholders
- Not just record keepers
- Influencers of future performance
- Changemakers
The Public Sector, Pioneer Network, CIPFA and the IIRC formed in 2014

CIPFA has identified that integrating thinking and doing an integrated report can readily be applied in the public sector

“Transparent, responsive and accountable institutions are a vital part of what it takes to improve people’s lives and implement a sustainable development agenda.” Helen Clark, Administrator, UNDP
INTEGRATED THINKING

- Understanding, knowing and then planning:
  - How the public entity creates value for money?
  - How the entity will create value for money in the long term in a sustainable manner?
  - Board should determine, inputs, how, products, outcomes
INTEGRATED THINKING

- Every entity dependent on relationships and resources
- Mindset change at board & senior management level
- Symphony
- Knowledge of stakeholders’ legitimate NIE’s
- Greater stakeholder expectations
- Agenda: Inputs to outcomes and stakeholder relationships
FIRST STAGE OF IT

- Einstein’s definition of insanity – “Doing something over and over again and expecting a different result.”
- Belief only financial capital
- Can determine value for money
- Result could be destruction of value and waste of money
SECOND STAGE OF IT

- Acknowledge there is a problem
- New solution required
- But based on old thinking
- Einstein: “We cannot solve our problems with the same thinking we used when we created them.”
- Strategy only considers financial capital
- Sustainability issues not embedded in strategy
THIRD STAGE OF IT

- All 6 capitals considered
- Symphony of resources and relationships
- Business model – how does the public entity create value for money
- Informed decision making – data overload - analytics
- Three agenda items
- Knowledge must not be lost in information
- Value creation, increases, decreases or transformation
- Caused by how the entity creates value for money, outputs and outcomes, internal and external
To be accountable you have to be understandable

“If I had more time…”
1. **Connecting departments** – one of the most mentioned benefits of Integrated Reporting is the opportunity it provides to connect teams from across an organisation, breaking down silos and leading to more integrated thinking.

2. **Improved internal processes leading to a better understanding of the business** – changes to systems driven by Integrated Reporting requirements are providing greater visibility across business activities and helping to improve understanding of how organisations create value in the broadest sense.
3. **Increased focus and awareness of senior management** – a shift to Integrated Reporting is increasing the interest and engagement of senior management in issues around the long-term sustainability of the business, which is helping them to gain a more holistic understanding of their organisation.

4. **Better articulation of the strategy and business model** – better understanding of organisational activities is enabling companies to establish a holistic business model and helping to streamline communications.

5. **Creating value for stakeholders** – organisations are starting to identify ways to measure the value to stakeholders of managing and reporting on sustainability issues.
THE ROLE OF THE CFO

- Has changed with evolving expectations
- Needs value for money in a sustainable manner in the public sector
- The CFO in the public sector does not only deal with the financial statements
- Deals with a value creation process
- Does so in order to have value for money in the public sector
- Has an ongoing communication with stakeholders as to their legitimate needs, interests and expectations
- Should more appropriately be called the Chief Value Officer
- Greenleaf Publishers
ACCOUNTABILITY

- Public sector entities accountable to their entity
- Through their entity to the members of the public
- IFRS and IPSAS incomprehensible to the public
- To be accountable one has to be understandable
- Hence CIPFA’s support for IR
- IFAC January 2017 global adoption
GLOBAL PUBLIC SECTOR NETWORKS
ADOPTING IR

- World Bank
- UNDP
- The City of London Corporation
- The Wales Audit Office UK
- Auditor General SA approves IR
May well be the sustainability report
According to GRI standards
Financial report materiality
Material matters in clear, concise and understandable language in the IR
Different definitions
MATERIALITY

- The Corporate Reporting Dialogue
- Material information is any information which is reasonably capable of making a difference to the conclusions stakeholders may draw when reviewing related information
- The future
- No good having sight but no vision
Vision in public sector has to be to create value for money in a sustainable manner and be transparent and understanding in its accountability.

Accept that it is operating in a digital world with robotics, analytics, the internet of things, nano-technology, biotechnology, being a reality.

Develop strategy on an integrated thinking basis for value for money creation in a sustainable manner.
ORIGINAL THINKING

- Inclusive stakeholder centric model
- Basic good governance principles
- To achieve four outcomes
- Regimen of apply and explain
- Parity of sources of value creation
- Through the prism of the six capitals
STEPPED APPROACH

1. Practices

2. Principles (Objectives)

3. Governance outcomes (Intended benefits)
APPLY AND EXPLAIN

- 75 principles in King III
- Application register
- 16 principles plus one in King IV
- Apply and explain
- Explain how achieved or striving
- User draws inference on quality
- And on achieving the outcomes
FOUR OUTCOMES

- Ethical culture and effective leadership
- Performance and value creation in a sustainable manner
- Adequate and effective controls
- Trust, good reputation and legitimacy
KING IV CONCEPTS (1)

- Independent director
- Variable remuneration
- Performance targets
- Say on pay – 25% invited
- Tax policy
- Audit committee determines independence of external auditor
KING IV CONCEPTS (2)

- Organisation and governing body
- Responsible citizen
- Strategy and sustainable value creation
- Report to enable informed assessment
- Diversity and composition appropriate to the organisation
KING IV CONCEPTS (3)

- Delegate but interrogate being accountable
- Shareholders appoint directors and audit committee
- No split of authority and responsibility
- Directors appoint board chairman
- Board appoints CEO
- Education to lead to more effectiveness
KING IV BASICS

- I C R A F T
- Incapacity
- Good faith, care, skill, diligence
- Essence of corporate ethics – acting with intellectual honesty in the best interests of the incapacitated company of which the director is its heart, mind and soul
THANK YOU

Prof Mervyn E King SC