



INSTITUTE OF DIRECTORS  
SOUTHERN AFRICA

# PRACTICE NOTES

King III Chapter 9  
The Integrated Report

April 2012

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## Introduction

King III recommends integrated reporting to reflect the business reality that strategy, risk, performance and sustainability have become inseparable. This integrated thinking is evidenced in the integrated report. The JSE has adopted the King III principles as part of its Listings Requirements which require companies to apply the King III recommendations, or explain which recommendations have not been applied and provide reasons therefore. A company's integrated report also assists institutional investors such as pension fund trustees, insurance companies and asset managers as well as other investment consultants in executing the responsible investment criteria contained in the Code for Responsible Investing in South Africa (CRISA)<sup>1</sup> and Regulation 28<sup>2</sup>, issued in terms of the Pension Fund Act. The need to prepare an integrated report is contained in all of these requirements.

Since the release of King III in September 2009 the Integrated Reporting Committee (IRC) was formed in May 2010. The objectives of the IRC are:

- (a) To establish good practice in integrated reporting;
- (b) To promote international harmonization of integrated reporting by working with the International Integrated Reporting Council (IIRC);
- (c) To consider the recommendations of King III.

The International Integrated Reporting Council (IIRC) was formed in July 2010 and is leading the development of the global framework for integrated reporting. Both the IRC and the IIRC have issued Discussion Papers (DPs), the aim of which is to establish practice guidelines for integrated reporting. The local DP and the International Discussion Paper (IDP) are broadly aligned in respect of key principles, with the IDP referring to the local DP.

The purpose of this practice note is to clarify the linkages and the different purposes of King III and the DPs respectively. It will also attempt to align the terminology used and the meaning attached thereto.

## Key points of this Practice Note

- The DPs issued by the IRC and the IIRC and King III address different facets of integrated reporting;

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<sup>1</sup> Code for Responsible Investing in South Africa [www.iodsa.co.za](http://www.iodsa.co.za)

<sup>2</sup> Excerpt from the preamble to regulation 28: "A fund has a fiduciary duty to act in the interests of its members whose benefits depend on the responsible management of fund assets. This duty supports the adoption of a responsible investment approach that deploys capital into markets that will earn adequate risk adjusted returns that are suitable to the members profile, liquidity needs and liabilities. Prudent investing should give consideration to any factor that may materially effect the sustainable long term returns on a fund's assets, including factors of an environmental social and governance character. This concept applies across all assets and categories of assets."

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- There is growing awareness that a company operates in an economic, social and environmental (triple) context;
  - An integrated report "brings together material information about a company's strategy, governance, performance and prospects in a way that reflects the commercial, social and environmental context within which it operates".
  - It provides a clear and concise representation of how a company demonstrates responsible corporate citizenship and how it creates and sustains value;
  - An integrated report allows stakeholders to make an informed assessment of the company's prospects for future value creation as recommended in King III.
  - The approach taken in King III was that the form of the integrated report is less important than the substance of evidencing the integrated thinking of the collective mind of the board. A single concise integrated report giving material information about the company as advocated in the DPs will suit larger companies and can be regarded as global best practice. However, smaller or less complex entities may wish to present their integrated information in other formats.
  - Whilst the triple context in decision-making is a revolutionary approach to the management of environmental and societal issues the integrated report is an evolutionary process. There will be different pathways towards an integrated report for different companies depending on their size, nature and complexity of their business.

### **Background**

The role of the company has evolved from it being a vehicle that has generated only economic benefit to shareholders to one where the company is seen as an integral part of society and should act responsibly towards its stakeholders - hence the notion of corporate citizenship. As a responsible corporate citizen the company has to take cognisance and report on the impact of its activities, positive and negative on the economy, society and the environment, while considering its dependencies thereon and the related risks. "Value" and "performance" are no longer understood as being financial only.

Financial, socio-economic and environmental performance and reporting are not parallel matters. It is for this reason that King III no longer refers to the triple bottom line as it did in King II but rather to the triple context. There is now an understanding that the financial impacts on the non-financial and vice versa. It is in fact not appropriate to use the term non-financial as all of these matters eventually have an effect on the long-term financial performance of the company.

The evolving economic, social and environmental context has brought new regulations, pressures, risks and opportunities and these must be managed by a company as a direct impact/risk of doing business.

### **The respective functions of King III and the DPs**

It is recognised that corporate reporting must keep pace with the growing awareness that a company does not operate in a vacuum but in an evolving economic, social and environmental context. It is also recognised that having the integrated report as the end goal in mind plays an important role in driving integrated thinking. The King Committee is therefore supportive of the initiative embarked upon by the local IRC and the IIRC as detailed

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guidance is required in order to give integrated reporting the required impetus and to lay down standardised guidelines. It is widely acknowledged that integrated reporting is on an evolutionary path and as such the guidance to companies will progress and develop over time as it is honed by the practical experience of reporters and the needs of users.

King III and the DPs address different facets of integrated reporting. King III recommends an integrated approach to strategy - in short, integrated thinking with the outcome being the integrated report. It is neither the intention nor the purpose and role of King III to prescribe the format of the integrated report. The IRC has set out to design best practice guidelines for a framework for an integrated report with the purpose of the IDP stated as *offering initial proposals for the development of an International Integrated Reporting Framework and outlining the next steps towards its creation and adoption*. As such the principles and practice recommendations of King III operate on a conceptual level whereas the DPs offer implementation proposals.

### **The term "integrated report"**

In order to achieve reporting within the triple context it is necessary that companies issue reports that relate and link material information in order to provide a holistic view of the strategy, risk, performance and impact of the company on the economy, society and environment and its dependencies thereon. It was also the intention that companies needed to provide information to *enable a stakeholder to make an informed assessment of the company's ... prospects for future value creation* (refer par 9 of Chapter 9 of King III). These prospects should be considered and disclosed within the triple context and not presented as only a financial consideration. This type of report is referred to as an integrated report.

The IIRC describes the integrated report as follows: *An integrated report "brings together material information about an organisation's strategy, governance, performance and prospects in a way that reflects the commercial, social and environmental context within which it operates. It provides a clear and concise representation of how an organisation demonstrates stewardship and how it creates and sustains value"*<sup>3</sup>.

The integrated report is the culmination of integrated thinking. Principle 2.2 of King III states that: *The board should appreciate that strategy, risk, performance and sustainability are inseparable*. This integrated thinking process is initiated with the development of strategy. The integration of risk, performance and sustainability into strategy is achieved by companies identifying the business' key dependencies and value drivers, and identifying and engaging on an ongoing basis with key stakeholder groupings. This should lead to a better understanding of risks and opportunities that need to be taken into account when strategy is formulated. Following from strategy setting, the integrated report should then explain how the execution of strategy formulated through the process as explained above in turn impacts on the economy, society and the environment.

It should further be noted that King III recommends a stakeholder inclusive approach to governance in accordance with the approach adopted in King III and also implied by the stated purpose of the Companies Act. While the local

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<sup>3</sup> *The IIRC "Towards Integrated Reporting: Communicating Value in the 21st Century"*

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DP concurs, the IDP states the integrated report should initially be aimed at the needs of investors.

### **The form of the integrated report**

The approach taken in King III was that the form of the integrated report is less important than providing the information on an integrated basis. The emphasis is on substance over form. There may be a single integrated report or a suite of reports containing integrated information and consisting of the annual financial statements and in addition any one or more of the following at the choice of the company: sustainability, governance, environmental, remuneration, management and corporate citizenship reports, etc.

The understanding as set out above is borne out by paragraph 1 of Chapter 9: Integrated Reporting and Disclosure: *Integrated reporting means a holistic and integrated representation of the company's performance in terms of both its finances and its sustainability. This can take the form of a single report or dual reports. The emphasis is on substance over form and integration should not be reduced merely to the manifestation in physical terms of one or more documents. While a truly integrated report should be presented in one document, it can be presented in more than one document. If the integrated report encompasses more than one document, the documents should be made available at the same time and disclosed as an integrated report.*

As the purpose of the DPs is to provide a specific framework for integrated reports, these guidelines are more prescriptive on the format of the integrated report. The DPs advocate a single report which holistically and concisely presents only material information. This single high-level report will, in terms of the guidelines contained in the DPs, be linked to more detailed reports which could be accessed online.

The King Committee is of the view that this format of the report will assist especially larger companies which may find it difficult to evidence the connection and linkage of information whether it be across multiple reports or within a single voluminous report. A single high-level report would in these circumstances constitute global best practice. However, smaller or less complex entities may wish to present their integrated information in other formats. In that case the preparer must ensure that the information is easily accessible to the user.

King III allows for a "summarised" integrated report which refers to a summary of the combined reports as informed by integrated thinking. The term "summarised" should not be understood simply as an abbreviated version of the underlying reports which then becomes the integrated report. This summarised report may indeed incorporate all of the elements of the integrated reporting suite referred to above in the one report by reference. (One of the means to achieve such incorporation is through including electronic linkages to the detailed information). However, a mere summary may not suffice as integration denotes an attempt to connect certain material information in the underlying reports as opposed to merely being an abbreviation. As such there should be an interpretive component to the "summarised" report. The interpretation of information involves applying a

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methodology that assists with distilling the material information.<sup>4</sup> The underlying reports should however be prepared on an integrated basis as the integrated process should flow through all forms of reporting.

In most approaches to format one will have an integrated report and more detailed information in other places. The challenge is whether the integrated report can stand on its own as a holistic account of the “state of play” in the company’s business. A summary report will not achieve the objectives of an integrated report if it is in fact a collation of silo information bolted together. Whatever form the integrated report takes, the end result should be that strategy, sustainability and financial information are integrated. The ultimate test is whether the integrated report evidences that the sustainability issues material to the company’s business have been embedded into long-term strategy so that an informed assessment can be made about maintaining value creation in the longer term.

The references made in King III for specific matters to be disclosed should be incorporated in the integrated report either directly or by reference to other reports.

### **The way forward**

The IIRC is expected to issue further guidance later in 2012 taking into consideration the public comments it has received on its first DP and the practical experience of the companies participating in its pilot programme, with an exposure draft on the framework issued in 2013. The IRC will continue its work in localising the international guidance and will issue updated guidance following the IIRC’s guidance.

In conclusion: The principles and practice recommendations in King III are consistent with international governance trends. They are also consistent with adopting an evolutionary approach towards achieving best practice integrated reporting as envisaged by the IRC and the IIRC. Many aspects remain to be addressed; assurance on the integrated report being one of them. As such, there will be different pathways towards integrated reporting for different organisations depending on their size, nature of business and complexity.

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<sup>4</sup> Providing guidance on the methodology to determine material information falls outside the scope of this practice note and is a matter that needs to be addressed by the DPs and other guidance documents.