

## THE RELEVANCE OF INTEGRATED REPORTING IN GOOD CORPORATE GOVERNANCE

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*Purpose* – The purpose of this paper is to show that corporate governance is fundamental to the continuing operation of any corporation; hence much attention has to be paid to the procedures of such governance. One crucial component of this governance is sustainability and this paper discusses whether the current practices of reporting actually benefits the society by adopting sustainable procedures or just provide sustainable features at face value in order to lure investors.

*Design/methodology/approach*- This Paper compiles various facets of corporate governance in India and through a survey of existing research, identifies the need and history of evolution of corporate governance reforms in India. This paper also identifies the policy measure that needs to be undertaken for addressing lacunae in the existing corporate governance framework.

*Findings* – This analysis found that there is an urgent need for companies to incorporate sustainability more strongly in their core strategy and inadvertently not considering it only for reporting purpose. In this regard, integrated reporting can help business to take more sustainable decisions by creating a link between corporate financial performance and social, environmental, & economic context within which it operates.

*Research limitations/implications* – The paper has implications in enhancing the understanding of the necessary components of corporate governance, as covered by case studies in this paper. These additions in corporate governance would not only create more confidence for the investors in the company but also make the employees feel more responsible and proud of the organization, thus adding to productivity and also the credit value of the company.

**Key words:** Corporate Governance, Corporate Social Responsibility, Sustainability, Integrated Reporting.

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## 1. INTRODUCTION

All corporations need capital or “money” to run and execute their day-to-day activities. A large portion of this capital is raised from investors in the domestic and in the international capital markets and when an investor invests money in a corporation, they expect the board and the management to act as trustees and ensure the safety of the capital and also earn a rate of return that is higher than the cost of capital. In this regard, investors expect management to act in their best interests at all times and adopt good corporate governance practices leading to their wealth maximization. Corporate governance is basically the “ethical standards” followed by a company and refers to the set of systems, principles and processes by which a company is governed and provides a framework for excellent future growth of the company. They essentially provide the guidelines as to how the company can be directed or controlled such that it can fulfill its goals and objectives in a manner that adds to the value of the company and is also beneficial for all stakeholders in the long term.

Corporate governance works on the basic axle of transparency, accountability, fairness and responsibility and about making a distinction between personal and corporate funds in the management of a company.”

## 2. NEED FOR CORPORATE GOVERNANCE

The corporate form is increasingly emerging as the preferred form of business for carrying out economic and commercial activities and accordingly the number of companies has expanded immensely. In such an emerging corporate scenario, there is a need for fair and transparent for the business environment where companies can be held accountable for their actions. Hence there has to be a system of good governance. Good corporate governance practices are a sine qua non for sustainable business that aims at generating long-term value to all its shareholders and other stakeholders.

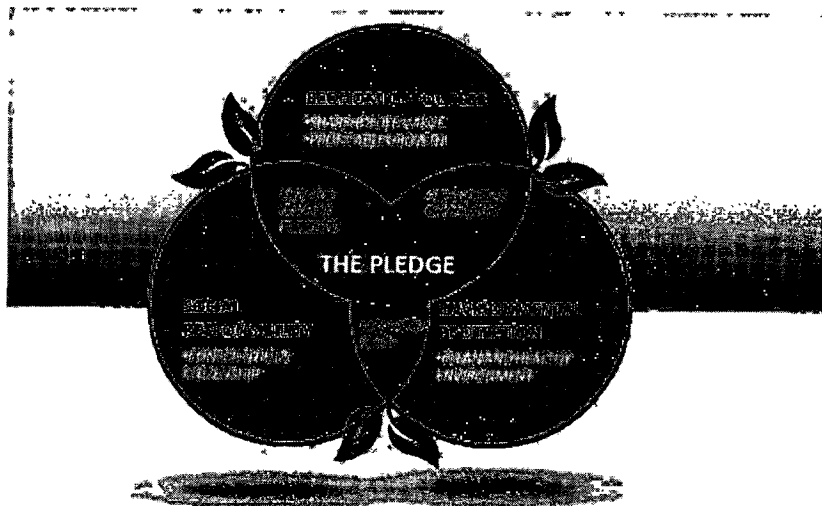
In recent years the need for corporate governance has gained much significance. This is mainly because of the scams, frauds; misuse and misappropriation of public money that have been taking place in India and worldwide. Good corporate governance has become indispensable with increasing globalization where the big companies now have access to global pools of capital and global markets for selling their goods and with increasing collaborations, takeovers and mergers.

In corporate form of business, ownership and management are two different entities. The

Shareholders (owners) in a company are scattered over large areas and are mainly inactive in the management of the company. In such a situation, the directors can misuse their powers for their own benefits, which are detrimental to the interests of other stakeholders.

### 3. CORPORATE SOCIAL RESPONSIBILITY

As explained in the previous section, good corporate governance ensures better performance, promotes transparency, enhances accountability and helps in building sound relationship with stakeholders. It enables a corporation to operate with best international practices in a competitive manner, while fostering a positive environment for investment and growth. To give information about how organizations are managed and conduct their businesses, external corporate reporting has evolved from the simple financial reporting of profits and losses, assets and liabilities. This change has embraced information on governance as well as non-financial information on environmental and social performance. In parallel, a separate strand of reporting has emerged under the "Corporate Social Responsibility" (CSR) or "sustainability" banner, which, covers the environmental impacts of the companies work, but can also cover the corporate relationships with employees, their health and well-being, relations with local communities, working conditions in the supply chain, transparency of business dealings, and anti-fraud and anti-corruption behavior.



In this article, we use the term corporate responsibility interchangeably with the term sustainability, to include social as well as environmental aspects of acting responsibly. CSR is not just an act of philanthropy (by giving donations to charitable institutions usually unrelated to an operation's social and environmental responsibilities or its

business objectives) but it is an act of being responsible in terms of meeting high ethical standards in procuring their raw materials and adopting the practices that causes minimal damage to the society as a whole. The concept of giving back has undergone a sea change. The challenge is to ensure that sustainability information is included in mainstream reporting and is strategically included such that it forms a part of the decision-making process of the business. This differs from much of the current corporate responsibility reporting, which is not connected with the business and its strategic thinking. This integrated reporting would raise the overall standards of the company and create a trust worthy image that would yield higher returns in future.

#### 4. RATIONALE OF STUDY

Though there have been many studies addressing the role of corporate social responsibility, in the light of recent tragedy in Uttarakhand state of India (where in many people lost their lives due to massive flood and various cloud bursts), it has made us think - If human actions are responsible for this massive disaster that is considered as a natural phenomenon? We raise this question as there are various reports suggesting that companies operating in this region flouted a number of environmental legislations and there were no lessons learnt from past disasters. The state DMMC report of a similar tragedy in Sept 2012 had made recommendations to reduce the risks of landslides in landslide prone state, and one of them read, "Use of explosives in the fragile Himalayan terrain for infrastructure developmental works introduces instability in the rocks and therefore use of explosives should necessarily be banned." Use of explosives is used for clearing way for various developmental projects like better roads, hydel power projects etc. Nothing was done about this recommendation. Through this paper we want to throw light on the responsibility of corporations towards the environment. In the face of the challenges of climate change and the over-consumption of the Earth's finite natural resources, it is increasingly important for organizations to understand how such issues will impact on their continuity and success in the short, medium and long-term. It is only through the integration of environmental and social factors into business and management reporting that the fundamental connection between strategic directions, financial performance and sustainability impacts will be made clear. This would be important both for the company to earn credibility but also for clients who would be assured that their activities in collaboration with the company would not leads to any adverse effects on the society at large. It is a win-win situation for all and can be attained simply by adopting better standards and better reporting.

## 5. LITERATURE REVIEW

This review examines the disclosure practices adopted by various corporate and the factors governing them.

Mastrandonas and Strife (1992) study finds that stakeholders demand disclosure of company environmental information because of the magnitude of liabilities and cost associated with environmental issues. They say that corporate should consider using environmental annual reports to communicate with their stakeholder and that will foster their partnership.

The paper by Kolk and Pinske (2011) analyses to what extent corporate governance has become integrated in MNEs' disclosure practices on CSR. Based on an analysis of CSR reporting of Fortune Global 250 companies, findings show that more than half of them have a separate corporate governance section in their CSR report and/or explicitly links corporate governance and CSR issues. It was found that MNEs that disclose information on a wider variety of social and environmental issues and frame CSR with a focus on internal issues are more inclined to integrate corporate governance in their CSR reporting.

In another study Madhani (2011) annual reports of twenty Indian corporate entities for the financial year 2007-08 were taken as sample. The sample company includes ten public sector companies and equal number of private sector companies. The study has revealed that corporate entities have put some efforts to preserve the environment. Out of sample companies 75% (7 public and 8 private) of them disclosed that they have put emphasis on reduction of emission of green house gases from their industrial plants. Again, 60% of the sample companies have undertaken afforestation drive as trees can contribute important role for the protection of environment and maintaining ecological balance by sinking carbon dioxide and generating oxygen. 65% of the sample (7 public and 6 private) companies have adopted policy of reduction in uses of natural resources, reuse of such resources and recycling of the used resources.

Murthy (2008) conducted study on 16 top software firms in India concluded that human resource category was most frequently reported attributes followed by community development activities and environmental activities were least reported. The annual reports in the sample were analyzed in order to quantify the voluntarily disclosed corporate social information using the content analysis technique. The study was sector specific and covered only software firms.

Choi and Mueller (2007) contended that corporate operations, for the most part, concern themselves with production processes and technological innovation. These activities, however, do not take place in a social vacuum and corporations both domestic and multinational are being called upon to account for social responsibilities that transcend purely "bottom line" concerns. Social responsibility disclosures are an integral feature of this behavioral phenomenon. Finally, corporations should recognize in self-interest the importance of anticipating public opinion on matters of social concern. A reputation of being an enlightened employer with a sincere regard for environmental responsibilities translates directly into future economic dividends such as low levels of industrial disputes and favorable government relations.

Jones (2010) advocated that companies could provide a statement of their corporate philosophy towards the environment in the annual report or stand-alone environmental reports. In particular, identifying any threats they recognize and, in particular, whether their business activities potentially contribute to those threats. Whether the company recognizes a duty to act and what in broad terms it intends to do. A statement of its attitude to sustainable development, what it believes the phrase means, and how it operationalises sustainable development. Compliance with a clear comprehensive set of time-series performance indicators either internally devised or externally such as the GRI. These should embrace, *inter alia*, targets on water, waste, recycling, energy, pollution, biodiversity and, in particular, given the current concerns with climate change comprehensive details of air emissions, particularly tonnes of carbon dioxide.

Pramanik (2008) maintained that protecting the environment is the social responsibility and commitment of corporations towards the society. It is believed that corporation is responsible for the environmental crisis and so they should pay for this (cost-benefit trade off). However, reporting is mostly guided by standards, guidelines etc. And, we do not have any standards designed for such disclosure. So, such reporting is still voluntary that has no specific format and style. Voluntary disclosure often leads to non-disclosure and mandatory disclosure leads to minimal disclosure. Thus, environmental disclosure should have both type of orientation, as it is a question of life and sustainability.

Dhar and Mitra (2010) reviewed annual reports of 100 companies randomly selected out of BSE 500 index. CSR disclosure items were handpicked from the annual reports and an unweight disclosure index was conducted. The study used content analysis and the Overall Corporate Social Responsibility Disclosure Score were calculated. The study found that there is scope for improvement in corporate social reporting practices in

India. Although, a few companies have started to publish separate sustainability or corporate social report, there is lack of objective and informative reporting as demonstrated by this survey.

The research paper of Firoz (2010) made a critical appraisal of the contemporary environmental accounting literature and examined whether IFRS can contribute towards monitoring and protection of environment. The study concluded that the organizations are required to enhance the scope of environmental financial reporting from the present reporting practices as recognition and measurement of environmental benefits, environmental costs, environmental assets and environmental liabilities.

## **6. EVOLUTION OF INTEGRATED REPORTING**

The impetus behind issuing this document was the King Report on Governance for South Africa 2009 (King III), written by University of South Africa professor Mervyn King, which recommended that companies and other organizations produce integrated reports connecting material financial and sustainability information. King III was created to maintain South Africa's leadership in standards and practices for corporate governance. Although still largely a voluntary practice in most countries, it already is (South Africa) or soon will be (France) required of all listed companies.

## **7. RELEVANCE OF INTEGRATED REPORTING**

In more recent years, growing social (e.g., poverty, deteriorating social equality, and corruption) and environmental (e.g., carbon emissions, water usage, and waste) concerns have pressured companies towards a more systematic treatment of sustainability reporting. Through reporting, the firm would disclose how it is utilizing, developing (or depleting) and more generally affecting human capital and natural resources. Faced with the environmental risks that are currently occurring worldwide (climate change, dwindling natural resources, drastic loss of biodiversity, natural and industrial disasters, etc.) and the pressure of public opinion, some companies have recently integrated sustainable development into their strategy. Although in its infancy in terms of development (Eccles and Armbrester, 2011), integrated reporting promises to be an ideal system to provide answers for decision making. Integrated reporting is a new concept not only in South Africa but also all over the world. It is defined in the King Report on Governance for South Africa 2009 (King III) as a "holistic and integrated representation of the company's performance in terms of both its finance and its sustainability" (IOD, 2009). In terms of

this definition, companies are encouraged to assess their performance holistically in that they have to consider various aspects that are essential to the success of their businesses. These aspects include (1) the adoption of good and effective strategies; (2) implementation of good corporate governance practices; (3) application of effective risk management processes; (4) assessment of the company's financial performance; and (5) promotion of sustainability which includes addressing economic, social and environmental issues (IOD, 2009; SAIRC Discussion Paper, 2011). Long-term sustainable value creation requires the company to take a holistic view of its decisions and the consequences of these decisions regarding financial, natural, and human resources in terms of how decisions about each type of resource affect the other ones. It also requires good governance and risk management in order to ensure that decisions producing short-term performance do not threaten the company's long-term performance or even existence. As expressed by the IIRC, through integrated reporting, a company is able "to demonstrate the linkages between an organization's strategy, governance and financial performance and the social, environmental and economic context within which it operates.

Integrated Reporting brings together the material information about an organization'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 organization demonstrates stewardship and how it creates value, now and in the future. Integrated Reporting combines the most material elements of information currently reported in separate reporting strands (financial, management commentary, governance and remuneration, and sustainability) in a coherent whole, and importantly:

- Shows the connectivity between them; and
- Explains how they affect the ability of an organization to create and sustain value in the short, medium and long term.

## **8. PRESENT STATUS OF INTEGRATION OF NON-FIANANCIAL INFORMATION**

Adoption of integrated reporting or having information about environmental and social factors is still in its infancy in India and other Asian countries. The GRI has been working with the Confederation of Indian Industry (CII) for a better understanding of the Indian context of reporting and ways of applying the international framework standard domestically.



Integrated Reporting by Companies			
		Low	High
Investor Interestst	High	Canada Greece India Japan Singapore Switzerland United States	UK Germany Italy Spain
	Low	Australia China Hong Kong Netherlands South Korea	Belgium Brazil Denmark Finland France South Africa Sweden

As per the data provided by Bloomberg and SAM, in Sustainable investor countries such as India, Japan and United States there are very little integrated reporting by companies but a high level of interest by investors in non-financial performance matrices so the dominant force lies with the investors.

According to the CSR index 2011, following is the score chart of countries in the integration of environmental and social information in annual reports.

Table 1: Integration of Environmental and Social Information by Countries

Rank	Country	Environmental score	Rank	Country	Social score
1	UNITED KINGDOM	54.5	1	UNITED KINGDOM	48.2
2	FRANCE	54.5	2	BRAZIL	48.0
3	DENMARK	46.2	3	GERMANY	46.8
4	SWEDEN	45.5	4	SWEDEN	45.5
5	FINLAND	44.4	5	FRANCE	42.9
6	PORTUGAL	44.4	6	FINLAND	33.3
7	BRAZIL	40.0	7	SOUTH AFRICA	30.8
8	RUSSIAN FEDERATION	33.3	8	ITALY	29.2
9	GERMANY	29.8	9	DENMARK	23.1
10	LUXEMBOURG	25.0	10	BELGIUM	16.7
11	SOUTH AFRICA	23.1	11	IRELAND	11.1
12	NETHERLANDS	9.1	12	SPAIN	6.7
13	SWITZERLAND	8.1	13	NETHERLANDS	6.1
14	SPAIN	6.7	14	LUXEMBOURG	0.0
15	BELGIUM	-5.6	15	MALAYSIA	0.0
16	ITALY	-8.3	16	SINGAPORE	-4.3
17	IRELAND	-11.1	17	SWITZERLAND	-5.4
18	MEXICO	-12.5	18	MEXICO	-12.5
19	GREECE	-18.2	19	HONGKONG	-17.1
20	AUSTRALIA	-19.7	20	AUSTRIA	-22.2
21	JAPAN	-20.0	21	INDIA	-26.3
22	SINGAPORE	-21.7	22	CHINA	-26.7
23	AUSTRIA	-22.2	23	AUSTRALIA	-33.3
24	INDIA	-31.6	24	JAPAN	-39.0
25	HONGKONG	-31.7	25	GREECE	-45.5
26	CANADA	46.2	26	CANADA	-49.5
27	CHINA	-53.3	27	COLOMBIA	-50.0
28	KOREA (SOUTH)	-59.0	28	KOREA (SOUTH)	-64.6
29	UNITED STATES	-79.0	29	UNITED STATES	-81.1

Source: Sustainable Asset Management (SAM) database 2009

Companies in the developing economies of India, China and Korea are more focused on pursuing the short-term growth opportunities they are facing and thus less concerned by long-term sustainability. The level of sustainability reporting in India is in its infancy and still evolving. In India, there are various drivers behind the increase in dialogue, discussion, and publication of sustainability reports – drivers that are somewhat different from other parts of the world. For example, pressure from the NGO sector is low in India when compared to other countries. Pressure originates rather from increasing involvement in the global business environment. Many companies issuing

CSR corporate communications now actively report on the social dimension as well. For institutions in India one of the primary drivers of their involvement in activities in social and environmental spheres is their reputation and branding.

There are many reasons for this change in mindset. Foremost is the increasing globalization of business. As more Indian companies expand internationally and acquire interests overseas, demands on transparency from a more "global audience" have put pressure on Indian companies to start reporting on sustainability issues. Within India, there has also been a change in the mindset and attitudes of stakeholders on issues relating to environmental and social responsibility. Recently, government faced public protests and pressure to refuse entry to foreign ships that were brought to India for decommissioning, as they contained large amounts of asbestos and other harmful substances. While the general public opinion on sustainability issues is still evolving, companies taking the first steps can expect intense public scrutiny, which again highlights the need for transparent reporting on operations. Another significant push factor has been the role of government as a stakeholder. India has historically had stringent laws on labor, environment, health, and safety. Over the past few years the government has become increasingly proactive in addressing enforcement. Intense media attention and scrutiny on corporate social responsibility has also led to companies taking more cognizance of their activities and engagement with stakeholders.

## 9. CONCLUSION AND RECOMMENDATIONS

Traditional accounting has lost its instrumental ability of entailing the informational dimensions that are requested in the process of comprehending the phenomenon of identifying and reporting entity's activity in the context of sustainable development. Most companies prepare standalone CSR/Environmental Reports or in a separate section of its Annual reports, which seem completely disintegrated from its main operations. Most actions taken by Companies seem to be philanthropic acts unrelated with the corporate goals. It's time for the companies to rethink in terms of its operational strategies to assess their impact on the environment. They should discard those projects and products that could harm the environment. By bringing the sustainability in its core strategy, a company can assure its stakeholders of growth, which is maintainable. Though integrated reporting is not a panacea to all the CSR issues, it can be said that corporate reporting influences corporate behaviour, thus changes in reporting through the shift to an integrated report may result in changes in behaviour within the corporate community around the world. "If we ruin our biosphere, as scientific evidence suggests,

then all of our corporate responsibility initiatives become irrelevant". Besides, for a country like India, that aims to become a global power in the coming decades, development is must. Development at the cost of sustainability might have deeper consequences that could throw the country off its tracks towards a future it envisions. To motivate the companies for meaningful environmental reporting, rewards for good quality of environmental reporting should be instituted similar to the rewards for good environmental performance. Environmental legislation, perhaps, is adequate. What is needed is its enforcement.

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**Web Resources:**

<http://www.corporate-responsibility.com.au/>

<http://www.southafrica.info/news/business/king-260111.htm>

<http://www.prconversations.com/index.php/2011/11/integrated-reporting-and-strategicpublic-relations>

<http://www.theiirc.org/>

<http://www.accountingforsustainability.org/connected-reporting>

<http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/integrated-reporting/Documents/integrated-reporting-issue-2.pdf>