

**INTEGRATED
REPORTING:
What do financial
analysts ask?**

Abstract

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INTEGRATED REPORTING:
What do financial analysts ask?**

Working group AIAF
“Mission Intangibles®”

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The English translation is edited by Dr.ssa Federica Doni

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After his degree in Economics, obtained with the highest honours at the University of Verona and the qualification of chartered accountant, he began his professional career in 1987 in a leading International Company operating in IT (IBM Italia). Later, he worked for a Consulting and Financial Audit Company (Arthur Andersen & co.) and for a Brokerage Company (Gabetti Real Estate). Currently, after coordinating the planning and the realization of its management control, he is the Senior Credit Officer of an International Banking Group. He is author and co-author of several articles and essays, published in various journals and management and economics texts about management control, finance and business organizations and three books: "Il valore del capitale intellettuale. Aspetti teorici e casi aziendali di reporting" (2006), "Capitale Umano e performance di business. Misurare il ROI del capitale umano" (2008) and "Il vero Bilancio Integrato" (2013) published by Ipsoa. He attends as a speaker at Master & Conferences organized on these field. Since 1993 is AIAF (Italian Association of Consultant and Financial Analysts) member and in charge of research projects and study of the working group AIAF "Mission Intangibles®" whose role is to guide, motivate and critical compare analysis on methods for measuring and communicate the intangible assets / liabilities and enhancement of intellectual capital and since 2006 he is member for Italy of the Commission on EFFAS on Intellectual Capital (CIC now C ESG) and Deputy Secretary of the Board of Network of Italian Business Reporting (NIBR).

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Veronica Praticò

She has collaborated to the management of the questionnaires and to the referring drawn-up of the graphs edited by B2 Axioma.

INTEGRATED REPORTING: What do financial analysts ask?

Introduction

The issue of intangibles is an increasingly crucial topic and for this reason it is important to be at the center of the discussion. It would appear to be an innocuous, not central theme, while instead it elicits strong debate between schools of thought which focus on the role and weight that intangible resources should play in the evaluation of companies.

Given these premises the AIAF Mission Intangibles working group, Project Leader dr. Andrea Gasperini, in collaboration with dr. Federica Doni, University of Milano-Bicocca and dr. Riccardo Taverna, partners in B2 Axioma, conducted a survey aimed, first and foremost, at the more than one thousand members of AIAF and all those who operate as Financial Analysts. The objective of the survey was to understand if the Integrated Report <IR> proposed by IIRC, which includes also non-financial information relating to intangible resources and risks and environmental social and governance issues (ESG) and allows financial analysts to acquire an important database, can be used to more easily compare organizations working in the same sector, market or economic area and to make, therefore, a reasoned judgment on their ability to create value.

Considering the ample participation of Financial Analysts in this investigation it would seem that we can affirm that the provision of non-financial information and, in particular of a document of integrated reporting, is considered to be definitely of interest

in order to better understand the capacity of organizations to create / not destroy value.

I want finally to thank the members who worked on this project and the members who participated in the survey, with the hope that, through this White Paper, AIAF has honored its statutory task of enhancing the role of the financial analyst in order to contribute indirectly towards the growth and transparency of financial markets.

Paolo Balice

President of Associazione Italiana degli Analisti e Consulenti Finanziari

Foreward¹

The first aim for Integrated Reporting listed in the International <IR> Framework is to “improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital.” In other words, it is the IIRC’s aim that through Integrated Reporting analysts can understand how businesses are facing the challenges that arise for a business in the 21st century, so they can make better assessments over the short, medium and long term. It is evident from this survey that we were right to focus on

investors as the key audience.

According to those surveyed, 76.4% consider strategy the most important ‘type of non-financial information’ for a final view for the purchase, retention or sale of securities. It is a clear indication that analysts can benefit from Integrated Reporting, which puts strategy and the business model at the heart of reporting. Integrated Reporting brings with it the opportunity for more stable long-term returns through access to wider information on a range of capitals that are relevant to the business. Furthermore, it gives investors greater confidence in the management of the companies they invest in through the company evidencing integrated thinking in its approach to value creation over time.

Decision-making and policy formulation are strengthened as a result of enhanced corporate

NOTE

- 1 Paul Druckman is Chief Executive Officer of the IIRC. Paul is well-known and respected in business and in the accounting profession worldwide. Following an entrepreneurial career in the software industry, Paul operated as a non executive chairman and director for companies in a variety of sectors until taking over this post. Formerly a Director of the UK Financial Reporting Council; member of the City Takeover Panel; and President of the Institute of Chartered Accountants in England and Wales (ICAEW). Other interests have included chairing The Prince’s Accounting for Sustainability Project (A4S) Executive Board. (paul.druckman@theiirc.org).





transparency and reporting. Through a focus on strategy, Integrated Reporting offers a business the opportunity to put transparency into context, weaving a golden thread through the information they release, linking the information that is relevant to providers of financial capital into one clear, concise, integrated story that explains how the broad range of resources are creating value over time.

This survey demonstrates that analysts place a value on understanding how businesses use and affect more than just financial capital. Integrated Reporting ensures businesses are thinking holistically about how all of their resources are creating value over time. However, it also goes one step further, by recognizing that the capitals are all inextricably interconnected. The evolution towards Integrated Reporting enables businesses to make these connections, and allows analysts to understand how businesses are, for example factoring risks such as climate change into resource allocation decisions.

Integrated Reporting is market-led, developed in response to a belief by businesses that other standards were not enabling them to tell their full story of value creation over time. However, for Integrated Reporting to become mainstream there must be a pull from the investor community, demonstrating that investors do want information about strategy, governance, performance and prospects. Businesses need to know that investors will make investment decisions based on their evaluation of a truly integrated story about how all of a business's resources are creating

value over time.

Paul Druckman

Chief Executive Officer - The International Integrated Reporting Council

Executive Summary

The theme of the definition of a new tool for Corporate Reporting which includes, in addition to financial information, non- financial information, about the capacity of an organization to generate sustainable value and the associated risks - understood as the negative impact that uncertain events have on objectives - is a topic that in recent years has been gaining an increasingly high place on the agenda of priorities of those who are professionally involved in corporate management and financial analysis, as it is clearly an open problem which is still unresolved. It remains a problem to which, according to many authors, the existing reporting tools available to companies are not yet able to provide a definitive, or at least, a convincing answer, and one is left with a feeling of a situation of confusion, disorder and fragmentation.

Annual Reports are often too long, many of the pieces of information given are not related to each other, high gaps in communication remain and the investors, institutional lenders, management and more generally the stakeholders believe that a large part of the information that is disclosed is not adequate to facilitate their decision-making process.

These same limitations can also be

ascribed to the Sustainability Reports in as much as they rarely show how the performance of social responsibility is incorporated into the business strategy and into the processes of value creation. There is often no link with the results highlighted in the Annual Report, which deals with a wide range of information, but which often does not contain sufficient material facts, trusting in this way to respond to the needs of all stakeholders at the same time, but often failing in the attempt to satisfy the requests of each and every one of them.

But what would financial analysts like to know in particular? Below a summary of the main answers to our questionnaire is shown:

- In the first section S1 of the questionnaire potential factors of influence on the outcomes of the responses related to the profile of respondents have been highlighted, such as the indication of the category of activity of financial analysis to which the analyst claims to belong, the distinction between the traditional analyst and the ESG analyst, the type of company that is the subject of financial analysis, whether listed or not and the number of years of experience of the analysts.
- The second section S2 of the questionnaire is devoted to giving an overview of the Integrated Report and the "value relevance" of non financial information in relationship to one of the benefits expected from the Integrated Report, which provides access to this data, limiting an information

gap that, in fact, inevitably affects the process of evaluation of companies by financial analysts. On this point there is widespread appreciation on the part of analysts who responded to the questionnaire and there is also general recognition of the importance of non financial information disclosure. Financial Analysts expressed the view that the "privileged" users who are more interested in having integrated information on an organization's ability to create value over time are investors (90.72%), financial analysts themselves (81,44%) and banks (53.61%), while a much smaller percentage is attributed to other categories of stakeholders such as suppliers, associations and experts in basic economic and financial issues. Not surprisingly, a percentage of 83.51% of the analysts acknowledge that the Integrated Report as well as being a tool of corporate reporting for the external communication of information can also be used as a tool for internal communication of information to the Board of Directors. Integrated Reporting is indicated as a corporate reporting tool which is among the most used in the acquisition of non-financial information (41.25%) compared to the Sustainability report (17,72%), especially for companies operating in the consumer services (66.67%), health care (65.79%) and industrial (64.47%) sectors. Finally financial analysts were asked to indicate what non-financial information is most relevant in order to make a

reasoned judgment on the purchase / sale of a security and a large majority indicated information on company strategy (76,40 %) and subsequently that related to innovation (44.94%) and to reputation (38.20%);

- Section S3 of our survey, dedicated to the development of guidelines and key performance indicators (KPIs) and risk (Kris), showed that among the factors most commonly cited by financial analysts are those connected with GRI (44,16%), and those that have been promoted by EFFAS through the activities of the Commission on Intellectual Capital (now CESG) (19.48%) and DVFA KPIs for ESG 3.0 (16.88%), while with reference to the KPIs and Kris a general usefulness was recognised (83.13%) but with a request from many analysts to limit the number of indicators and try to get a degree of standardization that allows for the development of specific indicators for the type of company rather than for the sector of industry.
- Looking at the guideline principles set by IIRC that must be followed by companies to prepare the Integrated Report shown in the S4 Section it is possible to note a greater importance attached to principle n. 1 (business strategy) (60.42%) followed closely by principle number 6 (reliability and completeness) (48,42%) and number 7 (consistency and comparability) (42.71%). What is surprising, perhaps, is the lower degree of relative importance attributed to the principle of connectivity (12.50%), and the

skepticism expressed by financial analysts regarding the possibility of implementing operationally the connection between all the information that is disclosed by the companies through the formula of the Integrated Report;

- Section S5 that is devoted to the analysis of capital resources shows that even financial analysts agree with IIRC in the classification of the resources that are used by companies for value creation into six separate areas where by far the greatest relative importance with a percentage of 98, 97% is attributed to financial capital while a low relative importance equal to 84.84% is attributed to natural capital; More in detail, with reference to the three dimensions of intangible assets, as regards human capital and its relationship with the level of business performances, great importance is given by financial analysts to the leadership of top management (49,43%), even though a limited number of analysts believes that this information is easily obtainable from the companies (14.12%), and a very high risk (53.49%) is perceived regarding an inadequate capacity of the Board of Directors and an inability of the independent directors to perform an activity of control. Among the intangible resources which fall into the dimension of structural capital that have an impact on the performance of the organization by far the highest score is attributed to business strategy (51.76%) and research and





development activities (35,29%) even though financial analysts are very skeptical about the possibility of obtaining this information directly from companies. With regard to the risks that fall into this dimension the main risks have been attributed to the inability to identify the risks inherent in the business model and those that may have an impact on the corporate reputation (41.86%).

Finally, with reference to the impacts on company performance related to the intangible assets that fall within the dimension of relational capital, by far the highest score was attributed to customer satisfaction and to brand power even though the investigation has shown that companies are more favorable to providing information on market share than information on customers (33,72%) and on the brand (25.88%). Among the risks the need emerges for high attention to the possible loss of clients and partners (21.18%) and the dependence of customer loyalty primarily on individual relationships rather than on a relationship with the company (23.81%).

- Section S6 was dedicated to sustainability ratings and the trustworthiness of the non-financial information. More than a third of the Financial Analysts survey respondents (39.08%) indicated a limited expectation regarding the acquisition of relevant non-financial information through the sustainability ratings in order to assess the capacity of companies to create value in the short, medium

and long-term;

- Finally, in the last section S7, the opinion of the financial analysts was asked as to which are considered the main benefits to be derived from the availability of an Integrated Report. Among the possibilities, the opportunity to evaluate future performance (32, 18%) comparability (33.33%) and the accessibility of information (31.40%), are judged very favorably. On the other hand financial analysts showed themselves skeptical about the possibility of reducing the costs inherent in the acquisition of information.



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