

INTEGRATED REPORTING IN SMEs

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ABSTRACT: *Globalization, growth in the volume of transactions in the form of foreign direct investments, an increase of transactions of multinational companies, have led to changes both in the way of doing business and in the way of business reporting. Irregularities in the operations of many companies have led to the need for implementation of the Corporate Management Code. Finally, the need of companies to be social and socially responsible towards the wider social community, but also to the use of resources, has led to the implementation of the Report on sustainable operations. In this connection, the traditional financial statements cannot meet the new requirements, so it is necessary to have a comprehensive joint report that would satisfy the needs of all stakeholders: employees, owners, managers, suppliers, customers, the government and all others. The aim of this dissertation is reflected in pointing out the importance of integrated reporting and the possibility of applying the same in SMEs.*

Key words: *financial statements, social responsibility, stakeholders, new paradigm*

Introduction

Changes in the global environment are reflected in the operations of the company, changes in the mode of production, sales, advertising, all of which leads to a new paradigm of business, as well as to a new approach in financial reporting. In other words, the change of business environment changes the way companies report, perform operations and create value.

Over the past years, many authors in the field of business and / or financial reporting, have pointed to the limitations inherent in the conventional system of financial reporting at the same time advocating for the introduction of the new model. That need is especially emphasized in the context of the global financial crisis and analyzing its consequences. In addition, what should not be ignored is a number of other circumstances that have occurred in the previous period. The aim of these initiatives is to provide as complete and relevant information as possible on an ongoing basis in order to increase the efficiency of capital allocation. (Malinic, S., Savic, B. 2011, page 105-124)

Main role of financial statements is to provide to its many and variously motivated users the relevant information on the operations of given business entity, on which it will continue to base its future economic decisions. Various reports provide information relating to the various segments of business, together giving a clear picture of the character of the overall corporate performance. The introduction of international accounting standards which significantly contributes to the unification of financial statements, has reduced the informational asymmetry and increased the quality of information that reports provide. This improves the safety of users of reports, encourages investment activities and capital mobility, which further results in more efficient functioning of the market. Thus, at the time of the new economy, the central place is occupied by finances, and the most important role is taken by financial statements, as the key to understanding the financial position of the company.

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The need for transparent reporting has become frequent, not only of the authorities or banks, but also of other stakeholders interested in financial and overall operations of companies. Creating and presenting value in contemporary business conditions is a complex and holistic approach to business and the interpretation of short-term goals and outcomes implying permanent alignment of strategy with changes in the business environment.

As a multidimensional concept, it is conditioned by the specifics of the business model, the effectiveness of defined strategies and efficiency of their implementation, the availability of different types of capital, as well as the ability of companies to face numerous challenges. However, for a company, in addition to creating value, business imperative is presented by the process of maintaining and preserving the defined performances. Therefore, companies increasingly pay more attention to sustainable business, not only from the aspect of environmental resources, but also from the aspect of financial resources. In other words, companies need to adequately manage and coordinate the effects that current operations have on the immediate environment in order to be able to maintain and support social development.

Integrated reporting as strategic decision

Due to the need of coordinated action and integration of financial and non-financial instruments to measure the progress of operations, the so-called integrated reporting has been created that integrates all relevant information on business strategy, the manner of management of given company, type of organizational structure, risks that the company faces and other environmental and social aspects that have an impact on the financial aspects of the company's performance. Reporting that occurs as a product of holistic process of integration of more parameters, which transparently shows the company's efforts in creating value not only for its own needs but also for the needs of all interested parties in the business operations of the company is known as integrated reporting.

Integrated Reporting is a new trend which, in the world, is only accepted by a few of the most progressive and socially responsible companies. In some countries within and outside the EU, integrated reporting is governed by legal provisions and various initiatives of the regulatory bodies. (Krzus, M., 2011, page 273-274) It is the format of reporting dominated by a holistic approach. Financial information, information about the sustainability of the company's business and information in the field of corporate management are simultaneously displayed. In this way, a synergetic effect is being reached. Namely, if the financial information is displayed separately from information on the sustainability of the company, this approach is considered to be materially incorrect. Isolated display of information on sustainability will result in the ignorance of their user. Joint presentation of information contributes to a better understanding of the company's business and evaluating its survival in the long term. This becomes obvious if we consider the various dimensions of corporate responsibility. (Malinic, S., Savic, B. 2011, page 105-124)

Integrated reporting can be defined as an integrated depiction of performance of the company, both financial and non-financial, in order to show the extent to which the company incorporates the idea of sustainable development into its operations. It includes a set of processes and activities with an aim to concisely show the effect of the strategy and management on the amount of generated value for stakeholders. (International Integrated Reporting Council, 2012, page 1) Information shown is of key importance for (International Integrated Reporting Committee Towards Integrated Reporting Communication Value in the 21st Century, page 7):

- ❖ Meaningful assessment of long-term sustainability of the business model and strategies,
- ❖ Satisfaction of the information needs of investors and other stakeholders and
- ❖ Efficient allocation of limited resources.

As the business strategy is the starting point in creating a new approach to Integrated reporting, it is therefore necessary in the same way to access the function of accounting, bookkeeping and finances function, so that the process of making business decisions is raised to a

higher level. The application of this concept of reporting was introduced primarily in large multinational companies of developed economies, in which this concept can be applied more effectively. However, it is necessary the given concept is implemented in small and medium-sized enterprises. In order to achieve the business reports have informative power for all their users, it is necessary to align business strategy with the financial plan. External users need information that tells how the company plans to achieve the defined rates of growth, profitability and liquidity, in order to find security in a given company. Therefore, the process of defining the strategy is equally important both for the company and for external users.

Formulating the strategy is a complex process that is subject to permanent changes and continuous adjustments so that the company could respond promptly to the needs and requirements of the environment. In other words, the formulated strategy should be flexible and subject to changes. Therefore, the prerequisite for a coherent and successful strategy is an adequate organization. The strategy is formulated on the basis of insight into the internal possibilities as well as external environment. Main internal factors are managers, owners, employees, resources and competences. When it comes to external factors, today they are, more than ever, changeable. External factors include: the economic system, branches and direct competitors, banks, suppliers and others. The basic premise of business within the scope of formulation of business strategy is constantly striking a balance between the opportunities and threats from the internal and external environment in order to achieve the intentions of its owners.

Therefore, the company has a duty to respond to the opportunities and threats from the environment, so as it will maximize its internal strengths and take advantage of the opportunities that the market offers. While on the other hand, it should minimize weaknesses and overcome the dangers of the external environment. The point is to make opportunities and threats from the environment complementary, on the one hand, and the strengths and weaknesses of the company, on the other hand.

Business strategy of the company as the most important document should also contain the plans and objectives relating to measurable indicators of successfulness of business. In this context, business reporting on the value of the company should assume an adequate system that will measure performances. Based on the company's performance, management can perform control of the long-term and short-term situation. Therefore, the key performance indicators reflect factors that are the basis for achieving the defined goals and, as such, should represent the backbone of reporting for stakeholders.

Further, the effective implementation of the concept of business reporting implies the basis for stakeholders in the sense of gathering information about the company and the development of the business model. Developed a business model based on the performance of the company is used for reviewing cause - effective relationship between realized and planned success factors and a value to shareholders. In this way, through the development model and business reporting, the requirements of reporting transparency are met.

Successful value creation requires that all components of performance management system are aligned with the company's strategies, which contributes to maximizing value. Performance management system usually involves long-term strategic plans, capital budgeting, reporting on performance and compensation framework.

Process of integrated reporting

The main objective of Integrated reporting is reflected in the fact that the general public gets a picture of the way the company does business not only in terms of financial indicators and the ways the company uses its resources, but also in terms of informing the general public about how it contributes to the development of environment in which it operates.

Creating value for stakeholders is a basic prerequisite for the successful business performance of a company and in this regard, the management has a responsibility by a choice of

strategy and business management, to ensure the realization of this objective. Namely, the company depends on the resources of many stakeholders, due to which the management faces the challenge to ensure compliance with the society through the communication of the benefits that companies create for society, as well as the effects of their activities on the sustainable development of society. On the other hand, the vision of sustainable development implies the participation of stakeholders which in turn requires the reporting of issues and activities that are relevant for each category of key stakeholders. (Herzig C., Schaltegger S., 2006, page 301)

Financial statements do not include many financial, commercial, environmental and legal aspects of the environment, then the trends and changes that need to be taken into account for the purposes of assessing the perspective of the company, its opportunities and threats arising from environment in which the company exists. (Bazley M., Hancock P., Berry A., Jarvis., R., 1999, page. 26) Starting from the concept of corporate social responsibility of the company, the role of accounting and corporate reporting is reflected in the transparent representation of the way the company has fulfilled its responsibility. Although some of those disclosures in most countries still have a voluntary character, for an increasing number of international companies such practice is the norm, not the exception. (International Survey of Corporate Responsibility Reporting 2008)



Figure 1: The process of integrated reporting

Source: The International Integrated Reporting Council (IIRC): <http://www.theiirc.org>

The Figure 1 shows the aspects that ought to be incorporated into an integrated report. In other words, a broad portfolio is to be noticed of interested stakeholders and their needs which should be unified and transparently displayed. The question is asked, what does this report integrate? As an answer to this question, different observations may be given depending on the point of view on business and depending on from whose point of view we look at the company as a whole. However, a single answer to this could be that this report is linking all those areas of business that are relevant in two aspects. The first aspect relates to current operations, while the second aspect is related to the future performance of the function of sustainability of resources, and accordingly the sustainability of the company.

The Figure 2 indicates phases in the process of creating of integrated report. In the beginning, it is necessary to identify the main business activities taking place within the company, and then to identify the resources required to perform each activity and ultimately to identify relationships with stakeholders and to identify key stakeholders and create maps for all concerned. Then, in the second phase, the key business results achieved by the company in a given fiscal year are presented after which the comparison of the data with data from the previous year or the year in which the company achieved the best performance is conducted. After that comes the defining of the manner in which the company will achieve its time-bound targets. Within the last section, it is

necessary to define the place of the company in the chain of supply, threats and shortcomings in terms of resources in the future time period as well as the strategy of sustainable business.

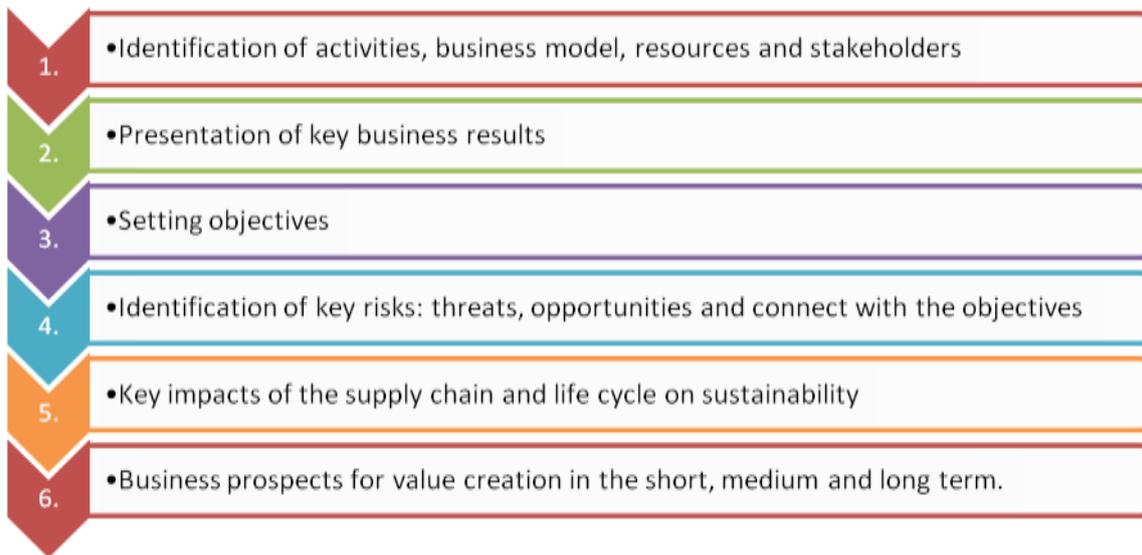


Figure 2: Phase of the Integrated Report

Source: Adjusted on the basis of Prosic, D., (2015) Integrated reporting – the new approach to corporate reporting and management, The Banking , page 62-87.

Implementation of integrated reporting begins with the identification of ways to measure the value for other stakeholders such as employees, regulators, customers, local communities and not just for investors. In other words, the implementation of integrated reporting should begin with the presentation of the elements conducive to a company, the benefits that are realized by using the report, then the implementation plan and stage for the implementation of application, as well as planning ways to communicate with stakeholders.

Connection of various company's functions involved in the process of reporting on business (Accounting, Finances, Research & Development, Relations with investors, Management and Legal Service) contributes not only to the reduction of the number of repetitions and contradictions which is characteristic for the traditional annual reports, but to the identification of opportunities for more efficient use of data. The most successful in this area are organizations in which the integration between departments and groups is being encouraged by senior management. (Black, Sun, 2012, page 5-7)

According to IIRC, 2011, page 11- 15 Integrated Report includes the following information:

- ❖ key performance and business risk,
- ❖ equity and liabilities:
- ❖ assets,
- ❖ wide range of inputs (like raw materials, energy, water, etc.)
- ❖ intangible assets (like know how, trade mark, goodwill.),
- ❖ human resources and
- ❖ interaction between wide range of social aspects.

Having in mind all the above, the great importance of the application of integrated reporting is noticeable. However, as the application of any model including this one is not an easy process, there are certain limitations in the occasion of introducing the same into the company's practice. Although the concept of integrated reporting offers a number of advantages, reports can carry a number of problems with them in practice, double interpretation or evasion of application, subjective decisions of the board and similar.

First of all, the demands of stakeholders in terms of environmental issues can hardly be valuably demonstrated and therefore they cannot be incorporated into the financial statements. Therefore, it is necessary to move in the direction of finding model for their quantification. Furthermore, the traditional form of financial statements is focused on creating value primarily from property and capital the assets are financed with. It is necessary to move from the traditional approach to the new paradigm in financial and business reporting that in the near future would become a replacement for the balance sheet form we know today. Finally, taking into account the new paradigm of reporting, it is necessary to increase the importance of intangible elements in the context of creating value based on them. In order to fulfill this intention, the harmonization of international standards for financial reporting is needed.

In other words, it is necessary to bring different functions in the interaction, that the boundaries between functions are "deleted", as well as to explain the employees within the company the importance of integrated reporting and how the information is connected together in one unit. The focus in the process of applying an integrated report is on the management of the company, which is to identify and understand the relationships and interconnection between functions, resources, and to create an atmosphere that will create and maintain the new value of the company. Then, the top management and directors of certain functions (Accounting, Finances, Human resources, Procurement, Sales, Marketing, etc.) must be in continual communication and there should be a feedback in terms of decision making.

It is completely certain that the integrated reporting is a long way, perhaps a new way of life, or even a mental model for companies that decide for it. This path is from the start intertwined with intensive communication in all directions so that the role of communicator in this process is inevitable. When applied in practice, this form of reporting will certainly improve the quality of corporate reporting and business decision making. When the trend of sustainability becomes part of daily operations, its evaluation occurs almost spontaneously, say the companies that have already entered on that path. (Prosic, D., 2015, page 62-87)

Research results

In order to explain the importance of integrated reporting and the possibilities that it offers to companies, whether it comes to large, small or medium-sized enterprises, researches have been conducted on the sample of the 15 companies. The questionnaire was distributed to the directors of financial services, which are most relevant to this domain of research. The analysis was conducted in the period from 1 September to 15 September 2016.

Answer to the question: *In your opinion, what business reports should be submitted by companies*, 74% said that, in addition to the financial statements, it is necessary to submit other mentioned reports, 2 respondents believe that it is necessary to submit financial statements only, 2 respondents believe that it is necessary to submit the annual report only,

Answer to the question: *Do you believe that an integrated report contributes to the quality of business reporting*, 93% responded that they consider the integrated reporting greatly contributes to the quality of business reporting, while only one company considers it contributes to it partially. However, none of the respondents said that they do not contribute.

Answer to the question: *Do you agree that integrated reporting contributes to greater company's reputation in the business environment*, 93% said they consider the integrated reporting greatly contributes to increasing the reputation of the company, because in this way the company connects all stakeholders and is dedicated to the interests of the wider community in which it operates as well as that it takes care of the sustainability of resources in the future.

Answer to the question: *According to your opinion, does the integrated reporting minimizes the free interpretation of the company's business in the minds of stakeholders*, 67% answered that the integrated reporting cannot greatly affect the free interpretation by stakeholders but it can

minimize the attempts of subjective assessment of the company's business because it offers a wide range of information about the performance.

Conclusions

Conclusion has been drawn that integrated reporting is to a greater extent viewed through the prism of the future operations of the company, with the current constellation of existing and available resources. This emphasizes the importance of this type of report that is much more than a mere transition from traditional reporting to a new, future report that would encompass financial and non-financial information about the business activities of a company and a transparent presentation of connection between business strategy and goals with the ways of achieving the same. In other words, this type of reporting by its nature represents a specific form of reporting on sustainable development, but in addition to non-financial dimensions of operations includes the financial aspects. Finally, it is evident that there are major benefits from integrated reporting model, but also certain obstacles and shortcomings. However, when all the disadvantages and advantages are elaborated, a conclusion can be drawn that the concept of integrated reporting greatly enhances the company's operations and brings a better reputation in the environment as well as higher operating efficiencies.

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