Integrated Reporting for SMEs – A Framework for Action

February 2021

The **International Integrated Reporting Council (IIRC)** is a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs. Together, this coalition shares the view that communication about value creation should be the next step in the evolution of corporate reporting.

The International <IR> Framework has been developed to meet this need and provide a foundation for the future.

Further information about the IIRC can be found on its website www.theiirc.org, including:

- The background to the IIRC's creation
- Its mission, vision and objectives
- Its structure and membership, and the membership of groups who have contributed to the development of this Framework
- Its due process.

The '**INTEREST – INTEgrated REporting for SMEs Transparency**' ERASMUS+ Strategic Partnership (nr: 2019-1-HU01-KA202-060911) project is a 30 month long (between 2019 and 2022) international cooperation of European universities and other partners to help the SMEs become familiar with Integrated Reporting and prepare them for completing their own Integrated Reports.

Project objectives:

The INTEREST project's consortium has set out the following objectives:

- To survey and summarize existing practice of IR across Member States represented in the consortium and draw from this a reference framework European SMEs can have easy access to. The International IR Framework refers to the "six capitals". The project will select and define unambiguously the most relevant capitals for use in the reference framework for SME IR.
- Based on this reference framework, to prepare a detailed guide providing hands-on, step-by-step support to the SMEs willing to adopt IR. On one hand, the guide is going to help SME owners and managers keep track of corporate performance through quantitative and qualitative (narrative) key performance indicators (KPIs) covering the entire value creation process, in terms of both financial and non-financial capitals; on the other, the guide is meant to help communicate value creation to external stakeholders based on to the reference framework for SME IR.
- On the basis of the guide, to develop a fully-fledged, interactive curriculum on the adoption of IR and the measurement and communication of value creation in the

specific context of SMEs, suitable for owners and managers (future SME CEOs, accountants, consultants, etc.) as well as for students; these are the two major target groups of the project.

Outputs and expected results:

In order to make results as perspicuous as possible, the deliverables expected out of the INTEREST project are summarized in three Intellectual Outputs.

IO1 – IR Framework for SMEs

The starting point of this project is to get acquainted with and collate examples of existing practice of IR by SMEs, together with existing practical experiences with IR in the Member States represented in the consortium. After having consolidated the multi-capital approach, the consortium set out to devise a reference framework for IR designed in such a way to allow easy adoption by SMEs and avoid overburdening their management.

IO2 – IR Guide for SMEs

On the basis of the IR Framework, a practical handbook on how to measure and communicate SME performance in an integrated perspective will be developed.

IO3 – IR Curriculum for SMEs

To help understand the concepts and use the tools featured in the Guide, the consortium will test and make available a set of learning units on how to measure and communicate value creation in the specific context of SMEs. Taking into account the time constraints of intended beneficiaries, a mixture of interactive workshops, online contents and work-based units will be used to make learning more attractive and easily accessible.

More information:

https://www.interest-project.eu/index.php

THE OBJECTIVE OF THE IMPLEMENTATION OF IIRC'S FRAMEWORK FOR SMES

Our <IR> framework is fully compliant with the "International <IR> Framework" recently updated by the International Integrated Reporting Council (IIRC). It incorporates the insights gathered through an in-depth assessment of the level of SME readiness and of current <IR> practices in six European countries, namely Germany, Hungary, Italy, Poland, Romania, and the United Kingdom. To our knowledge, this is the first systematic overview of the "state of the art" of <IR> among European SMEs; for this reason, we decided to publish these country reports as an edited volume, an additional intellectual output of the INTEREST project which is going to be available for researchers and practitioners alike.

This framework defines key principles and explains main concepts underlying the adoption of integrated reporting in accordance with the "Integrated Reporting Framework" of the IIRC but modified to the special needs and circumstances of SMEs. The main purpose of this framework consists of:

- highlighting key concepts and establishing a general understanding of the terminology;
- identifying key stakeholders and users of integrated reports and the required types of information;
- recognising the capitals and the interrelations between them
- assisting SMEs in adoption of an integrated reporting system and preparation of an integrated report;
- helping the users of the report prepared in compliance with this framework to understand and interpret the information disclosed.

Summarized, the key objectives of our professional material:

- to call the attention of SMEs' owners, managers and stakeholder to the existence and relevance of integrated reporting;
- based on IIRC's Framework provide an explanation in the context of SMEs;
- to show that SMEs can prepare <IR>, it has advantages for them at long run;
- to emphasise that if SMEs do the first steps toward <IR> using the Framework and Guide, it will help them improving the integrated thinking, identifying the values of the company; depending on the intentions of SMEs, these processes can result in preparing <IR>.

It is a journey to <IR>, and we are going to show the steps.

APPLICATION OF THE FRAMEWORK

The adoption of integrated reporting by an SME is a continuous process shaped by the availability of required data sources and the nature and development of the SME's business model. It is acknowledged that not all SMEs will apply all principles and requirements of this framework to an equal extent.

It should be noted that the economic benefits resulting from the adoption of an integrated reporting may not outweigh the costs of producing an integrated report in all cases. SMEs adopting an integrated reporting strategy for the first time may have limited experience and they may lack the required reporting data. Other SMEs may have simple business models and a limited number of potential stakeholders as users of integrated reports. Hence, any integrated report of an SME that has been prepared with reference to this framework is expected to apply its requirements, unless

a) the required information cannot be produced at reasonable cost or a specific legal prohibition results in an inability to disclose material information;

b) the SME has a limited number of external stakeholders;

c) the disclosures would cause significant competitive disadvantage.

ABOUT INTEGRATED REPORTING

"The IIRC's long term vision is a world in which integrated thinking is embedded within mainstream business practice in the public and private sectors, facilitated by Integrated Reporting (<IR>) as the corporate reporting norm. The cycle of integrated thinking and reporting, resulting in efficient and productive capital allocation, will act as a force for financial stability and sustainability. <IR> aims to:

- Improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital
- Promote a more cohesive and efficient approach to corporate reporting that draws on different reporting strands and communicates the full range of factors that materially affect the ability of an organization to create value over time
- Enhance accountability and stewardship for the broad base of capitals (financial, manufactured, intellectual, human, social and relationship, and natural) and promote understanding of their interdependencies
- Support integrated thinking, decision-making and actions that focus on the creation of value over the short, medium and long term." (IIRC Framework, 2021. p.2.)

"<IR> is consistent with developments in financial and other reporting, but an integrated report also differs from other reports and communications in a number of ways. In particular, it focuses on the ability of an organization to create value in the short, medium and long term, and in so doing it:

- Has a combined emphasis on conciseness, strategic focus and future orientation, the connectivity of information and the capitals and their interdependencies
- Emphasizes the importance of integrated thinking within the organization.

Integrated thinking is the active consideration by an organization of the relationships between its various operating and functional units and the capitals that the organization uses or affects. Integrated thinking leads to integrated decision-making and actions that consider the creation of value over the short, medium and long term." (IIRC Framework, 2021, p.2)

However, SMEs might question why should they consider integrated thinking and integrated reporting as a means of improving their operation is a challenging environment. Well, in our understanding, Integrated reporting is not an additional administrative tool of being engaged with another accounting report. Instead, the usefulness of integrated reporting lays in the fact that it can be used to rationalize and harmonize other reports as well. Depending on the legislation of the country of operation, in time an integrated report may replace some obligatory, but otherwise redundant, reporting requirements. For example, it may enable rationalization of reporting through merging financial, sustainability, and governance reports, and with savings in report production and distribution costs. It may also become part of the supply chain reporting (EFAA, 2017).

The suggested steps for the management of SMEs to implement integrated thinking into their businesses are the following (EFAA, 2017):

Step 1.	Issue a statement of intent. Advise stakeholders of your intentions: briefly explain the aims, ambitions, and rationale and consider reaffirming a commitment to good governance, transparency, long-term strategic thinking, and sustainability. It should also outline the implementation journey, including timeframe and key milestones.
Step 2.	Conduct a stakeholder mapping exercise. Identify principal stakeholders, such as primary customers, staff, local community, and bank. SMEs need to understand who its stakeholders are and their expectations of the business today and tomorrow.
Step 3.	Think about value creation. In what ways does the business create value? Does it manufacture goods or provide services? Does it invest in the local community? How does it look after its employees?
Step 4.	Consider the business model. Are your stakeholders highlighting any risks or opportunities to be managed or leveraged? How well does your business model and strategy support value creation? Does your business model reflect your stakeholders' expectations? Do you need to adjust your business model and strategy?
Step 5.	Determine what resources are needed. Now is the time to consider required resources to implement any changes to your business model and strategy. These include attracting and retaining new staff, enhancing product design and innovation, etc.
Step 6.	Improve cross-organization communication. Are the right people talking to each other internally? Is enough being done to break down silos and encourage cross-organizational communication and engagement with business strategy?"

This procedure will of course differ according to the characteristics and circumstances of the SME.

PART I – INTRODUCTION

1. USING THE FRAMEWORK

1.1. INTEGRATED REPORT DEFINED

An integrated report aims at concise and coherent presentation of the way how business strategy, governance, performance, and prospects of companies operating in external environment contribute value creation for stakeholders over the short, medium, and long term. Such a report combines non-financial issues with financial metrics delivering a more comprehensive picture of business activity with a holistic insight into inputs, outputs and outcomes used or produced by enterprises.

Consequently, an integrated report constitutes an improvement to the annual financial report and is voluntary for SMEs. The major goal of integrated report is to increase transparency by improving the relevance and quality of information available to financial capital providers and communicated to a wide range of stakeholders.

Besides, it can be a very useful tool for internal decision-making as it supports to develop a more conscious corporate thinking and decision-making procedure and system. Furthermore, it serves to deepen the understanding of the capitals (financial, manufactured, intellectual, human, social, and natural) and their interdependencies.

Companies who developed an integrated report following the IIRC concept overcome the problems traditional "silo thinking since they become the promoters of integrated thinking. They apply a multi-capital and multi-stakeholder management approaches to understand the factors influencing their business and fully consider legitimate needs, interests, and expectations of shareholders (owners), employees, customers, suppliers, local communities, and authorities, etc.

To fulfil its role, the integrated report should have a structure defined by the IIRC and follow seven Guiding Principles (see part 1.4). The structure of an integrated report should cover (IIRC Framework, 2021):

A. Organizational overview and external environment
B. Governance
C. Business model
D. Risks and opportunities
E. Strategy and resource allocation
F. Performance
G. Outlook
H. Basis of preparation and presentation
I. General reporting guidance

While SMEs are invited to adopt this structure, they have the discretion to determine the granularity of the content included in the report. SMEs should also consider benefits and costs of collating, summarizing, and analysing information for internal purposes and disclose such information to satisfy the needs of external stakeholders as well. They then need to think over how to ensure materiality and connectivity of information in the integrated report.

1.2. INTEGRATED THINKING

Integrated Thinking concept encourages organizations to actively consider the relationships that exist and appear between various operating and functional units and between six capitals that an organization uses or affects. It aims at enabling a decision-making process that is based on material, connected and comparable information deriving from reliable sources. Furthermore, the Integrated Thinking supports development and then permanent sustainment of organizations' ability to create value over time taking into account:

- the capitals affected by business activity, critical interdependencies and trade-offs between them;
- the ability to respond to key stakeholders' needs and interests;
- the way how the organization can design its business model and adjust its strategy to the external environment;
- the activities carried out and outcomes achieved thanks to capitals' involvement;

In the case of SMEs, the concept of Integrated Thinking should be embedded into their operational and strategic activities. This means that an owner or leadership of an SME will be the initial catalyst for its adoption. SMEs have fewer complex structures and for this reason they may be more agile in adopting the said approach that can be described as collaborative integrated thinking.

It is also important to bear in mind the nature and alterations of external factors, as for example, market conditions, demographics, technology development, availability of resources, and stakeholders' legitimate needs and expectations (IFAC, 2017). These aspects are out a direct impact of SMEs, but knowledge about them may be the first step on the way how to counteract potential external problems and work out effective solutions.

Instilling the Integrated Thinking in SMEs can begin changes in an organization. They may be reflected in the reinvention of a business model and assignment of new responsibilities within the governance structure.

These changes may also lead to a better internal collaboration that breaks down organisational silos and creates more productive and communicative working environments supported by efficient information systems. Finally, the Integrated Thinking may elicit alterations in the reporting practices. Enterprises adopting this concept will be encourage to report on current and material issues to stakeholders in a concise and cohesive way.

1.3. PURPOSE AND USERS OF AN INTEGRATED REPORT

While the primary purpose of an integrated report is to explain to providers of financial capital how an SME creates value over time. <IR> benefits all SME stakeholders interested in their organization's ability to create value over time. The most relevant stakeholders of SMEs are likely to be providers of financial capital such as banks and suppliers and customers. In addition, employees, other business partners, local communities, legislators, regulators, and policymakers may find the information useful. (IIRC Framework, 2021. p.4) <IR> encourages SMEs to identify and engage with key stakeholders so the SME can better understand the expectations of their stakeholders and how they create value for them.

In addition, a very important purpose of <IR> in case of SMEs is to improve the management decision-making process.

When the owners or managers of SMEs embrace integrated thinking and initiate focused communication within the company, the relevant data and information will emerge and the interrelationships between this data and the related departments identified.

<IR> also aims to help SMEs to better understand the relationship between their organisation's strategy, governance, and business model. Underpinning the production of an integrated report is the key concept of integrated thinking which provides a tool for the analysis of the impacts and interconnections of material financial and non-financial opportunities, risks and performance that impact on an SME's ability to create value. <IR> can therefore help SMEs understand the core drivers of value creation within their business so they can implement a business model that will help them grow and remain sustainable in the longer-term. The IIRC anticipate that, over time, <IR> will become the corporate reporting norm.

<IR> creates the potential to significantly improve the long-term health of SME's, and the external environment they impact, through consideration of the three indivisible and integrated dimensions of sustainable development, the economy, society, and the environment. Additionally, <IR> can contribute to a sustainable society by providing the opportunity for organizations to respond to the UN Sustainable Development Goals.

1.4. A PRINCIPLE-BASED APPROACH

The intention of the <IR> framework is to provide balance between flexibility and prescription, and therefore it is principles-based rather than being founded on a more rigid, rules-based approach (IIRC Framework, 2021). This approach recognises the wide variation in individual SME circumstances while at the same time facilitating sufficient comparability across SME's to meet the relevant stakeholder needs.

The 7 guiding principles underpin the preparation of an integrated report, informing the content of the report and how information is presented and are summarised below (IIRC Framework, 2021):

1. Strategic focus and future orientation – insight into the SME strategy.
2. Connectivity of information – showing a holistic picture of the combination, inter-relatedness and dependencies between the factors that affect the SME's ability to create value over time.
3. Stakeholder relationships – insight into the nature and quality of the SME's relationships with its key stakeholders.
4. Materiality – disclosing information about matters that substantively affect the SME's ability to create value over the short, medium, and long-term including how and to what extent it understands, takes into account, and responds to their legitimate needs and interests.
5. Conciseness – sufficient context to understand the organisation's strategy, governance, and prospects without being burdened by less relevant information.
6. Reliability and completeness – including all material matters, both positive and negative, in a balanced way and without material error.
7. Consistency and comparability – ensuring consistency over time and enabling comparisons with other organisations.

Arguably the most important guiding principle, and the one that really sets <IR> apart from other approaches to reporting, relates to connectivity and more creative, dynamic integrated thinking. If a compelling and transparent story of an SME's value creation is to be understood and communicated, then the capitals, the external environment, and the significant internal value and performance drivers need to be considered together.

1.5. FORM OF REPORT AND RELATIONSHIP WITH OTHER INFORMATION

The integrated report should not be perceived as a summary of information that can be found in other communication channels such as financial statements, CSR/sustainability reports or a collection of information at the company's website. Integrated thinking concept encourages organizations to focus on the connectivity and interrelations among a broad range of factors that may have a material effect on the SMEs ability to create value over time. Thus, the integrated reporting process may be considered a critical management tool which aims to embed the integrated thinking throughout an organisation, both in daily operations and in the organizational strategies. The form of the integrated report undoubtedly indicates that it is not a simple combination of different corporate reports but well thought-over business story which has its beginning and the end described in a balanced and accessible manner.

While developing an integrated report, SMEs may decide whether they want to prepare it as a standalone report or include it at the front of the financial statements. SMEs should also consider the preparation of an online integrated report that may be an "entry point" to more detailed information and documents connected by hyperlinks. This is particularly useful for external stakeholders, who may expect easy access to the report and its transparent navigation.

1.6. RESPONSIBILITY FOR AN INTEGRATED REPORT

Unlike large organisations, those charged with the governance in SMEs may typically be an owner as well as a manager. In SMEs, the implementation process of an integrated reporting will require an acknowledgment of the responsibility of those assigned to the preparation of the integrated report. It is important to ensure that those persons apply their collective interests while developing the report and ensure its integrity. In turn, a manager or an owner of SME is expected to share their opinion on whether the integrated report was presented in accordance with this Framework. if it does not follow fully the Framework, they should explain what the reason why.

1.7. COSTS AND BENEFITS OF <IR> FOR SMEs

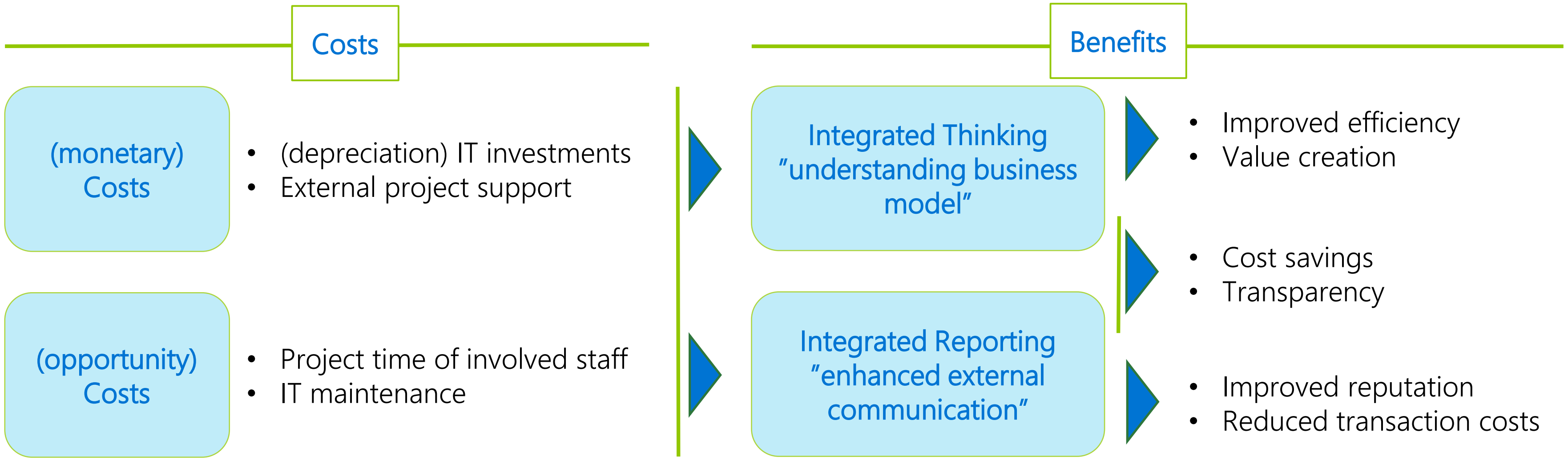
Before introducing Integrated Reporting, SMEs need to weigh up the estimated costs and expected benefits of this decision. Costs occur before (project setup costs) and after (maintenance costs) Integrated Reporting is introduced. Companies can only profit from potential benefits after having successfully completed implementation. The main cost factors and benefits are shown in Figure 1.

Costs are rather easy to determine as the tasks and required resources are mentioned in the project plan for <IR> implementation. They can be separated into two different dimensions.

Firstly, there are initial set-up or implementation costs and then costs of ongoing maintenance. Costs consist mainly of IT and staff costs. These can be further differentiated into costs which cause cash-outflows (monetary costs) and costs which are caused by using already available resources (opportunity costs).

For example, money has to be invested in enhancing IT infrastructure or hiring external support (consultants) to manage the IR project. Opportunity costs mainly result from employees participating in the project by contributing their knowledge about the company and its processes.

Figure 1: Costs and benefits of implementing Integrated Reporting *Source*: Own presentation



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SMEs can benefit from a better understanding of their own business model (Integrated Thinking) as well as from enhanced communication with external stakeholders (Integrated Reporting).

This can improve the transparency of the company internally (for employees and managers) and externally for external stakeholders (creditors, suppliers, and customers). Costs can be reduced through e.g., automated processes and more attractive loan conditions due to better information provided to banks (reduced transaction costs). SMEs and their employees can better understand the relations and interdependencies between the six capitals and the resulting effects on value creation in the whole company. Leaner and faster processes lead to more efficiency inside the company and better service for customers.

Many companies demand more and detailed information from their suppliers, for example to prove that their total supply chain is "green" or sustainable. Providing more and focussed information about the company improves the SME's reputation with external stakeholders, thus showing them the value-added of doing business with it. However, greater transparency can lead to proprietary costs, for example if disclosed information is used by competitors.

As benefits are uncertain and may be non-monetary, the valuation of overall benefits is quite a challenge. In the end, the decision (not) to implement <IR> is the task of senior management who must weigh up the (estimated) costs against the potential benefits for a specified period. Set-up costs are incurred mainly in the short term, but these can be exceeded by huge long-term benefits.

2. FUNDAMENTAL CONCEPTS

The fundamental concepts that are described in this chapter underpin and reinforce the requirements and guidance in the Framework.

2.1. INTRODUCTION

There are two fundamental concepts of integrated reporting: Value creation and six capitals. It worth mentioning that in 2013 the IIRC published two independent documents: Value Creation Background Paper and Capitals Background Paper for <IR> that introduce and support implementation of these concepts for organizations planning to start integrated reporting journey. This chapter explores the foundations of the integrated reporting process through the lens of value creation and six capitals.

2.2. VALUE CREATION FOR THE ORGANISATION AND FOR OTHERS

According to the IIRC Framework, value creation should be shown as increases, decreases or transformations of the capitals, caused by the SME's business activities and outputs.

Business activities are what the SME does, how it goes about creating value for itself and its stakeholders (including society). Outputs include an SME's key products and services as well as any by-products, waste or emissions that need to be discussed, depending on materiality relative to an understanding of the robustness and resilience of the business model.

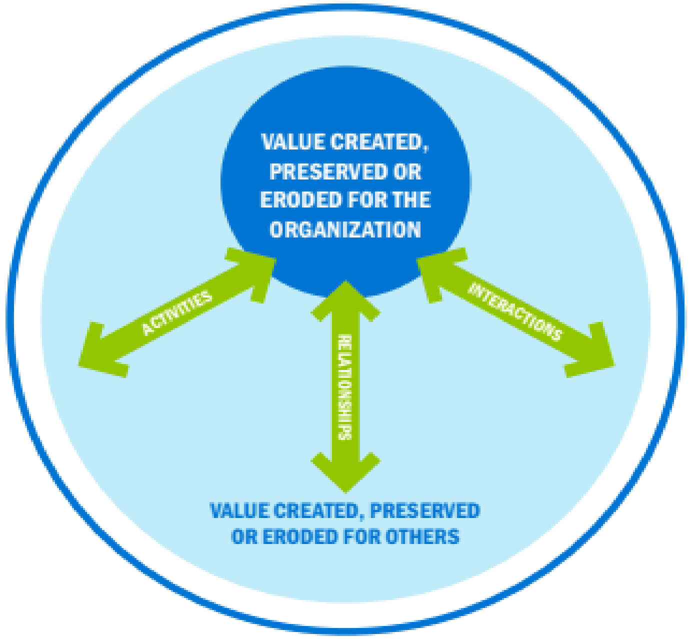
Value creation has two interrelated aspects: value created for the organisation itself, which enables financial returns to the providers of financial capital and value created for wider stakeholders (IIRC, 2021) (See Figure 2)

In creating value for itself, SME's create, preserve and destroy, value for others. Value is almost always co-created. Like two sides of a transaction, neither party will complete the transaction unless it perceives there is value created for itself.

Shared value is a concept that focuses on the connections between societal and economic progress and that expands the total pool of economic and social value. It is based on the idea that having environmental or social issues that are not addressed creates internal costs for SME's (e.g., wasted energy, low productivity and demotivated staff due to lack of training and career opportunities, resource scarcity), which constrain the extent of value creation, destroy value or, over the longer term, make the business model unsustainable. For example, poor environmental practices, such as in water and waste management, may impact a factory's ability to access the clean water needed for production in the future (Porter & Kramer, 2011).

Figure 2. Value creation

Source: IIRC Framework, 2021. p. 16.



The mind-set that considers that SME's should always maximize value for shareholders leads eventually to systematic underinvestment in other important relationships. While an SME will not survive for long without financial capital: debt, equity, or, commonly, both, SME's will only succeed in the longer term only if customers want their products, employees want to work for them, suppliers want them as partners, and communities want their presence. Figuring out how to maintain these relationships and deciding when trade-offs are necessary among the interests of these various groups are central challenges of SME leadership. How each organization considers, manages, and combines these factors in its particular circumstances are what make it unique.

It is recognised that there is conceptual difficulty in making trade-offs between the various interdependent factors and different stakeholders that contribute to, or are affected by, business activities aimed at value creation.

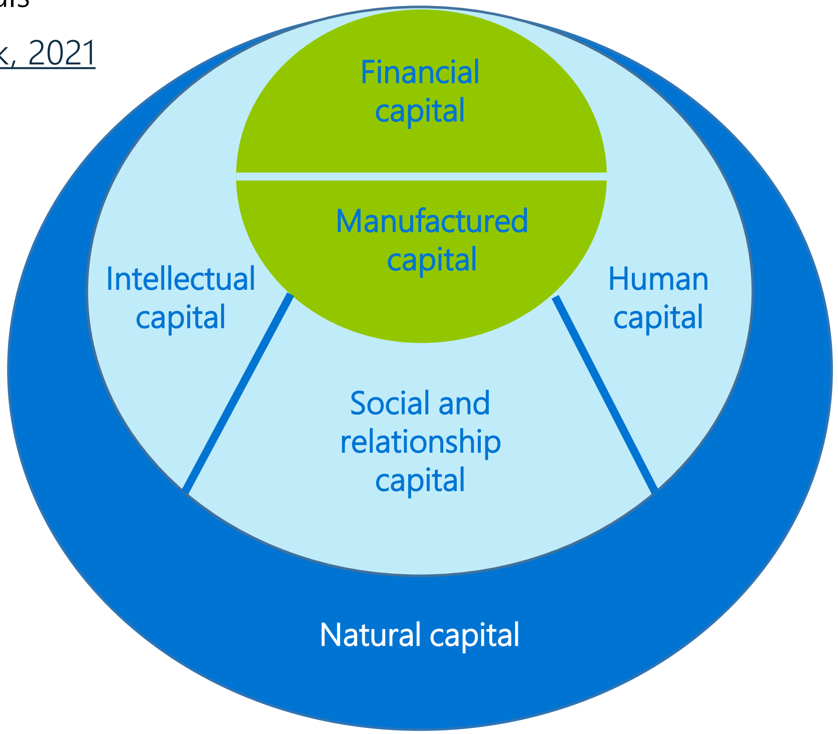
For example, customers want low prices, high quality, and full services; employees want high wages, high-quality working conditions and fringe benefits including vacations, medical benefits, and pensions; suppliers of capital want low risk and high returns; communities want high charitable contributions, social expenditures by companies to benefit the community at large, increased local investment and stable employment. In these circumstances, potential conflicts between various trade-offs can be resolved by setting a clear business objective, representing the core of any decision criterion to guide the way in which trade-offs between demands are made and enable management to evaluate decisions (Porter & Kramer, 2011).

2.3. THE CAPITALS

An essential concept of the value creation process is the notion that SMEs should expand their reporting beyond the stewardship of financial capital to include all resources they use as inputs to their business activities.

Figure 3. The Six Capitals

Source: IIRC Framework, 2021



According to the <IR> Framework, the success of any organization, including SMEs depends on various types of capital or resources, both internal and external, which are available to the company. The capitals represent the stores of value that are the basis of an organization's value creation. In particular, the <IR> Framework refers to Six Capitals (see Figure 3).

Financial and manufactured capitals are the ones SMEs will most commonly report on. However, there is a growing recognition that intangible assets form a significant part of an SME's business value which are not reflected in the financial statements. Indeed, research evidence demonstrates that only a small percentage of organisational market value is now explained by physical and financial assets.

<IR> also takes a broader view by considering intellectual, social and relationship, and human capitals (all of which are linked to the activities of humans) and natural capital (the environment in which the other capitals are ingrained) (see Table 1). Nowadays, factors such as climate change, depletion of the natural resources, human rights issues and extreme circumstances like pandemic seem to be of increasing strategic importance to an SME'S long term sustainability, and preservation of society. An integrated reporting which aims at providing the holistic picture of organization's business activity and its impacts on internal and external environment may balance all these critical topics in one combined report.

Table 1. Definitions of Six Capitals

Source: Adapted from Capitals Background Paper for <IR>

Capital	Description
Financial capital	The pool of funds available to an SME. This includes both debt and equity finance. This description of financial capital focuses on the source of funds, rather than its application which results in the acquisition of manufactured or other forms of capital.
Manufactured capital	Human-created, production-oriented equipment and tools available to an SME for use in the production of goods and the provision of services.
Intellectual capital	Intangibles associated with brand and reputation, in addition to patents, copyrights, organizational systems and related procedures. that an SME has at its disposal which provide it with a competitive advantage and positively affect its future earning potential.
Human capital	The skills and know-how of an SME's personnel, in addition to their commitment and motivation - which affect their ability to fulfil their roles which provide the foundation for future development and growth.
Social and relationship capital	The relationships – and attendant resources – between an SME and all its stakeholders, including communities, governments, suppliers, and customers.
Natural capital	Resources such as water, fossil fuels, solar energy, crops and carbon sinks, which cannot be replaced and which support the current and future prosperity of the SME and that are essential to the functioning of the economy as a whole.

This framework does not strictly require that an integrated report must adopt all the capital categories structured along the lines of the six capitals. *The capitals used will be determined by the SME and its activities*. For example, some of the leading-edge SME adopters of <IR>, such as Anglo African, have modified the <IR> Framework six capitals – merging some and retitling others.

By focusing on all relevant capitals which affect performance (past, present, and future), and how those capitals are used, the IIRC assert that information is available to ensure effective allocation of scarce resources, thus ensuring an organisation's longer-term sustainability. However, the framework allows organisations to classify capitals differently, as we have previously mentioned, and states that capital measurement is required only where it is material to the organisation's business.

SMEs should also take into considerations the following when using the capitals model:

- *Capitals are interrelated and trade-offs* are likely to occur: for example, an increase in human capital through investment in training programmes decreases financial capital (at least in the short run). Reporting on these relationships and trade-offs is of particular importance to <IR>.
- *Some types of capitals are more important than others:* While most SMEs rely on all capitals to an extent, some dependencies will be relatively minor or so indirect that they are immaterial for reporting purposes. As we mentioned before, the financial capital can be the most relevant one.
- An analysis of the correlation between capitals and stakeholder impacts (dependencies) helps to set boundaries for <IR>: An assessment of the significance of the impacts (or dependencies) helps to define the <IR> boundary (i.e., what to include / exclude in the report). In addition, *by analysing capitals in such a way an SME could enhance the robustness of its stakeholder analysis*.
- Reporting on performance through narrative or quantified metrics: In some instances, the uses and effects on an SME's capitals can be *quantified*, but in some instances, it may be best to report in the form of a *narrative*.
- Ownership of the capitals: An SME does not necessarily own all the capitals that it uses or affects. In fact, they may be owned by others, or may not be owned at all in a legal sense (e.g., access to unpolluted air). Like IFRS, the IIRC *capitals model appears to focus on control rather than ownership*.

2.4. THE VALUE CREATION PROCESS

The value creation process can be a valuable principle for all public and private organizations, large, medium, or small-sized. Value is created by organizations from a wide range of interactions, activities, relationships, causes and effects. Those interactions take place in the market, regulatory, societal, and natural / environmental context within which the organization operates and on which it depends. The interactions occur between the organization and its consumers, employees, stakeholders, regulators, suppliers, and others operating in the context within which an organization conducts business activities. The context is also affected by natural, environmental, and planetary limits.

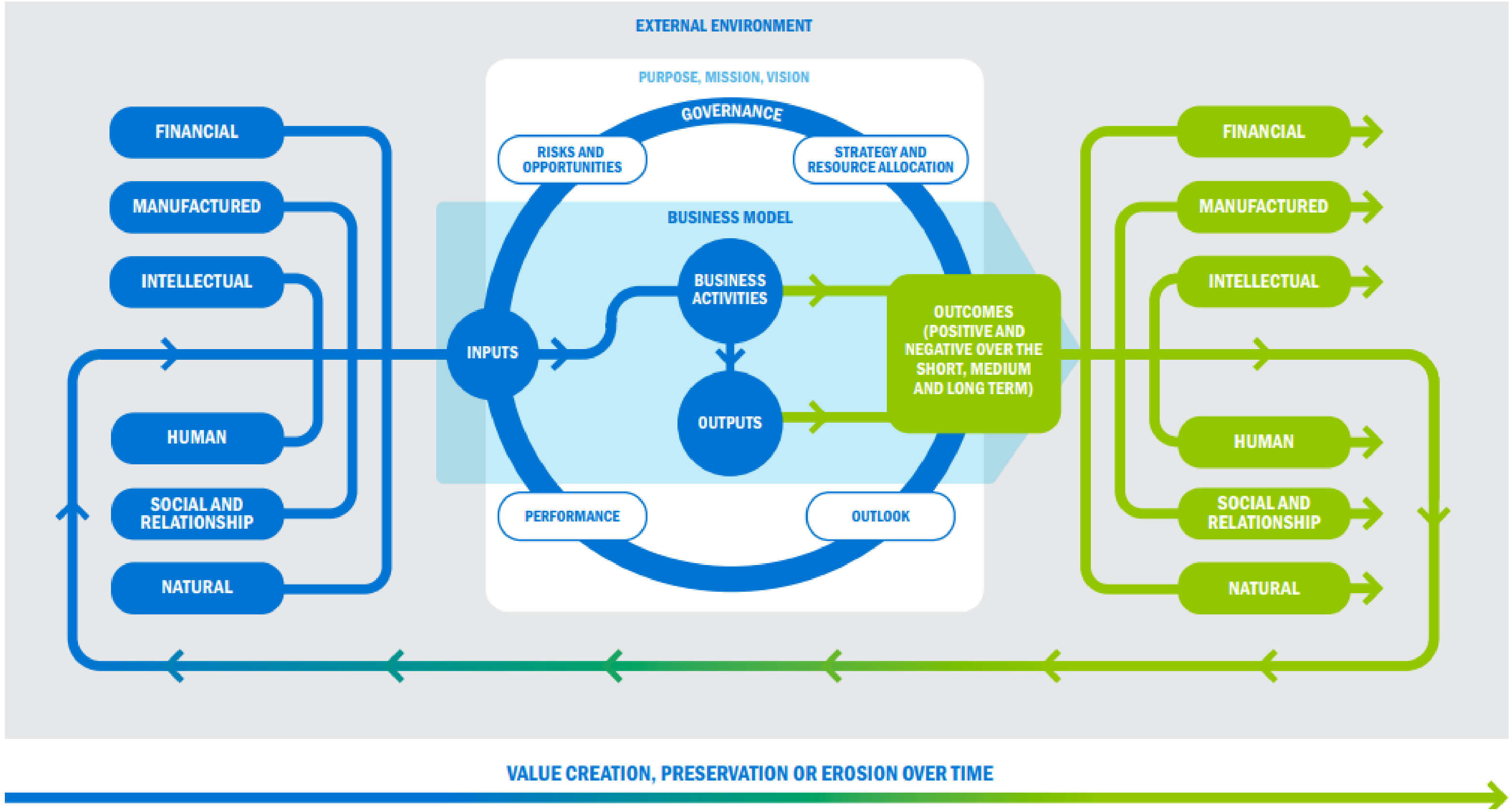
Value is created, transformed, or destroyed through an organization's business model, which takes inputs from the capitals and transforms them through business activities and interactions to produce outputs and outcomes that, over the short, medium, and long term, create or destroy value for the organization, its stakeholders, society, and the environment (see Figure 4).

At the core of the value creation process is an entity's business model, which draws on various capitals and inputs, and by using the entity's business activities, creates outputs (products, services, by-products, waste) and outcomes (internal and external consequences for the capitals).

<IR> is an effective way to help an SME better understand and manage how it creates value, as well as report on that value creation. More integrated information and thinking should lead SMEs to make better decisions about the key areas that affect its ability to create value that can then be communicated through an integrated report, which demonstrates a compelling business case to providers of finance, and other key stakeholders. Collectively, the process of creating value and telling the company story is <IR>.

Figure 4. The Value Creation Process

Source: IIRC Revised Framework, 2021, p.22



2.5. UNDERSTANDING THE NEED OF BUSINESS MODEL

Traditional reporting practices compare the financial value of the inputs used by a firm with the financial value of the products and services it sold to its customers to determine whether a business generates or destroys value. <IR> takes a more comprehensive view of the process turning inputs into outputs, by considering a broader set of inputs and a broader range of results stemming from business activities. *The way in which an SME pursues superior performance in its market as well as its non-market environment is often labelled its "business model"*.

A firm's business model is defined as "its system of transforming inputs, through its business activities, into outputs and outcomes that aim to fulfil the organization's strategic purposes and create value over the short, medium and long term" (CIMA, IFAC and PWC 2013, p. 6.).

The capitals of the <IR> Framework are made up of stocks whose value can be increased, decreased, or transformed; the business model determines the changes in the capital stocks used and affected by business activities, and as such is a key determinant of value creation. The definition of the business model is therefore a fundamental management decision: how do the internal and external inputs we use and the business activities we implement generate value for our customers and other stakeholders?

A credible definition of the business model is a fundamental precondition for <IR> in two respects. First, business models serve an internal purpose: *SME leaders should have a clear idea of how inputs and activities are expected to generate outputs and – most importantly – outcomes*. A business model has a central role in facilitating a better understanding of strategically relevant aspects: with a clear business model in mind, SME leaders can adapt to changes (e.g., in the availability, quality, and affordability of inputs) and understand how these changes might affect the firm's longer-term viability.

Secondly, business models serve an external purpose: to establish a sound dialogue with their market and non-market stakeholders (including investors), SMEs must be able to present their business model convincingly. *A clear, coherent, convincing business model is the best way for SME leaders to share their corporate philosophy on what matters most, i.e., their ability to generate long-term value*. The contents of annual reports can be fully appreciated by external stakeholders only on the backdrop of a good understanding of the business model of the firm issuing those reports.

2.6. THE ROLE OF NON-FINANCIAL INFORMATION

Over the recent decades, the technological progress, increasingly competitive environment, accelerated transfer of knowledge, the growing importance of the human factor and its impact on the environment stimulated an evolution of non-financial reporting.

Contemporary companies benefit from economic growth and globalization, but they are exposed to global challenges as well, such as climate change, health crises, economic, political, and legal turbulences.

Regardless of their size companies also consume resources that are regarded as scarce on a global scale, including water, food, forests, and fossil fuels. The extent and character of that consumption depend on the industry in which an organization operates and its environmental awareness.

All these issues cannot be underestimated and omitted in annual reporting. Therefore, the corporate reporting system is expected to be comprehensive and should adequately reflect all impacts that business activity has on people, planet, and prosperity.

The use of non-financial information has several potential benefits to SMEs. Nowadays, a great majority of SMEs prepare simplified financial statements or keep accounting records for tax purposes. That approach does not promote integrated thinking since it reflects primarily financial data deriving from business transactions.

Collection and analysis of non-financial information offer tangible opportunities to SMEs. It encourages enterprises to revise their corporate strategic position, redefine mission and values, evaluate progress, and manage relationships with stakeholders.

Consideration of non-financial information may enhance the ways SMEs measure and present achievements in creating more prosperous societies and a more sustainable relationship with the planet. It happens so since non-financial information helps in better understanding of overall performance, business strategy, and growth perspective of an enterprise.

Managers of SMEs often do not realize that they have a substantial impact on non-financial aspects of the business they lead by applying appropriate practices or actions. Controlling non-financial issues can bring long-term financial benefits, if managers use appropriate non-financial measures that reflect the broad impact of economic activity on the environment.

Thus, the non-financial disclosures should be quantitative, if quantification is sufficiently reliable for external presentation. Quantitative information is expected to be supplemented by qualitative disclosures formulating the broader context to quantitative metrics.

Non-financial metrics (i.e., customer satisfaction and loyalty, reputation, employee knowledge and experience, innovativeness, etc.) provide forward-looking information for better decision making. That undoubtedly drives the company's future financial performance. In contrast, accounting information is often backwards looking since it is based on historical data on economic transactions exerted from the accounting information system.

The advantage of non-financial metrics over financial ones is the way the former refers to intangible values. R&D productivity, for instance, which is a ratio of output to input is not recognized as an asset according to accounting rules, but it has an impact on future stakeholder value. While R&D may have a measurable input (i.e., salaries paid to R&D workers), the final output of a project may be intangible, difficult to quantify and distant in time.

Considering the applicability of non-financial information in the context to SMEs it needs emphasizing that SMEs are considered the backbone of the economy, contributing to economic growth by creating new jobs, bringing innovative solutions on the market, and developing the wealth of local and regional communities. Therefore, their reporting practices should be in focus.

Non-financial information is critical to assessment and monitoring of SME business performance and consequently to its competitive advantage. In this context, we emphasize the importance of non-financial information for internal, managerial purposes. Nevertheless, no less important is the use of non-financial information in external reporting. In that way, SMEs may maintain their license to operate and strengthen relationships with those who make their existence possible – their stakeholders.

PART II – THE INTEGRATED REPORT

3. GUIDING PRINCIPLES

The Guiding Principles underpin the preparation and presentation of an integrated report, informing the content of the report and how information is presented.

3.1. STRATEGIC FOCUS AND FUTURE ORIENTATION

The principle of strategic focus and future orientation requires SMEs to produce the integrated report which penetrates strategic processes and presents how strategy relates to the organization's ability to create value in the short, medium, and long term. Moreover, the strategy needs to be considered respecting its impact on the possibility to use and further build the Six Capitals by an SME.

The application of the strategic focus and future orientation principle poses problems and rises resistance in SMEs. Those organizations tend to take an informal and intuitive approach to strategy development.

Their strategic processes are market- or customer-oriented rather than directed at internal resources and capabilities. Moreover, short-term, or reactive thinking is not uncommon. Therefore, *SMEs are advised to redesign and consolidate their strategic processes with a focus on resources and capabilities in the long-range perspective which leads directly to the concept of Six Capitals*.

Companies should determine their *strategic pillars and define objectives* within each of those fundamental areas as well as set accountable persons for each pillar. The strategic objectives should be connected with value creation actions. The influence of the objectives on the Capitals needs to be explained. It is essential to establish and measure critical performance metrics across strategic objectives to assess their accomplishment level. *SMEs may also set KPI targets related to strategic objectives for the next 2-3 years.*

3.2. CONNECTIVITY OF INFORMATION

The principle of information connectivity requires SMEs to prepare an integrated report which reflects all the relevant relations and dependencies between the factors that enable an organization to create value over time.

SMEs should consider what information needs to be connected and what is the best way to demonstrate the connections. It is recommended that SMEs examine their information systems and identify the gaps which hinder their stakeholders from informed decision-making. They also need to analyse and improve communication and knowledge sharing processes.

For SMEs, it is essential to identify interdependencies and trade-offs between the capitals. SMEs need to understand how changes in availability and quality of capitals affect the ability to create value, and to produce desired outcomes for stakeholders and achieve targeted performance.

SMEs are also encouraged to connect the past, present and future aspects of their business. For instance, organizations should monitor how past achievements and misses affect the current strategy or how this strategy responds to future opportunities and risks.

For SMEs which prepare simplified financial statements, it is a challenge to identify and measure non-financial items. And if they fail to do so, the links between quantitative and qualitative information will be distorted. Therefore, SMEs are recommended to use narratives extensively. While numerical data guarantee objectivity and reliability, well-crafted narratives create a context for understanding internal trends and enable comparisons to industry peers.

Finally, connectivity is ensured when the report has a logical structure, linked sections, cross-referencing and navigation devices such as icons, colour coding or other tools. *SMEs may enhance information connectivity and transparency using web-based applications, which offer ease of navigation within the report and between its parts*.

3.3. STAKEHOLDER RELATIONSHIPS

The value creation process is affected by the external environment, stakeholder relationships and dependency on resources. The long-term prosperity of an SME is determined by its ability to establish and maintain relationships within all its stakeholders. In this respect *an integrated report of an SME should evidence the nature and quality of the organization's relationships with its stakeholders, demonstrating how and to what extent the organization understands, considers and addresses their legitimate needs and interests*.

SMEs which operate in the market for a long time will depend on long-lasting relationships with market and non-market players. Therefore, they are exposed to various stakeholder pressures and consequently should respond adequately. They may also consider choosing a way to address a broader audience by emphasizing their social and environmental awareness. Sometimes when SMEs have limited capacity to respond to stakeholder demands individually, they may form organizational clusters to enhance their visibility.

In case of start-ups, whose innovativeness enables them to challenge the market standards and grow quickly in a global space, a focus on providers of critical resources, including employees offering knowledge, investors supplying capital and business partners securing market relations is vital. With a more established position, the scope of stakeholder relationship management may expand and include customers, suppliers, media, or even governmental agencies.

Importance, roles, rights, and impacts of stakeholders on medium enterprises may be summarized in a statement that without its stakeholders, an organization would cease to exist. Such a perception of stakeholders' role is particularly important when enterprises face a crisis, in particular the one resulting from external, uncontrolled factors (like Covid-19 pandemics). Employees, customers, suppliers, and financial providers may jointly contribute to an organizations' survival, securing resources needed for SME to operate.

Consequently, to reduce their vulnerability, SMEs need to consider viewpoints of their stakeholders, be responsive to their requests, foster mutual relationships and build trust. In this respect integrated reports not only improve transparency and accountability but, above all, support integrated thinking which is needed to coordinate collective actions aimed at financial recovery, rebuilding the scale of activity, and restoring efficiency.

3.4. MATERIALITY

"*Relevant matters* are those that have, or may have, an effect on the organization's ability to create value. Relevant matters will be considered as *material* if a matter is sufficiently important in terms of its known or potential effect on value creation." IIRC Framework, 2021. p. 30.

<IR> Framework words the materiality determination process for the purpose of preparing integrated report. These are:

1. Identifying relevant matters based on their ability to affect value creation
2. Evaluating the importance of relevant matters in terms of their known or potential effect on value creation
3. Prioritizing the relevant matters
4. Determining the information to disclose about material matters" IIRC Framework, 2021. p 29.

The materiality determination process is integrated into the organization's management processes and includes regular engagement with providers of financial capital and others to ensure the integrated report meets its primary purpose.

This process applies to both positive and negative matters, including risks and opportunities and favourable and unfavourable performance or prospects. It also applies to both financial and other non-financial information.

Identifying relevant matters

"This is determined by considering their effect on the organization's strategy, governance, performance or prospects. An understanding of the perspectives of key stakeholders is critical to identifying relevant matters." IIRC Framework, 2021. p. 30.

Relevant matters can be solved easily in the short run but if left unchecked, become more damaging or difficult to address in the medium or long term.

The first element in identification relevant matters is to analyse the main activities and risks in interrelation with the existing and desired values of the company.

The identification of relevant matters, issues – again- requires the awareness of the owners and management in developing business strategy, serving the needs of stakeholders and having realistic operating goals.

When the relevance matters are identified significant external factors (like changes in the tax systems, presence of new and agile competitors, negative or positive changes in national and/or international markets, circumstances, etc.) or internal factors (pricing the products/services, number and fluctuation on employees, availability, and costs of financial sources, social activities, etc.) shall be considered as well.

Evaluation of importance and prioritizing

Relevant matters will be considered as material if a matter is sufficiently important in terms of its known or potential effect on value creation.

Once the SMEs has defined its strategy, stakeholders, and values, these acts as support to, and help find the best way to materiality.

The process of identify relevant matters is eased by a clear understanding of the value creation as well of the business model.

When more relevant matters are identified, it is recommended to prioritize them based on their nature, interrelations with each other and with the strategy or based on any other important aspect. Depending on the nature of the matter, both qualitative and qualitative evaluation might be appropriate.

In evaluating the magnitude of effect, the organization considers:

- Quantitative and qualitative factors: how it can be measured and whether the company has its own information system for measuring
- Financial, operational, strategic, reputational, and regulatory perspectives:
- Area of the effect can be both internal or external: for example, focusing on improvement of skills and competencies or the employees or increase of market share, etc.
- Time frame: as the material matter can influence value creation in short, medium, or long run.

IIRC Framework, 2021. p. 31.

Determining information to disclose

"Judgement is applied in determining the information to disclose about material matters, internal and external perspectives shall be considered. Regular engagement is required with providers of financial capital and others to ensure the integrated report meets its primary purpose." IIRC Framework, 2021. p. 31.

"When SME considers disclosing material matters, the followings shall be considered:

- the matter itself and explanation of the matter;
  - its effect on the organization's strategy, business model;
  - the relevant interactions and interdependencies providing an understanding of causes and effects;

- the organization's view on the matter;
- actions to manage the matter and how effective they have been performed;
- the extent of the organization's control over the matter;
- quantitative and qualitative disclosures, including comparative information for prior periods and targets for future periods;
- if there is uncertainty of the matter, explanations shall be made and the presentation of possible outcomes;
- if key information about the matter is considered indeterminable, disclosure of that fact and the reason for it. IIRC Framework, 2021. p. 49.

If significant loss of competitive advantage would result, disclosures of a general nature about the matter, rather than specific details.

Care is needed to avoid generic disclosures. Information is only included when it is of practical use in achieving the primary purpose of an integrated report. This requires that disclosures be specific to the circumstances of the organization." IIRC Framework, 2021. p. 50.

Another determinant factor in disclosing can be the credibility and verifiability of the information.

For SMEs, the disclosed information and data can be developed using the capitals and their interrelations, explaining their relevance at the company and their value creation roles, and presenting <IR> information with more basic qualitative and quantitative indicators.

Reporting boundary

Determining the boundary for an integrated report has two aspects:

1. The financial reporting entity (i.e., the boundary used for financial reporting purposes)' IIRC Framework, 2021. p. 31.

In the financial statements of an entity several information and data can be found that can be useful in integrated reporting. On the other side, the information in the financial statements serve as an anchor or point of reference to which the other information in an integrated report can be related.

In most jurisdiction SMEs face less strict financial reporting requirements and financial reporting often primarily serves tax purposes. That means that even the "production" of more detailed financial data can be challenging for an SME. If the entity can identify the relevant matters, it will create not the boundary but the frame of the reporting.

2. "Risks, opportunities and outcomes attributable to or associated with other entities/stakeholders beyond the financial reporting entity that have a significant effect on the ability of the financial reporting entity to create value." IIRC Framework, 2021. p. 31.

At SMEs, the risk assessment and risk management and the analysis of risks and opportunities can be not so well-developed and systematic. If an entity creates its own strategy and business model, analyses these with easy methods - like SWOT or business model CANVAS, etc. - it will serve to find the required risk assessment and presentation of them as well.

Concepts in defining materiality

1. The definition of materiality focuses on the material information needs of the primary stakeholders for the report being issued. The primary stakeholder can represent a group and not only a single or atypical stakeholder or one who is behaving unreasonably or irrationally. It is assumed that the stakeholder has reasonable knowledge of business activity.
2. Judgment is necessary to determine the appropriate level of aggregation or disaggregation of detailed information.
3. Materiality must be evaluated and applied in context; what is material information in one context may be immaterial in another. Detailed promulgated requirements need not be applied if an item is not material to the reporting entity when viewed from the perspective of its primary stakeholders.
4. Assessment of what is or is not material is primarily qualitative and therefore judgement is both critical and necessary. Quantitative materiality thresholds have a role in this process but generally are not dispositive by themselves.
5. Assessment of what is or is not material is primarily qualitative and therefore judgement is both critical and necessary. Quantitative materiality thresholds have a role in this process but generally are not dispositive by themselves.
6. Business management is ultimately responsible for determining which information is material, i.e., relevant, to the purposes of its primary stakeholders (such as investors), for being reported.
7. This assessment is made from the perspective of stakeholders and not the perspective of management and should reflect management's best interpretation of stakeholder expectations as of the reporting date.

It is frequently necessary to make estimates when preparing reportable information. When estimates of, or about, material information are necessary, such estimates should be free from bias, objectively consider all reliable and available inputs and other evidence and consider the material information needs of relevant stakeholders.

Corporate Reporting Dialogue, Materiality, 2016

3.5. CONCISENESS

In case of SMEs, to prepare a concise integrated report, it is not only a principle, but a very reasonable requirement as the size, the complexity, the information system, and the available information can create a limit about information worth presenting.

It is essential to apply the materiality approach - to be able to present the material and relevant issues in a well-structured, logical way, highlighting the correlations of Capitals. The references to other reports, like financial statements, web page information as well as the use of cross-references can serve the purpose of conciseness.

The concise nature of the report should not impact on its understandability;

it is recommended to explain the integrated thinking, business model, the capitals, etc. specifically to the company, in a clear and short way, and using plain language.

Conciseness can support the creation of a detailed, impactful, and readable integrated report.

3.6. RELIABILITY AND COMPLETENESS

An integrated report should include all material matters, both positive and negative, in a balanced way and without material error. IIRC Framework, 2021. p. 34.

RELIABILITY

"The reliability of information is affected by its balance and freedom from material error. Reliability (which is often referred to as faithful representation) is enhanced by mechanisms such as robust internal control and reporting systems, stakeholder engagement, internal audit or similar functions, and independent, external assurance." IIRC Framework, 2021. p. 34.

The smaller entities focus on external financial reporting or tax reporting and create the accounting information system to serve these purposes. The management accounting, controlling system is not so detailed and it can be more informal and mainly based on excel charts. At medium size entities usually, there are different IT solutions for internal control and reporting combined with lots of excel charts. These will be reliable if the information and management systems are built logically and the data and information are managed in closed systems and do not permit of having material mistakes is the databases.

As one of the key purposes of <IR> is supporting the value creation at the company, *the owners, and managers of SMEs must take the responsibility to develop reliable systems and present true and fair information about the company. It can be a motivation at an entity; to establish a system that can provide reliable information and data to serve the managers and owners and to make them aware in doing business and decision making and meanwhile supporting value creation.*

BALANCE

"A balanced integrated report has no bias in the selection or presentation of information. Information in the report is not slanted, weighted, emphasized, de-emphasized, combined, offset or otherwise manipulated to change the probability that it will be received either favourably or unfavourably." IIRC Framework, 2021. p.35.

To create a balanced <IR> an SME can do:

- *Identify honestly the positive and negative issues*, data, tendencies, etc. at the company. Think over the capitals and the changes of them.
- *Using the materiality principle*, define the information shall be presented, both favourable and unfavourable ones.
- *Use a logical and complete <IR> presentation format* that can support to present the <IR> information in a neutral manner.
- *Compare the previously reported financial or non-financial data*, forecasts, and expectations with the current situation, explaining the changes.

FREEDOM FROM MATERIAL ERROR

At an SME it is easier to assess in financial reporting or taxation issues if the data are free from material errors. Developing the reporting of <IR>, it is more problematic because of the lack of complex and integrated information and controlling systems and processes. The <IR> will contain estimations and assumptions, again, these must be reliable ones and the nature, limitations, and risks behind them shall be explained.

It is the responsibility of the <IR> corporate team to understand and assess the information and data and to ensure that these are free from material errors, so they need to create certain level of verification system with control points. IIRC Framework, 2021. p.35.

COMPLETENESS

"A complete integrated report includes all material information, both positive and negative." IIRC Framework, 2021. p.35.

To prepare a complete <IR>, the industrial and company level specialties shall be considered as well.

A good, logical structure of <IR> can guide to each the completeness.

Of course, there are constraints over completeness, as cost-benefit, competitive advantage, confidential information, and future-orientation.

COST/BENEFIT

Cost/benefit means that the benefit of obtaining information should exceed the cost of it. It will be critical in decision- making at SMEs as they can face with the lack of information or reliable information. Thus, they must assess how costly it is to obtain and compare it with the benefits. It will be one element of integrated thinking and value creation process and assessing the materiality.

COMPETITIVE ADVANTAGE

When a company prepares its <IR> and decides on disclosures, the management/owners need to consider prudently not to publish confidential and other information that might cause a significant loss of competitive advantage.

For SMEs, the number of competitors in the same industry - even in a country – can be very high. Judging if information or data is so confidential to SME that it is not recommended for disclosure is shaped and influenced by the company's market position, risks, and sensitivities around the activities, as well as cultural aspects.

FUTURE-ORIENTED INFORMATION

"Future-oriented information is by nature more uncertain than historical information. Uncertainty is not, however, a reason to exclude such information." IIRC Framework, 2021. p.36.

The presented information shall be explained in the context of the changing legal regulations or other internal or external factors to call attention to uncertainties.

On the other hand, if the information is unreliable because of the future expected but unpredictable changes or there are legal restrictions on disclosure, the presentation of this information can be omitted.

3.7. CONSISTENCY AND COMPARABILITY

CONSISTENCY

Consistency means that in <IR> reporting the same presentation and measuring principles shall be applied in each year. This enhances the understandability, and comparability.

If there are changes in the applied principles, structure, disclosure, business model, KPIs or any other material issues, it shall be highlighted and explained.

COMPARABILITY

In <IR>, comparability is even more difficult than in financial reporting as each company will identify different values, business models, relations of capitals.

The purpose of our Framework and Guide is to support the companies in preparing transparent, readable, and logically structured <IR>. We will present the elements of an <IR> report and provide a possible structure for the report that can be applied by any of the companies.

As the IIRC expressed, the comparability can be enhanced by using benchmark data, ratios, and quantitative information. Qualitative information is more difficult to compare and assess its reliability.

4. CONTENT ELEMENTS

According to the IIRC's Framework an integrated report includes eight Content Elements which are fundamentally linked to each other and are not mutually exclusive. The content of an organization's integrated report will depend on the individual circumstances of the organization.

The order of the Content Elements as presented here is not the only way they could be sequenced. The Content Elements are not intended to serve as a standard structure for an integrated report with information about them appearing in a set sequence or as isolated, standalone sections. Rather, information in an integrated report is presented in a way that makes the connections between the Content Elements apparent. IIRC Framework, 2021, p.38.

4.1. ORGANIZATIONAL OVERVIEW AND EXTERNAL ENVIRONMENT

In the part of organisational overview, the SME communicates to stakeholders the main activity of the organization and under what circumstances it operates.

In particular, the organizational overview shall explain, in a concise way, the following organizational elements related to what the business does and the circumstances under which it is operating:

- the SME might reveal here them cultural and ethical values, which can sustain the organization in communicating its purposes and values related to their region and sector of activity.
- moreover, the preparer shall communicate SME ownership and operation structure, the SMEs' strategy, and business model, that will drive the organization forward to meet its objectives,
- the specific opportunities and risks it faces,
- the main competitors on the targeted market,
- further plans concerning the development of the activity in new locations, or in new domains.

Some possible questions that enable to prepare this section might be those presented in Figure 5.

Figure 5. Tangible solutions for corporate boards Source: Webforum

This provides context to current and prospective equity investors, banks, and other providers of financial capital who can appreciate "the full picture" of the SME organisation, how the organization is put together and how it works and might contribute to build trust.

Besides, numerical information shall be included in the elements mentioned above. Such as the number of employees, total revenue and assets, and countries in which the organization operates or deliver its products. In addition, some financial information from the previous years shall be included in comparison with the results from the current year. Moreover, when discussing the organizational overview, significant changes affecting the organization environment shall be included.

The external environment section aims at demonstrating the crucial factors that may affect organizational activity. SMEs carry their business within a dynamically evolving environment, which is changing in technical, behavioural, and ecological aspects.

They interact with innumerable external factors that together compose their economic, political, social, regulatory, market, and technological environment, which, in turn, influence their ability to create value. In this part, the SMEs can present the environment in which the organization fits.

The SME's external environment should refer to the legal, commercial, social, environmental, technological, and political context that can affect the organization's ability to create value in the short, medium, or long term.

For example, the regulatory changes, fiscal fees and different certifications or approvals for different type of activities, the tightening of the imposed conditions regarding the development of an activity, the new client's expectations, suppliers' requirements, increasing competition or availability or affordability of new technologies. Technology presents opportunity as well as risk. For some SMEs, however, technology might be the key to their unique value proposition, especially if they own a flexible organisational structure.

It is important, that the organisation's external environment and the performance drivers need to be considered together, as the listed elements outline how the organization creates value in the future.

Therefore, the SME preparing an integrated reporting, through this section shall be able to demonstrate in a few words in which industry the SME is working, the industry trend and under which market forces the company is operating. In this section, both financial and non-financial results shall be included, in particular information that can have an impact on the organization.

4.2. GOVERNANCE

The Governance section shall demonstrate to stakeholders how the governance structure supports the organization's ability to create value over the short, medium, and long term.

The SME can disclose the following information to demonstrate stakeholders how people in charge are supporting the company's activity. In this vein, the following information can be included in the SME <IR>:

- Description of the SME's leadership structure (information about their background)
- Employees skills and certifications, professional development,
- Internal assessment, promotions, rewards, incentives policies
- The departments description and employees (sales, acquisitions, human resources, production)
- Diversity and inclusion policy concerning the employee, if the SME had embraced the need for diversity of skill set, gender, race, age, and physical ability, as a valuable contribution to the society.
- Remuneration equality policy, remuneration for each employee category by significant locations of operation for priority areas of equality: women to men, minor to major ethnic groups, and other relevant equality areas.
- Training policy, as for example average hours of training per person that the organization's employees have undertaken during the reporting period,
- Health and well being policy, and if exist, an explanation of how the organization facilitates workers' access to non-occupational medical and healthcare services, and the scope of access provided for employees and workers.
- Training policy, as for example average hours of training per person that the organization's employees have undertaken during the reporting period.

4.3. BUSINESS MODEL

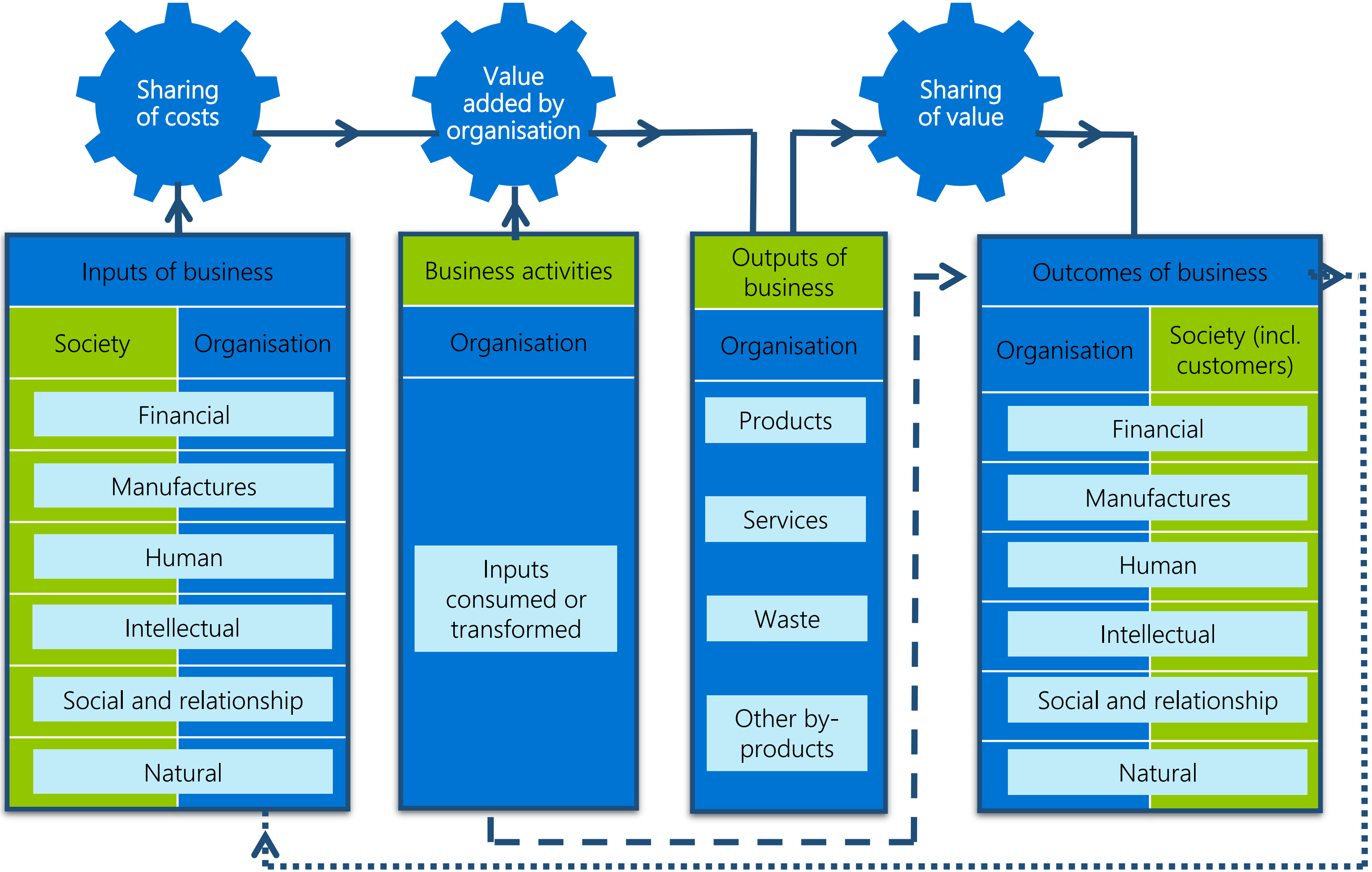
The "Business model" section should clarify how internal and external inputs are used to generate added value and distribute it to the organization, to its customers and to other stakeholders. A firm's business model is its system of transforming inputs, through its business activities, into outputs and outcomes that aims to fulfil the firm's strategic purposes and create value over the short, medium, and long term.

The following graph – Business model IIRC, Business Model, 2013 – clarifies the essential components of a business model in the context of <IR> (see Figure 6).

Figure 6. Business model

Source: IIRC TCG Group, CIMA, IFAC & PWC 2013: 9,

[IIRC, Business Model, 2013]



Inputs are the resources, relationships, and other capitals that an SME depends upon or which provide a source of differentiation. The section should focus on those inputs that have a material bearing on the ability to create value in the short, medium, and long term, whether or not the capitals from which they are derived are owned by the firm. These may include resources in the form of raw materials, common resources, employees, research, ideas, financial capital etc. as well as relationships with suppliers and other stakeholders. Some of their costs may not be borne directly by the firm, and as such they are not recorded by traditional reporting practices, but they are nevertheless a necessary input in the business model of the firm leveraging them.

Taking inputs from various forms of capital does not create value in itself, though; value is created through the key activities business conducts. *Activities* entail using processes, tools, technologies, and innovation to achieve the outputs and outcomes identified by the firm's strategy.

A wide range of interactions occurs through the course of business activities, both internally, among employees and contractors, as well as externally, with suppliers, consumers, regulators, communities, and the environment. This section should clarify through which activities the firm differentiates itself in the market; value creation is assessed in part by considering the interactions between a firm's competitiveness and success, and the communities and natural environment it affects and on which it draws.

Outputs include a firm's range of products and services as well as any waste, emissions or other by-products that need to be identified, described, and quantified in this section, depending on their materiality. It goes without saying that producing something or making a service available are not necessarily value-creating activities; what is crucial is the resulting outcome. For example, do target customers purchase the output? Do they make repeat purchases or recommendations to other potential customers?

Outcomes can accrue to the firm (revenue, cash flows, reputation, employee morale) or to society, including customers (customer satisfaction, brand loyalty, tax payments); they can be either positive or negative, can be short-, medium- or long-term, and can span the full spectrum of all six capitals. A full grasp of the range and nature of outcomes is a key component in the description of the business model, as it allows to clarify whether business activities generate or destroy value, and to identify the value drivers a firm can leverage, i.e., the capabilities or variables resulting in outcomes that give a firm competitive advantage and over which it has some degree of control to create value. They may include financial drivers, such as pricing strategy, operational efficiency, brand equity and cost of capital, as well as non-financial drivers, such as customer relations, societal expectations, environmental concerns, innovation, and corporate governance.

SMEs may employ more than one business model, reflecting different product or service lines, different customer groups or different geographic markets in which they operate. In this case, the business model section should unbundle the firm to its constituent operations, to clarify how value is generated. This requires not only the description of each material business model, but also a commentary on the extent of connectivity among the business models, with special reference to positive or negative synergistic effects among inputs, activities, and outputs.

4.4. RISKS AND OPPORTUNITIES

The "Business model" section should clarify how internal and external inputs are used to generate added value and distribute it to the organization, to its customers and to other stakeholders. A firm's business model is its system of transforming inputs, through its business activities, into outputs and outcomes that aims to fulfil the firm's strategic purposes and create value over the short, medium, and long term.

<IR> is expected to consider the connectivity and interdependencies between the range of factors that affect a firm's ability to create value over time, including the risks and opportunities it faces and how the firm tailors its business model and strategy to tackle them.

The assessment of risks and opportunities is even more important for SMEs, because their size makes them more vulnerable to risks and requires even better focus to exploit opportunities. Larger companies are aware of these challenges: consequently, they embed formal risk assessment routines into decision-making processes and identify specific organizational responsibilities and data bases to support these routines. SMEs often lack suitable procedures, skills, and data sets, and tend to rely on past experience and intuition. Especially when, due to their size, they are forced to sell through agents or wholesalers, they may be late even in understanding market shifts, let alone non-market developments. In dynamic environments this is extremely dangerous because it exposes them to adverse consequences, even of easily preventable risks, such as currency fluctuations.

The "Risk and opportunities" section, therefore, should disclose any hazard, danger, harm, threat or exposure, or any opportunity or prospect, that has already impacted or may impact upon the firm in the future that are fundamental to its ongoing ability to generate value, and the specific steps being taken to mitigate or manage key risks or to create value from key opportunities.

This section should identify and disclose forward-looking information on risks and opportunities that are specific to the firm, including those concerning the firm's effects on, and the continued availability, quality, and affordability of relevant capitals in the short, medium, and long term. The description of relevant risks and opportunities should be complemented by an assessment of their likelihood, the identification of the specific circumstances that would cause them to materialize, as well as an estimate of the magnitude of their effect in case they do.

Considering the guiding principle, Materiality, any real risk that is fundamental to the firm's ongoing ability to create value should be disclosed, even when the likelihood of its occurrence can be considered quite small.

4.5. STRATEGY AND RESOURCE ALLOCATION

<IR> is not only about taking stock of the past, but also signalling the development trajectory the firm wants to pursue, and most importantly how it plans to get there.

SMEs usually lack formalized objectives and clear plans on how to reach them, also because of a limited ability to monitor systematically their operating environment. Whereas flexibility is an important advantage for SMEs, in many cases it translates into trial and error, or the attempt to meet too many commitments, especially to satisfy the expectations of important customers. This willingness to "cover all bases" clashes with limited resources and managerial capacity, exacerbated by centralized decision-making.

What SMEs need are not detailed strategic planning processes, but the ability to define priorities and identify realistic approaches on how to reach them.

The "Strategy and resource allocation" section, therefore, should disclose the firm's short, medium and long term value creation objectives as well as outline the strategies it has in place, or plans to implement, to achieve these objectives.

This outline should clarify what makes these strategies unique, i.e., what is expected to give the firm a competitive edge in its ability to generate value, be it the role of innovation, the way in which the firm nurtures and harnesses intellectual capital or the extent to which environmental and social considerations have been embedded into the value proposition.

For obvious reasons, this section should be closely connected, in logical terms, to the "Business model" and to the "Risks and opportunities" sections: taking into account the current and expected features of the external environment, changes to the business model might be needed to achieve the value creation objectives the firm is pursuing.

Strategies usually require changes to the deployment of inputs and business activities to tackle future challenges. Suitable resource allocation plans are therefore a natural complement to strategies; for this reason, the two elements are bundled together in this section, which is expected to clarify how inputs and activities are expected to support the execution of strategies, as well as how the achievement of value creation objectives is going to be monitored in the short, medium, and long term.

4.6. PERFORMANCE

In the Performance section the SME shall explain if they implemented a performance measurement system and monitor it. The performance measurement allows a SME to measure and keep track whether the objectives were reached. The goals controlled through performance indicators should be monitored according to past, present results and future expectations in relation to the objectives, in the period and might be developed in line with the SMEs capitals.

To do so, in this section *a SME can include the following elements of performance measurement*:

- *Quantitative indicators* how the performance was measured, identifying KPIs.
- Mainly *qualitative indicators regarding risks and opportunities* explaining the methods of measurement and the results.
- Presentation of the performance regarding the effects on the identified and relevant capitals.
- Explanation how the performance served the stakeholders needs and if this has any effect on the relationship with the stakeholders.
- A performance analysis can present a more comprehensive picture if it contains a comparison with the previous year(s) and the future forecasts. Thus, it is recommended to prepare comparisons highlighting the major favourable and unfavourable changes.

4.7. OUTLOOK

The SME shall demonstrate to stakeholder if they are aware about possible, probable future changes and risks that may affect their business and moreover how the SME is preparing for these changes. In this section projections, forecasts and expectations concerning the future of the SMEs activities can be outlined as well.

To provide a perspective on the long-term activity and results of an SME, the <IR> requires communicating toward stakeholders the expected challenges and uncertainties the organization is likely to face in pursuing its strategy in the future. It is also needed to explain the implications of changes in the organization's business model. Accordingly, *the following elements should help SMEs to focus their outlook analysis on*:

- *Expectations on what external and internal changes the SME is likely to face in the short-medium and long term, including legal or regulatory changes.*
- *How these changes will affect the organization's strategy, operation, external and internal position, risks, and opportunities and KPIs*
- *Why these are relevant in value creation.*
- *How the SME is preparing for facing these changes.*

The presentation of the future outlook shall be reliable and keeping the competitive advantages. If there are significant uncertainties in the outlook, sensitivity analysis can be done and summarized in <IR>.

4.8. BASIS OF PREPARATION AND PRESENTATION

The basis of preparation and presentation section can be seen as an overall explanation of how the <IR> was developed, what it contains and why it is included.

This section can include the followings at an SME:

- A brief description of the processes used to identify relevant matters, how the importance was evaluated and the persons in charge who made the identification. Of course, reference can be done to the Materiality part of <IR>.
- Presentation of reporting boundaries and their relevance. It is a summary about material risks, opportunities, limitations on disclosures.
- Summary of significant frameworks and regulations used to quantify or evaluate material matters. At SMEs it will be mainly the regulations on financial reporting and the international or local regulations over their activities.

4.9. GENERAL REPORTING GUIDANCE AND DISCLOSURES

With this simplified Framework our aim is to support the implementation and application of <IR> for SMEs. Besides, we will support SMEs in integrated reporting with a more detailed Guideline where we present how to prepare an <IR> step by step, what kind of questions can arise in the process of preparation and we provide possible answers as well. We are going to focus on:

- Motivation
- Materiality analysis
- Data sources and process requirements
- Organizational overview and external environment
- Stakeholders
- Governance
- Value creation and Business model
- Identification and measurement of capitals
- Interrelations between capitals
- Reporting and visualization

GLOSSARY

As it is essential to understand the phrases used in IIRC's Framework, we decided to cite the Glossary of it, IIRC Framework, 2021., page 53-54

"For the purpose of the Framework, unless stated otherwise, the following terms have the meanings attributed below:

1. **Business model**: An organization's system of transforming inputs through its business activities into outputs and outcomes that aims to fulfil the organization's strategic purposes and create value over the short, medium, and long term.

2. **Capitals**: Stocks of value on which all organizations depend for their success as inputs to their business model, and which are increased, decreased, or transformed through the organization's business activities and outputs. The capitals are categorized in this Framework as financial, manufactured, intellectual, human, social and relationship, and natural.

3. **Content Elements**: The categories of information required to be included in an integrated report; the Content Elements, which are fundamentally linked to each other and are not mutually exclusive, are stated in the form of questions to be answered in a way that makes the relationships between them apparent.

4. **Guiding Principles**: The principles that underpin the preparation and presentation of an integrated report, informing the content of the report and how information is presented.

5. **Inputs**: The capitals (resources and relationships) that the organization draws upon for its business activities.

6. **Integrated report**: A concise communication about how an organization's strategy, governance, performance, and prospects, in the context of its external environment, lead to the creation of value in the short, medium, and long term.

7. **Integrated Reporting (<IR>)**: A process founded on integrated thinking that results in a periodic integrated report by an organization about value creation over time and related communications regarding aspects of value creation.

8. **Integrated thinking**: The active consideration by an organization of the relationships between its various operating and functional units and the capitals that the organization uses or affects. Integrated thinking leads to integrated decision making and actions that consider the creation of value over the short, medium, and long term.

9. **Material/materiality**: A matter is material if it could substantively affect the organization's ability to create value in the short, medium, or long term.

10. **Outcomes**: The internal and external consequences (positive and negative) for the capitals because of an organization's business activities and outputs.

11. **Outputs**: An organization's products and services, and any by-products and waste.

12. **Performance**: An organization's achievements relative to its strategic objectives, and its outcomes in terms of its effects on the capitals.

13. **Providers of financial capital**: Equity and debt holders and others who provide financial capital, both existing and potential, including lenders and other creditors. This includes the ultimate beneficiaries of investments, collective asset owners, and asset or fund managers.

14. **Reporting boundary**: The boundary within which matters are considered relevant for inclusion in an organization's integrated report.

15. **Stakeholders**: Those groups or individuals that can reasonably be expected to be significantly affected by an organization's business activities, outputs or outcomes, or whose actions can reasonably be expected to significantly affect the ability of the organization to create value over time. Stakeholders may include providers of financial capital, employees, customers, suppliers, business partners, local communities, NGOs, environmental groups, legislators, regulators, and policymakers.

16. **Strategy**: Strategic objectives together with the strategies to achieve them.

17. **Those charged with governance**: The person(s) or organization(s) (e.g., the board of directors or a corporate trustee) with responsibility for overseeing the strategic direction of an organization and its obligations with respect to accountability and stewardship.

18. **Value Creation**: The process that results in increases, decreases or transformations of the capitals caused by the organization's business activities and outputs."

APPENDIX – SUMMARY OF REQUIREMENTS

USING THE FRAMEWORK

A summary can be found about the use of IIRC's Framework: IIRC Framework, 2021., page 55-56

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