

INTEGRATED REPORTING

The Connection Between How An Organization Performs And How An Organization Behaves

What is integrated reporting?

Integrated reporting (IR) integrates formerly separate annual financial and CSR (sustainability) reports into a single entity and clearly demonstrates the linkages between an organization's strategy, governance and financial performance and the social, environmental and economic context within which it operates. In IR, a company can connect financial value to a sustainable strategy ad to specific sustainable behaviors, be they environmental or social. By reinforcing these connections, IR can help a business internally to make more sustainable decisions and externally by enabling investors and other stakeholders to understand how sustainability equates to performance.

Integrated reporting is not combined reporting.

Combined reporting, or simply combining the two reports under one cover, is not true IR. In IR, it is necessary to make a financial connection to your sustainable strategy, tactics and actions. IR will change some of the fundamentals of the way you report your CSR information. It will require broader thinking and the use of

“We realize every day that economic efficiency and environmental performance are far more closely linked than people tend to think.”

*Henri Proglia
Chairman and CEO, Veolia Environnement*

multidisciplinary teams with specific skills and experience, including the judgment and analytical skills of an accountant to fully integrate sustainable behaviors with financial statistics.

IR creates the connection between how an organization performs and how an organization behaves.

The problem with CSR reports

Current CSR reporting is not reaching the right readers. IR can elevate environmental, social and governance (ESG) communications to the level of stakeholder engagement. According to a survey of over 5,000 reporters and readers of CSR reports commissioned by the Global Reporting Initiative and conducted by KPMG, SustainAbility and Futerra:

- 57% of CSR reporters cited engaging with stakeholders as one of their top three reasons for reporting, but only 41% of CSR readers agreed with this point.

- Only 17% of CSR readers claimed to actually use these reports as a source of information on how to engage further with an organization.
- 44% of readers are internal audiences.
- Only 16% of readers come from the financial community.
- Only 3% of investors read 10 or more reports per year, compared with a total average of 5%.
- 70% of investors chose performance data as their number one factor in trusting an organization's sustainability commitment. Investors place greater importance on performance data in building trust than some other stakeholder groups.
- An even stronger response was received from labor organizations, public agencies and rating agencies. Between 74% and 78% of these CSR reader groups desire robust performance data over anything else.

“Global warming will be the most important investment issue for the foreseeable future.”

Jeremy Grantham
Co-founder, Chief Investment Strategist
Grantham Mayo Van Otterloo (GMO)

Where reporting is headed

The trends show that corporate responsibility and investor communications are evolving to connect a company's environmental, social and corporate governance (ESG) performance and long-term business success. IR provides concrete facts, proof points and market context to help investors appraise material ESG issues and benchmark performance over time and relative to the competition.

In the 18 months prior to October 2010, about 260 reports were produced by traditional Wall Street firms on the financial implications of topics such as climate change and water shortages. In the 18 months prior to that, only about 15 such reports were written. And in the 18 months before that there were no reports including these topics. (Source: HBS Workshop on IR)

Required reporting

IR is not only becoming more popular, it is beginning to be mandated. “IR is set to spread quickly, both in developed and emerging markets. In South Africa, for example, several firms, including Angle Platinum and Eskorn (heavy environmental concerns) have already produced integrated reports. This follows the introduction of the country's King Report on Corporate Governance in 2009, with which all companies listed on South Africa's JSE Securities Exchange must comply. **The report recommends that all firms produce an integrated report in line with GRI guidelines, or else give an explanation as to why they have not.**” (Source: KPMG International, “Corporate Sustainability, A progress report,” April 2011)

France has passed a law requiring integrated reporting for companies of more than 500 employees.

Denmark adopted legislation in 2009 requiring the top 1,000 Danish companies to disclose material CSR impacts and strategies in their financial reporting. The view is that society and the markets have a right to know about companies. Companies must either report or explain why they don't. As a result, only about 11% of companies choose not to report.

Challenges to the IR process

In the overall IR discussion, questions remain: *Will integrated reporting be a catalyst for embedding sustainability leadership? Will it materially change the way the investment community assesses businesses? Will it be a turn-off for anyone other than investors and analysts?*

Integrating your internal teams: “A collaborative and multifunctional process is required for producing the integrated report; no one group has all the information necessary for doing so. Internal control and measurement systems for non-financial information are typically not as sophisticated and robust as those for financial information. Internal skeptics have to be brought onboard.” (Source: Accountancy Futures, Accountants for Business, Integrated Reporting, March 2011)

Ensuring clear relationships between financial and non-financial: “Even in the better examples, we are hard-pressed to find a clear relationship between the business performance and

sustainability initiatives. If IR should be used for assessing the impact of non-financials on business performance, then the absence of this connection in the disclosure defeats the purpose.” (Source: Elaine Cohen, CSRwire contributing writer)

Keeping data fluid and getting feedback: Fluid reporting on an integrated website makes it easier for users to find and analyze in one place financial and non-financial information, including more detailed information of particular interest to specific stakeholders and using the website for dialogue and engagement with shareholders and all other stakeholders to create a collective conversation.

Tactical Tips for Beginning The IR Process

Best Practices

Best practices can help on the IR journey, including:

- Secure CEO buy-in. That is critical.
- Discuss integration challenges/ opportunities to start the process; then much will fall into place.
- Engage diverse stakeholders by sharing drafts with them and addressing their issues.
- Understand the vision. A forward-looking report with KPIs would differ greatly from one that just reported past results.
- Identify material sustainability issues and relevant linkages to financials. Implement processes to collect and analyze the right data.
- Have a rigorous, integrated assurance process; not different auditors for financial and sustainability metrics.
- Think beyond the report. Embed integration objectives into the culture.

Characteristics of the IR Team

1. **Balance:** Your IR team needs balanced ability across all competencies.
2. **Energy:** *the ability of the team to proactively conceive of and pursue productive initiatives aligned with the transition to integrated reporting.* The team is energized by working together; members support and reinforce one another. All members volunteer to take on substantive workloads.
3. **Openness:** *the ability of the team to engage with the broader organization and the outside world and build the connections required to develop IR.* Critical thinking and debate are encouraged among all team members. The team challenges itself by seeking new information, best practices, and outside perspectives. Everyone questions current thinking. The team must remain innovative, translate feedback into heretical questions and continuously evolve (and re-design, if necessary) your IR approach.
4. **Resilience:** *the ability of the team to remain cohesive and composed under persistent internal or external stress and effectively overcome resistance as trends emerge and expectations grow.* Within effective teams, members rely on mutual respect to constructively and transparently deal with internal conflicts and with the resistance that may arise from stakeholders across the organization. Team members take responsibility for their

actions, trusting the team to support them. When things go wrong (as they inevitably will, at times, when tackling a mission as challenging as IR), the team focuses on finding fresh solutions.

5. **Efficiency:** *the ability of the team to harness all available resources and efficiently translate their aspirations into the measurable results at the core of effective integrated reporting.* The team continuously monitors performance against plan and makes calculated trade-offs to optimize resources and minimize wasted effort. Team meetings have clear agendas, schedules and rules of engagement.
6. **Alignment:** *the ability of the team to consistently distill individual and collective actions congruent within the overall sustainability strategy.* The team must not only be aligned with each other but also with other functions and teams across the organization as well as external stakeholders. Should also play a key role in fostering alignment, in part by continuing to ask tough, probing questions: How can we create differentiation and competitive advantage in our markets? What will consumer expectations be, and how do we stay ahead of them or shape them? Above all, the IR team asks: What evidence can we present to quantifiably demonstrate that our operational reality matches our aspirations and the public perceptions they inform?