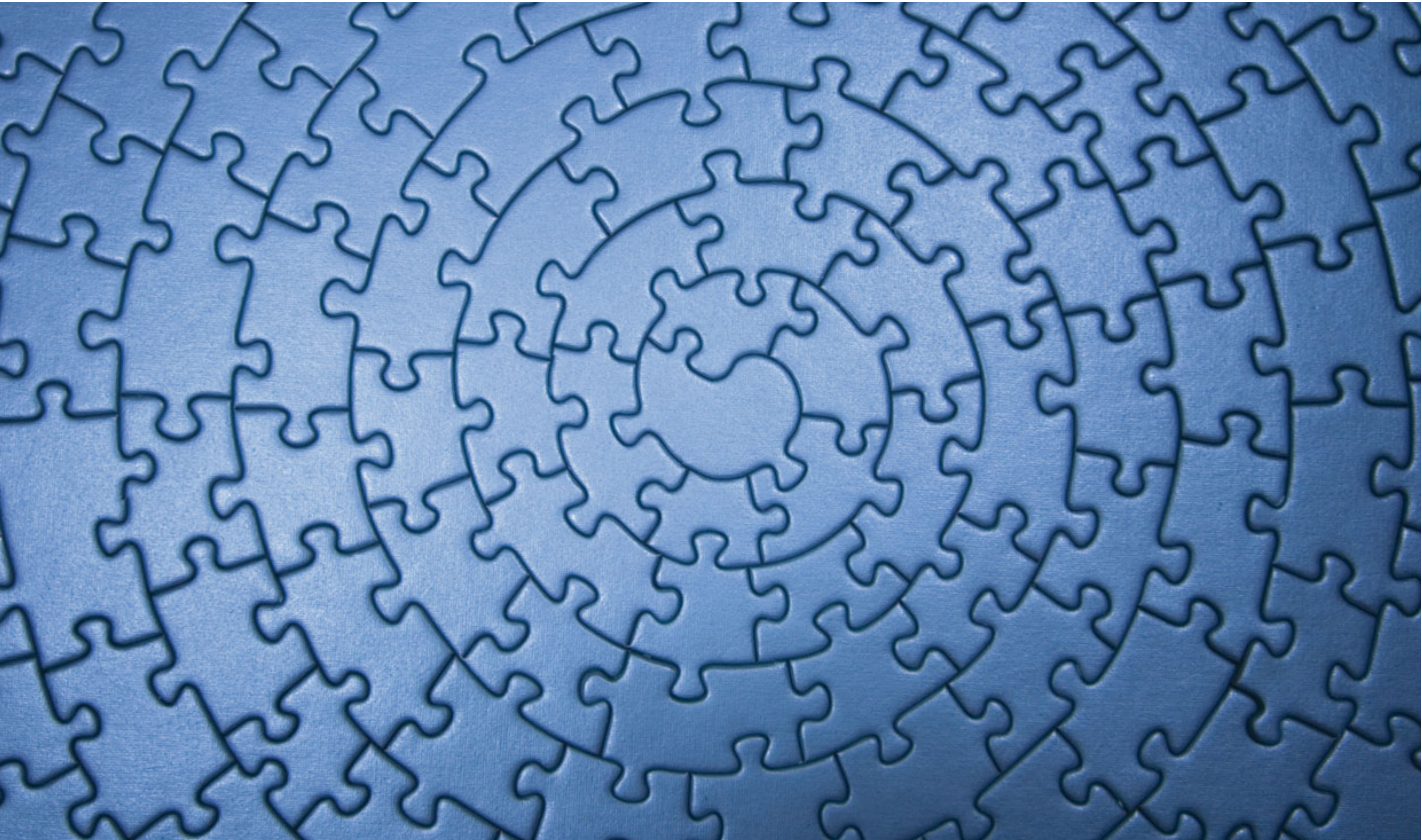
Making Investment Grade:
The Future of Corporate Reporting

New trends in capturing and communicating strategic value



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Making Investment Grade:
The Future of Corporate Reporting

New trends in capturing and communicating strategic value

Edited by
Cornis van der Lugt and Daniel Malan

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Forewords

United Nations Environment Programme

Rio+20, as the United Nations Conference on Sustainable Development has come to be known, provides an unprecedented opportunity for the world to transform the current economic paradigm into one that enhances human well-being, while respecting planetary boundaries and environmental limits. To facilitate this transformation, we need to measure what matters, so that we are able to understand whether we are making progress. This will require changes in the way we perceive progress, make financial decisions and do business, to ensure that social and environmental considerations are fully integrated into decision-making. The issue of sustainability reporting, in particular, has gained traction on the international agenda as there has been growing recognition that financial reporting alone is insufficient and that not enough companies are reporting on sustainability performance.

Many companies – and the majority of leading multinationals – are reporting, with most using methods based on those of the Global Reporting Initiative, of which UNEP was a co-founder. Reaching companies in developing and emerging economies remains challenging, as is reaching smaller companies along global value chains – which are estimated to be responsible for more than 50 per cent of GDP worldwide. Against this backdrop there is also the drive towards integrated reporting of financial and ESG (environment, society and governance)-related issues.

UNEP, through various efforts including the 'Carrots and Sticks' series of publications, has promoted sustainability reporting for private and public institutions along globally applicable guidelines. UNEP works in close cooperation with the United Nations Global Compact, the International Integrated Reporting Council, and others, to help companies better understand and address their integrated environmental and social impacts. UNEP supports increased sustainability reporting for investors to use in financial decision-making, life cycle-based methodologies such as resource footprinting, science-based information on critical resource flows, and capacity enhancement in developing and emerging economies.

We don't know how sustainable reporting will evolve, but we know it is evolving – and rapidly. In this publication, thought leaders, practitioners and companies were invited to reflect on achievements and speculate about future developments. It provides an impressive overview of the range of opinions on the future of sustainability reporting.

With this publication, UNEP hopes to enhance the debate and thinking around integrated reporting and the movement to mandatory reporting, as well as to highlight future challenges and opportunities – most notably in harnessing the private sector to contribute to delivering a resource-efficient and Green Economy.

Sylvie Lemmet
Director Division of Technology, Industry and
Economics (DTIE), United Nations Environment Programme (UNEP)

Deloitte Southern Africa

Deloitte Southern Africa is grateful, and proud, to have been able to co-sponsor this very timely and topical publication.

South African listed companies, which are required by the Johannesburg Stock Exchange to report on the financial, social and environmental sustainability of their operations in accordance with the King Report of Governance for South Africa 2009 (King III) on a "Comply or Explain" basis, have been grappling with the challenge of producing integrated reports since March 2011.

The approach of our firm to this very practical challenge, and opportunity, for companies to tell their story with credibility has been to provide our view, based on empirical examination and analysis, on the state of the actual emerging practice of integrated reporting, and integrated reports, in South Africa. We see our role as active and constructive contributors to both the debate and the process.

This publication of Deloitte, the United Nations Environment Programme and the Centre for Corporate Governance in Africa at the University of Stellenbosch Business School serves to provide an international perspective on integrated reporting, by articulating the views of internationally pre-eminent role players on topical issues associated with integrated reporting and integrated reports. The pivotal importance of a symbiotic manner of organisation and operation, the reciprocal relationship between sustainability (in all its dimensions) and business models, and the fundamental need of stakeholders to understand what actually happens around the boardroom table come through clearly and consistently. As a result, we believe the content of this publication advances the debate on integrated reporting, and integrated reports, in very important respects.

We do hope that the reader, having read and digested the content, will come to the same conclusion.

Bertie Loots
Leader, Integrated Reporting, Deloitte Southern Africa

Centre for Corporate Governance in Africa

The Centre for Corporate Governance in Africa is proud to be a partner of the United Nations Environment Programme (UNEP) and Deloitte in this important publication.

The purpose of the Centre for Corporate Governance in Africa is to improve the effectiveness of corporate governance within African organisations, predominantly in the private sector. The Centre conducts multidisciplinary research and is particularly interested in the link between corporate governance, business ethics and total organisational performance. Its main focus areas are integrated reporting, responsible investment, values and board leadership.

We hope that this publication will be of use to regulators, corporate reporters and researchers. It brings together the views of global thought leaders – both scholars and practitioners – about the future of the rapidly developing field of corporate reporting. The aim of the publication is to share views and to encourage critical thinking, not to declare a bias in favour of any one practice or to suggest premature solutions.

The principles of transparency and accountability that underpin integrated reporting are fundamental governance principles – we therefore believe that this publication will also contribute to broader discussions about governance.

South Africa has been acknowledged as a leader in both governance and integrated reporting. As a South African institution we are proud of this reputation, but believe that we should remain modest about what we have achieved thus far and continue to contribute to global discussions about the topic.

We would like to thank our partners as well as Standard Bank who kindly agreed to sponsor the printing of this publication. We trust that you will enjoy reading it.

Daniel Malan

Director, Centre for Corporate Governance in Africa, University of Stellenbosch Business School

Part 1: Introduction

From clutter to investment grade information

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The word 'clutter' has often come up in discussions about corporate reporting in recent years – clutter being "a collected mass, a crowded and confused assemblage" as the Oxford English Dictionary describes it.[1] The related question is whether more information is necessarily good, and whether it enables better decision-making and management quality. Less information on the other hand awakens the suspicion of secrecy, insufficient disclosure and lack of accountability. Most commonly, however, the arrival of the increasingly connected and transparent economy bogs decision-makers down with information overload which necessitates a desperate search for the most relevant information. What constitutes 'relevant' is often determined by the eye of the beholder. Yet crisis events in the global economy have served to sharpen the mind and rivet greater attention on research findings about where this world seems to be heading. This is accompanied by consideration of the role of business in developing inclusive markets and the Green Economy.

Added to the feeling of information overload and seeming lack of quality investment grade information is the apparent lack of understanding among mainstream investors of the material importance of sustainability information. This is complicated by a lack of comparability, reliability and consistency of the information disclosed. As with any stakeholder group, investors have their unique preferences – some are short-term

[1] Ten years ago a global benchmark survey of sustainability reporting by SustainAbility and the United Nations Environment Programme (UNEP) spoke of the "carpet bombing syndrome", referring to companies bombarding readers with ever-more information without providing much insight as to relevance and meaning. See SustainAbility and UNEP. 2002. Trust Us – The Global Reporters 2002 Survey of Corporate Sustainability Reporting. London, Paris: SustainAbility and UNEP.

traders, some long-term value generators. Examination of information management systems and reporting over the past two decades has shown varying stakeholder preferences for what was often presented as opposites, such as:

- historical information versus forward-looking information;
- quantitative versus qualitative information;
- core indicators versus additional indicators;
- input indicators versus output indicators;
- process indicators versus performance indicators;
- physical metrics versus financial metrics;
- micro level, local site versus macro level, aggregated data;
- direct versus indirect impact or dependence values;
- tangible versus intangible asset values; and
- internal (private) versus external (public) information.

The current debate on corporate reporting and integrated information management is seeking more suitable midways between these opposites. The debate takes place against the background of a world in which advances in information and communication technology (ICT) are opening up new ways of digital communication and participation never imagined before. This poses a challenge for established professions such as accounting and law, which still show a preference for historical facts, established currencies and documentation with clear boundaries. Debate about the future of reporting is therefore not only a discussion about content and different ways of communicating with diverse stakeholders, but about re-examining convention in some established professional disciplines. The discipline of management is one whose very survival depends on an ability to adapt and be responsive to constant change in market demand. In addition, the debate needs to remind participants repeatedly that reporting cannot be a stand-alone exercise, but that the report and the process behind it need to be part and parcel of management planning, stakeholder engagement, performance management and strategic decision-making.

The evolving debate about corporate reporting also reflects current thinking about corporate governance. The core corporate governance principles of honesty, transparency and accountability are important requirements for effective and credible reporting. The emerging corporate governance emphasis in favour of performance, as opposed to conformance, presents a logical link to reporting. Many companies report to comply with either a voluntary or mandatory standard, while the content of the report itself has to reflect the actual performance of the company. Increasingly, the credibility of the report does not rely so much on the requirement for the measurement to be accurate, but, to start with, on the relevance of the chosen indicators. Reporting integration can play an important role in bringing these requirements – accuracy and relevance – closer to each other. Getting this right will make a contribution to good corporate governance, both in terms of support for the core governance principles as well as

getting the right balance between performance and conformance.

There is also a business case for reporting. Although it is always a secondary activity, reporting is critical in an age of transparency and increased stakeholder interest in the activities of all companies. The UN Global Compact has promoted this through its requirement of annual Communications on Progress by signatory companies worldwide. The Global Reporting Initiative (GRI) has summarized the value uncovered during the reporting process by referring to both internal and external benefits.[2] In a recent global survey conducted by Chatham House, major stakeholder groups identified the following five issues as the greatest benefits of sustainability reporting: increased data transparency, improved organizational governance, an expanding reporting universe (organizations thinking about sustainable development issues), increased stakeholder engagement and greater data comparability.[3] These benefits recognize the value of both the reporting process and its outputs, including a sustainability report printed and/or communicated online. Special interest target groups such as investors have expressed greater appreciation for theme-specific accounting and reporting, such as carbon disclosure under the Carbon Disclosure Project (CDP).

Despite the clear business case, for many companies the catalyst for reporting remains regulation. As the discipline of sustainability reporting evolved, many voluntary and mandatory reporting standards have emerged in the last ten years. The report Carrots and Sticks: Promoting Transparency and Sustainability (2010) revealed 142 reporting standards in 30 Organisation for Economic Co-operation and Development (OECD) and emerging market countries.[4] From a voluntary perspective, the trendsetters for addressing a comprehensive sustainability agenda today are the GRI guidelines and draft guidance from the International Integrated Reporting Council (IIRC). The arrival of the IIRC signals growing interest from the accounting industry as well as convergence between sustainability and financial reporting.

Table 1 below compares the recommended content elements found in the GRI Sustainability Reporting Guidelines and the proposed content elements of the integrated report, as contained in the framework discussion paper of the IIRC.[5] This shows remarkable similarity. One can imagine the addition of

[2] Global Reporting Initiative (GRI). 2011. Sustainability Reporting: How valuable is the journey? Amsterdam: GRI.

[3] Hohnen, P. 2012. The Future of Sustainability Reporting – EEDP Programme Paper 2012/02. London: Chatham House.

[4] In its analysis, “standards” referred to voluntary and mandatory requirements or frameworks for disclosing information on sustainablity topics, as found in for example national industry initiatives and legislation. See UNEP, GRI, KPMG and the Unit for Corporate Governance in Africa (Stellenbosch University Business School). 2010. Carrots and Sticks: Promoting Transparency and Sustainability. Nairobi, Amsterdam: UNEP et al.

[5] Global Reporting Initiative (GRI). 2006. Sustainability Reporting Guidelines Version 3.1. Amsterdam: GRI; International Integrated Reporting Council (IIRC). 2011. Towards Integrated Reporting – Communicating Value in the 21st Century. London: IIRC.

Table 1: The evolving reporting frameworks of the Global Reporting Initiative (GRI) and the International Integrated Reporting Council (IIRC) compared

GRI G3.1 standard disclosures	IIRC content elements (rearranged sequence)
Strategy and analysis	Strategic objectives and strategies to achieve those objectives
Organizational profile	Organizational overview and business model
Report parameters	Operating context
Governance, commitments and engagement	Governance and remuneration
Management approach	Future outlook
Performance indicators	Performance

Consolidated Sustainability Accounts alongside Consolidated Financial Accounts, complementing discussion on the link between their respective indicators. The proposed content elements signal key sustainability and governance topics that are of primary interest to those involved in the reporting field, from a management, investment and accountability point of view. These key topics are covered in the contributions to this report. The pages that follow address a variety of questions, namely:

- Who drives reporting?
- Should the reporting process lead to the annual publication of one or multiple reports?
- What are the most relevant or material issues to address?
- Who are the target readers or users of reports?
- Who governs the reporting process?
- Who regulates reporting?

The final section of the report provides thoughts about future challenges and opportunities in the further evolution of the reporting field. As may be expected from a field that attempts to be inclusive and relies heavily on stakeholder engagement, there will be diverse views on the questions listed above. In preparation for this report a group of sustainability researchers was asked to provide brief responses to these. The group comprised 31 researchers from five continents, with 65 per cent representing North America.[6] According to this group, the most important internal drivers for integrated reporting are sustainability departments (39 per cent) and the board of directors (32 per cent). The vast majority (90 per cent) supported mandatory integrated reporting standards for large, listed companies, and regarded civil society (44 per cent) and regulators (30 per cent) as the most significant readers that should determine the content and format of the report.

[6] The group was polled during a session at the 2012 Sustainability Centres Workshop, organized by the Network for Business Sustainability, a network of international academic experts and business leaders based in Canada at the Richard Ivey School of Business (Western University, London, Ontario). More information is available at www.nbs.net.

Making Investment Grade: The Future of Corporate Reporting includes 21 contributions from recognized experts in the reporting, corporate governance and responsible investment fields. These experts are based in different business centres, leading discussions on corporate responsibility from Sao Paulo to Hong Kong, from London to Johannesburg. Their unique contributions provide a gripping overview of the status of the reporting landscape and the future of corporate reporting. This publication provides a stark reminder of the challenge that lies ahead, a challenge of bridging the gap between entrenched opposites, as well as the gap between executive statements and fundamental change in daily business practice.

Cornis van der Lugt is Senior Research Fellow at the Centre for Corporate Governance in Africa at the University of Stellenbosch Business School and Geneva-based consultant with over twenty years of experience in the sustainability field at international level, including as Subprogramme Coordinator at the United Nations Environment Programme (UNEP). In recent years he served as member of the Lafarge Stakeholder Advisory Panel, as nominated expert in the ISO 26000 process on Social Responsibility, and as member of the Reporting as Process, Boundary and Materiality Expert Working Groups of the Global Reporting Initiative (GRI).

Daniel Malan is a Senior Lecturer in Ethics and Governance at the University of Stellenbosch Business School (USB) and Director of its Centre for Corporate Governance in Africa. He is also a member of the World Economic Forum's Global Agenda Council on Values in Decision Making and the International Corporate Governance Network's Integrated Business Reporting Committee.

Part 2: Context and challenges

Annual reporting needs to account for more

Alex Watson
Professor, College of Accounting
University of Cape Town

Ideally, reporting by a business should communicate the risks that the business is facing and the impact that such risks could have on its ability to continue operating – thus influencing an assessment of its sustainable value. Realistically, reporting could never have predicted a threat like the Japanese tsunami. But, following the financial crisis, a fair question is: Why did reporting not bring to light the financial risks to which many companies were exposed? The weaknesses in reporting shown up by the financial crisis, as well as an increasing awareness of the impact of business on the natural environment and the long-term availability of resources, have created the right environment for the advent of integrated reporting. Consequently, integrated reporting is gaining rapid acceptance as the way forward for corporate reporting.

Initially, financial reports included only statutory financial statements, providing largely backward-looking financial information. Over time, management commentary was added to provide context to the financial information. Since the 1990s, additional non-financial information has been introduced, often in a separate sustainability report or annual review, typically including information on employment (e.g. safety records, expenditure on training, etc.), environmental factors (e.g. carbon emissions, electricity and water usage, etc.) and corporate social responsibility activities. While this triple bottom line or environmental, social and governance (ESG) information is useful to some and serves as a good public relations exercise, not all of it is relevant in predicting the ability to create long-term sustainable value.

The financial statement component of the annual report has become longer and more complex for a number of reasons. These include the complexity and increased disclosure requirements of financial reporting standards, perhaps combined with the increasing fear of preparers and their auditors for regulators. The resulting financial statements appear to be influenced by disclosure checklists to ensure compliance with reporting standards, rather than by what is most relevant for the investor. Some steps have been taken to review the increasing disclosure requirements of annual financial statements, with the publication in July 2011 of Losing the Excess Baggage –

Reducing Disclosures in Financial Statements to What's Important[1], wherein a joint working group from New Zealand and Scotland suggests a structured approach to addressing the problem.

Irrespective of the approach countries and individual companies take to reporting, the annual financial statements will remain a significant part of the reporting process, even if they do not continue to be routinely distributed to all stakeholders. Whatever reporting format is used, the financial information, to have credibility, needs to be prepared in terms of clearly understood recognition and measurement principles with more details available for those who need them. A reporting framework, such as International Financial Reporting Standards[2] and detailed annual financial statements are therefore necessary for corporate reporting in any format.

Providing a framework for the disclosure of narrative information in an annual report is more challenging because of the diversity of business models, risks and environments which need to be considered. There are some reporting models that are widely used, with the Global Reporting Initiative being globally recognized as providing appropriate guidance for sustainability reporting.[3]

Adding more information is not always beneficial, and there is increasing concern that additions may detract from the annual report's usefulness.[4] This problem is exacerbated when different components of the report are prepared by different teams, resulting in repetition (or worse still, contradictions), silos of information that do not demonstrate their interconnectedness, and inconsistent messages on how the governing body of the organization is fulfilling its stewardship obligations. The report will achieve its purpose when investors understand the strategic direction that the board is following, the successes in exercising the strategy, and the risks the company faces and how these influence strategy.

An annual report should provide the information that an investor needs to make decisions about whether or not to invest in that entity, and one should therefore expect a close alignment with the information included in investor presentations given by management. Anecdotal evidence suggests that this is not the case, with investor presentations focusing on the message that management knows investors need, while aspects of corporate reports are compliance-driven. Reporting should be driven by the needs of investors, who are

[1] Joint Oversight Group of the Institute of Chartered Accountants of Scotland and the New Zealand Institute of Chartered Accountants. 2011. Losing the Excess Baggage – Reducing Disclosures in Financial Statements to What's Important. July. Available at www.frc.org.uk/about/cuttingclutter.cfm

[2] International Financial Reporting Standards (IFRS) are reporting standards issued by the IFRS Foundation. Its objectives and processes are available at www.ifrs.org/The+organisation/IASCF+and+IASB.htm

[3] The Global Reporting Initiative (GRI) provides all companies and organizations with a comprehensive sustainability reporting framework that is widely used around the world. Available at www.globalreporting.org/information/about-gri/Pages/default.aspx

[4] See for example Financial Reporting Council. 2011. Cutting the Clutter. Discussion Paper. Available at www.frc.org.uk/images/uploaded/documents/Cutting%20clutter%20report%20April%2020112.pdf

increasingly asking for information that links the organization's strategy, governance and financial performance to the economic, social and environmental context within which it operates.[5] Integrated reporting is intended to fill those needs.

Leaders from the regulatory, securities, standard-setting and corporate fields have formed the International Integrated Reporting Council. Its working group has published a Discussion Paper describing and promoting integrated reporting, which is intended to encourage discussion and elicit feedback to develop appropriate guidance on integrated reporting.[6]

The Discussion Paper suggests that the result of integrated reporting is a primary report that highlights the most relevant information about how an organization demonstrates stewardship and how it creates and sustains value. As the integrated report reflects on the way in which the organization is managed, an organization can only produce a truly integrated report if the organization has integrated thinking, which requires the organization to "monitor, manage and communicate the full complexity of the value-creation process, and how this contributes to success over time".[7] If strategic decisions are made by considering sustainable value added by the business (including non-financial such as employment opportunities, customer benefits from products, etc.) and the impacts on resources it needs, communicating that in an integrated report should be easy. If decisions are based on short-term financial gain, integrated reporting is challenging and may be perceived as window-dressing.

The integrated report is intended to do far more than select the material aspects of the existing suite of reports and combine them into one report. The report should have a strategic focus, making it clear how the risks and opportunities have influenced the business model, while demonstrating the linkages between the organization's strategy, governance and performance. The Discussion Paper identifies strategic focus, connectivity of information, future orientation, responsiveness and stakeholder inclusiveness, plus conciseness, reliability and materiality as the guiding principles underpinning the preparation of the integrated report.[8] Clearly not all the needs of all stakeholders can be dealt with in a concise document: that is where electronic information can assist.

[5] The United Nations Principles for Responsible Investment (UN PRI) and the South African Code for Responsible Investing (CRISA) are examples of codes that institutional investors are agreeing to abide by. These require them to incorporate environmental, social and governance issues in their investment decision-making processes.

[6] International Integrated Reporting Council. 2011. Towards Integrated Reporting – Communicating Value in the 21st Century. Discussion Paper. September. Available at theiirc.org/wp-content/uploads/2011/09/IR-Discussion-Paper-2011_spreads.pdf

[7] Ibid., footnote 6.

[8] Ibid., footnote 3.

The integrated report will probably need to be supported with annual financial statements, employment-related information, more detailed governance disclosures, etc., for different stakeholder groups available online.[9]

As an integrated report requires management to report on how it manages the business and what may impact on the sustainable value of the business, reporting requirements cannot be prescribed. The Discussion Paper therefore does not specify the format of an integrated report, focusing instead on guiding principles, with limited guidance on the elements which may be included. The publication of the Discussion Paper followed on from related guidance documents and publications, including an earlier Discussion Paper on integrated reporting issued in South Africa.[10]

South African companies with years ending from 31 March 2011 are required to prepare an integrated report, or explain why they have not done so.[11] This requirement has resulted in some early examples of what an integrated report could contain. Generally speaking, the shorter reports appear to have been produced from scratch and have been more successful in achieving the goal of integrated reporting than those that appear to have used prior reports as the starting point. Evidently, longstanding leaders in sustainability reporting worldwide will face some difficult choices in deciding on content for inclusion in either an integrated report or other sustainability communication.

Alex Watson is a Professor at the College of Accounting of the University of Cape Town. She is a member of the South African Working Group on Integrated Reporting that developed the South African Discussion Paper on Integrated Reporting. Previously she chaired the Accounting Practices Committee, the technical accounting committee of the South African Institute of Chartered Accountants. She currently chairs two audit committees of South African listed companies that have recently produced integrated reports, and is one of three adjudicators of the Ernst & Young Excellence in Corporate Reporting Awards.

[9] Companies in some European and North American countries have been required by law to disclose employment and pollutant-related data through reports such as the Bilan Social and Ökobilanz since the 1970s.

Available at www.sustainabilitysa.org/Portals/0/IRC%20of%20SA%20Integrated%20Reporting%20Guide%20Jan%20 11.pdf

[11] In February 2010, the Johannesburg Stock Exchange, through its listings requirements, made it compulsory for all listed companies to comply with King III, including the requirement for a company to produce an integrated report for its financial year starting on and after 1 March 2010, or to explain why it was not doing so.

Sustainability reporting for 'the future we want'

Ernst Ligteringen
Chief Executive, Global Reporting Initiative

Encourage industry to improve social and environmental performance through voluntary initiatives, including environmental management systems, codes of conduct, certification and public reporting on environmental and social issues. Thus reads the first part of paragraph 18-A in the 2002 Johannesburg World Summit on Sustainable Development (WSSD)'s Plan of Implementation. Placed under the chapter "Changing unsustainable patterns of consumption and production", this sentence perhaps best communicated the view of governments that transparency and public reporting are part and parcel of the Green Economy.

At the time, sustainability reporting was practised by some 200 companies as a stakeholder engagement and accountability exercise. Many companies – largely those hailing from developed economies – used the fledgling Global Reporting Initiative Guidelines. If 2002 was the successful launch of sustainability reporting on a global stage, what is the state of the art ten years on? How has the reporting journey developed and how will it need to develop to continue to be a useful tool for sustainable development?

There have been major developments in the number of reporting entities and the consideration of reported information. The 2011 KPMG survey of Corporate Responsibility Reporting shows that 95 per cent of the 250 largest companies in the world published a sustainability report in 2011, up from 83 per cent in 2008. On average, 64 per cent of the largest 100 companies in each of the 34 countries reviewed reported. It was the first time there were significantly more sustainability reporters than non-reporters in this pool of companies. Conducted every three years, the survey shows a strong and sustained growth trend in the uptake of sustainability reporting.[1]

In total, at least 5 700 sustainability reports were published in 2010, with year-on-year growth in the range of 17 to 20 per cent between 2006 and 2010.[2] From its origins in the Organisation for Economic Co-operation and Development (OECD) countries, sustainability reporting is now also rapidly evolving into an accepted practice among large companies in

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[1] KPMG International Corporate Responsibility Reporting Survey. 2011. Available at www.kpmg.com/global/en/issuesandinsights/articlespublications/corporate-responsibility

[2] A per year count of all reports issued across all countries and sectors. Last updated 27 March 2012. Corporate Register. Available at www.corporateregister.com/stats/

emerging economies. For instance, in 2011, more than 800 sustainability reports were published in China alone.[3]

As sustainability reporting is becoming common practice among an increasing number of companies, it has also come of age in the last ten years. In a time of financial crisis, with budgets tightening across the board, a potentially superfluous exercise would surely be discarded. And yet sustainability reporting has survived. While there is certainly room for improvement in focus and relevance of reported information the practice has seen sustained growth. Why is that?

Firstly, sustainability reporting is a useful basis for dialogue on impacts and risks, and their management. As companies and their internal and external stakeholders enter into a dialogue, understanding deepens regarding the sustainability impacts, risks and opportunities of company operations. Opportunities for improvement are identified and can be acted on in each subsequent reporting cycle. For instance, when United States conglomerate General Electric launched its Ecomagination initiative, a high profile investment in green R&D, part of the commitment was to report about it; while for Brazilian cosmetics company Natura key issues raised by stakeholders in one year are placed on the board's agenda in the next.

Secondly, policymakers have stepped in. Governments and regulators have been pushing for greater corporate transparency. They are doing so, among others, through a combination of direct regulation and stimulus, as in Denmark; or by making sustainability reporting a requirement for state-owned enterprises, as in Sweden, Norway and China; or by asking for reporting from companies supplying to government, as in the Netherlands.

Importantly, a growing number of diverse stakeholders are indeed reading the reports, or rather processing the information contained therein. Market analysts are increasingly finding and valuing sustainability performance information.

Market data providers such as Bloomberg and Thomson Reuters have started wholesaling sustainability information. Bloomberg now provides environmental, social and governance information on 3 600 companies to its 300 000 terminal subscribers.

Furthermore, there is an increasing assertion of stakeholders as owners. Pension funds screen investments for environmental, social and governance information.[4] In the United States, shareholder activism is on the rise.[5]

[3] Emerging Best Practices of Chinese Globalizers. 2012. The Corporate Global Citizenship Challenge by the World Economic Forum in collaboration with Boston Consulting Group. Available at www3.weforum.org/docs/WEF_EmergingBestPracticesChineseGlobalizers_IndustryAgenda_2012.pdf

[4] Report on Socially Responsible Investing Trends in the United States. 2010. US Social Investment Forum Foundation and European SRI Study. European Sustainable Investment Forum. Available at www.eurosif.org/research/eurosif-sri-study/2010

[5] Proxy Review. 2012. As you Sow Foundation. Available at www.asyousow.org/csr/proxyvoting.shtml

Academic research links corporate transparency to lower risk, including the risk of regulation on sustainability issues. [6] A growing number of asset owners, asset managers and data providers are signatories to sustainable investment initiatives such as the United Nations Principles for Responsible Investment, which has just exceeded 1 000 signatories.

Despite significant gains in the number of reporters and the consideration of sustainability information, the majority of companies do not yet report. And while many reporting companies present sustainability information as being just as important to organizational success as conventional financial performance information, most do not yet make sure that this information is regularly discussed in the boardroom. Long term investors in particular lament that sustainability information that they find important is not always reported in a clear and focused manner.

Markets can only function effectively when well informed, and a sustainable market economy therefore needs relevant sustainability information. For sustainability reporting to provide this information base, it needs to develop and mature still further. Effectively, it needs to provide more robust, more relevant, more reliable, and more readily available performance information, the four 'Rs':

The first R, i.e. more robust, precisely defined information, is critical for sustainability performance information to be of use. The Global Reporting Initiative (GRI) has been a focal point for this development. GRI is the world's most widely used set of guidelines for sustainability reporting with 80 per cent of reporters in the 250 largest companies in the world using it as the basis for their reporting.

While sustainability reporting is a relatively young practice, much experience has been gained over the past few years. This experience is being brought to bear on GRI's largest innovation project to date: the development of the next generation of its Sustainability Reporting Guidelines, G4. The G4 Guidelines will provide more robust technical definitions to aid assurance of reported information and improved guidance to support the reporting practices of organizations.

The second R, i.e. more relevant information, comes with an understanding of sustainability strategy as an inherent part of business strategy in the short and long term. For a growing number of reporting companies and report information users, a key aspect of relevance therefore comes from relating sustainability performance to that other set of performance information: financial reports. The emerging field of integrated reporting entails the effort to develop the corporate reporting practice to the point where companies plan, manage and evaluate their impacts on the value of all forms of capital – financial, environmental, social, manufactured, intellectual and human.

[6] See, for example, Bauer, R. & Hann, D. 2010. Corporate Environmental Management and Credit Risk. Maastricht University, European Centre for Corporate Engagement (ECCE) and Ghoul, S.E.l., Omrane, G., Chuck, C.Y.K. & Dev, R.M. 2011. Does Corporate Social Responsibility Affect the Cost of Capital? Journal of Banking & Finance, 35(9), September, 2388-2406.

The intention of the International Integrated Reporting Council (IIRC)[7] is that concise, comparable integrated reports will inform investors and governments on corporate performance and strategy for the short and long term. The IIRC is developing a high-level framework for this purpose, building on and galvanizing the ongoing development of financial and sustainability reporting. A further goal of GRI's G4 Guidelines is to provide guidance on placing sustainability performance information in an integrated reporting format, while also supporting organizations that want to report using a stand-alone sustainability report. Alignment of GRI G4 and IIRC's high-level Framework will provide a broad basis for companies to report relevant, reliable information to share- and stakeholders.

The third R, i.e. more reliable information, refers to the importance of the reliability of information. As the relevance of sustainability information becomes clearer and its use increases, reporting entities can expect a more critical examination of their data as information users base their business and investment decisions on this content. The assurance of sustainability and integrated reporting will therefore become a key area of development, requiring assurance providers to scale up their professional grasp of sustainability content and the process of sustainability reporting.

That leaves the fourth R, i.e. more readily available information. Market consideration of sustainability performance information, from either integrated or stand-alone reports, requires the systematic and pervasive availability of such information.

As with financial reporting, a completely voluntary practice cannot achieve this type of universality at the speed we need for the green economy. In 2002, in Johannesburg, the role of sustainability reporting by companies was recognized and encouraged. In 2012, along with Rio+20 deliberations, we have to take the next step, because we cannot afford to wait until Rio+30 or Rio+40.

There is a growing body of evidence that smart policy is an effective tool to mainstream the reporting of sustainability performance. Harvard Business School research shows that sustainability reporting regulation drives sustainability performance, including improvement in the quality of sustainability management, more ethical business practices and better supervision of managers by their boards of directors.[8]

The Danish Government in 2008 introduced regulation, asking its 1 000 largest businesses to report on their corporate responsibility practices or, if not, to explain why. This has driven 50 per cent of large Danish companies to become more transparent to the point where, in 2010, 87 per cent reported. An assessment of the impact of the law showed that performance

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[7] Founded by, among others, the Prince's Accounting of Sustainability Project, the International Federation of Accountants and the Global Reporting Initiative. See www.theiirc.org/the-iirc/how-we-work/ for the full membership of the Council.

[8] Ioannou, I. & Serafeim, G. 2011. The Consequences of Mandatory Corporate Sustainability Reporting. Harvard Business School Working Paper 11-100. Available at: www.hbs.edu/research/pdf/11-100.pdf [

and quality of reporting on performance improved.[9]

Without introducing a weighty compliance framework, the policy principle of asking large companies, in particular, to 'report or explain why not' maintains the voluntary choice of companies, while establishing the expectation of transparency on sustainability performance. This principle allows for flexibility, while driving transparency on a global scale. Companies can report, or not, but have to be accountable for that choice.

This policy principle is signalled by the United Nations Secretary-General Ban Ki-moon's call to governments, a call shared by GRI, the IIRC, the investor-led Corporate Sustainability Reporting Coalition, the Green Economy Coalition and many others: "Let us work together to forge a global policy framework for companies publicly disclosing information on sustainability performance – and explaining why if companies do not."

The year of Rio+20 offers the opportunity to establish this principle, as the next step in global policy development on corporate reporting. It is a key catalyst for transparency on sustainability performance and the contribution of business to the Green Economy.

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[9] Corporate Social Responsibility and Reporting in Denmark: Impact of the second year subject to the legal requirements for reporting on CSR in the Danish Financial Statements. 2011. Danish Commerce and Companies Agency. Available at www.dcca.dk/graphics/publikationer/CSR/CSR_and_Reporting_in_Denmark_2nd_year_2011.pdf

The integrated reporting journey

Paul Druckman
Chief Executive Officer, International Integrated Reporting Council

At the heart of integrated reporting (IR) is the growing realization that a wide range of factors determine the value of an organization – some of these are financial or tangible in nature and are easy to account for in financial statements (e.g. property, cash), while many are not (e.g. people, natural resources, intellectual capital, regulatory context, market competition, energy security). IR reflects decisions organizations make, based on a wide variety of factors, in order to create and sustain value. IR enables an organization to communicate in a clear, articulate way how it is using resources to generate value in the short, medium and long-term, helping investors to manage risks and allocate resources most efficiently.

The present corporate reporting framework needs to evolve to reflect the wide range of factors that affect corporate performance. The conventional corporate reporting focus on an organization's financial statements is insufficient to answer the question: What is the value of the organization? The financial statements show the money that flowed into the organization and the money that flowed out, and the assets and liabilities that resulted from those transactions. In this scenario, it is the investor's job to assess the organization's future value from historic data and make investment decisions accordingly. The investor is required, in these circumstances, to navigate a course around the next corner with reference only to the financial picture presented in the rear view mirror. IR, on the other hand, is the route map that supports investment decision-making.

Central to the IR process is 'integrated thinking', which is the application of the collective mind of those charged with governance (the board of directors or equivalent) and the ability of management to monitor, manage and communicate the full complexity of the value creation process and how this contributes to success over time. It takes into account the connectivity and interdependencies between the full range of factors that have a material effect on an organization's ability to create and preserve value over time, including (but not limited to):

- the resources and relationships on which the organization depends or which it affects;
- the external context in which the organization operates;
- the opportunities and risks faced by the organization and how its business model deals with them;
- activities, results and performance, past, present and prospective; and
- financial and non-financial information.

We live in a world where the thirst for information, as a symbol of transparency and accountability, is insatiable. In response to this demand, new company laws, regulations and practice have resulted in ever more detailed, dense and lengthy reports. Financial reports are supplemented by chairman and CEO reports, business reviews, governance reports, sustainability or corporate social responsibility reports – each in its own way valuable by shining a light on a different aspect of operations, but together they do not provide a concise, coherent and unified picture of how the business strategy is linked to each of the component parts.

To be effective, corporate reporting, like all forms of communication, must provide clear and relevant information to the reader. To do this, organizations need to have a well-developed understanding of both the purpose and intended audience of reporting. In recent years, too often reporting has been seen as a compliance-driven exercise, to meet regulatory and standard-setting requirements, rather than to achieve its true purpose of providing information, primarily to investors, regarding the material factors that contribute towards the value creation process.

This is why the journey towards IR must continue to be driven by the broad coalition of regulators, investors, companies, standard setters, assurers, accounting firms and non-governmental organizations that the International Integrated Reporting Council (IIRC) has assembled. Collectively, these organizations believe that IR should be adopted globally as the next step in the evolution of corporate reporting. Together they will help to create the world's first International IR Framework. The IIRC's Pilot Programme, a network of over 70 global organizations, underpins the development of the International IR Framework. Through the Pilot Programme, the principles, content and practical application of IR are being developed, tried and tested by reporting organizations and investors. The IIRC's Investor Network has been established to provide an investor's perspective.

IR can be incorporated into existing reporting to enhance the overall quality and value of that reporting. IR complements other forms of reporting and is not expected to replace them in the foreseeable future. As technology and corporate reporting evolve, however, the format and placement of integrated information is expected to change.

The desired outcomes of IR are:

- More efficient resource allocation: by focusing on the full range of factors that materially affect the ability of an organization to create and preserve value over time, IR enables decisions by investors and other stakeholders that allocate resources to those organizations that are most likely to create long-term value; and
- Internal decisions that are better aligned with the creation and preservation of value: by facilitating integrated thinking, IR results in internal decisions that are better aligned with the creation and preservation of value by the organization.

Much innovation in corporate reporting has taken place since the 1990s with the growth of non-financial reporting, as organizations have become more aware of the impact of a broad range of factors on performance. However, this movement has been sporadic and largely does not communicate the linkages between these non-financial factors and the organization's business model. IR represents this evolution.

The emerging evidence from South Africa shows that the journey towards IR is taking place as companies begin to implement the King III recommendations, now incorporated into the Johannesburg Stock Exchange listing rules. A recent report by Deloitte (published in January 2012) showed that companies were generally doing a good job at setting out the corporate context and this is being done in an easily readable and understandable format. Companies were also using visual elements, for example charts, pictures and photographs combined with explanations, to communicate effectively with stakeholders.

The 'Comply or Explain' principles-based system of corporate governance, supported by underlying company law, allows for the flexible application of integrated reporting, meaning its evolution will take place over several reporting cycles. The advantage of this approach over more rules-based systems is that companies can introduce IR at a pace that is most appropriate to that business, while keeping shareholders informed about the progress being made.

The 'Comply or Explain' model enables the organization to tell its story in its own way, focusing on communicating the most relevant information to its shareholders and stakeholders. In South Africa, companies are finding their way and making significant progress themselves towards integrated thinking and reporting. However, many companies are looking for structured frameworks to guide them. Consistent application will indeed add to the credibility of non-financial information in reports and enable investors to compare information between companies, sectors and markets. This is vital in achieving an efficient allocation of capital, one of IR's main aims. So, while flexibility is important to enable organizations to start on the journey towards IR, the development and

adoption of a globally accepted framework will be important to achieve consistency and comparability of information.

The absence of a framework that guides organizations on how to communicate their performance, taking account of the wide range of factors and interconnections between them, results in both too much and too little information. The International IR Framework that is under development is designed to address this absence by setting out how organizations can report on how they create value over time, taking account of the broad range of factors that influences this, including alignment between their strategies, and their economic, social and environmental impact. The task now is innovation. Implementation will only be meaningful if the IR framework adequately reflects an integrated strategy. IIRC is working with its stakeholders, exchanging visions and sharing best practices. This thought-provoking, ongoing dialogue is imperative as various stakeholders work to balance interests.

The time has come for organizations to move towards IR. Many of the challenges society faces must be addressed by businesses. The potential impacts of a globally accepted International IR Framework are far-reaching. Challenges lie ahead, but IR is worth it, our future is worth it.

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Part 3: Who drives reporting?

Finding the right mix of board-level oversight, managerial expertise and organizational culture

Barbara Krumsiek
Chief Executive Officer, Calvert Investments
and Co-Chair of the UNEP Finance Initiative

Managing an effective reporting process, integrated with core planning and decision-making, requires involvement of external oversight and internal management at various levels. The more integrated and strategic, the higher level one would expect. To start with, the board needs to be engaged.

The value of timely board-level oversight

Historically, corporate boards have played a critical role in overseeing the financial reporting process. Leading boards have extended and established their oversight function beyond just financial metrics to key environmental, social, and governance (ESG) risks and opportunities metrics, including sustainability reporting. Similarly, board-level support for the emerging process of integrated reporting is essential. Integrated reporting will bring together material ESG metrics with material financial metrics. As such, it is critical to ensure that material ESG data are subject to the same governing structure as conventional financial reporting. This will reinforce a true sustainability commitment on the part of the reporting company by ensuring engagement at the highest level of the corporation. Board audit committees (or similar structures) will become increasingly engaged with, and knowledgeable about, ESG issues as a consequence of integrated reporting.

Calvert has focused on the need for companies to establish board-level oversight of ESG-related risks and opportunities. The BP Deepwater Horizon disaster may be an example of what can follow from limited, or a lack of, relevant governance oversight. Presently, Calvert is also considering how, for example, companies such as Apple may benefit from greater board oversight of social risk when managing its supply chain responsibilities. In the 21st century, boards that do not pay close attention to sustainability-related risk and opportunity are not serving their shareholders well. An integrated report, in particular, can give investors the information necessary to quantify how leading companies are managing material risk. For investors, the result may be valuations that more accurately reflect the foresight and planning of companies that take sustainability seriously.

When the role of governance is extended beyond risk and opportunity

analysis to reporting, it is again important not to consider ESG reporting in isolation. To accelerate the progress of integrating reporting through the collection, interpretation, and communication of material information, companies will need board-level support. As integrated reporting explores the intersection of sustainability and financial performance information, board-level involvement within the company process and related decision-making becomes essential.

Beyond the involvement of the board and senior management, the nature of the company and its materiality agenda will determine who needs to be closely involved in the reporting process. In the case of, for example, a high tech company where the recruitment and retaining of top talent is critical Human Resources personnel need to be more closely engaged in the process. In, for example, a manufacturing company where supply chain management is critical Operations personnel should be more deeply involved. The engagement of internal role-players is therefore determined by the nature of the business and industry sector.

The board should be involved in initial stages of defining materiality for that company and be involved in general oversight over data and information disclosed. In these early stages, board members should therefore help to determine what type of sustainability risks and opportunities the company faces, and what needs to be measured, monitored and disclosed. This is, of course, a two-way street, involving management insight as well as board member insight. Board members themselves often have limited understanding of specific sustainability topics and therefore need to procure external insights via stakeholder engagement at either global or local level. Accordingly, the board should bring in expertise as necessary through systematic stakeholder relations. Even if the disclosure of sustainability information is not regulated in the same manner as financial information with respect to audit requirements and disclosure, board members need to approach the process of analysing and disclosing ESG information in similar spirit and expand their oversight scope accordingly.

Making the internal process work

To examine the convergence of financial and non-financial measurement and reporting, it is useful to analyse the progress made in recent years by major accounting firms in taking on sustainability research and consulting. It is striking how far these firms have come in converging financial analysis with sustainability research. While this can serve as inspiration, there is still a long way to go. Sustainability content also needs to become more integrated into business schools' curricula and MBA programmes. This is key to ensuring that the early education of managers prepares them for the new way of approaching business performance and financial value.

When reviewing the processes within companies, one can imagine that the process associated with integrating reporting may cause tension between different departments within the company – for example, the investor relations or financial departments on the one hand, and the corporate affairs or sustainability departments on the other. To deal with this tension, companies will need to have greater cross-training and skill-building for

managers within these key departments. Beyond training, more supportive organizational cultures are also needed for sustainability mainstreaming and integration to happen effectively. It is often the case that managers with an accounting background have limited interest in environmental or social issues, yet they are familiar with the notion of being more effectively able to manage what actually gets measured.

As progress is made with quantitative analysis of ESG risks and opportunities, managers with financial backgrounds and those with technical sustainability backgrounds will increasingly find common ground. Sustainability managers also need to improve their ability to illustrate to others in the company how ESG issues are indeed material and can impact on financial metrics. This may be challenging, as many social issues are still difficult to capture and translate into financial data when compared with environmental factors such as energy and natural resource use, which may be translated into metrics relatively easily.

Disclosing relevant information within the right context

Over the last decade, investors have increasingly demanded to see the data necessary to assess the impact of corporate policies and programmes on ESG issues. Still, the accounting framework, methodologies and policies for measuring and reporting ESG issues have not evolved to the same advanced level of their financial cousins. This presents investors with the challenge of obtaining the same level of vigour and clarity regarding material information, both quantitative and qualitative. There is no reason why ESG information should not also be expected to meet this quality and comparability of disclosure. The significant progress made with Global Reporting Initiative-based reporting over the past decade bolsters confidence in the prospect that pressure to improve sustainability reporting will continue to drive best practices and enhance the development of effective integrated reporting.

One of the key ongoing challenges is that ESG information tends to be disclosed in an ad hoc and siloed fashion. Though companies may be collecting a large sample of sustainability data, they may not always be willing publicly to disclose that full data set. Business and industry groups, however, can play an influential role in providing industry-wide information and moving their individual members to disclose specific information at the company and product level. Industry bodies therefore present a real opportunity in helping to improve the level and quality of reporting and accountability.

It is hoped that more integrated reporting will bring about a more concise and consistent summary of material ESG risks and opportunities. In addition, it is desirable that reporting helps to place company performance in an appropriate and comparable context. This includes disclosure of relevant information not only at the corporate-wide level, but also at the business unit and segment level. It is critical to be able to assess the sustainability performance and material impacts of various business units.

The different countries in which operations are situated may also have different sustainability profiles, and data should be provided accordingly. The local context and dynamics of national

information are also important where companies face specific, varying sustainability risks. This requires more disaggregated data, and makes the case for national-level reporting in addition to global-level disclosure. In this context, it is a positive development to see emerging market stock exchanges taking the initiative to encourage corporations listed on their exchanges to report and improve their disclosure of ESG data. These self-regulatory initiatives are important in helping to initiate the processes associated with the collection and management of sustainability data.

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Building bridges between different forms of corporate reporting and expertise

Roger Adams
Director of Special Assignments,
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Annual financial reporting generally does what it says on the label, and for many people it is the most familiar form of corporate reporting. According to the International Accounting Standards Board (IASB), the objective of general purpose financial reporting is:

to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.

Sustainability reporting is another form of corporate reporting. It has evolved from the environmental and social reporting experiments of the early to mid-1990s and is a more broadly focused accountability tool. According to the Global Reporting Initiative (GRI), sustainability reporting is:

the practice of measuring, disclosing, and being accountable to internal and external stakeholders for organizational performance towards the goal of sustainable development. 'Sustainability reporting' is a broad term considered synonymous with others used to describe reporting on economic, environmental, and social impacts (e.g., triple bottom line, corporate responsibility reporting, etc.). A sustainability report should provide a balanced and reasonable representation of the sustainability performance of a reporting organization – including both positive and negative contributions.

Integrated reporting is 'the new kid on the block', a relatively recent addition to the corporate reporting lexicon. There is much less consensus about what integrated reporting is and why it might be important. According to the newly formed International Integrated Reporting Council (IIRC), the objective of integrated reporting is:

to demonstrate the linkages between an organization's strategy, governance and financial performance and the social, environmental and economic context within which it operates. By reinforcing these connections, integrated reporting can help business to take more sustainable decisions and enable investors and other stakeholders to understand how an organization is really performing.

Generally speaking, all corporate entities are required to file an annual financial report and accounts, either with the national registrar or with the local tax authorities. That represents millions of sets of financial statements each year.

Sustainability reporting – with relatively few exceptions – is a voluntary activity of much more recent origin. Since the late 1980s, public awareness of the social and environmental impacts of corporate activity has grown exponentially. At the corporate level, the perceived need to link economic, social and environmental impacts took root in the late 1990s a nd has grown into an entirely new form of corporate reporting, unknown only two decades ago.

Given that in 1990 there were no stand-alone environmental reports, let alone sustainability reports, it is legitimate to ask what it is – or who it is – that has driven the continuing upward trend in sustainability reporting, and now the movement towards integrated reporting.

Drivers of sustainability reporting

All external reporting is assumed to be driven by one stakeholder group or another. As indicated in the IASB quotation above, the primary stakeholder of this form of reporting is assumed to be the investor and it is the interests of that group (and those concerned with the effective and efficient regulation of capital markets) that drive developments in financial reporting.

Sustainability reporting is driven by a wider coalition of interest groups including non-governmental organizations (NGOs), employees, communities, customers, governments and investors. Each of these stakeholder groups has identifiable information needs, and formal, company-initiated, stakeholder engagement exercises are now commonplace – seeking to ensure that sustainability disclosures and explanations meet the demands of the various stakeholder groups.

There are other issues, however, which may affect, positively or negatively, the quantity and quality of sustainability reporting:

- **Ownership structures**: KPMG [1] says "as might be expected, the ownership structure of a company has a direct impact on their propensity to report CR activity . . . with 69 percent of listed companies around the world now reporting on CR."
- **Corporate size (by revenue)**: Size is not necessarily a reason for reporting, but size often reflects ownership structure, the need to reflect risk issues, the susceptibility/vulnerability to regulation, the influence of stakeholders and the range of cost savings and opportunities that are available.
- **Regulation**: Sustainability reporting is primarily a voluntary activity, but ownership or size issues may not always be the key drivers. In China, for example, it seems more likely that government regulation and stock exchange requirements are behind much of the new wave of reporting on sustainability issues. Likewise in the Swedish state-owned enterprises sector.
- **Cost-saving and new market opportunities**: Organizations of any size can benefit financially from

[1] KPMG 2011. International Survey of Corporate Responsibility Reporting. Amsterdam: KPMG Netherlands / KPMG International. Available at www.kpmg.com/PT/pt/IssuesAndInsights/Documents /corporate-responsibility2011.pdf

- initiating environmental cost-savings programmes and from the process of developing closer relations with both employees and supply chain partners. Similarly, all organizations can benefit financially from early entry into new, sustainability-positive markets. If the results of these actions are financially positive then there is a definite value to be gained from good sustainability reporting.
- **Corporate values:** A number of companies have always let their values do the talking for them. In an era of (Western) financial crisis, reporting on and promotion of one's own ethical values structure is an important differentiator in an over-crowded market place.

Drivers for integration

Explicit linkage of corporate strategy and sustainability strategy, financial performance and sustainability performance is practised by very few reporting organizations. The IIRC's own explanations of why integrated reporting differs from conventional financial reporting refer to aspects such as integrated thinking, future orientation and longer term focus.

The evidence is mounting that boards are becoming more aware of the need for an integrated form of thinking. A recent Global Compact-Accenture[2] study found that 93 per cent of Chief Executive Officers (CEOs) believe that sustainability issues will be critical to the future success of their business; 96 per cent believe that sustainability issues should be fully integrated into the strategy and operations of a company; and, looking into the future, 86 per cent of CEOs believe that accurate valuation by investors of sustainability in long-term investments will be a tipping point for sustainability.

CEO opinions not withstanding, there has long been a suspicion that a gulf exists between pure sustainability practitioners (responsible for the corporate social responsibility programme and the stand-alone sustainability report) and the chief financial officers or finance directors (responsible for the annual report and accounts package). The gulf exists, it is argued, largely because the issues that concerned the future-focused sustainability group did not excite the imagination of either of the more short-termist finance groups – the investors and the chief financial officers. For them, the relevance of sustainability was (and for many still remains) unrecognized.

But there are signs that this gulf is closing. The reaction of Western markets in the years since the 2008/2009 global meltdown has been to try to adopt a longer term view of business and create sustainable value. Initiatives such as The Prince's Accounting for Sustainability Project (A4S) have sought to build bridges between the different communities – especially the finance and accounting group, the sustainability expert group and the investor group. A4S has published a range of case studies showing how sustainability issues are being embedded within business and how these different internal groups and external stakeholders

[2] United Nations Global Compact and Accenture. 2010. A New Era of Sustainability. CEO Study 2010. Available at www.unglobalcompact.org/docs/news_events/8.1/UNGC_Accenture_CEO_Study_2010.pdf

can work together to make "moving away from unsustainability" a real possibility.

Accountancy bodies at the national, regional and global level have also sought to address the 'why is it relevant to me?' question via changes to the education curriculum, and promotion of sustainability issues via continuing professional development programmes. This work does not seek to place the accountants in pole-position on the sustainability starting grid. More prosaically it seeks to demonstrate why sustainability issues are or might be relevant to a profession of 'bean counters'.

More tragically from a sustainability perspective, it has also been the case that many of the issues previously dealt with through the sustainability report or by internal groups largely remote from the chief financial officers or financial directors – issues such as climate change, carbon emissions, labour standards and human rights – have now been recognized as being issues which carry important strategic, financial or governance messages for the investor community.

As such it is important that all these issues – from long-term sustainable shareholder value, through product strategy and employee satisfaction ratings to supply chain audits – are embraced strategically and operationally at the highest level through the board and the appropriate governance bodies. That does not mean, however, that any one group should be seen as the 'owner' of sustainability within an organization. Sustainability is way too big and complicated for any one group to claim that privilege – many of the issues are and will remain well outside the comfort zone of most accountants!

A well-managed organization is also a balanced organization, and there is a well-founded expectation (supported in the emerging literature justifying the need for the IIRC and the next generation of GRI reporting) – that cross- disciplinary groups at board level and throughout the firm will both challenge and enrich the organization. The IIRC wants companies to tell stakeholders how key sustainability issues have shaped its corporate strategy. The GRI wants companies to tell stakeholders exactly how they learn about which sustainability issues are important to them and how they embed this learning process within the conventional governance process. No one group has a monopoly of knowledge in the sustainability domain. But the board (the 'highest governance body' in GRI parlance) does have a monopoly on responsibility and a responsibility to see that the organization acts in a sustainable manner.

Financial reporting will continue to provide important factual data for investors, and sustainability reporting will do the same in respect of sustainability issues for a wider circle of stakeholders. But, increasingly, as the interests of both sets of report users begin to merge, as investors become concerned about the risk implications of climate change and human rights, and as other stakeholder groups become concerned about long-term financial viability and the quality of corporate governance at the highest level, these two forms of reporting will start to converge. The end result of this convergence process is integrated reporting.

The main planks of the Integrated Reporting Framework will become clearer as the IIRC continues the work started in 2011.

Although integrated reporting is just one aspect of the overall sustainability programme, it should become the main way in which an organization's ability to integrate sustainability considerations with its conventional business rationale is publicly evidenced.

Roger Adams directed the sustainability work of the Association of Chartered Certified Accountants (ACCA) from 1990 to 2010, first as Technical Director and subsequently as Policy Director. He represented ACCA as a founding member of the Global Reporting Initiative (GRI), served on the GRI Board for six years and chaired/served on the GRI Technical Advisory Committee for eight years. He has also represented ACCA on the Executive Board of The Prince's Accounting for Sustainability Project (A4S) and the Sustainability Group of the Federation of European Accountants (FEE).

Part 4: One report or multiple reports?

Capturing the link between non-financial and financial performance in one space

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Senior Researcher, University of Pretoria

George Serafeim
Assistant Professor of Business Administration, Harvard Business School

Global interest in integrated reporting continues to grow and many countries are watching with great interest the lessons to be learned from South Africa on becoming the first country to mandate integrated reporting on an 'Apply or Explain why not' basis. In the case of South Africa, the requirement of King III[1] is that the company's annual report becomes an integrated report. King III does not preclude a company from issuing a separate sustainability report that provides more detailed information of interest to particular stakeholders.

This raises the question of whether the goal of integrated reporting is to have a single report and eliminate all other reports or whether the integrated report is intended to exist alongside one or more other reports. Consistent with the view of Eccles and Krzus (2010), the authors of this paper do not believe that the overarching goal of integrated reporting is to put all information relevant to shareholders and other stakeholders in a single document or 'One Report'.[2] Rather, it is to report in one document information on the key dimensions of financial and non-financial (e.g. environmental, social, and governance - ESG) performance and the relationshi ps between them. In some cases, such as

[1] King III refers to the third King Code of Governance Principles and King Report on Governance for South Africa. Johannesburg: Institute of Directors Southern Africa, 2009. Available at www.iodsa.co.za/PRODUCTSSERVICES/KingIIIReportPapersGuidelines.aspx

[2] Eccles, R.G. & Krzus, M.P. 2010. One Report: Integrated Reporting for a Sustainable Strategy. New York: John Wiley & Sons, Inc.

occurred at United Technologies,[3] the company converts its annual report into an integrated report. In others, such as Southwest Airlines,[4] the company converts its sustainability report into an integrated report.[5] The primary audience of the integrated report is shareholders and other stakeholders who want to have a holistic view of the company's past performance and future prospects. Shareholders who care only about financial performance can simply look at the company's financial statements. Stakeholders who are only interested in a particular issue can focus on whatever the company reports on that (which is often not much), whether in a separate sustainability report or an integrated report, or both.

The term 'report' connotes a paper document and ignores the growing importance of the company's website as a source of both reporting and engagement. Thus, it is useful to make a distinction between a 'report' and 'reporting.' A report is a static document – whether a hard copy that is sent in the mail or picked up off a shelf in the company's headquarters or a PDF posted on the company's website – that is produced on a fixed-interval basis, such as every year or every quarter. Reporting, on the other hand, involves providing information as it becomes available and in a more disaggregated form. It can also include tools for analysing this information and gathering feedback from users about the company's performance and reporting practices and getting suggestions for improvement. This paper will discuss both the issue of 'one versus multiple reports', focusing on the United States and South African markets as examples, and the importance of more explicitly recognizing the role of the Internet when debating the merits of one versus multiple reports.

In the United States, all listed companies are required to file a Form 10-K. As explained on the website of the Securities and Exchange Commission (SEC), this is separate from the company's annual report, which is also required:

The annual report on Form 10-K provides a comprehensive overview of the company's business and financial condition and includes audited financial statements. Although similarly named, the annual report on Form 10-K is distinct from the "annual report to shareholders," which a company must send to its shareholders when it holds an annual meeting to elect directors.[6]

Form 10-K is the 'official' regulatory filing and must follow a fairly prescribed format. In contrast, companies have much more flexibility in terms of the content and format of their annual report to shareholders. This report typically contains a letter from the Chief Executive Officer (CEO), and sometimes from the chairperson as well, when these are separate roles; the 'Management

[3] United Technologies Annual Report. 2011. Available at 2011ar.utc.com/

[4] Southwest Airlines Annual Report. 2010. Available at www.southwestonereport.com/2010/_pdfs/SouthwestOneReport2011.pdf

[5] Eccles, R.G., Cheng, B. & Thyne, S. 2010. Southwest Airlines One Report™. Harvard Business School Case 9-411-042. Revised 7 October.

[6] Available at www.sec.gov/answers/form10k.htm

Discussion and Analysis (MD&A)', which explains the company's financial results in the context of the company's industry and general economic conditions; descriptions of the company's major business lines and products; and the audited financial statements and accompanying footnotes. For large companies, the annual report is often a fairly glossy document (although usually printed on recycled paper) that contains pictures (including those of employees, customers, and vendors) and diagrams and figures of various kinds. The services of a professional corporate reporting or public relations firm are often obtained in order to make this document an appealing marketing tool to a broad range of stakeholders. In contrast, the Form 10-K is a rather long, legalistic, and, for the lay reader, boring document. It may contain, by reference, sections in the annual report, such as the MD&A. Small and medium-sized enterprises, with fewer resources, often create their annual report to shareholders by simply enclosing their Form 10-K with a 'wrap-around' letter from the chairperson or CEO and perhaps a picture or two.

Unless the SEC mandated integrated reporting, in whatever language, companies in the United States would still be producing at least two reports – even if every single company converted its annual report into an integrated report on a voluntary basis. And this would be the case, unless the SEC explicitly stated that the Form 10-K could be used as the annual report for shareholders. If a company refashioned its sustainability report into an integrated report, it would still be left with having to produce three reports. If a company changed its annual report into an integrated report, it still might choose to produce a sustainability report, again leaving it with three reports. In countries where there is only one required report, regulation can specify this report to be an integrated report, but unless precluded by regulation (unlikely in most countries), the company could still produce a supplemental sustainability report.

In South Africa, with the recommendations of the third King Code of Governance Principles (King III) now applicable to all organizations, all companies are in theory expected to produce integrated reports. The Johannesburg Stock Exchange (JSE) has continued to promote good corporate governance by incorporating the principles as a listing requirement and, consequently, the over 400 companies listed on the JSE are expected to produce integrated reports on an 'Apply or Explain' basis. For many listed companies, these integrated reports represent in one report what were previously both an annual report and a separate, voluntary sustainability report. The new South African Companies Act allows companies to distribute only abridged financial statements as long as they are in line with the accompanying regulations. Vodacom's 2011 Integrated Report[7] provides an example of a listed company that has produced an integrated report with abridged financial statements included in the same report.

Most companies operating in high-impact industries, such as energy and

[7] Available at vodacom.investoreports.com/vodacom_ir_2011/

mining, continue to produce separate sustainability reports which contain more detail than their integrated reports. Harmony Gold Mining Company,[8] Imperial Group Holdings[9] and AngloGold Ashanti[10] are examples of listed South African companies producing both consolidated integrated reports and additional sustainability reports containing further detailed information. Those looking to keep in place their Global Reporting Initiative (GRI) application levels (and assurance where applicable) that were previously reported through their sustainability reports are now reporting on key material issues in their integrated reports and leaving the rest to be reported through the company's website. Many South African companies producing integrated reports are achieving varying levels of interactive web-based representation of their integrated reports, such as the interactive online integrated report of Bidvest Group Limited.[11]

In the case of non-listed companies, it is easier for many to explain their way out of an integrated report by claiming to have fewer stakeholders to whom they need to report. Some non-listed companies with high public interest scores (PISs), however, are under greater pressure to produce integrated reports. Public interest scoring has been introduced under the new Companies Act and is used primarily to determine whether or not private companies will require an audit, and if an ethics committee need be established. A company's PIS is calculated annually through the number of employees, third-party liability, turnover and number of shareholders (for profit companies) or members (for non-profit companies). Rand Refinery (Pty) Ltd[12] is an example of a private company that has produced an integrated report in line with what it believes to be best practice in corporate reporting.

This analysis shows that producing 'one report' is heavily dependent on the regulatory environment of a company's home country, but in general something that is difficult to achieve. The virtue of having one report is that all information of interest to shareholders and stakeholders is contained in a single document. However, unless the report somehow highlights the truly material non-financial information and discusses its relevance in the context of financial information, this one report is an integrated report in name only, and in practice is no different from having financial and non-financial information reported in separate reports. The real issue isn't whether there is one report or multiple reports, but whether the company provides a concise presentation of the critical dimensions of financial and non-financial performance and discusses the relationships between them. How are

[8] Available at www.harmony.co.za/sd/s_i.asp

[9] Available at www.imperial.co.za/CMSFiles/File/Documents/2011AnnualResults/ImperialIntegratedReport2011.pdf

[10] Available at www.aga-reports.com/11/integrated-report

[11] Available at bidvest.com/ar/bidvest_ar2011/index.php

[12] Available at www.randrefinery.com/Rand%20Refinery%20Integrated%20Annual%20Report%202011.pdf

improvements in non-financial performance contributing to improvements in financial performance? Or, is the company consciously making sacrifices in terms of its financial performance, at least in the short term, in order to improve on some dimension of environmental, social and governance (ESG) performance for reasons that it clearly explains? Conversely, strong financial performance may enable the company to make the necessary investments to improve some dimension(s) of non-financial performance that will contribute to further future improvements in financial performance.

The right question therefore isn't whether the company is producing one or multiple reports, but rather whether the company is providing an integrated presentation and analysis of financial and non-financial performance in some report. Regulatory constraints, desired economies from reducing the number of reports (where possible), and wanting to target different constituencies with different reports are all factors that determine whether the company is producing one or multiple reports.

The relative unimportance of the question of one versus multiple reports is seen even more clearly in recognizing that static documents are of decreasing importance in how a company provides information on its financial and non-financial performance. The Internet makes it possible to provide a wide range of information in many formats at virtually no distribution cost, since users simply access the company's website. A good example is Philips, the Dutch healthcare and lighting company, whose annual report website contains the 2011 integrated annual report and annual reports dating back to 1998. The full 228-page annual report is in English and there are shorter versions in Dutch (44 pages) and Mandarin (79 pages).

The page for the 2011 annual report contains videos in English from the CEO, providing overview information on the company, and the Chief Financial Officer (CFO), providing a review of the 2011 financial results.[13] Both videos have subtitles in English in order to make them accessible to the hearing impaired. Underneath each video are separate pages providing specific information – such as 'Our company' and 'Our strategic focus' as from the CEO – and 'Group performance' and 'Sector performance' as from the CFO. There is also a section, but no video, on sustainability, covering such topics as 'Green manufacturing 2015' and 'Social performance'. There is also a Mandarin version of the website, where the video subtitles are in Mandarin

Philips provides three different reports, called 'Analyst selection', 'Sustainability selection', and 'Employee highlights', that contain information of particular interest to different users. In addition, the user can create a completely customized report (in either a regular or eco-version with smaller pages and pictures), based on whichever of the 19 sections in the full annual report are of interest. The report is e-mailed and the user is asked to take a short survey to help Philips better understand what information they are interested in and how they use it.

The survey concludes with a request as to whether or not Philips may contact the user with questions.

[13] Available at www.annualreport2011.philips.com/

In addition to a wide variety of PDF reports which can be accessed and created, the website includes Excel spreadsheets which can be downloaded (financial statements, five-year overview, and performance highlights) and interactive charts (balance sheet, statement of income, profitability, cash flow, key figures per share, employees and sustainability). Each chart, which may be viewed as a bar or line graph and downloaded into an Excel spreadsheet, provides data for 2007-2011 and may be viewed by year (each data item in the category for each year) or by data item (all years for each data item). Since the information in these charts may be downloaded into a spreadsheet, the user is able to perform his or her own analysis, looking for relationships between different performance metrics – such as Green Product Sales, Green Innovation, and Lost Workday Injuries as a function of sales growth and profitability – and combine the information provided by Philips with other information, such as comparing the performance of Philips to that of its competitors. Showing the growing importance of social media, the annual report website contains videos of Philips on YouTube, pictures on Flickr, and tweets on Twitter, where the user can also Tweet Philips back. The company also has a page on LinkedIn.

So, one report or multiple reports? This is the wrong question. The right one is: “Is the company providing an integrated presentation and discussion of its financial and non-financial performance in at least one document, and has it, in addition to this, designed its website to be as useful and integrated as possible?”

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Sustainability reporting at a crossroads: time to embrace the digital revolution

Elisabeth Laville
Founder of Utopies

Romain Brillié
Senior Consultant at Utopies

A research team of Utopies recently conducted a benchmarking exercise which examined the sustainability reporting practices of 60 multinational companies selected on a geographical basis, with particular reference to their leading reporting practices. This analysis was complemented by interviews with 29 international sustainability and reporting experts, investors, and experts in the specific communication trends identified. The resultant report[1] highlighted eight key trends that are shaping the future of sustainability reporting – ones that pioneering companies are already exploring.

The following discussion focuses on those trends particularly related to the ongoing revolution in information and communication technologies (ICT). At the outset, it should be stated that sustainability reporting needs to spread and transform in order to drive change more effectively and to respond to stakeholders' expectations. Sustainability reporting is at a crossroads today, a critical position possibly pointing towards becoming more integrated and regulated, but also more target-focused, interactive and accessible.

Integrated reporting

It was clear from the analysis and interviews of international experts that investors and shareholders want improved reporting, and that integrated reporting is a trend that no business will be able to ignore. The survey confirmed specific interest in the convergence of sustainability and financial information towards more integrated reporting. Materiality, balance and conciseness are key. Risks, opportunities and financial quantification of non-financial data are among the elements expected in the emerging integrated report. Investors, in particular, stressed that the company should have the capacity to report on material risk exposure, business model and

[1] Utopies. 2012. Sustainability reporting at crossroads. Reporting Trends Survey. Paris: Utopies. Available at www.utopies.com

strategy – in short, to explain the conditions of its long-term success.

The implications of integrated reporting are profound for businesses as the expectation is that it has to be the expression of integrated thinking and strategy. Over time, this will also affect companies in how they collect and report data. Experts agreed that integrated reporting will not mean the end of other forms of reporting. It is likely to be the top slice of information on material issues, specifically targeting investors. An effective approach will be to produce concise, integrated reports for investors, combined with harnessing the power of ICT to provide more detailed information online. This includes providing on-going, customized or interactive information on material sustainability issues for all stakeholders. This highlights high expectations with respect to the other trends identified.

360° reporting

Information broadcasting is dead. Business globally is witnessing a sea change in the role of stakeholders, from passive audience to influencers and even producers of sustainability reports. Web-based sustainability communications are becoming the norm, and innovative use of ICT is transforming any individual citizen into a potential information provider. While this comes at a risk for companies, as they increasingly lose grip of what is said about them, it is above all an opportunity to foster trust and dialogue between the company and the world in which it operates. ICT is also making data and information available to all. It reaches customers and citizens via social networks, digital applications and mobile internet devices, which have exploded onto the market. All of these can 'pull' any kind of information easily, at particular moments (e.g. when people make purchasing decisions).

In order to respond effectively to these new expectations, businesses will need to switch to what Utopies has dubbed 360° reporting. Contrasting the single, one-size-fits-all report, 360° reporting allows companies to communicate through the right channel, to the right stakeholders, with the right data, irrespective of the amount and complexity of data. Increasingly common will be the use of maps, interactive features and media-relevant content via technologies such as smart phones. Examples today include the stakeholder conversations with management teams in video format by L'Oréal, as well as the smartphone application of General Electric Company (GE) for its Ecomagination Annual Report.

Among the channels used, social media are increasingly explored by companies willing to foster dialogue with communities. Examples include Danone's elaborate social media platform. The ultimate change that new media bring to communications is the chance to collaborate, co-innovate and build stakeholder trust and interest by co-creating information. Consider, for example, SAP's web report, which offers the possibility to give real-time feedback, rate articles and modify content with some reporting tools (e.g. the materiality matrix). Another example of this is the Brazilian cosmetics company Natura which co-writes its

sustainability report with its stakeholders through a 'Natura Conecta' web portal.

The 360° reporting revolution also implies a change from top-down communications to a more bottom-up approach. Capturing the value of new media in a 360° reporting scheme requires organizational change, and individuals to act as 'connectors' between the company (including its people) and the community (with its people). Pivotal community managers are required to act as a bridge between several cultures: geeks and tweetos on the one hand, operational and communication managers on the other hand, along with other corporate departments. They will also help to identify weak signals before a crisis really starts, mindful that a high profile on social media also means attracting attention from potential detractors of the company or brand. As an example, BASF tracks and reports to external audiences everything that is said or written about its sustainability performance in social media, similar to what is done in its more conventional press coverage.

Open data

The trend towards open data – namely the publication of raw, unanalysed datasets for public download and analysis – is central in the move towards what has been called the Transparent Economy[2]. Companies have to deal with stakeholders that increasingly know all about them. In this context, publishing open data is merely an anticipation of what could be 'normal' practice sooner rather than later. After all, as The Economist stated in 2010, "the point of open information is not merely to expose the world, but to change it".[3] First embraced by governments willing to provide transparency and accountability to citizens, the open-data movement is progressively spreading to companies. Companies such as BP and Akzo Nobel are already offering the possibility to download their raw sustainability datasets.

Large companies today are assessing ways to merge their approach to sustainability reporting and the open-data movement. They start talking about 'collaborative data', not so much as a re-active end point of accountability but as a pro-active starting point for innovation. Where a company reports on its performance and gives its own interpretation of how data evolve, it may in the future also make the raw data accessible to others and have them draw their own conclusions. This will turn reporting into a livelier affair. After all, data do not tell a single story. Different users can draw their own story lines from it, and combine two or more sets of data to create new insights. In future, NGOs and stakeholders could end up publishing their sustainability report for a specific company. Coming on top of the company's own expression of its performance and direction, this will foster greater discussion and collaboration around the numbers.

Data visualization

Companies are flooded with an enormous amount of internal and external data. This represents tremendous opportunities to

[2] Volans and the Global Reporting Initiative. 2011. The Transparent Economy: Six Tigers That Are Stalking the Global Economy – and How to Tame Them. London, Amsterdam: Volans and GRI.

[3] The Economist. 2010. Data, data everywhere. 27 February.

better understand the business environment in which they evolve. Sustainability is indeed a complex topic, as listing of core and additional indicators by the Global Reporting Initiative has often displayed. When coupling that complexity with the ever-growing amount of information published by companies, it becomes clear that making data easily accessible and understandable is complicated, to say the least. Data-visualization skills are a critical part of solving this puzzle. In the world of the big media, teams of 'data journalists' and graphics departments have been assembled in the last decade to find new ways of turning numbers into beautiful, interactive and useful pieces of information. In the United States, the Obama Administration has appointed Edward Tufte, an expert in quantitative information design, to promote "the clarity of intense information" in a governmental initiative to promote open-data usage.

Even though data visualization has a great potential, it is not commonly used in corporate reporting. In fact, only 10 per cent of the 60 multinational companies that Utopies benchmarked use it. One of the few examples is GE, which provides a wide array of visualizations on its data-visualization blog. Some experts are concerned that data visualization will be used as a decoy to lure readers away from otherwise weak reporting or, worse, as a way to bend data in a favourable way. The quality and verifiability of, and integrity with which the data are used in data visualization is therefore important. To become an effective lever towards more transparency, data visualization will need to build on consistent and verified information. It will need to be honest in the use of scale graduations and contextualization, in order not to distort the message.

Local level reporting

It has been predicted that 2014 will signal a revolution, in that mobile Internet users will have outnumbered desktop Internet users. Conversely, the worldwide web is spreading extensively in countries experiencing strong economic growth – the so-called BRICS– with almost half of all Internet users located in Asia in 2011. From a communications point of view, the move from desktop to mobile requires adapting content to mobile screen formats. This means shorter, more direct and accessible content. What is more, people with mobile terminals are constantly connected. In the street, at home, in a shop – every situation may require the use of information made available by companies about their products and services.

At industrial site level, the mobile Internet also has the power to provide local stakeholders with instant online access to data and reporting. This could serve as a basis for local stakeholder engagement. The localization of data, along with the proximity and reach of social networks, will help to shape communications 'closer' to the needs and expectations of site-level neighbours. It can also contribute to building trust and acceptability, and help promote community awareness and preparedness for local or site-level accidents and industrial disasters. As example, companies such as BP provide online access to individual site sustainability reports. Nike provides access to a 'zoomable' global manufacturing map

with local information and local contacts available.

Considering the above trends, where do we go from here? Far from a compliance exercise, sustainability reporting is another exciting new frontier. The limits of highly structured, printed communications on performance and the actual ability of companies to solve the sustainability issues they face have been reached. It is high time to experiment again, to leverage the digital revolution to accelerate the pace of sustainability innovation, to unleash the network effect and to enable new models of collaboration, in order to better enable people outside companies to engage and collaborate with them. In doing so, companies may very well not only reinvent their approach to sustainability reporting, but their whole sustainability approach and business strategy.

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Part 5: What are the material issues?

Conventional and alternative materiality determinations

Chris Tuppen
Founder and Senior Partner, Advancing Sustainability

Conventionally, business strategy has been about issues such as growth, profitability, competitive positioning and returns to the shareholder. While business leaders need to continue to focus on exactly these issues, they can no longer proceed without a keen awareness that the context in which they are operating has changed.

It is the very success of business based on these principles which has created, over just one lifetime, the tremendous change and explosive growth that has transformed life for many – but not all – across the globe. However, all this growth has come at a cost. We now understand, better than ever before, that human behaviour is driving environmental degradation, that short-term thinking left us with a global recession, and that we are now facing unprecedented resource shortages.

Business leaders are steadily learning that these worrying social and environmental global trends cannot be ignored and that they will increasingly become material to the success of companies. It is therefore exactly these kinds of issues that lie behind the push for integrated reporting. However, global trends are often far less tangible than the shorter term financial transactions and liabilities that have sat at the heart of conventional annual reports. This has meant that companies have so far tended to report their performance in relation to such trends separately in stand-alone, non-financial sustainability reports.

The International Integrated Reporting Council (IIRC) discussion paper Towards Integrated Reporting – Communicating Value in the 21st Century proposes a principle-based approach to consolidating financial and non-financial reporting. The five underlying principles are:

- strategic focus;
- connectivity of information;
- future orientation;
- responsiveness and stakeholder inclusiveness; and
- conciseness, reliability and materiality.

It is hoped that, over time, integrated reporting will not only result in a single repository for a company's most material issues, but will also lead to more forward-looking reports that illustrate a greater strategic alignment between sustainability and conventional business objectives. For any company adopting the IIRC

framework, the process of materiality determination will therefore need to be at the core of their thinking.

Of course, the concept of materiality is not new and has long been established in financial accounting. The Generally Accepted Accounting Principles (GAAP) state:

"Information is material if its omission or misstatement could influence the economic decision of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful."

But how does the contemporary business strategist decide which issues to focus on? For all companies, getting the process of materiality assessment right is critical because correctly identifying the material issues creates a substantive and essential link between strategy and sustainability. And integrating sustainability into the business is a necessary precursor to integrated reporting.

When it comes to intangible asset valuation, sustainability issues that might initially be non-material, at least from a financial point of view, can quickly become material to a business if the wider stakeholder community deems them to be significant. Thus, in determining materiality from the sustainability perspective, most organizations consider a broad mix of views. The results are often presented graphically, with a 'stakeholder' axis (usually the vertical axis) and a 'company' axis. They may also be presented as a two-dimensional matrix in tabular form. Either way, the most material issues appear at the top right-hand corner[1].

Such an approach was first described in detail in the Materiality Report published by AccountAbility in 2006. This consolidated the work of a few pioneering sustainability reporters, including Ford and BT, and highlighted how sustainability in business needed to move from compliance to value generation. Since 2006 the AccountAbility methodology has been widely adopted and forms the basis of the related Global Reporting Initiative (GRI) technical protocol on report content.

Issues deemed highly significant by stakeholders, but insignificant by the organization, will be found in the top left-hand corner. These are likely to be indicative of emergent issues that could become financially significant over time. Issues deemed highly significant by the organization, but insignificant by stakeholders, will be located in the bottom right-hand corner. These are often mature issues, with stakeholders expecting them to be fully embedded in the organization as 'business as usual'. If a business fails in its diligence to do this, seemingly mature issues soon climb up the stakeholders' 'significance' ladder.

A recent analysis by Fronesys of materiality determination in sustainability reporting[2] found many companies saying that the results of their materiality process had guided their sustainability strategy. The

[1] Good examples may be found in sustainability reports from L'Oreal and SAP.

[2] Tuppen, C. 2011. Materiality Futures – Joining Sustainability to Business Strategy. London: Fronesys.

following was typical narrative in this respect:

“The issues identified as most significant, or material, form the focus of our CSR strategy, programs, and reporting. We report performance on the most material issues in the main issue sections of this CSR Report. Additional performance information is included in our Report Card.” (Cisco)

“This prioritization [also] forms the basis of our sustainability strategy and our sustainability program.” (Daimler)

“Since 2006 we have published the results annually in a Materiality Matrix, which we also use to develop our strategic CR approach.” (EON

“We have used this analysis to identify issues to cover in our reporting and as an input to our sustainability strategy development.” (Ford)

“We align our sustainability strategy and define and implement all our programs to reflect the core issues that have been identified.” (Siemens)

Two companies indicated that the materiality analysis went beyond sustainability and actually had a direct influence on their main business strategy. Interestingly, these were both from the finance sector:

“A key element of sustainable development is to identify the relevant environmental and societal topics that are financially material to our long-term business strategy.” (Allianz)

“The issues most material to our business and stakeholders are assessed throughout the year; they feed directly into strategy development and are discussed in this report.” (Westpac)

However, many questions around strategic alignment were left unanswered, in particular:

- Should an issue deemed to be material in a sustainability matrix automatically be considered material under a more conventional accounting approach?
- If not immediately, over what time frame might this be expected to happen, if at all?
- Should sustainability and traditional accounting and accountability remain separate or be combined into an integrated process?

One might have hoped that answers to these questions may have been found by those companies that have already experimented with integrated reporting. For example, Philips and Novo Nordisk are both well recognized for their approach to integrated reporting, so – at least with these two companies – one might expect to see strong use of a materiality matrix in aligning their sustainability and business strategies. Unfortunately, neither actually publish the detail of their materiality process.

Philips simply publishes a list of its most material issues alongside the following explanation:

“Based on ongoing trend analysis and stakeholder input, we identify the key material issues for our company from a sustainability perspective. . . . This is a

dynamic process, as we continuously monitor the world around us. Based on this, we develop our policies and programs."

Novo Nordisk states that it "seeks inspiration" from the AccountAbility guidelines on materiality, taking account of "formal reviews, research, stakeholder engagement and internal materiality discussions". The outcome is developed into a formal proposal to executive management and the board of directors, who take direct ownership in their annual report through a signed statement to shareholders.

Novo Nordisk's external assurance provider, PricewaterhouseCoopers, is asked to make sure all material issues have been covered in the report. Their report confirms this is the case, but goes on to make the following recommendation:

"We recommend that the process and criteria applied to assess materiality of non-financial issues is formalised and documented to ensure a consistent process." (PricewaterhouseCoopers)

Although the Fronesys analysis found the AccountAbility approach to be both workable and useful, it also highlighted a number of anomalies and shortfalls.

For example, for any given issue, there was often a large scatter in reported materiality levels, even from companies in the same sector.

In addition, while the underlying process framework was similar for all the companies surveyed, the detail of the process was often a black box with very little published detail on quantification algorithms and applied weightings.

It is clear that, to date, the AccountAbility approach has been mostly used to determine the materiality of sustainability issues. This is highlighted by the fact that most companies still disclose no more than tentative linkages between materiality in the sustainability context and their commercial business strategy.

With the advent of integrated reporting, it will be important to strengthen and combine sustainability and conventional business materiality determinations. This should reinforce the need for greater transparency on how the output of the materiality process has influenced the overall, long-term strategic thinking of the company. It should also involve a consideration of the full value chain impacts of the business and, in order to make a more direct link to financial accounting, possibly, the incorporation of environmental and social externalities.

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Integration and materiality: interrogating current business models

Jonathon Hanks[1]
Director, Incite Sustainability

An Integrated Report provides concise, reliable information that is material to assessing the organization's ability to create and sustain value in the short, medium and long term. (IIRC Discussion Paper)

When it comes to corporate annual reports, 'materiality' is what distinguishes the meaningful from the mediocre and mundane. Identifying and disclosing the issues that are of material interest to the reporting company's target audience is critical to ensuring a reporting process that is of strategic value and not simply limited to unthinking compliance. [1]

The issue of materiality has long framed the thinking – if not the practice – of annual financial and non-financial reporting. It is fundamental to the approach to integrated reporting that is developing through the work of the International Integrated Reporting Council (IIRC). It is one of the five proposed guiding principles that inform the process, content and presentation of an integrated report, and is an integral part of the IIRC's definition of integrated reporting. While there is a significant body of experience to draw on in understanding materiality for the purposes of annual financial and sustainability reporting, there is considerably less experience when it comes to integrated reporting.

Materiality and current annual reporting practice

The International Financial Reporting Standards (IFRS) states that:

Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.[2]

[1] Based on Hanks, J. 2011. Addressing the Challenge of Materiality. Accountancy SA, December-January, 18-20; Hanks, J. and Gardiner, L. 2012. Integrated Reporting: Lessons from the South African Experience, IFC Private Sector Opinion 25. Both available at www.incite-sustainability.com

[2] International Accounting Standards Board (IASB). 2010. International Financial Reporting Standards (IFRS). London: IASB.

From this definition it is clear that assessing the materiality of particular information will require the reporting entity, firstly, to identify the intended users of the report and, secondly, to understand the types of decisions these users may wish to make based on the report. Clearly annual reports cannot satisfy all the needs of all the potential users all the time; hence the requirement for some judgement regarding the nature of the priority user group and its particular information needs.

For the purposes of annual financial reports, the reported information is intended to facilitate informed financial decisions about the reporting entity. There is generally a clear expectation as to what this information should cover, including typically such issues as the financial position, performance and cash flows of the reporting entity. In the context of financial information, materiality is generally defined by the magnitude of an omission or misstatement of accounting data that misleads users. It is usually measured in monetary terms, and is judged both by the relative amount and the nature of the item concerned.

In terms of non-financial reporting, materiality is usually more difficult to assess, requiring greater judgement across a potentially vast array of social, economic and environmental issues. Arguably, the closest IFRS equivalent for sustainability reporting is the GRI's Sustainability Reporting Guidelines. In its third generation (G3) guidelines, the GRI suggests that the material issues that should be reported are those issues that "reflect the organization's significant economic, environmental, and social impacts, or that would substantively influence the assessment and decisions of stakeholders" (emphasis added). Further guidance on assessing the potential significance of a reported impact is provided in the international guidance standard on social responsibility, ISO 26000. In its guidance on determining the significance of social responsibility issues (Clause 7.3.2.2), the standard states that "issues that are generally considered to be significant are non-compliance with the law, inconsistency with international norms of behaviour, potential violations of human rights, practices that could endanger life or health, and practices that could seriously affect the environment".

Integrated reporting: addressing the 'materiality failure'

In the context of the global financial crisis, and amidst increasing evidence that the existing economic model is socially and environmentally unsustainable and that current reporting practice is not delivering, it is time for new and more effective forms of accountability. (South African Integrated Reporting Committee Discussion Paper)

In understanding the materiality process for an integrated report, it is useful to consider the rationale that has been driving the move to integrated reporting. Informing this shift is the belief that current financial and sustainability reporting practice has not kept pace with the recent dramatic changes and increasing complexity in the business environment.

The plethora of new reporting regulations, codes, listing requirements and guidelines may have prompted an increase in corporate disclosure, but it has also resulted in a reporting landscape characterized by "confusion, clutter and

fragmentation".[3] Most reports fail the test of materiality in that they do not provide the information stakeholders need to make an informed assessment of the total economic value of the reporting entity. It is this 'materiality failure' that is driving the move to integrated reporting.

Recognising this, the South African Discussion Paper on integrated reporting, launched in February 2011, defines an integrated report as "a report to stakeholders on the strategy, performance and activities of the organisation in a manner that allows stakeholders to assess the ability of the organisation as a whole to create and sustain value over the short, medium and long term".[4] This approach to integrated reporting is mirrored in the subsequent IIRC Discussion Paper, which opens with the following words:

Integrated Reporting brings together the material information about an organization's strategy, governance, performance and prospects in a way that reflects the commercial, social and environmental context within which it operates. It provides a clear and concise representation of how an organization demonstrates stewardship and how it creates value, now and in the future.[5]

[3] IIRC. 2011. Towards Integrated Reporting: Communicating Value in the 21st Century, p4. Available at www.theiirc.org

[4] Integrated Reporting Committee (IRC). 2011. Framework for Integrated Reporting and the Integrated Report: Discussion Paper, p1. Available at www.sustainabilitysa.org

[5] IIRC. 2011. Towards Integrated Reporting: Communicating Value in the 21st Century. September. Available at www.theiirc.org

As with the South African Discussion Paper, central to this definition is the appreciation that an organization's capacity to create value depends on a variety of "resources and relationships". Putting it simply, for the purposes of integrated reporting, materiality is about understanding the nature of these resources and relationships, and assessing their implications for value creation.

Materiality and integrated reporting: understanding value creation

As we saw earlier, information is material if it is of such importance and relevance that it could substantively influence the judgements and decisions of the intended user of that information. Assessing the materiality of the information to be included in an integrated report requires an understanding, firstly, of the intended users of that report and, secondly, of the types of decisions they may be seeking to make based on the report.

Informed by the approach to integrated reporting envisaged by the IIRC, it is suggested that the targeted users of an integrated report are those individuals or organizations (from whichever stakeholder category[6]) that wish to assess the reporting entity's capacity to create value, now and into the future. To enable these users to make such an assessment will require the organization to disclose information – relating to its strategy, governance and remuneration practices, performance, and prospects – that has a direct bearing on its ability to create value over the short, medium and long term. Significantly, this

[6] While long-term investors might be a useful proxy for the typical targeted audience of an integrated report, they are by no means the only audience.

not only involves disclosure of the organization's impacts, but also requires some reflection on the organizational competencies (the skills, operating systems, partnerships and company culture) needed to respond effectively to the changing business context.

An effective process of identifying and prioritising the material issues for an integrated report will necessarily involve an understanding and assessment of:

- the organization's business model (the process by which it creates and sustains value);
- the resources (or capital stocks)[7] and relationships that impact on the organization's current and future performance, noting how these may be affected by the external business environment;
- the issues that impact on organizational value over which the organization has some degree of control, including the capacity to exercise leverage through its value chain; and
- the nature of the organization's strategic response to the changing business environment.

As the organization's 'primary report'[8], the integrated report should include only those issues of strategic significance that influence the judgements and decisions relating to organizational value. Issues that are of interest to certain stakeholder groups, but that don't impact on the organization's capacity to create value, should not be included in the integrated report; these can be disclosed elsewhere (for example in a separate sustainability report). This distinction is important: the aim of the integrated report is *not* to address the interests of all stakeholders, but rather to reflect on those issues that have a direct impact on the business itself. While the suggestion that some stakeholders' concerns are not strategically important might be seen as "unpalatable to many in civil society, who see it as a move away from the stakeholder focus of sustainability reporting and an overemphasis on business opportunities and risks"[9], this understanding is fundamental to the underlying objective of integrated reporting: providing a concise, strategic insight into how the organization creates value.

Realising the potential of integrated reporting: Interrogating business models

John Elkington has argued convincingly that sustainability is about the fundamental task of winding down the dysfunctional economic and business models of the 19th and 20th centuries, and the evolution of new ones fit for a human population headed towards nine billion people, living on a

[7] The IIRC Discussion Paper speaks of six forms of capital: financial, manufactured, human, social, intellectual and natural.

[8] The suggestion that the integrated report will (in time) be the organization's 'primary report' is explicitly made in both the IIRC and IRC Discussion Papers.

[9] Accountability. 2006. The Materiality Report: Aligning Strategy, Performance and Reporting. November, p18. Available at www.accountability.org

small planet that is already in 'ecological overshoot.'[10]

Most corporate executives – not to mention the chartered accountants and corporate lawyers that advise them – are probably somewhat averse to being told that their business models are 'dysfunctional'. This is an uncomfortable and rather inconvenient truth, but it is a truth that is being embraced by a small (though increasing) group of business leaders. These are the business leaders who have the insight to understand the systemic nature of the societal challenges we face, the courage to challenge conventional accounting practice, and the vision and willingness critically to interrogate their current business models. They are the leaders who are asking, not "What should our sustainability strategy be in the light of our business?", but rather "What should our business strategy be in the light of sustainability?".

An underlying objective of integrated reporting is to contribute to addressing what Michael Porter has called the "out-dated approach to value creation" that pervades much of business, characterized by its obsession with short-term financial performance that ignores the broader societal influences that determine longer term success.[11]

Chairperson of the IIRC, Mervyn King, recognizes this potential for integrated reporting to prompt greater interrogation of current business models. In his introduction to the South African Discussion Paper, he suggests that:

[10] Volans and the Global Reporting Initiative. 2011. The Transparent Economy: Six Tigers That Are Stalking the Global Economy – and How to Tame Them. London, Amsterdam: Volans and GRI.

[11] Porter, M. & Kramer, M. 2011. Creating Shared Value: How to Reinvent Capitalism and Unleash a Wave of Innovation and Growth. Harvard Business Review, January-February.

[I]f done properly, organisations that produce an integrated report for the first time will take a new look at themselves and their business models . . . and will be encouraged to explore new and potentially innovative opportunities in their products, services, processes and markets.

If this potential for innovation and transformation is to be fully realized, it is critical that the integrated reporting process does not simply become a compliance-driven exercise administered in comparative isolation by the company secretary or investor relations department. Instead, it will require the active engagement of the organization's governing structure, in particular in the process of identifying, communicating on, and responding to those material issues that impact on the organization's capacity to create value.

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Part 6: Who reads the report?

The report as point of departure in a dialogue with investors

Claudia Kruse
Chairperson of the Integrated Business Reporting Committee of the International Corporate Governance Network (ICGN)

Herman Bots
Head of Fundamental Equities, APG

The original purpose of the corporate annual report is to communicate to investors. Hence the report and accounts are primarily read by financial market participants; and the sustainability report by social stakeholders and some investors who take account of social, environmental and governance (ESG) factors in their investment processes. Integrated reports are far and few between, and many of them are more of a combination of the annual and the corporate social responsibility (CSR) report, without achieving conciseness or genuine integration.

As providers of capital, investors should be the primary, intended audience of an integrated report. This, however, does not mean that investors are the sole or exclusive audience. The actual audience will likely be much broader than just investors, as a combined account of how a company creates and sustains value is of great interest to other economic and social stakeholders, alike. So, while an integrated reporting framework should be designed with investors as the primary audience in mind, it will also be of value to other stakeholders and will satisfy some, ideally most, but most likely not all of their information needs.

There will most likely be an array of additional disclosures targeting different stakeholders as supplements to the integrated report. One of the advantages of the integrated report is that objectives set by the company regarding its financial strategy, its sustainability performance and governance oversight, to name a few, will be brought together in one place which is easily accessible to all stakeholders. This is an important aspect as it allows for greater external scrutiny by the various stakeholders as to whether all of these objectives are in sync and can be achieved simultaneously, or are in fact mutually exclusive. We also look for consistency between the information that management uses to run the company and the

information made available to investors and others. Ultimately the aim is to understand how management intends to create and sustain value.

Is the long-term investor an accurate proxy of the intended target audience for integrated reports? We prefer to use the term investor. No doubt asset owners have a long-term perspective that sharpens their focus on longer term value creation. However, in order to meet a complex set of liabilities they also have to pursue strategies focusing on shorter term liquidity. At APG, 80 per cent of our portfolio is managed in-house. Many asset owners have outsourced all or a great part of their portfolio to investment managers who run the money on behalf of long-term investors, but may not necessarily pursue a long-term strategy as such. Recent corporate events have shown that issues covered in an integrated account of financial, sustainability, and governance strategy and performance can be very material in the short term.

While good management of sustainability issues, such as health and safety or community relations, helps to secure lasting success, shortcomings can have an immediate and sometimes severe impact. Hence we would argue that all investors, regardless of their stated goal, have to be aware of broader strategy and performance aspects and not just the reported accounts. This is supported by the fact that share prices in the short run often react more to management statements about future profitability than to the reported numbers. Arguably, an integrated report would shed more light on whether a company's cost of capital reflects its earnings potential, for example whether its oversight and performance with regard to health and safety is adequate in the context of continued cost-cutting.

What implications does an agreed understanding of the target audience then have for the reporting process and identification of material issues? The board should set out what it considers material to the company's success, taking into account its different stakeholders' interests. It is the board's assessment of what is, and will be, material to value creation that needs to be communicated in the integrated report.

An integrated report should be concise and bring out the key aspects relevant to an understanding of how a company creates and maintains value. If the integrated report were to become the main statutory report, then it will have to meet certain regulatory requirements. In most markets this currently means that it has to be available as a physical report and not just an internet-based report.

A concise integrated report cannot satisfy all information demands. One would expect companies to publish further web-based information on financials as well as sustainability aspects. Technology-enabled reporting such as XBRL is likely to increase in importance, allowing for much greater immediacy and more frequent updates. Additional reporting directed at diverse stakeholder groups will likely be based on what is material to them rather than necessarily to investors. Financial disclosures will have to follow recognized and accepted accounting standards. The narrative of an integrated report should be supported by key performance indicators (KPIs) that allow cross-company comparisons and are suited to support investment analysis.

In their reports, companies ought to tell their story of how they create and sustain value. Value creation goes beyond the financials and has to reflect the entirety of a company's strategy and performance. In most jurisdictions the 'value' that the company creates is linked to directors' duties and defined in the context of the interests of investors. Therefore a single account of overall value creation is likely to be a report that serves investors' interests.

Meaningful reporting has to start with the audience, as narrowly defined as possible, in mind. At the same time it is essential that companies communicate the same message(s) to all stakeholders and, vice versa, that all stakeholders are privy to the same information across financial, sustainability and governance aspects. This will help further the understanding of the company at large by all interested parties and avoid conflicting expectations being set. While certain company representatives increasingly take note of, and act upon, the request by institutional investors to produce a more integrated account, others baulk when fund managers raise this with them. Building consensus for the integrated reporting framework among reporting companies and investors, so that a basic framework is in place into which future developments can be incorporated, should therefore remain a priority of the International Integrated Reporting Council (IIRC). This will have to build and rely strongly on existing initiatives when it comes to, for instance, sector-specific KPIs.

Importantly, integrated reporting is a form of disclosure to create transparency and accountability. The report is only one element of a much wider process of enhanced communication that is required. Investors expect management to make itself available to investors, to provide timely and high-quality updates, and to engage actively with the company's stakeholders. The report should be both a reliable source of information that is relevant for investment decisions and a starting point for discussion between a company's management and its providers of capital, and other stakeholders, alike.

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What reporting means to company owners

David Pitt-Watson
Chairperson, Hermes Focus Asset Management

There is a dangerous logic which people often slip into when they discuss the value of information. That is to believe that information in the human world works according to the same rules that it might in the inanimate physical world. In particular, that its primary, indeed its only, value is if it changes the behaviour of people outside the entity being reported upon. In other words, that it is like a carpenter measuring the length of a piece of wood. No matter how it is measured, it won't make any difference to the length of the piece of wood, until the carpenter saws it to the right length. In economist-speak such information is 'exogenous' to what is being measured.

But when we report on human action it often isn't like that. We are all aware of the phenomenon. When the teacher enters the room, the class calms down – because now the learners are being observed. Similarly companies behave differently depending on what they measure and what is observed. As the old adage goes, "You get what you measure". Measurement is 'endogenous'. It affects the behaviour of the company. Any cursory reflection on human information systems will confirm that a key purpose of information is to ensure that agents behave properly. We ask people and institutions to "give an account of themselves", because we believe that by asking them to do so, we will help ensure that they do the right thing in the first place.

So in considering the 'target audience' of reporting, we need to be very careful that we do not fall into the trap of thinking that there is someone outside the system who is the principle user of information. We should rather realize that the information itself changes the way the system works. One should therefore not focus on some supposed 'external audience' of a report. Rather we should think about a process that is not limited to informing people outside the company, but one which aims to produce the best behaviour. Of course, the investor needs to know that the company is managed well and managed in his or her interest. But unlike the carpenter who is informed what the length of wood should be so that he can then take action, the value of this information is also to change behaviour in the first place.

When companies offer themselves to the public markets, they are asked "to give an account" of themselves; that is, to demonstrate that their behaviour is consistent with the obligation of an enterprise which offers its shares to the

public and which treats all its shareholders equally. So, when a company is publicly quoted, it is making a statement about its management. So, investment grade information isn't just about the nature of the information, it is to show that the company itself is worthy of that designation. And, of course, as with any human institution, the more relevant and clear the information the company discloses, the more likely it is to gain the trust of investors.

The long-term investor as target audience

It is generally agreed that the investment community is the primary external target audience of the emerging integrated report. Sometimes people think that this creates a problem because the information required for investors is different from that required by civil society, or by any other audience. However, the case can be overstated. A publicly listed company invites shareholders including pension funds, which are fiduciaries to millions of people, to invest in it. Investors in the form of funds and fund managers represent millions of beneficiaries worldwide. Think therefore of the investors as representatives of these beneficial shareholders. This makes it evident that a possible conflict with civil society is limited, as shareholders overlap with civil society. The long-term investor or fund manager is a proxy or an agent for the beneficial shareholders, millions of citizens who, among other things, are pension holders.

It is also important to distinguish the long-term investor from the short-term trader in shares. Traders use performance information differently. In the case of annual sustainability and integrated reporting, the long-term investor wants to know that the company has managed these aspects of its operations. The endogenous information you find in a sustainability report is not principally designed to help people trade shares, nor should it be. It is very different from the quarterly reporting and similar types of information used by traders. Long-term investors need information to enable them to know that the company is well managed; if it is, they may decide to take no further action, if it is not, they can quickly discover this because the management has revealed it to them. This is about good management of the company and not about the trading of shares.

The utility of a report

There is an important qualitative difference between audited annual accounts as fiduciary reports to the owners of companies and other forms of reports and information exchange. The audited information is critical for maintaining the integrity of the system. Its aim is to show how and whether directors and senior management act in the interest of the shareholder. In that sense annual reports are very different from reports by brokers created to encourage investors to buy or sell shares. Of course the annual financial report helps readers to understand the value of a company and thus the value of a share, but that is only a minor part of its role. More important is its effect in maintaining the integrity of the market. Third party-collected data is qualitatively different from the information that directors provide in an annual report. In the latter, they provide information to owners to show that they are running the company in good faith.

Integration of company information is very helpful. Financial data cannot tell the investor everything. The integrated report should take the annual report into account and provide a more strategic point of view. Millions of shareholder owners need to know more than just what can be presented through accounting conventions. Simply put, much information about a company cannot be effectively expressed in accounting language; for example, the company's impact on the environment. Nevertheless, these issues need to be addressed by the board as part of its fiduciary responsibility[1].

In most countries primary responsibility for reporting lies with the board, overseen by the auditor. Of course, management may wish to talk to investors about what they report. But ultimately it is they who are delegated to run the company and should have the best grasp of what is material and relevant. The technical and management expertise lies inside the company, including at the level of board members.

Trading and longer-term value

When investors show little interest in using sustainability reports, it is often asked whether the problem lies with the report or the investor. Some say the information provided is not on target. It lacks comparability and consistency. Others say investors as potential users do not have the necessary understanding to see the relevance or materiality of the information provided. In response to this, consider again the endogenous as opposed to the exogenous nature of the information. Investors need to act more as owners of companies rather than just as traders of shares, giving due consideration to the sustainability context when judging whether a company is managed well. But whatever investors do with the data, action takes place at the level of the board of directors, rather than with external parties such as the investor or regulator.

There are dangers if management simply follows the demands of traders of shares. Of course, shareholder value is central to the success of the company, but this concept can be misinterpreted to the point of abuse, with companies only focusing on tomorrow's share price as justification for whatever is done today.

Equally, it is foolish to see share trading as being a problem, rather than an opportunity, for creating long-term performance. The trading of shares should help a company to be long term. It allows companies to operate for hundreds of years, without having to liquidate in order to allow their owners to realize their returns. But at all times, management should consider the long-term interests of the owner, not those of someone who will sell the next day. Share trading shouldn't stop this happening. Rather it allows shareholders to pass on their ownership rights at the point when they need to realize their investment, and in a way which does not affect the operations of the company.

Quality reporting will support this effect, allowing management to demonstrate its long-term strategy and stewardship, and helping the market to set a proper price at which shareholders, old and new, can trade.

[1] For example, in the UK they would have such obligations under Sec 172 of the Companies Act, 2006.

Investors and reporting plus

So when thinking about the value of information, the first question to be addressed is, "What information will encourage the best behaviour by companies in the interests of their owners?" It is only within that context that one can consider what information sources the long-term investor will rely on most and find most useful. What will be its purpose? Is it for evaluating whether to buy and sell shares? If it is environmental, social and governance (ESG) information its value is likely to be less to do with evaluating short-term share price, but rather in helping the investor to understand if the company is well run.

Of course, the level to which shareowners act as good stewards is still limited. Many investors claim they do a lot, but civil society is right in saying they need to do more. The experience with responsible investment illustrates that having the information is necessary, but not a sufficient condition either for good company behaviour, (although it has certainly helped with that), nor is it a guarantee that the investor will do the right thing. Initiatives such as the UN-backed Principles for Responsible Investment (PRI) remain aspirational, with many PRI members yet to change the way they behave. And for every two steps forward, there is often one step back.[2]

Long-term investors often have engagements with hundreds of companies, some requiring more in-depth work than others. It is important, though, not to see the engagement or the report in isolation. It forms part of a broader process of improving corporate behaviour. Information is central to this and the annual financial report is the point of departure.

What the status of the emerging integrated report is, statutory document or not, requires further debate. What has to be avoided is tying the production of an integrated report so closely to legal requirements and possible liabilities that mere boilerplate statements are created. A fiduciary report is done in good faith, and if it is, that should be acceptable. Reporting on broad issues of sustainability can't be done by fiat. Most sensibly we should ask for reports to be done on a 'Report or Explain' basis, where responsibility is with the board to report to their millions of shareholder-beneficiaries how they have discharged their duties.

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[2] For annual progress reports of the PRI, see www.unpri.org/reporting/result.php.

Meeting the needs of multiple audiences

Aron Cramer
President and Chief Executive Officer
Business for Social Responsibility

By many measures, the rise of sustainability reporting has been one of the most important developments in the decade between the Johannesburg Earth Summit of 2002 and the Rio+20 Summit of 2012. Sustainability reporting has become a threshold expectation for large companies, not only in Europe, the United States and Japan, but also for companies in the rising economies of China, Brazil, South Africa and elsewhere. Sustainability reporting has not only provided more transparency, but has also catalysed a more strategic examination of how companies integrate environmental, social and governance factors into all their activities.

However, one crucial question remains unanswered: who exactly reads these reports, and for what purpose? Twenty years into sustainability reporting, there is little consensus on who the primary audience is, or even whether there is a main audience for these reports, in the way that there is for financial reports. Of course, companies that report don't have the luxury of ignoring this question, and they make decisions about the target audience(s). As things stand today, they tend to prioritize different audiences – which naturally leads to reports that prioritize different issues and bring different perspectives.

In one sense, a diversity of audiences is a very natural consequence of reporting on sustainability, which is an inclusive concept that addresses the impacts and contributions of business on a very wide range of stakeholders. With this in mind, the absence of a single audience is not only natural, but indeed preferable. The contrary view, however, is that without clarity on this question, financial markets will never take sustainability reporting seriously, and it will be impossible to produce comparable reports that enable anyone to gauge one company's performance against its peers.

A third perspective is found by advocates of integrated reporting, which aims to phase out separate sustainability reports in favour of one report that addresses financial performance as well as sustainability performance, for an integrated audience. And, at the end of the day, many companies lament the fact that few people – in any community of readers – look closely at their reports.

WHO READS THE REPORT?

Before resolving the best path forward, it is instructive to consider the various interests of different communities of readers:

Investors
In the minds of many, this is the holy grail audience that should be prioritized as a means of aligning financial incentives with sustainability objectives. This is unassailable as an objective, but not easy to achieve in practice, for the simple reason that investors are not a unitary group, ranging from institutional investors with a long-term mindset to trigger-happy investors looking to make a profit and get out.

Employees
This is probably the group that was most overlooked as reporting began to get traction. Regardless, it has become a matter of faith that reports are a crucial vehicle for communicating with present employees – and recruiting the best new employees.

Issue-based stakeholders
Here again, this category is crucial, and extremely diverse. Moreover, most stakeholder groups have acute but very specific interests (e.g. human rights, performance in their country or community). Reports may be perceived to be doing a great job of meeting the needs of a mythical entity called 'our company's stakeholders', and do a miserable job of providing sufficient information for any single stakeholder group. Given that inclusive stakeholder communication is considered to be one of the things distinguishing sustainability reporting from other forms of reporting, this remains a dilemma that demands attention.

Governments
Governments are important for two reasons. First, they are crucial stakeholders, and reports provide the opportunity to tell the company's story to governments that retain the right to approve or withdraw legal license to operate. Second, more and more governments are establishing regulatory requirements for reporting, meaning that this will come to define reporting more fully over the coming years.

Media
Journalists remain somewhat sceptical of sustainability reporting. They often see reports as an overly 'canned' account that accentuates achievements over challenges, and downplays errors and shortcomings. That said, the absence of a report, or an overly cautious report that glosses over challenges will invite more scrutiny on the part of journalists.

Customers/Public
Finally, there is the largest and most diffuse audience of all: a company's customers, and the wider public. Few companies believe that their reports get wide readership by this segment. Writing reports that resonate with one's customers would be ideal, as it would either reflect or catalyse far greater market demand for sustainable products and services.

It is also crucial to consider changes in the wider world that have an impact on how people receive and use information. The rise of social media has laid to rest the era of one-way communication. This

development, combined with advances in information technology, means that users of information expect to be able to access information tailored for their own particular interest, and also to have a steady stream of information.

This means that the very model of a single, static, annual corporate report – whether financial, sustainability, or integrated reports – may seem increasingly anachronistic. Just as companies have begun to 'micro-target' consumers to increase sales, it may well be that external trends mean that companies will need to micro-target information for purposes of sustainability reporting. It may well be that the future of sustainability reporting is in sustainability apps, updated regularly, and open to personalization by individual readers. This model may well emerge and render moot the question of whom the report is written for – it will be written for anyone and everyone.

In short, assuming that a single priority audience will emerge is highly unlikely, in light of the diverse nature of sustainability topics and the ever-fragmenting generation and dissemination of information in the digital, global, transparent world. This does not mean, however, that companies can simply avoid the question of priority audiences. Neither is it very likely that companies will devote the resources to produce mini-reports on all topics, for all audiences.

On the path forward, companies should have three main audiences in mind, with different approaches for each.

Investors

It is highly unlikely that sustainability will truly be mainstreamed if financial markets don't value sustainability more highly. For this reason, it is crucial that reporting matures to the point that it takes the business impact of material sustainability issues and the sustainability impacts of key business decisions head on. Integrated reporting is likely to be the best vehicle for making this happen.[1] This will require greater rigour on the part of reporting companies, who by and large have produced qualitative information about their impact, with anecdotes as illustrations. More importantly, however, it will require investors to give greater weight to long-term risks and opportunities, and pay greater heed to the intangible assets that are widely believed to represent a large and growing part of valuations.

Employees

This should remain a crucial audience for reporting. But the notion that any but the most interested employee will read a 40-page report is fantasy. Concise models that tell the story in an authentic way for existing and prospective employees is valuable here: Shell, among others, has produced a short overview of its more extensive report, with company staff in mind, and more companies would do well to adopt this approach. The content of sustainability reporting can also be used well in internal corporate communications

[1] Disclosure: the author of this article serves on the International Integrated Reporting Council which is charged with developing guidance on how to do integrated reporting.

to engage staff on the corporate vision, organisational change and progress.

Stakeholders

Possibly the most important deviation from current practice involves a company's most important stakeholders externally. In short, this group, which may have been the original 'muse' for sustainability reporting, may be least well served by existing models. The notion that a broad sustainability report can provide the depth, or the direct engagement, that a company's most important stakeholders seek should be put to rest. Instead, companies should aim their reports at the broad stakeholder community, but engage their most material stakeholders more directly. One mechanism that many companies have used is a global level stakeholder panel that advises on the content of the report. Shifting key stakeholders from report audience to report co-creator is likely to bring mutual benefit.

With this approach in mind, one might conclude that the days of the general sustainability report are over. Nothing could be further from the truth. Indeed, even if tailored approaches are adopted to reach and engage investors, employees and top-tier stakeholders, a broad-based report will still have utility, enabling a company to reach multiple audiences that reflect the broad range of parties interested in the comprehensive sustainability agenda Whether such a report reflects today's stand-alone reports or the integrated reports that are emerging as an alternative is not yet clear, and doesn't really change this analysis.

A diversified approach means that there is no single audience for a report. While it. is tempting to seek the clarity that that would bring, it neither reflects the essential nature of diversity, nor the way information is generated and used in the early 21st century. It is time to embrace that diversity, and build reporting models that make a virtue of that reality.

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Part 7: Who governs reporting?

Can investors trust boards' competence until boards can trust themselves?

Bob Garratt

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The Western credit and debt crises have caused the general public in those economies to distrust bankers (central, retail and investment), regulators, politicians, economists, credit rating agencies, chief executives and boards of directors.

This paper focuses on boards and their fragile relationships with investors. It attempts to address the entirely reasonable public question: "Where was the board of directors before and during the crisis?", but does not go as deep as the Queen of England's equally devastating question posed at the London School of Economics: "Why did none of you see this crisis coming?".

My argument is that 'corporate governance' has been seen increasingly by regulators and insiders as a toxic and reductionist mix of codes and quantification. The problem is that these solutions are mere pimples on a series of deeper issues which affect the value assumptions and the way we have constructed organisations and businesses since the late 1970s. Corporate governance concerns the way we give purpose to, and run, all organisations in our society – private, governmental, public and not-for-profit. It does not apply only to companies listed on stock exchanges and regulated by them. It concerns the way we deliver the purpose of the human organisations we have constructed to achieve our goals of health, wealth and happiness. The focus in this brief paper is on the wealth aspect, mindful that without the flow of wealth we cannot maintain and develop our current form of society.

The problem with current thinking on corporate governance

It is very convenient for politicians and regulators to focus only on the creation of codes and regulations as delivering effective corporate governance. They can show their public what they have done and then leave the enforcement process to chance with the hope that their actions will be forgotten – until another scandal is uncovered, when they can wring their hands again and set up another enquiry and produce more codes. This is no solution at all. But it is difficult for politicians to influence what actually happens around the

boardroom table. There is a cynical definition of organisational culture that says "it is what we do when no one is watching", and boards often feel like that. This is hardly surprising as, ultimately, the only immediate control is self-regulation around a boardroom table, set in a legal framework that is usually invoked only in the most extreme circumstances.

Yet all is not despair and frustration. Two countries stand out globally in their attempts to rectify matters and return to basics – South Africa and the United Kingdom. Both have not only produced codes of corporate governance, but have also attempted to produce much more important primary legislation on the duties (especially fiduciary) of directors and have very recently attempted to extend the concept of fiduciary duties to the owners and their agents. This is controversial and there is much resistance to this, especially in the United States. Those who resist run the risk of their markets becoming basket cases in corporate governance terms. Let us focus on those who are developing a reasoned way ahead.

Back to basics

There are two major distinctions between the roles of directors and executives. First, directing is a more cerebral activity because it needs the emotional intelligence and time to cope with high levels of uncertainty in understanding the massively uncertain external world, while at the same time having the ability to take strategic decisions that will ensure the future of the business. Second, the duties of a director are bound by many laws, while those of executives are bound by far fewer. Look at the Seven Non-exhaustive Duties which were the first part of the vast consolidation of three hundred years of law to create the UK's 2006 Companies Act. In terms of these, directors are impelled:

1. to act within their powers
2. to promote the success of the company
3. to exercise independent judgement
4. to exercise reasonable care, skill and diligence
5. to avoid conflicts of interest
6. not to accept benefits from third parties
7. to declare interests in proposed transactions

If one considers these for a few moments, it becomes obvious that the first duty is to remain within the law, as are the final three. The second is of crucial importance in delivering the directors' fiduciary duty – to hold the company in trust for the future. This is the very purpose of the organisation.

However, it is with the third and fourth duties – the human dynamics around the boardroom table and the interactions between the executives and stakeholders – that most boards fail. There is little that a code can do about these very personal and values-based expectations. Regulators cannot sit in every boardroom and monitor the independence of thought, or care, skill and diligence of every board decision of each director. This is left to trust and, more often, chance. But should it be? To avoid the imposition of vastly expensive national and international schemes on each board, we need to ensure that self-regulation of the highest quality is conducted. The UK's Chartered Director Accreditation is currently the world standard, but Australia

and South Africa are following a Chartered Director route.

A rethink on directors' thinking processes

Over 80 per cent of people who accept a director's job title do not act or think as directors. They have tended to come up an executive career path and are over-comfortable with the notion of fixing on a problem, then resourcing their preferred solution and driving it quickly through time to solve it. For an executive this would be excellent. But what if there is no single solution, or no solution at all? This is the world of the effective director, budgeting a serious amount of time way beyond board meetings (after all statutory directors are contracted 24/7; their liabilities are not activated just during board meetings). The director's 'homework' is crucial to ensuring investment grade decision-taking. This means ensuring that the board, both individually and collectively, is informed and sensitised as best possible to the trends in a messy and uncertain external world – in respect of political, physical, environmental, economic, social, technological, and world trade movements. Many current directors see this as both intimidating and well beyond what they thought their directoral remit was. It may be intimidating, but it *is* their remit; and it is the chairman's job to bring his or her board up to standard so that they achieve investment grade.

Do owners also need to be competent?

It is easy to blame the board of directors for incompetence, and there are many current examples to demonstrate this point. However, there is an unfinished agenda for corporate governance which is only just being revealed. The quality of ownership is now coming under scrutiny. This does not refer to high frequency traders who have no interest in even the concept of ownership. If these traders 'own' anything, it may be for nano-seconds. So they are irrelevant in this analysis. Rather, the focus is on those investors who have a medium to long-term interest in the ownership of a company, whether through equity or, increasingly, through debt.

It was noteworthy that in 2011 the UK's Financial Reporting Council produced its Stewardship Code and that this was followed by South Africa's Code for Responsible Investment (CRISA). These were early moves to highlight the notion that owners have rights as well as duties. These codes pushed the concept of balancing fiduciary duties on both sides of the owner/board equation. Underlying this thinking was the fact that, until the time of the Western economic crisis, the quality of individual investors, trustees and asset managers did not matter much. But since so much wealth had been destroyed, linking owners with their board agents was of critical importance to re-creating wealth.

From this, one can see the very early emergence of, for example, triple bottom line reporting (or integrated reporting), where the financial, environmental and social impact of the business is reported annually to the owners and wider stakeholders. But this is only the start. Much more has to be done to link boards and owners through areas such as:

- the board mandate
- the quality of chairmanship
- the quality of communication between owners and boards
- the quality of board debate and decision-making
- the quality of strategic thought
- the rigorous criticisms of business models
- integrated reporting
- board dashboards

As far as achieving investment grade is concerned, we have only just started.

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The governance of reporting and the reporting of governance

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Internationally the drive towards integrated reporting has been based on the concept that relevant data regarding a company's strategy, risk and governance procedures must be revealed to stakeholders in a manner that aspires to interlink these elements. The vehicle via which this information is shared is the integrated report – an annual report that comprises a holistic and integrated representation of the entity's efforts to enhance and preserve long-term sustainability in all its dimensions, without sacrificing short-term performance.

To quote the International Integrated Reporting Council (IIRC): "Integrated Reporting reflects what can be called 'integrated thinking' – application of the collective mind of those charged with governance, and the ability of management, to monitor, manage and communicate the full complexity of the value-creation process, and how this contributes to success over time."

It was in the use of the words 'integrated thinking' that the deceptively simple principles behind integrated reporting revealed the full import of the change that was expected of company boards and management.

Who governs reporting?

If the integrated report is to reflect the integrated thinking of those charged with governance, i.e. the board of directors, it follows that the report itself and the process of embedding the principles are ultimately the responsibility of the board. The board should therefore ensure that management embeds the process of integrated thinking throughout the organisation to enable it to create and sustain value and thereby ensure its future resilience.

Typically, the board allocates accountability for 'parts of the whole' to different committees. It is common for these committees, which may range from Social to Ethics, Remuneration to Sustainability committees, to play a role in governing specific company processes relating to ethics, performance, remuneration and environmental matters. In South Africa, the first country to mandate integrated reporting through the

King Report on Governance for South Africa, 2009 (King III), the level of care, duty, skill and diligence required of each director and the board as a whole is underlined by the requirement of a statement regarding the integrity of the report within the integrated report.

The audit committee, as custodian of the credibility of annual reporting, is usually tasked with the responsibility for the combined assurance model of the entity and, through this mandate, ensures the credibility of the information reported in the integrated report.

Clearly, the auditing of integrated reports is consistent with the need for greater reliability as well as consistency in reports. However, there is less experience available for the provision of external assurance for users of non-financial data than there is for the audit of financial data, which has decades of development behind it. For this reason, the assurance arrangements that companies adopt for integrated reporting, and which are articulated and represented in the integrated report itself, should be properly planned and tailored. Conceptually, the mindset that should be adopted by the audit committee and boards of directors vis-à-vis assurance is one that considers what should be assured, rather than what can be assured.

The guidance found in the literature and the practice demonstrated by companies which are leading in this area is clear: the company's key stakeholders, and their moderated needs and wants, fundamentally shape the strategy. The articulated strategy results in initiatives and business processes, the attendant risks of which need to be properly managed. A very important component of managing risk, and reducing it to an acceptable level, is securing the appropriate level of assurance from the appropriate parties (both internal and external to the company) that matters are indeed as they are supposed, and purport, to be.

What to report on governance?

There is, however, an important second aspect to governance and integrated reporting – the disclosure of the governance performance of the entity being reported on.

The integrated report as the organization's primary report provides a holistic view of the company's financial and non-financial performance in an understandable and integrated manner and can also be linked to more detailed reports and information, such as the annual financial statements, sustainability report and governance disclosure. This invites the obvious question as to how much information related to governance should be included in the integrated report itself.

An effective reporting framework allows leaders to reflect on the social, environmental, economic and financial impacts of the organisation they lead, and to demonstrate, through integrated reporting, integrity, transparency and accountability in their activities. Good corporate governance therefore has a direct bearing on a company's ability to create and sustain value in the short, medium and long term.

Corporate governance codes around the world stress that there is always a link between good governance and legal compliance. Good governance is not something that exists separately from the law. It is entirely inappropriate to unhinge governance from the law as, legally, directors have to meet their duty of care, skill and diligence and their fiduciary responsibility.

Within the South African context, companies listed on the Johannesburg Stock Exchange (JSE) are obliged to apply the governance principles set out in King III, or explain why they opted not to do so. King III recommends that companies issue an integrated report and identifies several specific and material governance disclosures to be made in this report.

In analysing approximately 100 integrated reports of companies submitted to the JSE since March 2011 (when companies listed on the JSE were expected to issue an integrated report in line with the recommendations in King III), most companies were found to score relatively well on corporate governance principles that pertain to the structure and composition of the board (balance between executive and non-executive directors, an independent non-executive chair, etc.). Scores dropped substantially when specific disclosures relating to ethics, assessment of the independence of independent non-executive directors, the board's role in determining the risk appetite and tolerance, and other issues were considered.

In general, companies that took integrated reporting seriously scored better on corporate governance. Companies scored particularly poorly on risk management disclosure. A possible conclusion here can be that companies are not yet geared to disclose to stakeholders how effective they consider their risk management structures to be. Information technology risk is not being accorded the important status that it requires.

In conclusion, the governance of the integrated reporting process and the integrated report, as well as the disclosure of the governance structure and process of the company being reported on, plays a critical role in integrated reporting. Without board involvement, the integrated report cannot claim to be a reflection of the integrated thinking of those charged with governance, and, without a public display of integrated thinking at the highest level of the organisation, the integrated report will not meet the high expectation it has set out to achieve.

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Part 8: Who regulates reporting?

Stakeholders and market forces as drivers for integration

Mervyn E. King
Senior Council
Chairperson of the King Committee on Corporate Governance

The answer to the question: 'Who regulates corporate reporting?' lies in the nature, quality and substance of a report. Financial reporting is regulated by a stock exchange if the company is listed, or by a regulator appointed in terms of a statute. There is no regulator who regulates sustainability reports or an integrated report.

Although we have had a century of financial reporting, we still do not have uniformity in the standards of reporting. Save for the largest capital market in the world, namely the United States of America, virtually the rest of the world follows the International Financial Reporting Standards as laid down by the International Accounting Standards Board. In turn, these are assured according to the standards in line with those set by the International Auditing and Assurance Standards Board. In the United States the standards for financial reporting are determined by the Financial Accounting Standards Board of America. Financial disclosure by companies listed on stock exchanges based in the United States are overseen by the Securities and Exchange Commission.

Although financial reporting alone has been mainstream for approximately 100 years, in the last 12 years sustainability reporting has become a matter of great importance in the corporate world. This is so because companies do not operate in a vacuum, but in the milieu in which they carry on their businesses. The present milieu of the 21st century is a changed one, consisting of global financial crises; the climate change crisis; the use of natural assets faster than nature can regenerate them; evolutionary, revolutionary and radical transparency; massive population growth; and greater expectations from increasingly connected stakeholders.

The stakeholders of today expect the company not to have profited at the expense of the environment, human rights, integrity or society. They expect the company to have adequate controls in place to monitor and manage material risks and opportunities. Today they want remuneration to be linked to overall performance, which includes social, environmental and financial aspects. They want to be able to make an informed assessment, from the company's announcements and reports, that its

business will sustain value creation in the long term in the changed world of the 21st century. In this context, the financial report as we have known it for 100 years is no longer fit for purpose. The new capitalists, namely all of us, have become the providers of capital to companies, through pension funds and investments in financial institutions. The trustees of our pension funds are required to make an informed assessment that the business of a company will sustain value creation before they invest our money in the equity of that company.

Trustees, in order to discharge their duty of care and diligence on behalf of the new capitalists, cannot rely only on a financial report. With their eyes fixed merely on the financial report, they would, as it were, be looking in a rear-view mirror of a motor car, as if there were no road ahead. Their assessment of the sustainability of the company's business would not be adequately informed. There is most certainly a road ahead, but there are no definitive road signs.

The United Nations-backed Principles for Responsible Investment (PRI) have laid down that environmental, social and governance factors should be taken into account in investment analysis by financial institutions before investing their ultimate beneficiaries' money. This evidences an acceptance that the financial report does not tell the user of the annual report the 'state of play' in a company. The reality is that a company operates in the triple context of finance, the environment and society. How has the financial impacted on the non-financial and vice versa? Has the company embedded material sustainability issues into its long-term strategy? On a reading of the report in clear and understandable language, will the reader be able to make an informed assessment about sustained value creation?

There are different categories of regulation. There is 'Comply or Else', usually with a criminal sanction, or 'Comply or Explain'. Ban Ki-moon, the Secretary-General of the United Nations, said on 16 February 2012 that the time had arrived for sustainability reporting to be integrated into the reporting cycle on an 'If Not, Why Not?' basis. Twenty years after the Rio Conference on Environment and Development (UNCED), heads of state are meeting major regulators, NGOs and investors - stakeholders who are pursuing a consensual statement about sustainability reporting on an 'If Not, Why Not?' basis. In the near future, the Global Reporting Initiative will issue its G4 guidelines with a focus on materiality and ESG (environmental, social and governance) factors. This is an important stepping stone for integrated thinking and an integrated report.

The revised Code of and Report on Governance Principles for South Africa (King III) of 2009 advocated integrated sustainability reporting, which was subsequently adopted by the Johannesburg Stock Exchange (JSE) as a listing requirement. This has now also been adopted by the Sao Paulo Stock Exchange (BOVESPA). PRI members such as the APB Pension Fund of the Netherlands and CALPERS of America are turning away from short-term capitalism to sustainable capitalism and are favouring integrated thinking. Facing questions for investors and others on the sustainability agenda, some leading multinational companies are

publicly stating how they embed sustainability issues material to their businesses into their long-term strategy. They are eager to communicate and show that they are able to sustain value creation on the road ahead.

Many commentators have suggested that integrated reporting should be mandated on a 'Comply or Explain' basis. In other words, an explanation as to why an integrated report has not been done would constitute compliance. In this instance it should be added that an explanation register should be kept by the company, so that any stakeholder or regulator can see whether the failure to do an integrated report was justified or not, in the circumstances.

Legislation in regard to corporate reporting is not the answer. It could lead, and has led, to mindless quantitative compliance. Instead, the system of integrated reporting requires the collective mind of the board to deal with the material financial and non-financial aspects and to show how the business of the company will sustain value creation. This must be expressed in clear and understandable language.

This is a concept whose time has come. It was illustrated by the formation of the International Integrated Reporting Council when the who's who of corporate reporting met at St James's Palace in 2010. Within an hour, despite disparate bodies sitting around the table, a unity of purpose was achieved and an agreement reached that corporate reporting as we know it today was no longer fit for purpose and the future lay in integrated reporting.

Who then should regulate corporate reporting? The answer is the stakeholders, with the nature, quality and substance of the report being driven by market forces. The market forces of responsible investment, such as the Code for Responsible Investment in South Africa and the PRI, drive companies which want to address a rights issue, do an Initial Public Offering or practise integrated thinking leading to an integrated report. In short, the collective mind of the board will be seen to have addressed the critical interdependencies of financial, human, natural, societal, manufactured and intellectual capital in developing strategy.

The greater expectations of stakeholders drive one to the conclusion that the ultimate compliance officer is not a compliance officer or regulator. It is in fact the company's stakeholders. If their expectations are not met, they as licensors who permit the company to carry on its business will withdraw their support.

If a company adopts a governance process or makes a business judgment call which stakeholders feel is not justified, the stakeholders will no longer support the company. There can be no better regulation than market forces and stakeholders' acceptance or rejection of a company's governance processes, its business model or its business judgment calls. That is why a company should annually do an integrated report which, in clear and understandable language, informs the stakeholder how the financial aspects have impacted on the non-financial and vice versa, how the company has made its money, and how the company has embedded material sustainability issues into its long-term strategy.

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Regulatory innovation in Denmark

Victor Kjær
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In 2008 the Danish Government and Parliament decided to make corporate responsibility reporting mandatory for all large companies and all financial institutions. What was the reason for that decision, taking into account, in particular, that at the time Denmark was in the midst of a serious financial and economic crisis and the Danish Government wanted to reduce – not increase – the cost of administrative burdens caused by regulation?

The new reporting regulation was part of a new comprehensive government policy to promote corporate social responsibility (CSR) as a means to increase the competitiveness of Danish business. Lack of CSR was considered a serious risk factor for business, and increased CSR was seen as an opportunity for economic growth and innovation. The Danish Government wanted Danish business to be associated with responsible growth.

However, whereas 77 per cent of Danish companies worked with CSR in some way or other, 55 per cent did not communicate or report on CSR. Mandatory reporting on CSR was therefore seen as a necessary step to encourage, in particular, large companies to communicate on CSR. On the other hand, there w ere also serious arguments against making CSR reporting mandatory. The concept of regulating CSR by law was in itself seen as very controversial. Firstly, it was a deeply rooted conviction that CSR should be a voluntary effort on the part of business. Secondly, it was not viewed as acceptable to increase the administrative costs of business in a time of serious economic crisis. So, regulation on CSR reporting was deemed necessary, but CSR should continue to be voluntary and a considerable increase in administrative costs avoided.

Concurrently, the new Danish CSR policy set two overall goals for companies: to promote the application of international principles and standards for CSR and to promote the integration of CSR in core business strategy. So, regulation on CSR reporting also had to be aligned with the goals of promoting international principles and standards for CSR and promoting the concept of strategic CSR

How could a regulation be drafted which would meet such different requirements? The answer was a piece of very simple and flexible regulation that has proved also to be very effective.

A new provision was introduced in the Danish Act on financial reporting that a large company or a financial institution

must either (i) give information on its policy on CSR, how it is implemented, the results that have been achieved and the expectations for the future or (ii) expressly state that the company will not be engaging in CSR.[1] In order to underline the role of supervisory and executive boards, the information must be placed in the management review of the financial report, while more specific information can be placed in other parts of the report, or even on the company website. In order to align with international principles and standards, an exception was added that a company which commits to the United Nations Global Compact may refer to their annual Communication on Progress[2] to the UN which will then replace a national CSR report.

It was decided to include the requirement in the Act on financial reports for two reasons. The main reason was that, increasingly, stakeholders of companies consider non-financial information on CSR just as important as information on financial performance. Information on economic, social and environmental performance is considered to be interdependent rather than issues apart. From an administrative cost perspective, it also appeared to be less burdensome that the information could be included in an existing document rather than necessarily requiring a separate sustainability report.

So, what was made mandatory was reporting on CSR, not CSR as such. Considerable administrative burdens were avoided by only requiring fundamental strategic information. In doing so the regulation also promoted a strategic view of CSR as a matter pertinent for boards and management. The regulation also encouraged companies to use international principles and standards. The regulation was flexible, taking into account different needs and situations in individual companies, and allowing for innovation on how best to present the reporting.

On the face of it, it seemed that Denmark had been able to draw up a regulation that would maintain CSR as voluntary, that would avoid considerable administrative burdens, and that would promote strategic CSR based on international principles and standards. However, the big question was whether such a simple and flexible regulation would also be effective.

To find the answer to that question an annual benchmark study was conducted on how the CSR reporting was done in practice. This benchmark study is carried

[1] The legal requirement applies to large businesses, listed companies and state-owned companies. Being “large” is defined in terms of exceeding at least two of three size limits: (i) total assets/liabilities of EUR 19.2 million, (ii) net revenue of EUR 38.3 million, and (iii) an average of 250 full-time employees. A subsidiary is not obliged to report on CSR if its parent company reports on CSR on the group’s behalf. The reporting requirement has also been introduced for institutional investors, mutual funds and other public limited finance businesses (e.g. financial institutions and insurance businesses) that are not subject to the Danish Financial Statements Act. For these businesses, the legal requirement has been introduced in executive orders issued by the Danish Financial Supervisory Authority.

[2] Since 2003 the UN Global Compact requires its participant companies to annually submit a Communication on Progress (in the form of an annual corporate report or other) to describe how they are internalising and supporting the ten principles of the initiative. The requirement encourages companies to use indicators such as those found in the Global Reporting Initiative (GRI) Guidelines. See www.unglobalcompact.org/COP/index.html

out by the Copenhagen Business School. The first study covered the financial year 2009, which was the first year of reporting. The benchmark study for the second year of reporting covering the financial year 2010 has now been published as well.[3]

Now, given the choice either to report on their CSR policy or to state that they did not have such a policy, what did large Danish companies actually choose? As many as 87 per cent of the companies chose to report on their CSR policy, and only 13 per cent chose to declare that their company was not engaging in CSR. For many of the companies it was the first time they had a CSR policy to report on (47 per cent in 2009 and 3 per cent in 2010). In other words, the effect of this requirement after two years of reporting has been that 50 per cent of large Danish companies have for the first time adopted a policy of CSR and for the first time reported annually on the implementation of that policy.

The first-year benchmark study saw a number of shortcomings in the quality of the reporting. This was not surprising since such a large number of companies reported for the first time. However, it was important that companies made an effort to improve the quality subsequently, committed to making the reporting more trustworthy. The new benchmark study confirms that this has actually happened. On nearly all criteria, there is a considerable improvement in the second year of reporting. Companies give much more information on how they implement their CSR policy and the results achieved. Ninety-five per cent now report on policies, 89 per cent report on implementation and 65 per cent describe results achieved. Also, the information on policy, implementation and results is much more coherent than that of the first year of reporting. Companies also report on a broader range of subjects. For instance, there has been a significant increase in the number of companies reporting on human rights (38 per cent compared to 16 per cent in 2009) and labour standards (35 per cent compared to 16 per cent in 2009).

The Danish regulation on CSR reporting encourages companies to base their CSR policy on international guidelines and standards, in particular the UN Global Compact. This has increased the number of Danish participants to the UN Global Compact from 50 to more than 200. There has been a significant increase in the number of companies that refer to their annual UN Global Compact Communication on Progress (16 per cent compared to nine per cent in 2009). The benchmark study also shows that Danish companies are increasingly using international principles and standards as the basis for their CSR policies (34 per cent compared to 28 per cent in 2009).

The Danish approach to CSR reporting has sometimes been criticized as being too narrative, in that companies are allowed to describe CSR in words alone, not giving any real facts or figures to support the words. However, also in this respect things appear to be improving. Thirty six per cent of the companies now use quantitative CSR indicators in their reports, even though this is not required by law. There has also been an increase in companies that use Global Reporting Initiative (GRI) indicators (16 per cent compared to nine per cent in 2009) in their reporting.

[3] The studies are available in English on the governmental website www.csrgov.dk.

To sum up, the evidence from the second year benchmark study of the Danish CSR reporting requirement seems to bear witness to a successful attempt to change the mindset of large Danish companies without creating much red tape. The Danish regulation appears to have been effective not only in encouraging large companies to adopt a policy for CSR, but also in regard to improving implementation of such policies and being able to account for what has been achieved. The regulation also enhances continual improvement in the quality of the reporting. It acts as a positive incentive – as a wake-up call – which has created a bridge between large companies and the challenges society faces, paving the way for partnerships for shared value to the mutual benefit of business and society.

Two such challenges business faces are human rights and climate change. Meeting these challenges will be decisive for the future of humanity and nature. Success is dependent on business contributing actively to promote respect for human rights and the development of a green, climate friendly economy. That is why the Danish Government, building on the success of the model for CSR reporting, recently proposed to expand it specifically to include human rights policy and climate change policy. If adopted by Parliament, the proposal will mean that large Danish companies and financial companies will in future also have to give information in their financial reports on their human rights and climate change policies or state that they have no such policies.

It is evident that new regulation on reporting does not necessarily have to increase costs considerably or stifle innovation. Simple and effective regulation can actually contribute to promoting increased corporate responsibility as well as economic growth and innovation.

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Government as a catalyser for sustainability reporting in China

Peter H.Y. Wong
Board Member, Global Reporting Initiative

There is a strong case for governments to take the lead by encouraging companies to follow mainstream international sustainability reporting practices. A government-led regulatory approach will, however, do nothing more than build a compliance-based, lowest-common-denominator system; one which is unlikely to encourage innovation and competitive differentiation.

From greenwashing to integration

Worldwide, sustainability reporting[1] has taken on a range of formats and allowed for varied degrees of sophistication, innovation and creativity within the corporate sector. Diagram 1 illustrates the different levels of progression.

Many critics claim that a large proportion of sustainability reporting is nothing more than greenwash. Others make the point that greenwashing is an early indication of a company's recognition that sustainability is relevant. While a company may start out at the greenwash level, over time its reporting systems will become increasingly more sophisticated as it starts to engage and respond to the needs of stakeholders.

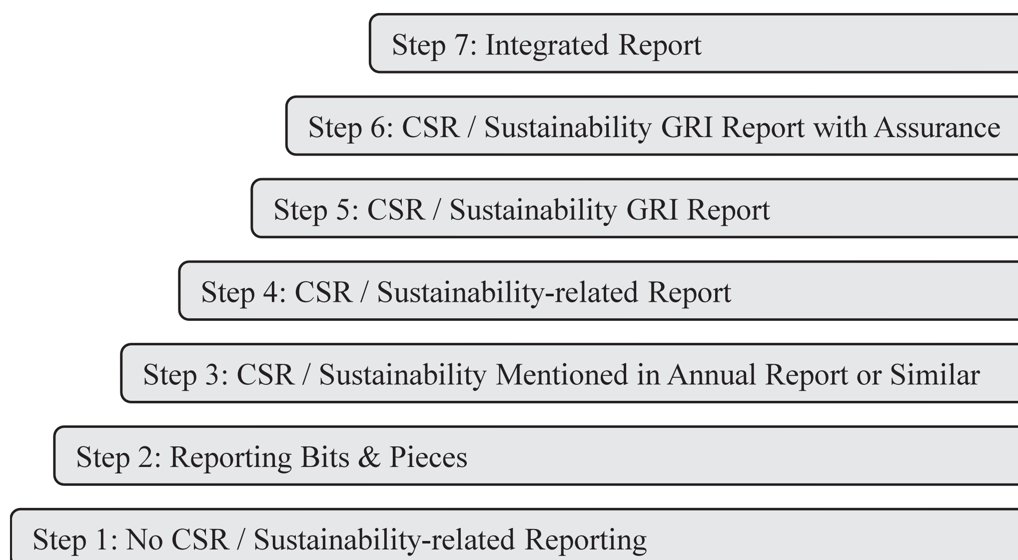
The real issue lies in how best to report, rather than whether to report at all. Many interest groups have called for a policy approach, one that encourages governments to set down frameworks and guidelines for reporting. They argue that mandatory guidelines build basic standards. Others argue that a compliance-based approach does not necessarily change the mindset of companies. It is only when the company itself decides to report on sustainability that it is motivated to embrace the underpinning principles associated with good environmental, social and governance practices and use them to drive the way it does business.

The case of China

Nowhere is the issue of regulation more relevant than in China, where a unique mix of guidelines serves to encourage the uptake of sustainability reporting. What does the future of corporate reporting hold for the world's largest economy-in-waiting?

[1] This includes corporate social responsibility (CSR), environmental, social and governance (ESG) and environmental reports.

Diagram 1: Historical steps towards integrated reporting



The answer depends as much on the conventional role of formal regulators as it does on the emergence of ever more powerful voluntary standard enforcers. The role of the Central Government is, and will continue to be, one of setting the tone and direction for policy. This, in turn, lays the foundation for the general regulatory and enforcement system. Local governments and industry regulatory bodies echo the vision of the Central Government, at the same time that state-owned enterprises act as 'showcase pilots' to signal to others that they lead by example. With enough leadership in place, the private sector gradually buys into the new trend and voluntary grassroots movements start to blossom. Going forward, however, the opinions of entrepreneurs, academia, consumer groups, institutional investors and rural communities will play an ever greater role in the regulation of sustainability reporting in China. These opinions are broadcast by an increasingly more powerful media. The nature of the information reported appears, at least for now, to be in alignment with the aims of the Central Government.

Diagram 2 provides an overview of the different types of formal regulators and voluntary standard enforcers for sustainability disclosure and reporting in China, as well as the measures these entities have adopted.

Amendments made to the Corporate Code of Governance for Listed Companies, the Company Law of the People's Republic of China and a policy instructing state-owned enterprises to adopt corporate social responsibility (CSR) practices and prepare

for compulsory reporting by 2012 signalled the start of a new policy direction adopted by the Central Government. Local governments, the Shanghai and Shenzhen Stock Exchanges and several industry associations followed steadily with a plethora of CSR guidelines that are aimed at providing a common level of information and awareness to prepare the ground for further uptake.

Social and environmental issues remain at the core of the CSR and sustainability agenda in China as these areas have come under most scrutiny from both local and international stakeholders. In order to support the Government's efforts to tackle these imbalances, particularly in the environmental arena, public sector inter-agency partnerships were formed to put in place targeted, mandatory schemes that will drive compliance and reporting. The green credit, securities and insurance policies are examples of such partnerships established between the Ministry of Environmental Protection (MEP) and different financial sector regulatory bodies to restrict financing options to a number of heavy polluters in an effort to force them to comply. The Shanghai Stock Exchange has mandated listed companies to disclose environmental and CSR information to help enforce government policies. Failure to disclose information on environmental protection may result in a MEP investigation and/or penalty.

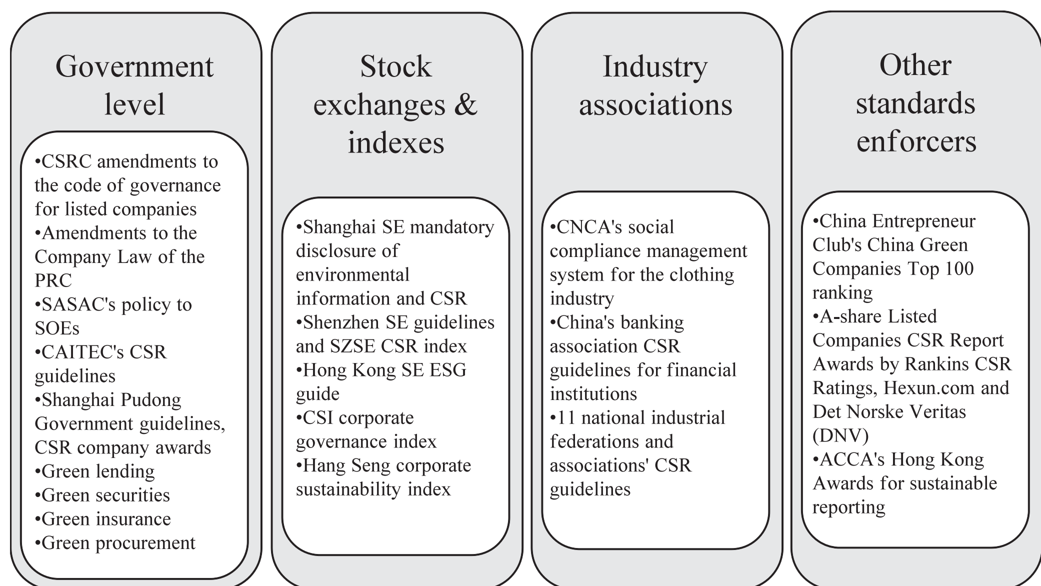
In terms of voluntary initiatives to encourage the uptake of sustainability reporting, the Shanghai and Shenzhen Stock Exchanges have been active in introducing thematic indexes that provide investors with information to improve their investment decisions. Both exchanges have come to rely more on partnerships with national and international entities to launch new initiatives such as the China ESG 40 Equity Index.[2] Influential opinion leaders in the private sector such as entrepreneurs, academia and professional firms and associations have also begun to form groups of stakeholders to push for increased CSR and sustainability disclosure and reporting standards through competitive means such as rankings and awards. The China Green Companies Top 100 Awards launched by the China Entrepreneur Club is one of the most well-respected and prominent examples of such a private sector voluntary initiative. Last year, the awards attracted significant local media attention by their exclusion of some high profile companies such as the online marketplace Alibaba.com, car manufacturer BYD and electrical appliances group Midea.

Government taking the lead

The mingling of mandatory and voluntary schemes on the one hand and formal regulators and other standard enforcers on the other is creating a hybrid system in China that is becoming the main driver for sustainability disclosure and reporting. The Chinese Government and its agencies have taken responsibility for introducing the trend, providing informational support and curbing the worst excesses of the system. Other standard enforcers are providing thought leadership and market competition to bring dynamism and innovation into the movement by encouraging companies to

[2] Key partners are the China Securities Index Company, a Shanghai and Shenzhen Stock Exchange joint venture, and ECP International, an independent sustainability ratings and indexes solutions provider.

Diagram 2: Mandatory and voluntary standards in China



CSRC – China Securities Regulatory Commission
SASAC – State-owned Assets Supervision and Administration Commission
SOEs – State-owned enterprises
CAITEC - *Chinese* Academy of International Trade and Economic Cooperation
CSR – Corporate Social Responsibility
SE – Stock Exchange
SZSE – Schenzhen Stock Exchange
ESG – Environmental, social and governance
CSI – China Securities Index
CNCA – Certification and Accreditation Administration of China
ACCA – Association of Chartered Certified Accountants

move beyond mere compliance. It is, however, an interconnected system: each side needs the other to achieve the overarching aim of increasing uptake and improving standards. As long as one side of this hybrid system does not try to outshine the other, the potential for corporate reporting in China will continue to look bright.

As the movement to 'mainstream' sustainability reporting develops worldwide, it raises the question: should we regulate? There is no doubt that data accuracy and consistency of reporting has been strongly advanced by the adoption of the Global Reporting Initiative (GRI) guidelines. A brief glance at the regulations of developed country counterparts indicates

the already strong presence of mandatory sustainability reporting laws implemented in countries such as Finland, Australia, Austria, Canada, China, Denmark, France, Germany, Greece, Indonesia, Italy, Malaysia, the Netherlands, Norway, Portugal, Sweden and the United Kingdom. Any new framework moving forward needs to consider consensus as well as consistency to ensure that international best practice is followed in the sustainability reporting sphere. It remains essential for the Chinese Government to promote an approach to sustainability reporting which encourages innovation and takes full account of political and geographic factors relevant to China and the wider international community.

The China equation will play out in a uniquely different manner, but the measure of success will be shown in the degree to which the practices and reporting systems of Chinese companies are credible and underpinned by improvement. Yes, China will have to wrestle with the political problem of how to report on labour practices and human rights, but it has no less of a dilemma than American companies that do not report at all for fear of litigation.

Overall, government-led or -inspired sustainability reporting will herald best practice. Sustainability is a journey and there is a long way to go before we get close to the end. The urgency for climate change action should nonetheless drive the Chinese Government's quest to promote measurement and reporting of relevant energy and emissions data for high-impact companies.

The real opportunity for China rests in its capacity to use sustainability reporting as a means to build consumer confidence in China's brands. This very concept flows through to supply chain, domestic Chinese consumers and others worldwide.

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Sustainability indices as motivators in reporting

Sonia Favaretto
Sustainability Director, BM&FBOVESPA, and
Chairperson of the Brazilian Corporate Sustainability Index (ISE) Board

One of the main debates surrounding the issue of sustainability in stock exchanges is the effectiveness of indices as motivators of this agenda. Indices by themselves have limited reach, similar to other initiatives and instruments that seek to promote the insertion of environmental, social and governance (ESG) factors in the business world. This is because the sustainability agenda is still being constructed and involves changes to behaviour, mindset, economic models and management. On the other hand, there is no ignoring the fact that since the launch of the world's first sustainability index in 1999 (Dow Jones Sustainability Index), equity indices have been important economic instruments for promoting the issue of sustainability across the world.

Keenly aware of this global movement, BM&FBOVESPA in 2005 launched the Corporate Sustainability Index (ISE), the fourth of its type in the world. The ISE is based on positive screening, meaning there is no restriction against companies participating in the process, as long as they meet the prerequisite of having one of the 200 most traded stocks on BM&FBOVESPA. This is an inclusive index whose development results from wide-ranging discussions with society. The ISE 2012 portfolio comprises 51 stocks from 38 companies, representing 18 sectors that correspond to 43.72 per cent (based on November 23, 2011) of the total market capitalization of the companies with shares traded on the Brazilian Exchange.

The International Finance Corporation (IFC) was responsible for financial support in the first two years of the ISE. For the fifth anniversary of the index in 2010, the IFC ordered an assessment of its impact on the strengthening of sustainability practices among member companies. It concluded that the main benefit of ISE adherence is companies' reviews of their own sustainability practices, resulting in greater competitiveness, satisfaction about being a sustainable firm, and an improved reputation. In the case of future challenges, the assessment concluded that it was essential for ISE to have an impact on the financial community beyond the already consolidated impact on corporate sustainability practices. This is also a challenge for other sustainability indices worldwide.

Also in 2010, based on the assessment and on meetings with five stakeholder groups (analysts and investors, companies,

academia and experts, press, and BM&FBOVESPA employees), the ISE Board as highest governance body established five strategic goals for the next five years (2011-2015). These are to (i) make more information available to the market, (ii) grant companies greater participation in the selection process, (iii) increase the volume of investment in products linked to the ISE and turn it into an investment benchmark, (iv) boost channels of communication and dialogue with interested parties, and (v) strive to perfect scope and processes when drawing up its questionnaire.

The first objective is directly and essentially related to the challenges singled out in the IFC assessment. Players in the financial community, investors in particular, increasingly request non-financial information from the companies in which there has been investment. Indices can offer an excellent service within this context of disclosure. The ISE provides good examples. All companies in its current portfolio publish a sustainability report, and 90 per cent of them use the Global Reporting Initiative (GRI) guidelines. It can be argued that this is to be expected of companies listed on a sustainability index. However, there should also be recognition of the power of leadership and example that these companies display to other firms, whether they are publicly traded or not.

As part of the ISE path of stimulating greater disclosure, its 2011 questionnaire included a high value question, requesting companies to authorize the publication of previously confidential answers. In this first year, 20 per cent of companies in the portfolio agreed, granting the entire market broad access to all of the approximately 200 answers contained within the questionnaire's seven subject areas (General, Corporate Governance, Financial-Economic, Environmental, Social, Nature of the Product and Climate Change), via the ISE website. This percentage is likely to increase in the coming cycle, becoming common practice in the medium term.

These ISE examples build on and realize the operational premise of placing BM&FBOVESPA at the heart of Brazil's capital markets by stimulating transparency among publicly traded companies. One of the most effective instruments for this accountability is the publication of sustainability reports or the like.

Even though good practices are already common in Brazil, BM&FBOVESPA understands that its role as promoter and agent of such practices can have concrete results. After a wide discussion with market institutions and companies, the BM&FBOVESPA Sustainability Committee decided to adopt a 'Report or Explain' approach to sustainability reporting. This supports the international initiative undertaken for the Rio+20 Conference in June 2012. In short, the Exchange now recommends that all its publicly traded companies either publish a sustainability report or the like, indicating where it can be found, or explain why it has not done so.

The 'Report or Explain' recommendation stems from a conviction that inclusive, inductive and progressive sustainability efforts tend to achieve greater and longer lasting success. In our experience with companies, massive adherence is clearly evident, as is the time

granted for understanding and adjustment on the part of firms that have not yet reached a mature stage for this agenda. In a relatively short period the recommendation has been so widely adopted that making it a rule becomes the next logical step.

For BM&FBOVESPA, transparency is the name of the game. This is a best practice that provides the foundations and robustness for a healthy capital market. For this reason we use a range of instruments to encourage publicly traded companies to follow this path. After all, it is a win-win game. The companies, their stakeholders, the market and society win the more sustainable society that we need to build.

Sonia Favaretto is Sustainability Director at BM&FBOVESPA and Chairperson of the Board of the Indice de Sustentabilidade Empresarial (ISE), the Brazilian Corporate Sustainability Index. She is also a member of the Advisory Boards of the Global Reporting Initiative (GRI) Brazil and the Businesses for Climate Platform (EPC) of the Fundação Getulio Vargas. The BM&FBOVESPA (Bolsa de Valores, Mercadorias e Futuros) was created in 2008 through the merger of the São Paulo Stock Exchange (Bolsa de Valores de São Paulo) and the Brazilian Mercantile & Futures Exchange (Bolsa de Mercadorias e Futuros).

Part 9: What does the future hold?

Designing a new navigation tool, just in time

Paul Hohnen[1]
Associate Fellow, Chatham House

Corporate reporting, as it is commonly practised, is no longer fit for purpose. However long it has been established and however widely it is used, the fact is that it no longer offers the level of transparency, accuracy or value that is needed in the 21st century. By excluding vital information about a wide range of issues, including how rapidly emerging social and environmental issues might affect the business model, conventional financial accounting mostly presents a two-dimensional picture of a three-dimensional world. [1]

The advent of sustainability reporting, now well established among the corporations listed on the Dow Jones Sustainability Index, FTSE4Good and Fortune Global 250, together with work under way for the development of a standard for 'integrated reporting', provides a hint of what the future of corporate reporting could be. The prize to be won is a practical, international reporting practice which enables companies to describe their strategy for navigating through the shifting economic, social and environmental landscape, and to show how they are delivering value – both financial and societal – in a transparent, measurable and comparable format.

The Rio+20 Conference offers an ideal opportunity to give political direction and impetus to the reform of reporting practices. This is recognized in a number of recent calls, including by the report of the UN Secretary-General's High-Level Panel on Global Sustainability, which recommends that "a framework for sustainable development reporting" should be developed.[2]

The vision of a corporate reporting system that picks up real-time and emerging issues and enables management to respond quickly should be seen as neither unrealistic nor impractical. After all, in the fields of aircraft navigation and medical diagnosis, speed, accuracy and completeness are now the norm. What is needed is that corporate reporting should match information collection, analysis and

[1] This contribution draws on the Chatham House Programme Paper The Future of Sustainability Reporting, written by the author and published in January 2012, and on related research conducted in the preparation of that paper. Paper available at www.chathamhouse.org/publications/papers/view/181687

[2] United Nations Secretary-General's High-level Panel on Global Sustainability. 2012. Resilient People, Resilient Planet: A Future Worth Choosing. New York: United Nations. Overview, paragraph 30. Available at: www.un.org/gsp/report

use which are routine in other fields. How might this be achieved?

A number of significant obstacles stand in the way of the development of the 'corporate accounting radar and navigation' system needed. Here are some of the main ones:

- Short-termism: We have constructed an economic system that prizes short-term financial performance above all else. This trend has been amplified by the rise of the virtual economy, where billions of dollars are made by computer-driven trading on the mere fluctuation of market prices. The simplicity of reporting on financial indicators is deeply seductive, if incomplete and ultimately misleading. In medicine, this would be like using only blood sugar levels or pulse rate as a measure of health.
- The economy: The current fragility of the global economy has greatly diminished the political appetite for policy change and regulation, at least in the near term. Any reforms that increase the transaction cost to business, and which are not matched by commensurate benefits (such as reducing risk and making business more responsible and innovative), risk being labelled as 'burdensome' and being opposed by both government and the private sector.
- Regulation: For similar reasons, it seems unlikely that the few examples of government-driven reform (such as instituted by Denmark and Sweden, which mandate a level of sustainability reporting for large companies) will be quickly or widely followed by other countries. While the 2011 European Union Corporate Social Responsibility policy highlighted the advantages of enhanced disclosure of social and environmental information, it made no commitments to extend the 2004 directive encouraging non-financial reporting. [3] In the absence of intergovernmental agreement on issues such as a carbon price, it is difficult for markets to respond appropriately. However, as witnessed during the 2008-9 financial crisis, public pressure for regulation can mount quickly.
- The unsustainable economic model: Finally, and probably most troubling, the initial experience of identifying, measuring and valuing sustainability impacts has confirmed an ugly truth about the current economic model. This is that it is built on the notion (and fiction) that social and environmental 'externalities' are of lesser (or no) importance to core business, either in assessing national economic performance (e.g. GDP) or corporate performance (i.e. annual accounts). The business, political and societal risks of continuing to pursue this model has been underlined in many areas.

To come back to the navigation analogy, humankind is currently in a jumbo jet, running short on fuel, heading for a hard (if not crash) landing in the not-too-distant future, in a world that will be very different and diminished from the one we left.

[3] 'A renewed EU strategy for 2011-14 for Corporate Social Responsibility', Communication from the Commission to the European Parliament, the Council the European Economic and Social Committee and Committee of the Regions, COM (2011) 681 final, Section 4.5.

Anyone who doubts this stark assessment should read the United Nations Environment Programme's 5th Global Environment Outlook[4] or any other of the many serious independent studies on the state of the planet. In our jumbo jet, we are using a primitive dashboard, whose compass – corporate reporting – is steering us towards short-term economic goals, while ignoring increasingly loud hazard warnings.

The time has come to develop a new corporate reporting dashboard to better help the business sector navigate through the increasingly rough weather that lies ahead.

While it would be presumptuous to describe what this corporate reporting dashboard should look like, we can already speculate about what its core principles and characteristics should be:

- Ecosystem-driven: Our economic and social systems have developed from, and are ultimately entirely dependent on, healthy ecosystems. Any dashboard that fails to reflect this reality is flawed and will fail us. Government and corporate reporting systems need to find ways of identifying and measuring ecosystem impacts and encourage behaviour that promotes environmental health above all else.
- Social values, business value: Reporting systems will need to recognize that sustainable business will involve a shift in strategic thinking. Rising population pressures, increased scarcity of raw materials, increased climate variability and the prospect of rising social unrest will favour business models that optimize the use of energy and raw materials and the provision of essential goods and services. The generation of profit alone will not guarantee a social 'licence to operate'.
- Materiality-based: Every company has a unique operating environment. The contours of this environment can best be addressed through an ongoing materiality assessment which – like an aircraft's radar – constantly scans the horizon for trends and issues facing the company's future health, and tracks progress. Any new system must be designed actively to seek and analyse information about the company's present and future operating environment, and form the basis for describing its 'flight plan' to regulators and stakeholders.
- Market-sensitive: While far from perfect, financial markets are powerful levers of change. While governments, not markets, must set policy directions, markets need to be provided with information in a form they can understand and use to price risk, evaluate management competence, and determine long-term value. In this context, governments need to respond to demands for more accurate information about long-term trends and the impact of corporate behaviour.
- Experience-driven: Experience with financial and sustainability reporting leads one to conclude that expert, multi-stakeholder approaches building on existing frameworks is the most effective way of developing and

[4] Fifth Global Environment Outlook (GEO-5), Draft Summary for Policy Makers (UNEP/GEO5.IGM/2), 2012.

deploying reporting standards. While the suggested reforms of information disclosure will constitute a new generation of corporate reporting, they will probably build on familiar concepts in international financial accounting and sustainability reporting.

- Technology-based: Data collection and processing software has revolutionized business management practices. Its potential is, however, largely untapped in the field of enhanced corporate reporting. Computer-based systems offer a path to low-cost, high value-added monitoring and reporting systems.

The International Integrated Reporting Council (IIRC) contains many of these features and aspirations. As such, it looks like the most promising framework on offer for developing the needed next generation of corporate reporting. In doing so, however, it will clearly need to integrate the lessons learned from the Global Reporting Initiative (GRI), both in terms of standards development and ongoing indicators refinement. As the GRI (itself involved in the IIRC process) develops the fourth generation of its Reporting Guidelines (G4), it has indicated its parallel interest in developing indicators that are more relevant to investors. In this sense, the two initiatives are very complementary. It seems likely that, while the identification of core materiality issues will offer a shorter and more financially measurable list of indicators for inclusion in an integrated report, experience suggests that the longer menu of issues addressed by the GRI network will continue to be relevant for most companies.

It is unnecessary, and arguably undesirable, for governments to become heavily involved in the development of the new reporting framework. However, it would be invaluable if the intergovernmental deliberations of 2012 could do three things to give direction and impetus to the process:

- First, to acknowledge the importance of developing a global sustainable development reporting framework (such as that proposed by the Secretary-General's High-Level Panel) that marries the best of current financial and sustainability reporting and fills the gaps left in conventional financial accounting;
- Second, to encourage the relevant intergovernmental organisations, including the World Bank, to participate actively in the process, and to provide substantial funding to support the process and enable participation by experts from emerging economies and civil society stakeholders needing assistance; and
- Third, to support the 'Report or Explain' approach to reporting. This requirement (based on simple regulation, such as in Denmark; or stock exchange action, such as in South Africa) is needed to ensure that the necessary momentum is maintained and experience is collected to inform the development of the new framework.

People all over the world now possess personal navigation devices that give them real-time information on weather, share and commodity prices, and contact information. It is time now for companies

to develop their own robust navigational systems that also bring together all the relevant information needed to ensure both corporate and planetary sustainability.

The most exciting thing is not just that this is achievable in a relatively short time, with diverse expert inputs and without an international treaty, but that it may represent capitalism's finest hour: by finally making markets work for the good of all humankind.

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Brace yourself for the transparent economy

John Elkington
Executive Chairperson, Volans

BY 2022 we will see more change in corporate transparency and reporting than experienced to date in the 40 years since the United Nations Conference on the Human Environment was held in Stockholm in 1972. This is not because the reporting community wants it so, but because the global economy cannot succeed without massively improved transparency, traceability and accountability.

To get a sense of where this is headed, read One Report: Integrated Reporting for a Sustainable Strategy[1]. The authors suggest that recent economic crises – and the looming demographic, resources and environmental crises – demand radically different policy and market responses.

Early on in the transparency revolution, the drivers could be found in the citizen and public sectors, such as the Global Reporting Initiative (GRI). Increasingly, in addition, the private sector is joining the movement, for example with what one colleague dubbed the 'Walmart Reporting Initiative', where the giant United States retailer is challenging thousands of suppliers worldwide. This forms an important part of the evolution over the past two decades from safety, health and environmental reporting, through sustainability and ESG (environment, social and governance) reporting, to a form of reporting which is more integrated.

From Lehmann Brothers to Bernard Madoff, the modern-day 'Great Recession' has exposed an array of financial outrages that profoundly shook trust in both business and governments, underscoring the need for greater (and more effective) disclosure, reporting and communication. Even brands like Toyota and Apple (the world's most admired company according to Fortune magazine) may hit the rocks. Nor is business alone: the Vatican and the Intergovernmental Panel on Climate Change (IPCC) have also been rocked by the surfacing of uncomfortable truths. Had these remained hidden, it may have suited them better.

As the writing of The Transparent Economy: Six Tigers That Are Stalking the Global Economy – and How to Tame

[1] Eccles, R.G. & Krzus, M.P. 2010. One Report: Integrated Reporting for a Sustainable Strategy. Hoboken, New Jersey: John Wiley & Sons.

Them[2] was racing towards completion, the Harvard Business Review published a cover story called "Leadership in the Age of Transparency".[3] The title was designed to worry many on the boards and in C-suites of major corporations: "Consumers know everything about your company," it ran, "not just its carbon emissions but its countless other 'invisible' effects on the globe. That has changed the rules of business forever."

Many of those who worked their way through scores of sustainability reports in the past rarely read individual company reports today. Why? The focus is now shifting from the publication and accreditation of company reports to the growing need to aggregate and analyse data. This comes with the movement to what some call the era of 'Big Data'.

So it's worth asking: If sustainability reporting is the answer, what was the question? It certainly wasn't to provide work for report-writing consultants and designers. It wasn't to boost the number of entries to sustainability reporting award schemes. And it wasn't to provide a justification for CSR (corporate social responsibility) and sustainability departments. Rather, it was designed to open business thinking up to a wider societal agenda, to spur the introduction of the necessary management systems, to create information-rich connections across global supply chains, to transform cultures and paradigms, and, ultimately, to better inform the global push towards more sustainable forms of development.

The Transparent Economy offered a vision of the status of reporting in 2020. It ran as follows:

Within the next decade, market and business transparency is universally accepted across the G20 countries and beyond as critical to economic resilience and sustainable value creation. Terms like triple bottom line (TBL) and environment, social and governance (ESG) have played their roles as booster rockets and fall away as new forms of integrated accounting and reporting take over.

Growing political and government involvement, bending rules, regulations and incentives towards sustainability objectives, have spurred intensive innovation not only in corporate reporting and engagement but also in areas like cleantech – and in crowd-sourcing approaches to many areas of innovation. Web 2.0 approaches are endemic – and Web 3.0 (Semantic Web) strategies are widely used across the leading edge of business. Companies increasingly expose critical internal data-sets to selected stakeholders.

Data aggregation and analysis have reached levels unimaginable in 2010, with the performance of individual technologies, products, value webs and even entire economies readily and powerfully visualized against the background on global limits, footprints and targets.

[2] Volans and the Global Reporting Initiative. 2011. The Transparent Economy: Six Tigers That Are Stalking the Global Economy – and How to Tame Them. London, Amsterdam: Volans and GRI. Available at http://www.volans.com/lab/projects/the-transparent-economy/

[3] Meyer, C. & Kirby, J. 2010. Leadership in the Age of Transparency. Harvard Business Review, April.

Common platforms – evolved from the likes of Google Earth[4] and IBM's Smarter Planet initiative[5] – are widely used to track progress in system level change, to connect and support innovators, and to inform, engage and motivate citizens.

Properly understood, sustainability is not the same as corporate social responsibility (CSR) – nor can it be reduced to achieving an acceptable balance across economic, social and environmental bottom lines.

Instead, it is about the fundamental, intergenerational task of winding down the dysfunctional economic and business models of the 19th and 20th centuries, and the evolution of new ones fit for a human population headed towards nine billion people, living on a small planet which is already in 'ecological overshoot'.[6]

After two decades of sustainability reporting, the foundations appear to have been laid for a continuing expansion of GRI-style reporting. If the best of current practice were to spread – for example Denmark's 'Report or Explain' requirement of companies – things could move both fast and far.

But while the trend towards a greater number of reporting companies worldwide is likely to continue, along with a broadening range of issues covered, the immediate future may see a slowing of the growth in the number of reporting companies, as greater effort is devoted to experiments in integrated reporting. If pioneer reports succeed – a process that could take much of the next decade – the number of reporting companies could open out explosively.

Whatever many business leaders thought they were signing up for, sustainability, increasingly, is likely to be an agenda of transformative – and often disruptive – change. Expect a shift to zero-based targets not only in such areas as accidents but also carbon, waste and toxics.[7]

Those in doubt should take a look at the Vision 2050 report produced by the World Business Council for Sustainable Development (WBCSD) – and signed off by the CEOs of many leading corporations.[8] The report is remarkably positive, by design, sketching a future "in which 9 billion people live well, enjoying health, food, shelter, energy, mobility, education and other basics of life". As Syngenta CEO, Michael Mack, put it, "Humanity has largely had an exploitative relationship with our planet; we can, and should, aim to make this a symbiotic one."

Then Vision 2050 spells out the 'must haves' – things that must happen over the next decade to make a sustainable global society possible:

These include incorporating the costs of externalities, starting with carbon, ecosystem services and water, into the structure of the marketplace; doubling

[4] See www.earth.google.com/

[5] See www.ibm.com/smarterplanet/us/en/

[6] See www.footprintnetwork.org/en/index.php/GFN/page/earth_overshoot_day/

[7] Elkington, J. 2012. The Zeronauts: Breaking the Sustainability Barrier. London: Earthscan/Taylor & Francis.

[8] Available at www.wbcsd.org/Plugins/DocSearch/details.asp?DocTypeId=33&ObjectId=Mzc0MDE

agricultural output without increasing the amount of land or water used; halting deforestation and increasing yields from planted forests; halving carbon emissions worldwide (based on 2005 levels) by 2050 through a shift to low-carbon energy systems and improved demand-side energy efficiency, and providing universal access to low-carbon mobility.

"Sustainability will become a key driver for all our investment decisions," explained Idar Kreutzer, CEO of Storebrand and project co-chairperson. Indeed, WBCSD argues that new rules for markets will reframe environmental challenges as economic challenges, driving innovation and competition in the direction of sustainability and away from resource- and energy-intensive production. "Rationalizing prices to include such externalities as climate and biodiversity impacts will make corporate environmental efficiency a true competitive advantage across all industries and regions," the report concludes.

However one looks at it, the business agenda seems set to move way beyond citizenship and CSR reporting in the next decade. Ceres, which did so much to shape the reporting agenda, published a business roadmap for sustainability earlier in 2010, called The 21st Century Corporation: The Ceres Roadmap for Sustainability.[9] Ceres President Mindy Lubber stressed that, while the reporting of performance in relation to 'material' issues will be increasingly important, the spotlight will switch to the extent to which particular companies, supply chains and economies are effectively moving towards economic, social and environmental sustainability.

Governments will play a central role in promoting, incentivising and steering the Transparent Economy – not because they want to but, increasingly, because they have to. This includes the makings of the Green Economy, as discussed at Rio in 2012. They will also be intensively engaged in adapting 21st century business to emerging environmental realities and in policing corruption and the various shadow economies that are an inescapable part of any society.

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[9] Ceres. 2010. The 21st Century Corporation: The Ceres Roadmap for Sustainability. Boston: Ceres. Available at www.ceres.org/company-network/ceres-roadmap

Mobilising a public fiduciary: corporate reporting futures

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The horse is here to stay but the automobile is only a novelty – a fad", argued the president of the bank advising Henry Ford not to invest in such newfangled nonsense. The media, predictably myopic, argued similarly when The Body Shop International in early 1996 published its Values Report, the world's first, externally audited sustainability report by a publicly listed company. Even the founders of the Global Reporting Initiative simply would not believe for many moons that they should create more than a global environmental reporting standard – regarding the social and economic to be beyond the scope of what was possible or needed. Yet today, we have successfully erected a 'self-evident truth' that sustainability and financial corporate reporting will converge. It is amazing how creative that historically familiar blend of unholy bedfellows can be: sceptics and cynics joined together with evangelists and practitioners. [1]

Modern sustainability reporting has moved from the margins to the mainstream. It has achieved this in less than two decades, albeit building on a rich history over many generations of experiments in social and environmental accounting, auditing and reporting. Having moved beyond the 'whether' to the 'how' sustainability reporting will manifest itself in mainstream is, however, only one step in a longer journey. The real issue now turns around the grander 'so what?', i.e. whether sustainability reporting will play an effective role in the timely transition to a sustainable economy.

Sustainability reporting, in its recent experimental phase, has driven change rather than merely being an outcome of it. There is clear evidence of shifts in business behaviour and outcomes where it has been

[1] The author has written this contribution in his personal capacity.

adopted, and to some extent across the corporate community where measurement has underpinned the formation of new norms. And with this early success has come an era of standards. Whereas measurement was initially stand-alone and voluntary, there is now a positive explosion of plug-in standards to statutory rules and non-statutory, mandatory governance frameworks, such as state-owned enterprise reporting and stock exchange listing requirements. Most recently we have seen the early stage of moves towards an integrated reporting approach underpinned by the world's leading accounting and auditing standards bodies. Journalists who once cynically dismissed Anita Roddick's catalysing vision and action should take note.

Standardization is both a mark of success in, and the consequence of, mainstreaming. But it comes at a cost, as it opens the field to professionalization, commoditization and legalization. The implications of this can most readily be seen in the field of statutory financial reporting, where the practice today is at best a reasonably effective insurance against gross incompetence and the more obvious misdemeanours. Accounting and reporting are not just about accountability, of course. The same metrics and methods have been used to advance every conceivable financial instrument, from high-frequency trading to long-term infrastructure investment to money laundering. These metrics and associated instruments, for better and worse, have become the all-important arteries of our modern economy.

Scenario 1:
The financial reporting pathway

Sustainability reporting may follow the same pathway as its more narrow-minded, financial cousin. In this scenario, victory for those advocating a sustainable development pathway may well prove hollow and fragile. Tradable externalities, such as carbon, would become embedded in corporate accounting and reporting, including those sustainability assets and liabilities subject to reputational and legal trading, i.e. in the courts of public opinion and law. Being tradable, such assets and liabilities will be priced and sold as a source of profit rather than be valued for their underlying impacts. While there may be little wrong with this in theory, startling practice has demonstrated the limitations of what markets can deliver in stewarding public goods.

We must expect – based on the current market norms and interests and associated rules and expectations – a generation of unintelligible derivatives in human rights, perhaps bundled with a bit of carbon from Chile and water rights liabilities from Cambodia. Robust research tells us that such financial engineering, today, is embedded in an endemic culture across capital markets of short-termism. Not only has this led to sub-optimal outcomes for the private investor, but it has also proved to be a threat to the stability of the economy that capital markets are intended to serve, indeed of the wider political economy. In this scenario, frankly, integrated reporting will be subordinated to these endemic problems rather than catalysing business-level, sustainability outcomes.

Cars turned out not to be a novelty, but over time have become a toxic aspect of modern society. Mr Ford cannot be blamed for not foreseeing this unintended consequence. But we can no longer afford such myopic views of the future. The sustainability imperative requires us to predict and act to mitigate weaknesses or unintended consequences of our collective innovation, namely integrated sustainability reporting.

Corporate sustainability reporting has two core purposes: guiding the allocation of capital towards investing in a sustainable economy, and supporting greater accountability to broader society for businesses' performance and impacts. Effectively addressing this dual aim requires that we shape the meaning of success in such a way that measures of sustainability count. As yet this is clearly not the case, except at the margin. Far from it, today's sustainability reporting can be, and is, too easily gamed to reduce its impact on the wider rules of doing business. Fortunately, there is real potential in the evolution of sustainability reporting to impact on the wider system, and this potential must be realized for the practice to achieve its goals.

Scenario 2:
A pathway of more fundamental change

A second scenario is that the growing practice of sustainability reporting, combined with the apparent weaknesses in today's global markets, will precipitate a broader systemic change in our governance of business and markets. In this scenario, a 'public fiduciary' would replace the current narrow focus of corporate governance on optimizing solely in favour of financial stakeholders. The dominant corporate governance model for publicly listed companies, broadly the Anglo-Saxon approach, would be overturned in favour of a pluralistic approach where corporate directors' fiduciary responsibility requires them to address financial and broader sustainability outcomes.

A public fiduciary is already a *de jure* feature of state-owned enterprises, cooperatives, social enterprises, and many family businesses. This is the case for many commercial businesses, including a surprising number of leading global corporations with dominant private shareholders or foundations with non-financial interests. And in the broader context, we see such pluralism of purpose nurtured by some of the world's most competitive economies, from Denmark and Germany to South Korea and Singapore. Even the heartland of today's narrowly focused approach to corporate accountability, the USA, is in its own way experimenting with such pluralistic approaches, consciously through legal innovations such as the 'B Corporation' and through forced policy-driven governance innovations underpinning the recent government bail-out.

Governance innovations in the investment community in this more disrupted scenario would mirror those of the wider business community. Developments in the rule of law that establish a public fiduciary for investors as corporations would embed a pluralistic approach. But, as with the wider business community, there are many *de facto*

changes that are already shaping this future. Policy-driven national development banks and sovereign wealth funds are becoming ever more important in global capital markets, especially at a time of extreme stress for many conventional financial players. Major stock exchanges increasingly require listed companies to set out non-financial factors in risk-related reporting. In some jurisdictions, such as Brazil and South Africa, investor governance codes and secondary market listings explicitly value how businesses deal with (not just report on) sustainability issues.

The future effectiveness of sustainability reporting does not, then, just depend on the continued development of its robustness, professionalization and institutionalization, although these are necessary developments. It depends on its impact, alongside other drivers, on the system of which it is a part. In the initial scenario, reporting standards and practices may become sophisticated and mainstreamed, but are likely to have only a weak effect on sustainability outcomes. At worst, such practices could become complicit in sustaining today's toxic economy. The second scenario, on the other hand, posits sustainability reporting as part of a deeper change in the governance and accountability of business, and the all-important operations of capital markets in shaping tomorrow's political economy. This second scenario, underpinned by a public fiduciary, offers more hope, but is undoubtedly more challenging. Yet, as with many other historically disruptive innovations, its seeds and, indeed, green shoots have already appeared. While this should not give us cause for predicting easy success, it should provide change-makers with the confidence to elevate their ambitions as to what must and can be achieved.

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Part 10: Conclusion

The steep learning curve ahead

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The contributions to this report reflect insights by experts who have been involved in the debate, analysis and practice of corporate reporting for many years. They have been asked to share their views on topical issues in the current evolution of the reporting and corporate governance field. Their collective wisdom provides some indication of where corporate reporting is heading, pointers that will no doubt provide inspiration for further debate, analysis and executive decision-making to speed up change both in the market and on the regulatory frontier.

Who drives reporting?

External agencies that have driven the practice of reporting have in the past generally been specific target groups which have a close interest in the operations of a business. Notably, in the case of financial reporting, these have been the finance community (investors, in particular) and the regulator (governmental departments of commerce and finance, in particular). In the case of sustainability reporting, a wide range of interest groups has added its voice to the call for reporting, both as tool for accountability and tool for internalising the sustainability agenda. However, experience has shown that those who actively read and use the published sustainability reports are a smaller (albeit influential) group of sustainability experts, consultants, data compilers, researchers and raters. Investors have failed to be active drivers of sustainability reporting and the use of sustainability reports, raising concerns about the lack of comparability, materiality and consistency of the information presented, among other things.

Within the reporting organization, key drivers have been both those with a special interest in finance or sustainability and those tasked with the responsibility of overseeing and leading the process of reporting. Various contributors to this report have highlighted the key role of the board of directors and senior management in leading eventual decision-making on materiality and reporting content. These senior executives, whose understanding and thinking is decisive, also represent a key internal target audience of reporting.

The summary of key trends and stakeholder expectations captured by reporting influences those who lead and oversee the process itself. In addition, the execution of a more integrated reporting process requires closer collaboration between sustainability managers and financial managers. This demands an ability in those with varying professional backgrounds – such as environmental engineering and accounting – to come to grips with each other's terminology and standards. To break down the still extant silos in so many companies necessitates the creation of integrated reporting teams to manage effectively the process of more coherent measurement, management, reporting and communications.

One report or multiple reports?

This is an important but wrong question, which may disappoint those who expected the advent of the integrated report to represent simplification and the creation of a one-stop-shop that replaces all other forms of reports. As confirmed by Eccles and others, the future holds a pyramid of communications tools with a concise integrated report at the top, followed by a second layer of financial and sustainability data that is captured in printed and online reports, and further layers of communications, that target specific audiences with varying degrees of technical or generic content published with the use of innovations in social media, web 3.0 and digital communications. Those looking for comparable and benchmark-able information on performance will not necessarily welcome a mass of online information. For this, tools such as a user-friendly XBRL system will be critical, while avoiding the comparison of apples and pears across industry sectors.

The reporting pyramid also signals the importance for the integrated report to be at the top, and not simply to be a object that displays superficial, condensed information, but one that really reflects deeper quality information. The whole has to be bigger than the sum of its parts. This includes the display of issue connectivity, showing how different sustainability and financial performance indicators interrelate. It also includes the description of the business model, the very logic of how the business creates and sustains value in a resource-constrained world.

What are the material issues?

The Generally Accepted Accounting Principles (GAAP) definition of 'materiality' refers to "economic decision-making" by users "taken on the basis of financial statements". This reflects the accounting approach or what some would call 'financial materiality' as opposed to a more inclusive sustainability approach advocated by sustainability experts. It raises the question of whether a topic is only material once it has (obvious, measurable) financial consequences. The GAAP definition also refers to "size", implying that it is not only financial impact as such but also the scale and nature of the impact that is relevant.

This points to the concept of “significance” as reflected in the boundary protocol of the GRI, and expanded upon in the materiality matrix presented by AccountAbility and the GRI[1], displaying level of significance from the point of view of stakeholders versus that of the business. Experience with applying the materiality matrix has shown that weighing materiality is not simply a mechanistic, predetermined decision. The more inclusive understanding of materiality fundamentally refers to the ability to make a judgement on an organization’s capacity to create and sustain value. This is a judgement based not only on the availability of sustainability metrics and financial metrics, but also on an understanding of the business logic (model) and context within which they need to be interpreted.

What is most relevant or material for inclusion in annual reporting is highly influenced by established accounting principles such as ‘recognition’. For example, at what point can a sustainability topic or action be recognized as significant enough for inclusion in the annual report? The difficulty of meeting the necessary requirements when dealing with complex societal issues such as ecosystem services has been highlighted by the Economics of Ecosystems and Biodiversity (TEEB) for Business report.[2] For an item to be recognized as an asset or liability, it must be considered probable that any future economic benefit associated with the item will flow to or from the entity and that the item has a cost or value that can be measured reliably. The reality is that many sustainability topics still fall outside these recognition criteria. They are therefore neither accounted for internally by organizations, nor are they reported externally in conventional financial statements. The exception is where a recognizable market such as carbon trading exists, one that gives rise to reliable valuations. This illustrates the role of regulation in moving sustainability factors from the periphery of financial reporting systems to the core of reporting on performance and emerging risks or opportunities. The shortcomings of ‘recognition’ as principle also illustrate the fact that future determinations of materiality need to be more forward-looking and not limited to strictly quantifiable value estimations.

Who reads the report?

The question of target audience is foundational in developing any report. As far as the emerging integrated report is concerned, the dominant assumption is that investors are the main target audience.

[1] See AccountAbility in association with BT Group and Lloyds Register Quality Assurance (LRQA). 2006. The Materiality Report. London: AccountAbility, BT Group Plc and LRQA (available at www.accountability.org); and Global Reporting Initiative (GRI). 2011. Technical Protocol – Applying the Report Content Principle. Amsterdam: GRI (available at www.globalreporting.org/resourcelibrary/GRI-Technical-Protocol.pdf).

[2] Bishop, J. (ed). 2011. The Economics of Ecosystems and Biodiversity in Business and Enterprise. London: Earthscan.

The integrated report is likely to serve as a central meeting place for decision-makers and stakeholders of various backgrounds, albeit a meeting place at the local investment institution. This signals a certain type of report content, influenced by conventional accounting and legal principles such as 'recognition' and 'control' but meeting new expectations that point to extended time frames, boundaries and value chains. And even if the content – qualitative and quantitative – is likely to have a certain technical nature, the contributions to this report make it clear that it will be content to which all have access. All stakeholders need to be privy to the same information across financial, sustainability and governance aspects.

If the integrated report were to become the main statutory report, corporate lawyers are likely to enforce a legalistic approach that is unlikely to satisfy the aspirations of those committed to a sustainability agenda. Forward-looking statements about performance, strategy, risks and opportunities are likely to be severely limited based on concerns related to liability and competition. Requests to add web links for additional information in the report may be refused since supplementary information falls outside the report boundaries of what has been audited and assured. Disclaimers will be common. All of this signals the tension between standardization and innovation, between legalistic professionalization and responsive accountability. It remains to be seen whether investors as key target audience will allow the process of integration to be truly transformative or have the values of sustainability suffocated by standard dogma.

Who governs reporting?

A focus on reporting as an ongoing process and its function in strategic decision-making highlights the role of governance and what is expected of leading actors involved directly and indirectly. Garratt and others have emphasized the importance of quality of leadership and management among directors, owners and their agents (e.g. asset managers). At times of uncertainty and when faced with dilemmas, it is essential for board members and senior management to act with knowledge, understanding, integrated thinking and commitment, and to exercise good judgement, reasonable care, skill and diligence. This includes a basic understanding of market and societal realities, clarity about values that go beyond mere financial values, and an ability to think over the longer term.

For those who have little faith in directors, owners, managers and regulators displaying these skills on their own, the opening up of governance to a public fiduciary is necessary. This implies a focus beyond so-called financial stakeholders and financial outcomes. Yet the fact that the currency of business performance is finance does not preclude the possibility of framing, measuring and communicating the performance of business with longer term and more holistic yardsticks. In addition, more informed governance could also be facilitated by the more active engagement of all citizens as providers of capital to companies, through pension funds and investments in financial institutions.

Shareholder activism and the ability of those committed to responsible investment to walk the talk will be key factors in ensuring that increasingly integrated reporting presents quality in the depth and use of information. Mainstream investors in particular will need to pay closer attention to the governance of reporting and improve their capacity to understand the relevance of environmental, social and governance (ESG) topics.

Who regulates reporting?

Discussion on mandatory versus voluntary approaches to reporting reflect, on the one hand, a sense of urgency to get relevant information systems and tracking of progress in place, and, on the other hand, a feeling that market-driven innovation will be more effective in establishing meaningful standards with an ability to adapt to evolving needs.

The more advanced nature of theme-specific reporting standards, such as greenhouse gas accounting and carbon disclosure, reflect areas where market players have felt the sense of urgency on the part of regulators and the public. Mandatory requirements for comprehensive reporting by state-owned enterprises or integrated reporting required by stock exchanges such as the Johannesburg Stock Exchange serve to put sustainability items on the agendas of board meetings and send a signal to all enterprises. Still, other than the impact of such requirements to promote the fact of reporting (or explaining why not), most prefer to leave the 'how' to market innovation.

Contributions to this report reflect the fear that extensive regulatory requirements lead to a tick-the-box approach, one of mindless, quantitative compliance, rather than one that requires an informed board and senior management to display their own strategic insight. Amid financial and economic crisis or recovery, the level of trust in regulatory and financial institutions is low. Yet, from some emerging and developed markets there are appearing building blocks of innovative, hybrid systems of smart and self-regulation that are paving the route for more sustainable ways of running business. The ability of professional bodies to support these with recognized accounting standards and assurance systems, as well as that of the investment community to use the information disclosed effectively will be central in proving its value.

The way forward

The contributors to this volume agree that continuing business as usual is not an option, and that the time for alternative disclosure models and more integrated reporting has come. Still it is unclear where the ongoing debate on transformation in corporate reporting will lead. Some of the complexities that have to be addressed include:

- the tension between short-term and long-term perspectives;
- the balance between backward-looking (interpretation) and forward-looking (planning) information;

- the conflicting interests and agendas of various stakeholder groups, including investors, customers and suppliers;
- the interconnectedness between environmental, social, governance, ethical and financial performance;
- the balance between management and public information; and
- the alignment of business model, performance, measurement and reporting.

It is still unclear to many whether an integrated report, as the potential ultimate executive summary, will replace existing reports (annual, sustainability, etc.), or whether it will be a consolidated report supported by all the existing reports. The expert responses provided above suggest that the latter is likely to be the case in future, with supplementary material increasingly taking the form of online communications and databases. A key contribution of the GRI network will continue to be, among others, the ongoing refinement of a comprehensive set of sustainability indicators and guidance on structured communications to a full spectrum of stakeholders. Yet there is a specific gap that needs to be filled. To elucidate the need for both forward-looking information and strategic financial information, Figure 1 illustrates how the integrated report has to fill a space that neither sustainability reporting nor annual financial reporting has been able to do effectively.

Critical in filling that space is the target audience of the integrated report, which raises the ability to communicate the business case and business model to that part of the investment community that applies a longer-term focus.

Figure 1: Positioning the integrated report

	Short-term & backward-looking	Long-term & forward looking
More ESG, non-financial information	Generic public relations, corporate communications	Annual sustainability report(ing)
More financial information	Annual financial report(ing)	Annual integrated report

NOTE: The term ESG, commonly used in the responsible investment community, refers to environmental, social and governance information. Distinctions such as more or less financial information and more current, past or future-oriented information are not absolute but points along a continuum, used illustratively to demonstrate predominant features of the different reporting tools and communication systems highlighted.

Innovations in social media, web 3.0 and other uses of information and communications technologies point to a diverse range of avenues through which supplementary communications will be channelled in years to come. This is the age of transparency, in which communications are highly interactive, real-time and multichannelled. It is the age in which not only the marketing department knows everything about buyers and consumers, but also consumer citizens know everything about the company. This poses a real challenge for corporate reputation and trust, as senior executives know very well. Yet, in order for multichannel communications about sustainability and business performance to have greater impact, consumer citizens will need to become more data literate, sustainability experts more finance literate, and finance experts more sustainability literate. No doubt, the future of corporate reporting holds a great deal of learning, learning in compliance and explaining.

At the heart of the debate on integrated reporting is the link between non-financial performance (sustainability interventions) and financial performance (financial value and its drivers), and whether the nature of this link signals a business logic that deserves a quality investment grade. Fundamental changes in the global landscape (physical, commercial and conceptual) make it impossible to carry on with business as usual, as if the sustainability link were of no direct relevance.

There are still those who apply old-style measures (e.g. quarterly growth) to determine whether business can escape from current sustainability dilemmas, but this approach negates the growing consensus that these measures contributed to business landing in the dilemma in the first place. [3] Future investors in the transparent Green Economy will need holistic information on material financial and non-financial issues to make good investment decisions.

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[3] In response, political and business leaders such as Al Gore and David Blood have called for an end to the default practice of issuing quarterly earnings guidance. See Generation Investment Management LLP. 2012. Sustainable Capitalism. London: GIM.

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