

# The Business Case for Integrated Reporting – from an Australian Stakeholder Perspective

**Draft discussion paper**

Prepared by a sub-group of the Business Reporting Leaders  
Forum (BRLF)\* in Australia

December 2010

- - Note that the BRLF is a voluntary group which includes observers and members from key Australian government departments, regulatory and professional bodies, as well as investors, analysts, corporate CFOs (G100), accounting firms, academics and experts in ethics, sustainability, governance and civil society. This draft discussion paper has been prepared by a representative sub-group of the BRLF, and will be discussed and finalised at a full meeting of the BRLF to be held in February 2011.



Society for Knowledge Economics

## Introduction

The International Integrated Reporting Committee (IIRC) remit is to create a globally accepted framework for accounting for sustainability: a framework which brings together financial, environmental, social and governance (ESG) information in a clear, concise, consistent and comparable format – put briefly, in an integrated report. The intention is to help with the development of more comprehensive and comprehensible information about an organisation's total performance, prospective as well as retrospective, to meet the needs of the emerging, more sustainable, global economic model.

*"The goal of the IIRC is not to increase the reporting burden on companies and other entities. Rather, it is to help them and all their stakeholders make better resource allocation decisions. All of us have a stake in a sustainable society. While integrated reporting alone cannot ensure sustainability it is a powerful mechanism to help us all make better decisions about the resources we consume and the lives we lead."*

**Ian Ball, CEO of the International Federation of Accountants and Co-Chair of the IIRC Working Group**

The IIRC's first phase is to develop a Discussion Paper setting out a framework, overarching concepts and guiding principles, under which the future of corporate reporting can evolve. This Discussion Paper, once agreed by various global stakeholders will be presented at the G20 in November 2011 for consideration and potentially adoption by global leaders as the way forward for transparent and business-useful reporting.

## Australian Response

The Society for Knowledge Economics (SKE) is a not-for-profit, established in Australia in June 2005 as an initiative of the Australian Government Consultative Committee on Knowledge Capital. SKE's vision is to position Australian workplaces as the most innovative, productive and fulfilling in the world. Through collaboration and cross-sectorial initiatives supported by industry, academia, policy makers and thought leaders, SKE is focused on developing workplace leadership capabilities.

In line with this vision, SKE has undertaken a number of collaborative projects focusing on better management, monitoring and reporting by organisations on their use and development of intellectual capital and other intangible assets e.g. *Australian Guiding Principles on Extended Performance Management (2005)*.

Therefore with an existing mandate to promote broad based business reporting, SKE has convened a relevant multi-stakeholder group to develop Australia's response to, and support of the IIRC. This group is called the Australian Business Reporting Leaders Forum's (BRLF) and has a core purpose of:

*'Collaborating with Australian stakeholders and working with global initiatives to promote and drive the development and implementation of a strategy-aligned integrated business reporting framework, thereby reducing complexity and enabling efficient allocation of capital.'*

The BRLF has also been working closely with the Worldwide Intellectual Capital Initiative (WICI). Over the last two years, WICI has developed a holistic strategy-centric business reporting framework, early days XBRL taxonomies (for efficient electronic data sharing) and emerging sector-specific KPI libraries. WICI is now working with the IIRC towards development of a single global solution.

To support the work of the IIRC, the BRLF has already delivered to the IIRC a Australian 'Landscape Review' that provides an overview of the regulations, standards, frameworks and guidance in place in Australia of relevance to integrated reporting and the implications for the IR framework.

## **Program of work**

The IIRC Working Group is starting to develop a conceptual framework and guiding principles for integrated reporting for inclusion in the Discussion Paper. The IIRC's objectives for an integrated reporting framework are to:

- Support the information needs of long-term investors, by showing the broader and longer-term consequences of decision-making
- Reflect the interconnections between environmental, social, governance and financial factors in decisions that affect long-term performance and condition, making clear the link between sustainability and economic value
- Provide the necessary framework for environmental and social factors to be taken into account systematically in reporting and decision-making
- Rebalance performance metrics away from an undue emphasis on short-term financial performance, and
- Bring reporting closer to the information used by management to run the business on a day-to-day basis.

Therefore as an initial step and an input to the development of the framework, principles and Discussion Paper, the BRLF has summarised the 'business case for integration' perspectives from key Australian stakeholders, namely:

1. Investment Community
2. Corporate Community and
3. Other Stakeholder Community (i.e. Governance & Civil Society experts).

This short paper sets out the business case for integrated reporting, the likely challenges as well as the priority issues that each of these stakeholder group believes must be addressed in developing the integrated reporting framework, principles and Discussion Paper.

Although this paper focuses on listed public corporations and long term equity investors, the challenges, issues raised and required outcomes are equally as applicable to private companies, public sector organisations/ departments and not-for-profit entities and their owners, financiers and providers of capital.

There are several requirements, and concerns, consistent across all stakeholders around the need to focus on broader based business (financial and non financial) performance reporting against strategy, with a focus on the longer term sustainability of the organisation.

As the IIRC develops the framework and produces draft Discussion Papers, the BRLF will use this initial thought-piece as a checklist to ensure key issues have been addressed, or the reasons why not have been clearly explained.

## 1. Investor's Business Case for Integration

### Drivers of change

In setting out the business case for an integrated approach to the reporting of Financial and Environmental, Social and Governance (ESG) performance, it is important to establish the **drivers** of increasing consideration of ESG. These include:

- The role of the asset owners in promoting ESG and the associated United Nations Principles for Responsible Investment (PRI). The leadership shown by the Australian asset owner signatories to the PRI is 'pushing down' on the rest of the funds management sector. Given the pool of superannuation funds in Australia (the fourth largest in the world) their perspective is certainly worthy of consideration.
- A genuine belief and an increasing amount of research that shows ESG consideration produces superior returns.
- Regulatory changes both on investors themselves and companies. For example the introduction of carbon markets creates real demand for environmental performance reporting.

### Challenges for investors

As more investors commit to mainstream consideration of ESG issues in their investment selection processes, they face a number of challenges relating to information flows, including a lack of:

- Usable information on a company's ESG performance, as current sustainability reports are targeted at stakeholders other than investors
- Information from many mid to smaller companies
- Consistent data year on year (in content and approach) and lack of consistency in definitions across the sector
- Candour and relevance in disclosure. (Sustainability reports are presented in a "marketing" style, and do not necessarily address the key issues that are the most material to company, as well as the investors.)
- Standardised methodologies for calculation of complex metrics and setting of boundaries (e.g. regulatory requirements which focus on local boundaries for companies with international operations).

### What investors want from integrated reporting, and why.

Investors want integration and standardisation of financial and ESG reporting as it will bring a rigour and consistent measurement of ESG performance as it relates to current financial results and future financial prospects. Integrated reporting by its very definition should make the links between ESG issues and business strategy clearer giving a fuller picture to investors.

Statutory financial reporting obligations mean that investors have access to audited financial data to compare performance and assess risks across companies. ESG information can be used to signal material risks too, and investors need a standardised reporting framework for ESG reporting in order to assess those risks. Standardised reporting could be achieved through a range of mechanisms, from legislation through to share market listing rules or voluntary industry codes. But without clear guidance for ESG reporting, companies are likely to continue to report information that is not directly useful for investors.

Investors would also like to see the relevance of ESG issues to the business and operations presented more clearly through integrated reporting. By communicating ESG performance against objectives in the context of traditional financial performance and even linking ESG performance to traditional

financial performance, we hope that companies will both better manage some of the longer term risks and opportunities for their business, and as a result protect and enhance long term financial performance.

It should be noted that when mainstream investors analyse the ESG performance of a company, they are not doing so to take a moral or ethical view on the company. They will not typically 'screen out' a company from the investment universe because of the ESG issues associated with their industry e.g. tobacco companies. Mainstream investors want to:

- Get insight into the risks for the company
- Understand how these risks are being managed, and
- Understand what growth opportunities the company may have.

By analysing ESG performance, investors will also gain insight into the efficiency of operations. Ideally investors would have access to reporting that disclosed:

- An articulation of the business strategy and the key strategic drivers, and how ESG issues could impact the company's ability to deliver on its strategy
- A description of the most relevant ESG issues for the company and the time frame of any potential impact
- The governance process in place for managing ESG issues (e.g. which ESG issues are managed by risk, strategy, the Board or operational management) alongside financial issues
- Information on whether, and how externalities are identified, measured and potential liabilities estimated (in the event that regulation were to internalise that cost in future)
- Relevant performance data to demonstrate the progress and success (or otherwise) of the approach e.g. energy use, safety performance. (This should include the data points that are the most meaningful for the company and ideally would be reported consistently year on year and across companies in the same sector to enable cross company comparisons. ESG performance data should ideally be verified and related back to strategic drivers and key risks and opportunities. Reference should be made to the best practice reporting standard e.g. the Global Reporting Initiative)
- A discussion around materiality and how ESG issues are being managed
- Quantification where possible of the relevant ESG metrics and potential financial impacts
- Forward looking discussion on how ESG issues are going to be managed and how these issues may impact the forward looking financial statements of the company
- Identified future ESG regulatory risks which could impact the balance sheet (e.g. through asset impairment)
- A simple concise summary of the key ESG issues without the marketing gloss.

In summary investors want access to data and information that would allow them to better understand the ESG and financial performance of a company and hence to make more informed investment decisions.

## **2. Corporate's Business Case for Integration**

### **Introduction**

The current approach to business reporting is focused on the financial performance of the entity with an emphasis on the stewardship of the shareholders' investment and compliance with a diverse and extensive range of regulatory requirements. This approach does not necessarily provide insights of the overall performance of a company in terms of the implementation of its strategy, management of its business risks and performance prospects. It does not explain the company's engagement with society including its governance and its impact on sustainability and social issues.

Progressive companies currently issue reports, such as an operating and financial review/ management discussion and analysis, that provide a comprehensive review of their activities (including both financial and non-financial aspects), performance and business model and/or prepare separate reports on sustainability and social impacts and issues. Such reporting is evolving but it is not general practice and nor is it standardised.

### **The objectives of integrated reporting**

From a business perspective the objective of integrated/comprehensive reporting needs to support the following:

- Better meet the information needs of shareholders and other users by providing them with more holistic/comprehensive information about the business strategy, business performance and future prospects to enhance their decision making about their investment and allocation of capital in a cost effective manner
- Better communication with a range of stakeholders about its business model and performance across the whole value chain of the company
- Potentially contribute towards investors/market adopting a longer term view of the performance, prospects and business model of a company
- Provide a framework and guidance whilst not inhibiting flexibility to adapt and experiment with forms of reporting to best communicate with shareholders etc.

The benefits of integrated reporting to a company need to be clearly demonstrated and articulated by its key mainstream stakeholders, not just specialised ESG bodies. For this to occur, investors/ markets need to show that "truth" in reporting does not lead to short term value erosion, particularly when the long term strategy and message is clear and well supported.

### **Challenges for integrated reporting**

From a Corporate perspective, integrated/comprehensive reporting presents the following risks:

- Ensuring that competitive advantages are not eroded and the need to avoid the disclosure of prejudicial and commercially sensitive information
- Avoiding information overload and the risk that the report will be too long and detailed and obscure reporting of key items and analysis
- Overbearing and inflexible regulation which impedes experimentation and evolutionary development of approaches to, and the content of, reporting and results in a further compliance exercise that imposes significant additional cost burdens
- Lack of acceptance by shareholders because benefits do not justify any additional costs involved.

## **What Corporates want from integrated reporting**

To be successful, an integrated reporting framework should:

- Report the strategy, performance in implementing the strategy, and insights into performance in such a way that key stakeholders can understand for the purpose of enhanced decision-making
- Seek to align internal and external reporting measures where possible (subject to competitive advantage risks outlined above) and report material and relevant information to meet specific stakeholder needs. It must avoid duplication and not report financial and non-financial measures just for compliance sake. Better alignment of internal and external reporting measures may lead to greater consistency of messaging to all stakeholders
- Reduce the complexity (and volume) in reporting, including financial reporting, by reducing the burden on a company's time and resources and not add to the cost burden of reporting
- Be mindful of changes in financial reporting requirements, not just focus on ESG reporting measures
- Focus on the key financial and non-financial performance indicators and drivers of corporate performance in accordance with strategy and the business model, and avoid overemphasis on items/issues that are not material, relevant and mainstream
- Initially be non-mandatory, not subject to formal regulation and focus on encouraging good practice.

### 3. Other Stakeholder's Business Case for Integration

#### Introduction

Sustainable, responsible business practice advocates that the real costs and obligations of business and organisational activity are accounted for - both financial and non-financial, and require a process of accountability, transparency and comparability through:

- Reflection on actual business impacts, risks and opportunities
- Integrated and inclusive management processes
- Integrated reporting on these practices in the public domain via a multi-stakeholder approach to management, measurement and monitoring, leading to
- Resilience through transparency, trust, adaptability and innovation. <sup>1</sup>

We believe:

- A new globally accepted integrated accounting framework would bring together financial, environmental, social and governance information in a clear, concise, consistent and comparable format.
- Business strategy needs to better link sustainability risks and opportunities with financial risks and opportunities in order to develop more comprehensive and comprehensible information to all stakeholders about an organisation's total performance, now and into the future. Short and long term sustainability strategy needs to underpin business decisions and actions.
- A globally accepted framework for integrated financial and non-financial reporting is necessary for the efficient and equitable use and development of resources both now and into the future.
- Current accounting frameworks over allocate attention towards short term financial performance, often ignoring crucial factors such as: innovation and the development of intellectual capital; formation of long term alliances and relationships; efficient use of rapidly depleting resources and waste minimisation; responsible development of people and removal of inequities and any human rights abuse in operations and supply chains. Factors, which when correctly understood and analysed, represent significant current and future opportunities and risks to communities, businesses, economies and societies.

#### Key business benefits and measures of success include:

- Greater access for all stakeholders to information that is clear, concise, consistent and comparable to assist in making short and long term decisions about interactions with a company
- Improved engagement of stakeholders by companies, specifically in decision making and communication feedback loops - the reporting process
- Improved transparency and accountability through the closer alignment between internal and external reporting by companies
- Transformative change - greater understanding and conviction by companies to embedding ESG into core business strategy
- Better allocation of shared resources, including human capital, financial capital and ecological capital; through the international adoption of a single reporting framework
- An agreed integrated reporting framework could help address businesses' lack of certainty on how to engage with the sustainable business practice agenda, and the confusion around initiatives of engagement and reporting (i.e. DJSI, CRI, FTSE4Good etc)
- An integrated reporting framework has the opportunity to assist the convergence of existing financial and non-financial reporting frameworks, into internationally recognised and comparable taxonomies (such as XBRL and semantic technologies) for a range of reporting

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<sup>1</sup> <http://thehub.ethics.org.au/what/>

purposes (e.g. for the investment community, annual reporting, employee and other stakeholder communication).

### **Up-front issues to be addressed**

- Ensure early and ongoing engagement of a diverse range of stakeholders including (but not limited to) non-government organisations, consumers, trade unions, government and citizens through an authentic approach to the stakeholder engagement process - a process that can be as valuable as the information output itself
- Meet the information needs of this diverse range of stakeholders by providing them with more transparent, comprehensive, accessible, timely, relevant and decision useful information on the total (financial and non-financial) performance of a company
- Enhance the scope of the content to reflect not only the assets of the company, but also the total sphere of influence of a company, including along supply chains and in assets of significant ownership
- Present both the positive and negative performance of a company in a balanced and decision useful manner
- Provide a meaningful balance between narrative and quantitative data
- Present material information that demonstrates a link between strategic financial and sustainability decisions
- Provide a framework that gives due regard to organisations both large and small, public and private that may be interested in integrated reporting
- Address the disconnect between current ESG reporting practices of business and the investment community assigning market value to non-financials
- Ensure global relevance through G20 and world trade and economic forums
- Acknowledge competing agendas and work to find common ground.

### **The risks of developing a standard international integrated reporting standard include:**

- Creating a ‘lowest common denominator’ framework that stalls innovation and becomes a ‘tick the box’ activity
- Lack of consideration for or involvement of stakeholders, other than the investor
- Losing material sustainability information due to fear of ‘publishing too much’
- “The accountants taking over the world” – a fear of many that integrated reporting will mean a reduced engagement of practitioners skilled in key areas of sustainability (such as human rights, climate change, water allocation etc.); leading to poorer reporting and reporting processes being used in key sustainability areas
- There is a temptation to bolt-on sustainability reporting to current financial reporting frameworks, which could simply preserve old economic and business models that are grounded in unsustainable practices. There is the need to reassess current systems, particularly with regard to the measurement and reward of economic growth in a world with finite resources, a growing population and stressed ecosystems
- In a rapidly changing world and business environment it will be critical to maintain an awareness of emergent issues. Rather than prescriptive, an integrated reporting framework will need to be predictive.

It is hoped that with the development of an internationally acceptable integrated reporting framework, responsible business practice will continue its journey into mainstream business practices. Through this companies will be able to incorporate broader interests from multiple stakeholders together with long-term decision-making with more forward looking disclosure that links environmental, social and governance issues into business strategy and risk management; that is, embedding ESG fundamentals into business operations

**For further information on the Society for Knowledge Economics – refer [www.ske.org.au](http://www.ske.org.au)**

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