

# Adoption of integrated reporting by the ASX 50

This report is part of a series of research projects carried out by ACCA Australia and New Zealand in collaboration with the Net Balance Foundation.

The series analyses disclosures on areas of non-financial performance by Australian Securities Exchange (ASX) companies.

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This report investigates the state of integrated reporting among Australia's 50 largest listed companies. It examines, on the basis of publicly available information, the extent to which companies have integrated non-financial matters into core business.

This report:

- provides an overview of integrated reporting and emerging reporting frameworks, guidelines and requirements
- analyses public reporting on financial and non-financial matters among ASX 50 companies
- identifies the aspects of business that companies within the ASX 50 need to evolve to adopt integrated reporting
- sets out a roadmap for Australia's listed companies to achieve integrated reporting
- identifies the challenges companies may face when moving towards a more integrated approach to business.

## Contents

Glossary	4
Foreword	5
Executive summary	7
1. Integrated reporting	10
2. Research methodology	13
3. Results	14
4. Roadmap to integrated reporting	22
5. Implementation challenges	24
6. Conclusions	26
References	27
About the authors	29

## Glossary

### ACKNOWLEDGEMENTS

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### Corporate social responsibility (CSR)

A commitment by business to contribute to sustainable economic development, working with employees, customers, suppliers, the local community and society at large to improve quality of life for all.

### Corporate social responsibility reporting

Organisations are increasingly disclosing their approach to non-financial (environmental, social and governance) matters via annual corporate social responsibility reports. These reports are also known as 'corporate responsibility', 'sustainability' and 'corporate citizenship' reports.

### Environmental, social and governance matters (ESG)

Also known as non-financial matters.

### Integrated reporting

The process of managing the material financial and non-financial aspects of business in a cohesive manner that acknowledges the interdependencies between them. An integrated organisation will have an integrated vision and strategy, an integrated approach to operations and performance, and will release integrated reports that disclose the financial and non-financial impacts of material risks.

### International Integrated Reporting Committee (IIRC)

The IIRC was formed in August 2010 to create a globally accepted integrated reporting framework. The IIRC was founded by the International Federation of Accountants, the Global Reporting Initiative, and the Prince's Accounting for Sustainability Project.

### Material (business) risks

These are risks that could have a material impact on a company's business. They can include but are not limited to: operational, environmental, sustainability, compliance, strategic, ethical conduct, reputation or brand, technological, product or service quality, human capital, financial reporting and market-related risks.

### Shareholder

One who owns shares of stock in a corporation, with which comes a right to declared dividends and the right to vote on certain company matters, including the board of directors.

### Stakeholder

A person with an interest or concern in an organisation.

### Sustainability

The Brundtland definition of sustainable development originates from the Brundtland Commission of the United Nations, led by the former Norwegian Prime Minister Gro Harlem Brundtland, in 1987. It defines sustainability as meeting the needs of the present generation without compromising the ability of future generations to meet their own needs.

### Sustainability reporting

See 'Corporate social responsibility reporting' above.

## Foreword

Interest in and excitement about integrated reporting – the reporting of information about material financial and non-financial (eg environmental, social and governance) performance and the relationship between the two – is growing around the world. The International Integrated Reporting Committee (IIRC) – whose members represent companies, investors, standard setters, regulators, the accounting profession, securities firms, academia and civil society through NGOs – is working to increase and harness knowledge and enthusiasm about integrated reporting. One important output of the IIRC is the recently released draft discussion paper on a framework for integrated reporting, *Towards Integrated Reporting: Communicating Value in the 21st Century* (2011). In the meantime, in January 2011 the Integrated Reporting Committee (IRC) of South Africa issued its *Framework for Integrated Reporting and the Integrated Report Discussion Paper* (2011) to support the fact that, as a result of the *King Code on Governance for South Africa*, (Institute of Directors Southern Africa 2009), integrated reporting (or an explanation for its absence) is required of all companies listed on the Johannesburg Stock Exchange.

We are clearly at the very early stages of developing frameworks and standards for integrated reporting that, if implemented by all companies all over the world, will make a substantial contribution to a more sustainable society. Yet even though no codified frameworks and standards exist, companies such as Rabobank and Novo Nordisk are already beginning to practice integrated reporting to varying degrees. This is a testimonial to both the power of this idea and the interest of executives in creating sustainable long-term strategies for their companies. In a short article I wrote with Michael P. Krzus (Eccles and Krzus 2011), I discussed the extent to which integrated reporting is already happening in 23 countries, including Australia, which ranks high in the group.

Thus, I am delighted to see that the Net Balance Foundation and ACCA have made a much more in-depth study of reporting practices in Australia through a thorough and careful analysis of the reporting practices of the largest 50 companies, by market capitalisation, in Australia. This study provides yet further evidence that integrated reporting is already being practised, albeit to varying degrees, by these important Australian companies.

The great strength of the research reported here is the recognition that integrated reporting is not simply a state (ie a company is either practising integrated reporting or it is not) but occurs to varying degrees across a number of dimensions and that it involves engagement (listening) as well as reporting (talking). By examining companies' reporting practices in a range of documents and their websites, this study provides tremendous insight on the level and range of integrated reporting in terms of (1) purpose, values and strategy, (2) management approach, (3) risk management, (4) measuring and managing performance, (stakeholder engagement), and (5) reporting format. The results are presented in concise charts accompanied by useful vignettes on leading practices.



**Robert G. Eccles**, Professor of Management Practice, Harvard Business School and author of *One Report*.

This study also confirms something I have found in my own research that, in my view, represents the frontier of integrated reporting and something that deserves the highest level of attention from executives, investors and academics: explicitly showing the relationship between financial and non-financial performance. 'No evidence was found that any company within the ASX 50 is yet linking financial and non-financial KPIs and only one company reported the financial impacts of ESG performance.' It is to be hoped that this study will be repeated in the future and the researchers will find evidence of this, providing knowledge that will be useful to companies all over the world.

Since integrated reporting occurs in degrees, it is also a journey of continuous improvement. In that spirit, at the end of the report are some useful practical guidelines about how companies can start to improve their integrated reporting practices over a three-year 'Roadmap to integrated reporting'. This makes the report especially useful to executives. But the report is one that anyone interested in and committed to spreading the adoption of integrated reporting will find worthwhile. Ideally, this report will inspire groups in other countries to do similar studies. The cumulative knowledge will benefit all of us and will contribute to the development of a more sustainable society.

**Robert G. Eccles,**

Professor of Management Practice, Harvard Business School  
and author of *One Report*.

## Executive summary

Recent corporate scandals have highlighted that a company's management of environmental, social and governance (ESG) issues can have significant impact on financial performance and thus shareholder value. Traditional forms of public reporting, which include both financial and non-financial reports, do not disclose this link and typically focus on short-term and retrospective performance. They do not provide sufficient information for shareholders and other stakeholders to make informed decisions about current and future company performance.

The concept of integrated reporting has arisen to address such deficiencies in current reporting regimes. The aim of integrated reporting is to acknowledge and seek to demonstrate how an organisation is managing material financial and non-financial risks and the interdependencies between them. It is forward-looking, focused on short-term and long-term strategies as well as recent performance, and identifies how resources and governance structure will be deployed to create value.

Notably, integrated reporting is much more than a public report to stakeholders and it is not merely a merger of financial and non-financial reports. For most organisations, adopting an integrated approach will involve a fundamental shift in their business model as they examine value creation through multiple dimensions.

### THE INTERNATIONAL INTEGRATED REPORTING COMMITTEE

The International Integrated Reporting Committee, comprising members from the corporate, investment, regulatory, securities, accounting, academic and standard-setting sectors as well as civil society, was formed to promote and develop a globally agreed integrated reporting framework.

The Committee's discussion paper, *Towards Integrated Reporting: Communicating Value in the 21<sup>st</sup> Century*, released on 12 September 2011, sets out the rationale for this new form of corporate reporting. Public response to this document, which is due 12 December 2011, along with a pilot program with more than 50 companies, will help shape the framework.

### INTEGRATION AMONG THE ASX 50

Net Balance Foundation, in collaboration with ACCA, assessed the public reporting of companies within the ASX 50<sup>1</sup> to identify the extent to which these Australian businesses have moved towards integration. The research examined six aspects of operations that would be affected should an organisation adopt an integrated approach.

A handful of companies appear to be performing very well, with 9 of the 50 scoring 70% and above. These companies are starting to recognise and communicate the importance of environmental, social and governance matters to their core business. Notably, however, 30 companies in the ASX 50 were assessed as having reporting that was less than 50% integrated. The poorest-performing company achieved a score of only 8%. Significant change is required before the majority of Australia's largest listed companies are ready to adopt integrated reporting.

### MISSION AND STRATEGY

Integrated reporting requires that the key documents that drive company activity acknowledge and reflect the interdependencies between non-financial and financial performance. Embedding non-financials within company values and corporate strategy provides a signal to staff at all levels and to the company's external stakeholders that these matters lie at the heart of company purpose and are thus to be reflected across operational strategies and policies, programmes and day-to-day operations.

The majority of companies (70%) have put policies in place to manage environmental, social and governance issues, suggesting recognition of the importance of these matters to business. Yet only a few (36%) have gone a step further and revised company purpose and value statements to reflect this.

1. As at 1 March 2011.

## MANAGEMENT APPROACH

By recognising that environmental, social and governance matters affect core business, integrated reporting necessitates that management responsibility throughout the company encompasses them.

Non-financials are an acknowledged board responsibility at 54% of the companies surveyed. Yet, it is not clear how this responsibility is apportioned throughout the company for 72% of firms. Incentives and training to instil staff accountability and ensure sufficient competency to manage these issues appear, in the main, to be lacking.

## RISK MANAGEMENT

Effective risk management procedures ensure that the company is responsive and proactive – that strategy and management address emerging issues that may inhibit or aid the realisation of company vision. An integrated approach therefore requires inclusion of non-financial risks on the company's central risk register with due consideration for their impact in terms of both financial loss and reputational damage.

Public disclosure of non-financial risks and associated management practices is not well practised by the majority of the ASX 50. Of those that do disclose, 71% appear to be integrating identification and management of non-financial risks into their central risk register. Companies are not yet, however, reporting that they are assessing the financial implications of these risks in a systematic manner.

## PERFORMANCE TRACKING

Company understanding of how strategy is being implemented and risks managed requires consistent and continuous reporting of key performance indicators (KPIs) and targets for the most material issues. To reflect the interdependencies between financial and non-financial matters, metrics for both must be aligned and quantified. For example, water management would be tracked through the volume of potable water used, recycled and treated, the volume and cost of water saved and the changes in utility costs over time.

Among all aspects researched, least evidence was found that ASX 50 companies are practising integration of performance management reporting. Only 36% reported KPIs for non-financial issues and no evidence was found that any company links financial and non-financial KPIs.

## STAKEHOLDER ENGAGEMENT

As companies move towards integrated reporting and adopt a longer-term view of performance, stakeholder engagement becomes an increasingly important business imperative. Developing a dialogue with key internal and external stakeholders can help to ensure that companies continue to focus on the most pertinent issues, identify opportunities for innovation and growth, and build public trust.

A handful of companies are clearly reporting stakeholder engagement practices. The top ten performing companies scored in excess of 85% for this criterion. Company disclosures on stakeholder engagement should not only detail consultation practices and issues raised, but close the engagement loop and state the firm's response to these issues. Only 18% of companies surveyed did this.

## THE FORMAT OF PUBLIC REPORTING

Although integrated reporting is promoted as the central reporting platform, its proponents do not intend that it should be all things to all people. To meet the diverse information needs of stakeholders, many companies will need to continue to report in a variety of formats and across a range of communication platforms. Stand-alone specialist reports, summary documents, micro-sites, interactive PDFs and investor presentations enable stakeholders to focus on the issues most material to them.

Eighty per cent of companies in the ASX 50 publicly report ESG performance using a variety of formats, including corporate social responsibility reports, websites, newsletters, and annual reports. This is predominantly through a sustainability report (58%), and for one-third through the annual report (36%). For this latter group, most (70%) report through a high-level overview of non-financial activity. Quantified strategy and performance data are lacking.



## CHALLENGES AHEAD

The research identified a number of challenges that Australia's listed companies will need to embrace if they are to become integrated companies.

Existing reporting procedures, knowledge management and data collection systems must expand to enable companies to articulate both the linkages between financial and non-financial performance and how they contribute to the value-creation process.

A new language for measuring and articulating corporate performance, making use of environmental and social accounting frameworks, is required.

The information needs of different stakeholder groups may necessitate the release of specialist reports to supplement the integrated report.

Financial thresholds are not a sufficient test when assessing risks to non-financial areas. A broader consideration of impacts and time frames is required, informed by transparent materiality determination and prioritisation processes.

Although standards for the assurance of financial and non-financial information currently differ, auditors of integrated reporting will need to assess all data in a consistent and cohesive manner.

Auditors of integrated reporting will need the right skills and to be versed in a broader range of performance fields to assess financial and non-financial information. Conversely, different auditors and different standards may be applied within a hybrid audit model to achieve the desired assurance outcomes.

With the exception of climate change risk, interest in non-financial matters among investors is low in Australia. Demonstrating to asset and fund managers that integrated reporting, with its holistic overview of company performance, will be of value in assessing other investments will be critical in stimulating uptake of this new form of reporting.

# 1. Integrated reporting

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The aim of an integrated report is to allow stakeholders to gain a complete understanding of a company, its strategy and performance, and of how it is dealing with and has addressed sustainability challenges.

SUSTAINABILITY SOUTH AFRICA

The purpose of integrated reporting is to demonstrate the impacts of the organisation's environmental, social and governance matters on its financial performance, and vice versa, and how this flows from strategy and internal management processes. It should illustrate the extent to which the financial, social and environmental management systems of the organisation are creating and sustaining value over the short, medium and long term. For example, the application of integrated reporting could see a company monitor the links between investment in customer service training for employees and the changes in customer and employee satisfaction and return business that result.

Integrated reporting:

- outlines the organisation's material social, environmental and economic risks and opportunities and how, from a forward-looking and holistic perspective, they have been integrated into core vision and strategy, over the short, medium and long term
- sets out both financial and non-financial key performance indicators (KPIs) for material risks and opportunities and demonstrates how performance against each is managed to deliver value in the short to long term
- identifies existing resources and details the executive team and governance structures to use those resources effectively and responsibly
- provides commentary on prospective performance as well as past performance
- improves the quality of information available to stakeholders to allow them to make informed judgements and actions.

By enabling investors to assess the relative sustainability of companies over an extended time frame, integrated reporting can assist in focusing the financial system on longer-term value creation.

It is important to note that an integrated report is not achieved by merely merging the annual or financial and sustainability reports. For most organisations adopting an integrated approach will involve a fundamental shift in their business model as they examine value creation through multiple dimensions.

Integrated reporting requires that organisations evolve their core mission and strategy to incorporate environmental, social and governance matters and correctly reflect their impacts on the company's financial performance, and vice versa (Jeyaretnam, T and Niblock-Siddle, K, 2010). The way companies do business and the goods and services they provide may be challenged. New opportunities, processes and markets may be explored.

## FRAMEWORKS TO GUIDE INTEGRATED REPORTING

In August 2010, the International Federation of Accountants, the Global Reporting Initiative (GRI), and the Prince of Wales' Accounting for Sustainability Project formed the International Integrated Reporting Committee (IIRC). The purpose of the Committee is to create a globally accepted integrated reporting framework. The discussion paper, released in September 2011, sets out the vision for integrated reporting and the emerging framework will be piloted with companies from around the world until late 2013.

While in Australia there are clear guidelines governing how and when companies disclose financial data, it is not mandatory for ASX-listed companies to report publicly about non-financial data such as environmental and social performance figures. In practice, the ASX Corporate Governance principles (ASX Corporate Governance Council 2010) do support disclosure on non-financial matters. The principles include the expectation that processes will be in place to safeguard the integrity of company reporting when presenting the company's financial and non-financial position (Principle 4), that companies establish policies for the oversight and management of material business risks and disclose a summary of those policies (Principle 7), and that they provide a timely and balanced picture of all material matters (Principle 5).

Globally, there is evidence of increasing requirements for listed companies to disclose non-financial matters, whether through integrated reports or other means.

A working group of ASX 200 companies has recently formed to discuss the value of introducing more formal requirements around disclosure of non-financial performance on an 'if not, why not?' basis. The Corporate Sustainability Reporting Coalition, which represents \$1.6 trillion in assets, announced in September 2011 a proposal call on United Nations' member states to develop a global policy framework that requires listed and large private companies to integrate sustainability information throughout their annual report and accounts – or explain why they are unable to do so.

South Africa is at the forefront of integrated reporting regulations. The Institute of Directors in South Africa formally delivered the *King Code of Governance Principles* and the *King Report on Governance (King III)* in Johannesburg in September 2009. King III came into effect in March 2010 and requires all listed companies to adopt integrated reporting on a 'comply or explain' basis. Disclosure should be formalised as part of the company's reporting processes. King III identifies the Global Reporting Initiative as the accepted international standard for non-financial reporting to complement existing financial reporting standards.

The Sustainable Stock Exchanges initiative, which is led and supported by investors, indicates the key role global stock exchanges can play in promoting transparent and sustainable financial markets.

Tables 1.1 and 1.2, below, set out some international requirements from both governments and stock exchanges for the disclosure of non-financial information alongside financial information.

**Table 1.1: International stock exchange requirements for reporting non-financial information**

Stock exchange	Reporting requirements
TMX Group; NYSE Euronext; BM & FBOVESPA; Bourse de Luxembourg	Developed sustainability indices. For example, NYSE Euronext has developed indices targeting the growth in listed cleantechs and tracks the companies whose employees are most represented in share ownership. The index enables investors, fund managers and issuers to assess market performances and compare cleantechs with those of other listed companies.
Johannesburg Stock Exchange	Mandatory and full disclosure of non-financial matters is required as part of listing rules.
Bursa Malaysia	Mandatory and full disclosure of non-financial matters is required as part of listing rules.  Companies must include in their annual reports a description of their CSR activities and practices or, if there are none, a statement to this effect.
Singapore Stock Exchange	Voluntary guidelines for sustainability performance reporting and disclosure of sustainability policies.
Shanghai Stock Exchange	Mandatory environmental reporting for companies from the 14 most energy-intensive industries before registering an IPO.

**Table 1.2: International government requirements for reporting non-financial information**

Country	Reporting requirements
France	Enacted a disclosure framework for sustainability reporting as part of the Nouvelles Regulations Economiques, which requires listed companies to disclose information related to corporate governance, social and community impacts, environmental management, and workplace practices.
United States	Introduced new corporate governance disclosure requirements under the <i>Sarbanes-Oxley Act 2002</i> , in response to corporate collapses such as Enron and WorldCom. This act requires companies to disclose annually whether they have adopted a code of conduct, and if they have not, why not. Listed US companies must also report on their environmental performance under Securities and Exchange Commission regulations.
Denmark	Expanded the requirements of the Danish Financial Statements Act from reporting on environment and intellectual capital, to include sustainability reporting in general.
Sweden	Issued guidelines for external reporting by state-owned companies. State-owned companies are required to put forward a sustainability report in accordance with the Global Reporting Initiative's guidelines. Sustainability reports need to be externally assured for quality.
European Commission	In 2006, the European Commission and the European business community formed a partnership to create the European Alliance for Corporate Social Responsibility (CSR). It aims to promote CSR and assist 'enterprises to integrate social and environmental considerations in their business operations'.

## 2. Research methodology

This report has been informed by an assessment of publicly available financial and non-financial performance data of the ASX 50. Annual reports, sustainability reports, shareholder briefings, websites and so forth were reviewed to identify the extent to which companies have disclosed whether non-financial matters are integrated into core business. Research was conducted between April and May 2011.

The focus on publicly available disclosures is appropriate for this research, as a key feature of integrated reporting is greater transparency and ease of access to information for stakeholders. Companies that are taking an integrated approach to operations but that have not communicated this to a broad range of stakeholders, will not have scored highly in this study. To date, companies have been reporting non-financial matters through a number of media, including annual reports, sustainability reports, ASX disclosures, websites and shareholder briefings, which are each typically aimed at a specific stakeholder group. An integrated approach to sustainability does not require that companies report information in only one place; rather, it brings all the reporting 'pieces' together to ensure that the message across all media is consistent. Integrated information should be available, for example, in the annual report, on the website and at the AGM and so forth. For this reason all publicly available information has been given equal weighting in this study.

The assessment of company performance was guided by criteria developed by the Net Balance Foundation that address six key aspects of operations that would be affected should an organisation adopt an integration agenda:

- mission and strategy
- management approach
- performance tracking
- risk management
- stakeholder engagement
- the format of public reporting.

In order to ensure the accuracy, quality and impartiality of the research a number of company analyses were checked by a second researcher.

**Table 2.1: ASX 50 companies**

1	AGL	26	Mirvac Group
2	Asciano	27	National Australia Bank
3	Amcor	28	Newcrest Mining
4	AMP	29	News Corporation
5	ANZ Banking Group	30	Oil Search
6	ASX	31	Orica Limited
7	AXA Asia	32	Origin Energy
8	BHP Billiton	33	Qantas Airways
9	Bluescope Steel	34	QBE Insurance Group
10	Brambles	35	Rio Tinto
11	Coca-Cola Amatil	36	Santos
12	CFS Retail Trust	37	Sonic Healthcare
13	Commonwealth Bank	38	Stockland
14	Computershare	39	Suncorp
15	Crown	40	Tabcorp Holdings
16	CSL Limited	41	Telstra Corporation
17	Fortescue Metal Group	42	Toll Holdings
18	Foster's Group	43	Transurban Group
19	GPT Group	44	Wesfarmers
20	Insurance Australia Group	45	West Trust
21	Incitec Pivot	46	Westfield Retail Trust
22	Leighton Holdings	47	Westpac Banking Group
23	Lend Lease Group	48	Woodside Petroleum
24	Macquarie Group	49	Woolworths
25	MAL Group	50	Worley Parsons

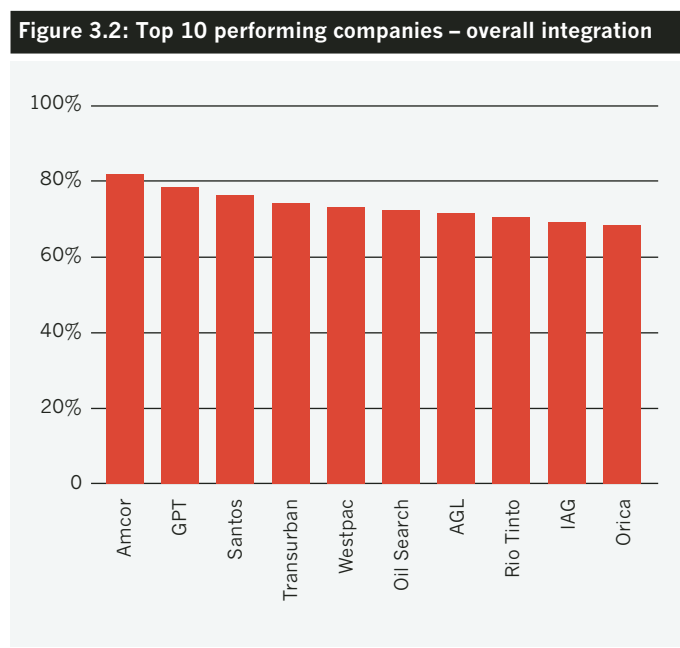
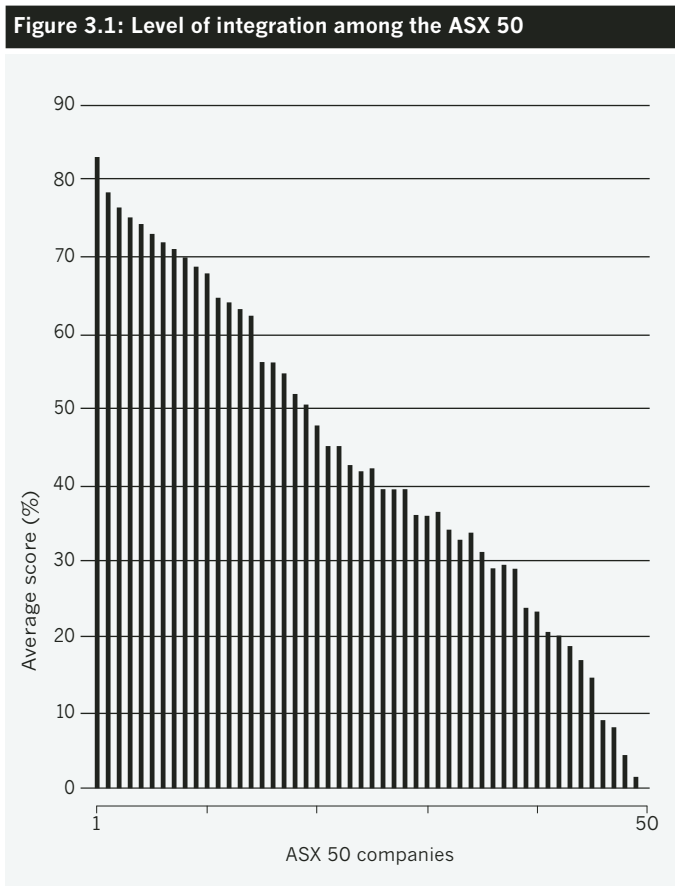
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### 3. Results

#### OVERVIEW

The assessment found a great degree of variability among the ASX 50 regarding the degree to which companies have started to adopt an integrated approach to business. As shown in Figure 3.1, companies range from those whose reporting is 83% integrated to those for whom non-financial matters are viewed as peripheral to their business.

Figure 3.2 shows the 10 companies judged as being the closest among the ASX 50 to integrated reporters. These 10 have made the greatest progress in integrating material non-financial concerns into their vision and strategy, management process and systems, core risk management frameworks, approach to performance tracking and their public reporting. They also demonstrate a relatively transparent and comprehensive approach to stakeholder management which, as detailed below, is an essential part of integrated reporting.

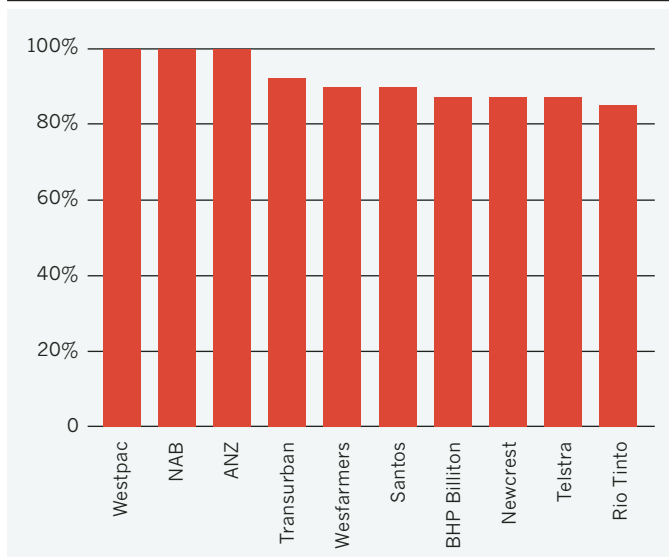


## PURPOSE, VALUES AND STRATEGY

Integrated reporting requires that the strategies that guide company activity acknowledge and reflect the interdependencies between ESG and financial performance. This may lead to a fundamental shift in the way organisations operate as the purpose of the company is re-cast and the broad range of stakeholders that provide inputs to, and are affected by, the firm are acknowledged. Embedding ESG within company values and corporate strategy provides a signal to staff at all levels that these non-financial concerns lie at the heart of company purpose and are thus to be reflected across operational strategies and policies, programmes and day-to-day operations.

The extent to which companies are making progress towards integrating ESG into core purpose and strategy varies among ASX 50 companies. Figure 3.3 shows the 10 companies with the highest scores, of which three achieved the highest possible score. The poorest performing company scored only 25% against this criterion.

**Figure 3.3: Top 10 performing companies – purpose, values and strategy**



The mission and value statements of 36% of surveyed companies acknowledge the interdependency between their financial and non-financial performance with predominantly a focus on staff, community and customers, but not yet the environment. Similarly, only 26% of the ASX 50 were found to have integrated ESG issues into core strategy.

Yet there is evidence that almost all companies are starting to recognise the importance of ESG issues to their core business. Companies surveyed have adopted policies for maintaining good governance (70% of companies surveyed), managing environmental performance (56%) and addressing their impacts on their staff and wider society (54%).

### Case study: Wesfarmers

The Wesfarmers values statement covers a number of aspects of its financial and non-financial performance.

*[The company] focus[es] on providing a satisfactory return to shareholders; looking after its employees and ensuring they have a safe environment in which to work; providing excellent products and services to its customers; looking after and caring for the environment; and making a contribution to the communities in which it operates. Wesfarmers (2010)*

Like many of its peers, Wesfarmers has developed specific sustainability principles to articulate how the company's values are translated into operations.

Notably, given that it is a large company operating in highly concentrated markets, Wesfarmers potentially has a significant influence on suppliers and the Australian community more broadly. It has developed an ethical sourcing policy to guide expenditure. It is not clear yet whether the organisation has extended this approach to other investment decisions. As the environmental risks faced by its business divisions are diverse, each has its own environment policy, which complements the Group Environment Policy.

## MANAGEMENT APPROACH

By recognising that ESG is core business, integrated reporting necessitates that management responsibility throughout the company encompasses material non-financial issues. This means that the full range of material non-financial matters must be a standing agenda item at meetings of the board and board committees.

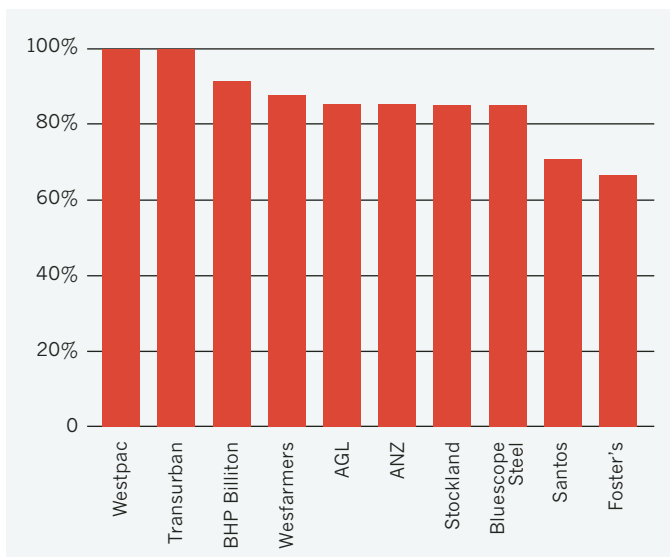
Embedding responsibility for ESG within existing functional responsibilities allows management of ESG to be deployed throughout the company. While select non-financial matters will remain a particular focus for specialist teams (eg the occupational health and safety (OH&S) team), the company's ESG performance should be a concern for all staff and across all business units. There is an opportunity for integrated organisations to be learning organisations.

Aligning performance appraisal and incentive structures to account for non-financial KPIs can help ensure that the board and staff are accountable for non-financial issues and thus serve to implement integration. Consistent communication from senior executives explaining how each staff member can contribute to and benefit from implementing the integrated agenda is also critical.

ESG matters are discussed at board level at 54% of surveyed companies. In practice, this is generally done by a board committee rather than the full board, suggesting that many companies' most senior decision makers need to intensify their focus on these matters. Similarly, there is an opportunity to increase staff focus on, and awareness of, ESG matters. ASX 50 companies provide limited public information on how board direction on ESG matters is implemented. Only 28% provide commentary on how their management structure supports a focus on ESG throughout the company.

Increasing the practice of linking remuneration to ESG KPIs and providing training on material non-financial matters could aid this. Only 13% of companies surveyed link executive pay to non-financial criteria. For other staff such linkage stands even lower, at 7%. The company education platform encompasses non-financial matters, beyond occupational health and safety training, in only 28% of ASX 50 companies.

**Figure 3.4: Top 10 performing companies – management approach**



### Case study: Woolworths

Woolworths has put in place a number of mechanisms to embed the management of non-financial matters across the company. The board oversees the company's approach to corporate responsibility and sustainability and receives updates on these matters on a monthly basis. A detailed presentation is provided to the board on a quarterly basis.

To drive implementation of the sustainability strategy, the company has established a Sustainability Executive Committee headed by the CEO and appointed sustainability champions from across its business divisions. These individuals monitor progress of the strategy against targets, work to ensure that the company is compliant with emerging legislation and public opinion, and identify the business processes required for adoption of sustainable practices.

Woolworths runs voluntary training on environmental sustainability, which assists staff to align their behaviour with the sustainability values of the company. Extending such training beyond those employees 'passionate' about sustainability and expanding it to address the full range of material non-financial matters would aid integration.

Recognising that profitability is linked to matters such as staff turnover rates, staff safety and food safety, short-term incentive payments for senior executives are linked to select non-financial KPIs.

Woolworths Limited (2010).



## RISK MANAGEMENT

Risk management procedures ensure the company is responsive and proactive – that strategy and management address emerging issues that may inhibit or aid realisation of the company vision. An integrated approach therefore requires inclusion of non-financial risks on the company’s central risk register.

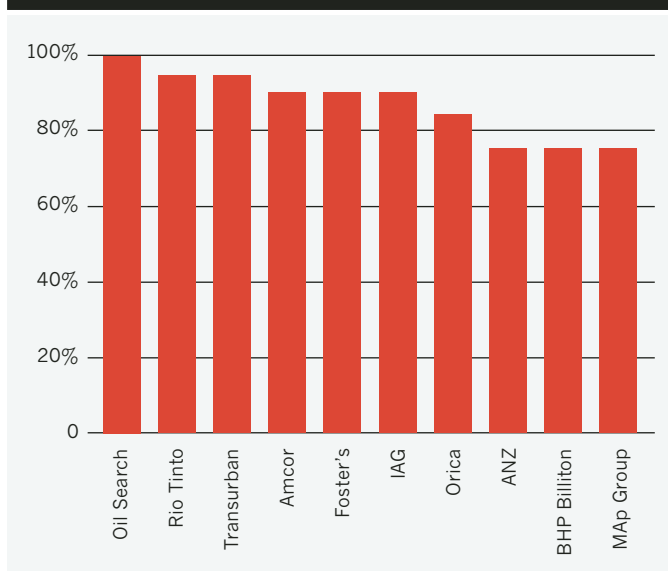
Formalising consideration of material non-financial issues in the company’s risk registers can help ensure they are addressed with the same vigour applied to ‘traditional’ risks, as can quantifying their impact both in terms of financial loss and reputational damage.

Defining ESG risks may not be as straightforward as it is in financial reporting, where impact on earnings is the determining factor. Regular analysis to identify and track the most strategic ESG matters is required. The materiality assessment should also inform how risks are escalated. This means that the most material issues should be represented on the organisation’s risk profile, regardless of assessed financial impact and associated thresholds.

Public disclosure of non-financial risks and associated management practices is not well practised by the majority of ASX 50 companies. Outside the top 10 shown in Figure 3.5, most companies scored well below 50% in this category.

Under half (42%) of the companies surveyed disclosed their non-financial risks. Positively, from the perspective of integrated reporting, 71% of these appear to identify and manage non-financial risks as part of their core risk management approach with an additional two companies reporting that they were moving to this integrated approach in the near future. Despite this, little evidence was found that companies in the ASX 50 currently assess the financial and reputational impacts of non-financial risks. Only 6% reported that they did.

Figure 3.5: Top 10 performing companies – risk management



### Case study: Amcor

The Amcor 2010 sustainability report (Amcor 2011a) includes commentary on the key risks the company faces and maps them according to both the degree and the nature of each risk (compliance, operations, strategic and financial).

Amcor draws on the results of internal engagement, issues raised by stakeholders, and international benchmarks to define and prioritise its ESG risks and opportunities, which are managed through its enterprise risk-management system.

Risk assessment informs strategic planning and the operating plan processes. These processes suggest the company has gone some way to integrating financial and non-financial risk management (Amcor 2011b).

## MEASURING AND MANAGING PERFORMANCE

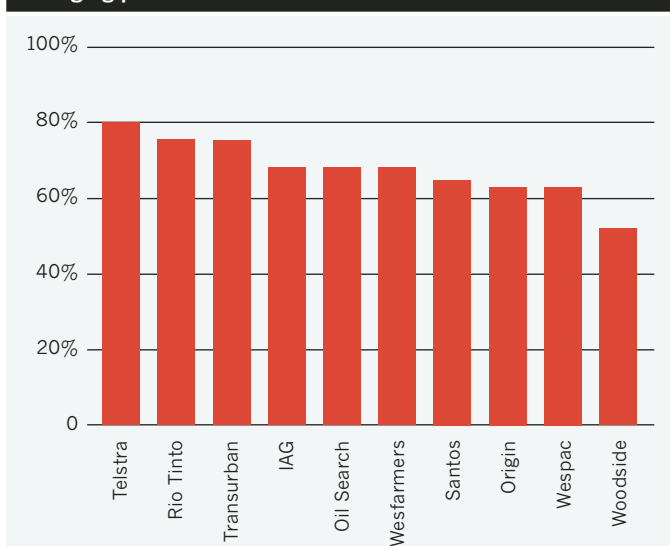
Company understanding of how strategy is being implemented and risks managed requires consistent and continuous reporting of KPIs and targets for the most material issues. To reflect the interdependencies between financial and non-financial matters, metrics for both must be aligned and quantified. To provide stakeholders with an adequate understanding of company performance, trends for the most material KPIs should be disclosed along with an explanation of why targets have been set, and whether these targets have or have not been achieved.

WICI (World Intellectual Capital/Assets Initiatives Network) is preparing a globally accepted suite of KPIs for non-financial reporting. While there are many KPI libraries currently available, WICI seeks to promote uniformity across different industries. The principles of consistency and comparability, well established in the realm of financial reporting, should also apply to ESG reporting. To support this, a number of global initiatives are being set up to leverage XBRL (eXtensible Business Reporting Language) technology to aid non-financial reporting. The company's ability to integrate financial and non-financial issues clearly depends on the extent to which reporting procedures, knowledge management and data collection systems enable the dual collection and consideration of both sets of data. This means expanding non-financial reporting

systems to facilitate collection of data on *all* material matters and aligning them with the company's financial collection systems (through inclusion on performance dashboards and so forth). On-demand sharing of standardised data 'up' and 'down' the management chain and across different divisions is required to support effective decision making.

Overall, ASX 50 companies scored poorly against this criterion, with an average score of 35%. Only 36% of companies surveyed set KPIs specifically to measure and manage material ESG issues, with most of these (89%) also reporting trends in performance. Around one-third set targets for these issues yet the focus for over half these companies is on outputs (eg developing a policy) rather than outcomes (eg reducing water consumption) and frequently targets do not relate to KPIs. Furthermore, benchmarking, which helps stakeholders understand the relative performance of a company against its peers, is only reported by 12% of companies. Typically this benchmarking relates to the company's approach and investment in the community or to its brand reputation. Regardless, stakeholders are not left with a clear and consistent picture of companies' performance or performance objectives. No evidence was found that any company within the ASX 50 is yet linking financial and non-financial KPIs and only one company reported the financial impacts of ESG performance.

**Figure 3.6: Top 10 performing companies – measuring and managing performance**



### Case study: Rio Tinto

Rio Tinto sets KPIs for injury rates, occupational illnesses, noise exposure, greenhouse gas emissions, use of fresh water, diversity and community contributions. Progress is measured against targets and trends in data are reported for the past four years. In order to advance its reporting, Rio Tinto should begin to demonstrate the interdependency between non-financial and financial performance.

Rio Tinto communicates non-financial performance through its sustainable development website and its annual report website (Rio Tinto 2011). Within the performance highlights section of the annual report, safety and greenhouse gas (GHG) emissions intensity are reported alongside financial highlights, demonstrating that non-financial targets are a core part of overall business performance. Goals and targets are presented in both reports with progress to date against established baselines (Rio Tinto 2010).

## STAKEHOLDER ENGAGEMENT

As companies move towards integrated reporting and adopt a longer-term view of performance, stakeholder engagement becomes an increasingly important business imperative.

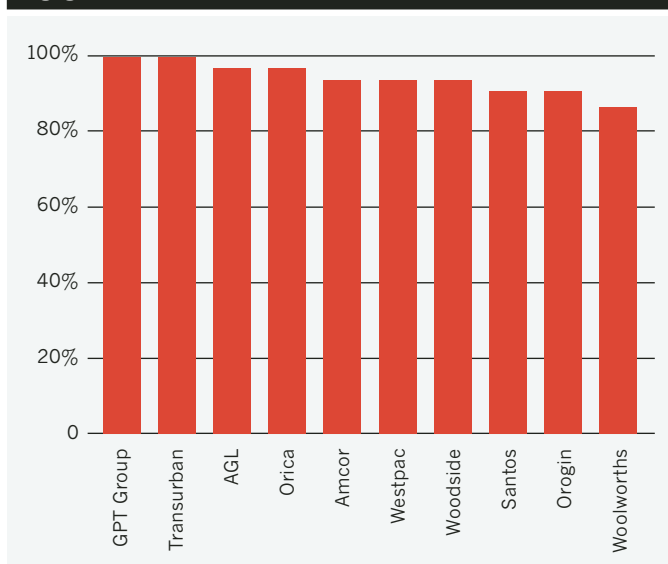
Developing a dialogue with a range of internal and external stakeholders can help ensure companies continue to focus on the most pertinent issues; identifying opportunities for innovation and growth and building public trust.

Companies that are doing this well report which stakeholders they engage. They explain why and how. They detail the outcomes (ie the company's response). This reporting format is recognition that transparency is the key to maintaining trust and delivering value over the longer term.

Extending engagement activities is not without its challenges. It may open the company up to greater scrutiny and involves an investment in time and resources. Moreover, many companies experience difficulty engaging stakeholders on a continuous basis and ensuring that stakeholders remain informed.

There is a great deal of variability among the ASX 50 with respect to how they manage and report stakeholder engagement. Scores allocated against this criterion range from 0 to 100%. Companies generally performed best at identifying stakeholders, with 52% of companies clearly identifying stakeholder groups such as customers, suppliers, community groups, employees, investors, regulatory authorities and government. Even so, the number of companies clearly outlining their stakeholder engagement process for each group and identifying the material issues dropped to 32% and 28% respectively. Even fewer (18%) fully disclosed the company's response to those issues and the outcomes, and 32 companies did not detail their response at all.

**Figure 3.7: Top 10 performing companies – stakeholder engagement**



### Case study: AGL

The AGL 2010 sustainability report includes a three-page table listing each of the company's key stakeholder groups. The report outlines why each group is a key stakeholder for the company. The key issues for each are outlined, as are the engagement activities the company undertook during the year. These include opening information centres, establishing websites for particular projects, and holding face-to-face meetings.

The company's response to stakeholder issues is not included within the table, but is scattered throughout the report. Listing how the company has responded to each stakeholder issue would improve transparency and clearly demonstrate that the company is addressing the needs of stakeholders effectively (AGL 2010).

## REPORTING FORMAT

There is, as yet, no common format for integrated reporting. Nonetheless, there is a broad consensus among commentators on the key components of the integrated report. An integrated report should, they suggest, be a succinct presentation of quantified performance data with supporting narrative that provides a rationale for performance and explains the company's understanding of its most material risks and opportunities and its strategy to address these (Integrated Reporting Committee (IRC) of South Africa, 2011; Accounting for Sustainability, 2010).

Notably, integrated reporting does not require disclosure of all material financial and non-financial data in a single report. To meet the diverse information needs of stakeholders, companies will need to continue to report in a variety of formats and across a range of communication platforms. Stand-alone specialist reports, summary documents, micro-sites, interactive PDFs and investor presentations enable stakeholders to focus on the issues most material to them (Jeyaretnam and Niblock-Siddle 2010).

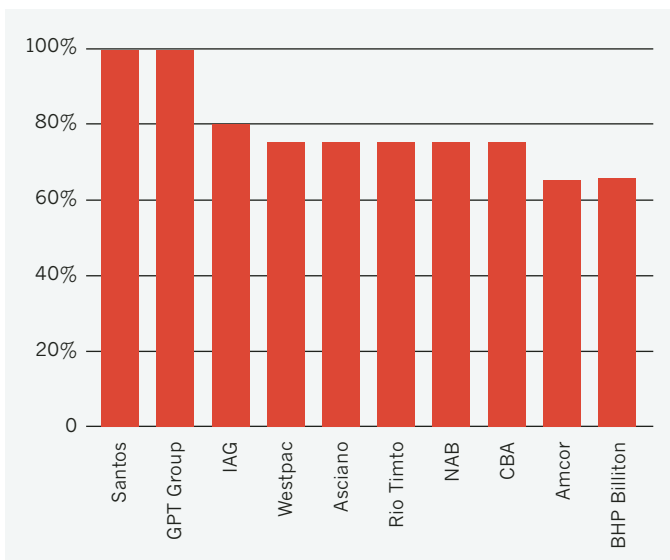
Micro-sites are becoming a particularly effective method of delivering performance data. The best sites not only summarise but build upon information contained in ESG reports, capitalising upon internet functionality and showcasing blogs, videos, interactive maps and 'build your own report' features (which allow stakeholders to download sections of the annual or sustainability report by key topic or chapter). Such functionality also facilitates a move from a single static report to continuous reporting (as currently occurs with financial reporting) thereby further facilitating integration and increasing transparency.

One drawback of multi-format and multi-platform reporting is that it is not always clear what information a company is disclosing nor where it can be found. A clear statement of a company's public reporting activity and frequent cross-referencing between static and online reports is required to assist stakeholders to negotiate integrated reporting. Ideally reports covering the same reporting period should be released at the same time.

Non-financial information was found to be communicated in a number of ways by each company, commonly through a sustainability or corporate citizenship report (58%), summary information in the annual report (36%), and documentation, other than the aforementioned reports, on the company website (42%). It appears that companies are confining reporting on non-financial matters to once a year. Only 12% of the ASX 50 were found to communicate to external stakeholders on ESG issues regularly through media such as newsletters, media releases and websites. Twenty per cent of companies in the ASX 50 reported no or very limited information on their management of non-financial matters for 2010.

Companies that do report on ESG performance in their annual reports often provide a high-level narrative of initiatives rather than quantified performance tables or strategies for managing ESG risks and opportunities. Information to enable stakeholders to evaluate the company's non-financial performance is limited.

**Figure 3.8: Top 10 performing companies – integrated reporting format**

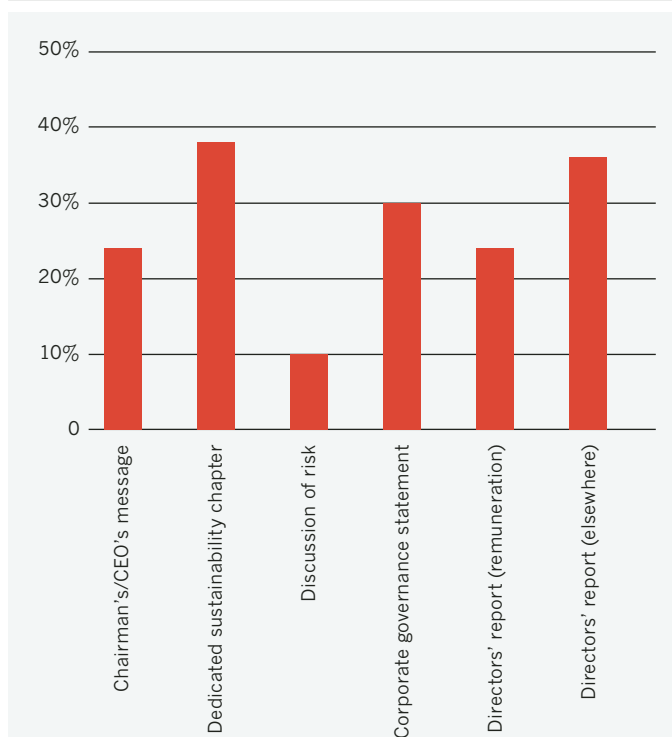


Commentary on ESG issues in annual reports is largely confined to discussion of environmental regulation and diversity, the latter in response to the ASX's corporate governance principles (ASX Corporate Governance Council 2010). The exceptions are the three companies that issue their annual report as a combined report detailing financial and non-financial performance.

Notably, ESG issues are mentioned in the chairman and/or chief executive officer messages of 24% of the annual reports reviewed. This perhaps signals that such companies have started to acknowledge the centrality of these matters to financial performance, a first step towards integrated reporting.

Thirty per cent of the ASX 50 provide briefings on non-financial performance to investors, either at a dedicated session or as part of the annual general meeting, signalling that they understand that such issues inform the flow of capital on financial markets.

**Figure 3.9: Location of non-financial information in annual reports**



**Case study: GPT Group**

GPT Group produced a 2010 annual review that includes financial summaries from the 2010 Annual Financial Report and the 2010 annual results announcement, together with non-financial information. Strategy and management approach disclosures can be found in the annual report, annual review and website, while risk management, performance and stakeholder engagement disclosures are located in the annual review and on the website.

GPT Group has followed the Global Reporting Initiative (GRI) guidelines, producing an A+ level report. An interactive GRI index can be found on the company website, containing links to where information on each indicator can be found. This allows readers ease of access to information material to them (GPT Group 2011).

## 4. Roadmap to integrated reporting

Integrated reporting necessitates a fundamental change in how business is conducted and so requires robust and long-term planning. The results of this study have shown that the ASX 50 companies investigated are at varying stages on the path to integration, eg some have gaps in their approach to strategy while others perform poorly in demonstrating integrated risk management. Overall, performance was found to be best in the areas of stakeholder engagement and purpose and strategy, which are both core steps in integrating sustainability. Within the

other four areas investigated, results in the 10 companies fell, with measuring and managing performance being the worst area.

The roadmap shown in Figure 4.1 is a guide for companies to help ensure sustainability is integrated into all areas of the business. As the results of this study show and as discussed by Massie (2010), companies are at different stages of integration and will take different steps to get there, depending on the areas in which they need to

Figure 4.1: Roadmap to integrated reporting



improve. Organisations will begin at different stages on this roadmap, some will take just a few of the points as guidance and some may wish to use this as their roadmap for their company's journey.

Companies with a strong recognition of the importance of sustainability to their business, and which currently disclose material ESG performance, are likely to start at the later stages. Those that have yet to issue public sustainability reports may focus on stages one and two.

The roadmap takes account of the integrated reporting best practice and challenges identified throughout this report. It is designed to assist companies to make the transition to integrated reporting in a smooth and timely manner. The roadmap can be used as a communications tool to explain to stakeholders, both internal and external, company performance management aspirations and why and how company management and reporting processes are changing.

### STAGE THREE

- Seek external and internal stakeholder feedback on the previous year's report and the reported KPIs and targets.
- Gain external feedback on KPIs from investors, communities, customers and employees through company website and other means.
- Improve stakeholder engagement through a higher level and greater number of disclosures.
- Review reporting against the revised GRI G4 Framework, *if available*.

### STAGE FOUR

- Seek feedback on the previous year's report.
- Engage stakeholders online through a facility that allows them to provide feedback, ask questions and discuss issues.
- Develop a roadmap to secure third-party assurance for the report.
- Issue a public integrated report and continue to release financial and non-financial performance data through-out the year.

## 5. Implementation challenges

Integrated reporting is an evolving reporting mechanism. Early adopters of integrated reporting will be required to experiment with systems, data collection and public disclosures and identify how the interconnections between financial and non-financial performance are best understood and communicated. Indeed, the fact that the IIRC's pilot is scheduled to run for almost three years indicates that there are a number of lessons to be learnt along the way. South African listed companies under the King III reform are endeavouring to report in an integrated fashion and some other global companies, including BASF, Novo Nordisk and Vancity, are rapidly moving in this direction. They provide some insight into how integrated reporting might work across different sectors and economies.

The fact that the exact format of the end product is unknown should not be taken as a sign for companies to continue reporting only to agreed standards. The risks and business opportunities posed by climate change, water shortages, population change, poverty, the changing needs of the workforce and so forth will continue as the IIRC firms up the integrated reporting framework. The best performing companies are those that recognise changing market demands and take the lead in addressing them.

This research indicates that as they commence integrated reporting, companies will face a number of challenges. These are outlined below.

### UNDERSTANDING AND ARTICULATING LINKAGES

Integrated reporting requires a detailed understanding of the complexity of the organisational value-creation process, including the relationships between financial and non-financial performance. A company's ability to articulate such linkages will depend on the extent to which its reporting procedures, knowledge management and data collection systems enable consideration of the relevant data. This will require expanding non-financial reporting systems to facilitate collection of data on all material matters and aligning them with or incorporating them into the company's financial data collection systems.

### QUANTIFYING PERFORMANCE

The metrics required for quantifying ESG performance and demonstrating the linkages to financial performance are very different from traditional corporate performance measures. Integrated reporting will involve the development of a new language for measuring and articulating corporate performance, including an increasing use of environmental and social accounting frameworks. For example, in this new language the value of ecosystem services may be incorporated and expressed. This is likely to drive the uptake of initiatives such as The Economics of Ecosystems and Biodiversity (TEEB) project that calls for companies to provide increasing disclosures on issues such as biodiversity impacts.

### MAINTAINING RELEVANCE TO STAKEHOLDERS

A key objective of integrated reporting is to provide an organisation's stakeholders with the information needed to make informed decisions. It is critical therefore to ensure that integrated reporting is relevant to each stakeholder group. This will require report content and stakeholder communications to be focused on those issues of greatest materiality. For many companies it may necessitate the release of specialist reports to meet stakeholders' needs and regulatory requirements.

### INTEGRATED RISK MANAGEMENT

Effective risk management ensures that a company is proactive in anticipating and managing its emerging risks and opportunities. Defining, prioritising and managing ESG risks is not as straightforward as conventional risk management. Determining risk through application of financial thresholds is not sufficient. It requires a broader consideration of impacts and time frames, informed by transparent materiality-determination and prioritisation processes.

















