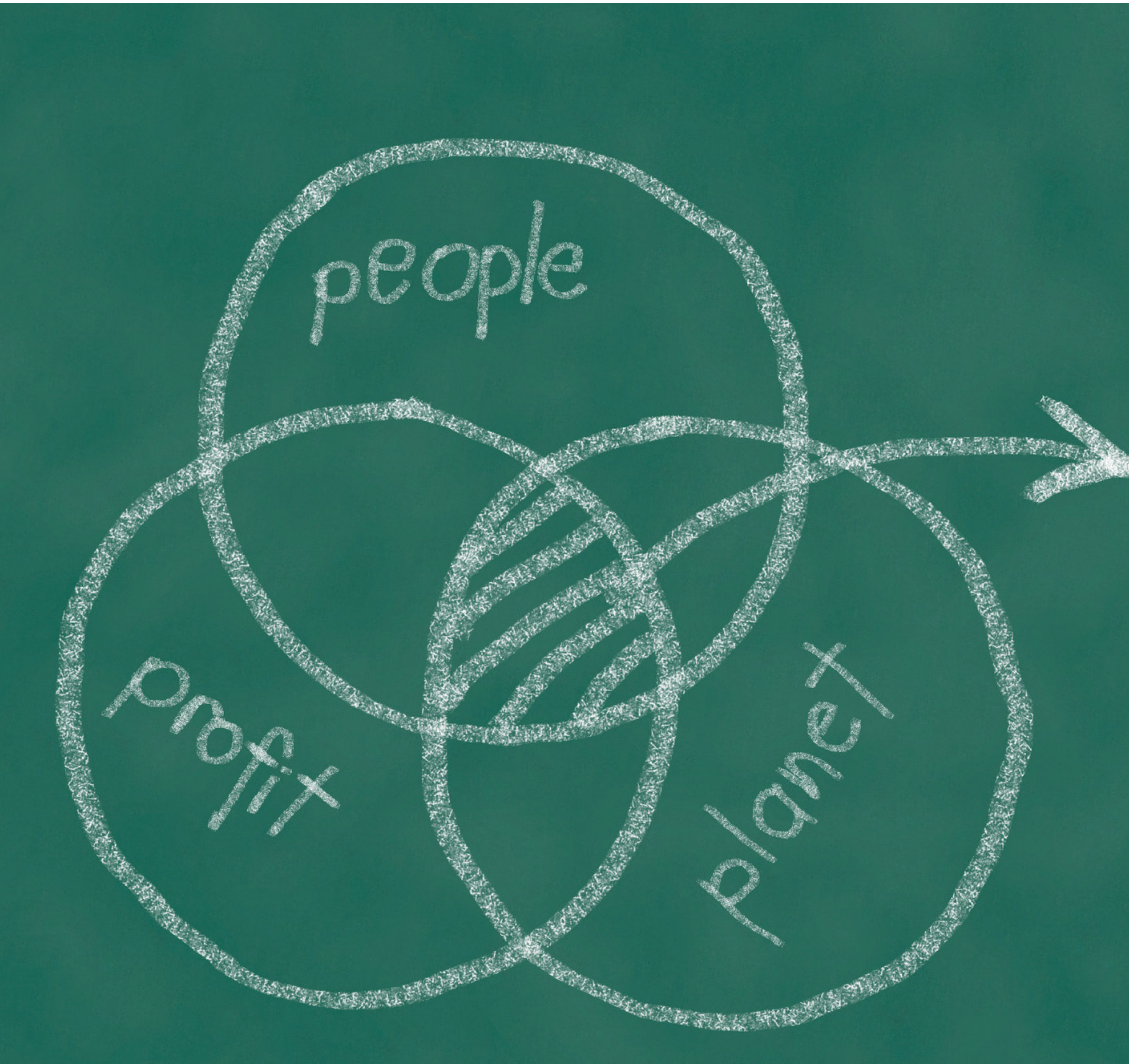
THE CONFERENCE BOARD

INTEGRATED REPORTING WORKING GROUP

The Emergence of Integrated Reporting



The Emergence of Integrated Reporting

A Report of The Conference Board Integrated Reporting Working Group

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Executive Summary

The dynamics of how business value is created are changing, moving from a system based largely on tangible assets to one that favors intangible ones. Over the last 30 years, intangibles have moved from 20 percent to over 80 percent of the value of public companies, yet decision making within companies has not consistently kept pace. Financial reporting has also not fully addressed these changes. Eighty percent of institutional investors recently surveyed said they support the concept of integrated reporting (see page 25).

As US public companies and large institutional investors take sustainability and environmental, social, and governance (ESG) impacts ever more seriously, investors are urging management and the board to adopt a reporting method that accounts for both types of assets. "Integrated reporting" is such a method: it provides a framework of six types of "capital" (financial, manufactured, intellectual, human, social and relationship, and natural) that allows for a more comprehensive understanding of the factors that affect value creation. For instance, human capital—people's competencies, capabilities, experience, and motivation to innovate—is often the most significant asset an organization has as business models become centered on people and technology.

The critical elements of integrated reporting typically address the company's business model, materiality of issues that affect value creation, and stakeholder engagement. While integrated reporting is often thought of as a framework for external reporting, its greatest benefit may be its ability to foster "integrated thinking," enabling a better understanding within companies of the factors that materially affect their ability to create value over time.

Recent research by Sustainable Investment Institute (Si2) into the current state of integrated reporting at S&P 500 companies shows that while there has been some uptick in this area, reporting is still nascent for public companies as they try to address the confusion about the differences among sustainability, ESG, and integrated reporting.

What is integrated reporting?

Our working definition: "Enhancing corporate reporting to more comprehensively explain how the company creates value in the short, medium, and long term through the eyes of management." Our definition and the report itself address only information voluntarily disclosed by US public companies that is not otherwise required by the SEC. European countries already require such reporting. In 2017, the Non-Financial Reporting Directive came into effect in all EU member states. All 28 member states have since adapted the NFR Directive into national law.

Should ESG and integrated reporting become mainstream forms of US corporate communication in the coming years, investors and other stakeholders will need to trust that the information is accurate and reliable. Engaging an experienced and certified third party to report on management's claims can provide assurance that the information is of high quality and can be trusted.

All working group participants recognized the increased investor appetite for enhanced corporate reporting; perhaps more importantly, all participants emphasized the desirability of aligning on a market solution before a regulated approach is brought to bear.

Recommendations

The Conference Board Integrated Reporting Working Group recommends preparers of US public company integrated reports address the needs of users as they make investment and risk management decisions as follows:

Secure commitment from the board and management To ensure that appropriate governance and other processes are in place to generate an integrated report, the board and senior management must commit to both the financial and human capital investment necessary to produce such a report. They need to be convinced of the benefits the company would derive from a more comprehensive articulation of the value of business intangibles, which is what integrated reporting is trying to accomplish.

Adopt a framework and standards specific to your company Determine the reporting framework that is appropriate given your company's industry and business. You can then more effectively identify the recognized standards and measures needed to support the reporting framework as well as internal and external reporting: it may be a hybrid approach using parts of different frameworks, as well as one that has metrics tailored to the company that do not appear in existing external frameworks. No matter what, the framework should take into account financial materiality, and the report should be written in plain language.

Start with "bifurcated" and off-cycle reporting of financial and nonfinancial matters Separating the cycles of required financial reporting from other nonfinancial disclosure is a pragmatic start toward meeting investor expectations that would satisfy some company concerns regarding the administrative burden of such reporting.

Rethink how your company tells its story As you prepare to write an integrated report, start by determining and prioritizing the report's audiences: institutional investors and smaller shareholders; the company's employees, customers, suppliers, and communities within the company's orbit; the company's board (which sets policies that govern ESG, sustainability, corporate culture, and reputation), and the CEO and management team.

Include the critical elements of an integrated report Create a visual representation of your business model (how the company creates value). Address the materiality of the issues that can affect value creation, such as shareholder value, and the stakeholder engagement that helps the company understand its needs and interests related to nonfinancial matters which may be deemed material for purposes of the SEC's 2010 interpretative guidance regarding climate change matters. Keep the report concise, so it provides information with context that doesn't overburden readers.

Consider competitive and legal considerations Neither competitive nor legal obstacles to disclosure have historically been a bar to companies reporting on matters beyond those that are required. On the contrary, companies generally disclose a considerable amount of information beyond what is legally required, driven by considerations of responsiveness to investors and other stakeholders and the importance to companies of effectively telling their "story." Apply similar considerations for integrated reporting topics.

Debunk the myths regarding integrated reporting Set aside the myths and concentrate on legitimate challenges to producing an integrated report, such as legal risk, administrative burdens, and the lack of market consensus around the framework for integrated reporting. Myths include: (1) there is a lack of investor interest in integrated reporting; (2) investors have certain expectations regarding the form of an integrated report; and (3) the current level of reporting is sufficient.

Why an Integrated Reporting Working Group?

Interest in and adoption of integrated reporting regarding an organization's business model and strategy for value creation both in the short and long term has grown rapidly in recent years. While there are many different interpretations of what "integrated reporting" means, there is some consensus on what could be considered as a working definition: "Enhancing corporate reporting to more comprehensively explain how the company creates value in the short, medium, and long term through the eyes of management."

However, integrated reporting is still voluntary, and market practices in preparing "integrated reports" are still evolving. It is important to note the differences between integrated reporting, sustainability reporting and environmental, social, and governance (ESG) reporting. The latter have existing reporting frameworks and standards (e.g., Sustainability Accounting Standards Board, Global Reporting Initiative) which are not equally relevant to all companies. Addressing the combination of integrated, ESG, and sustainability reporting is a challenge for corporations.

For the purpose of this report, the working group acknowledges that there is not a generally accepted definition of sustainability. It is an evolving area where there is not much consistency. With that said, The Conference Board has historically defined sustainability as internal organizational practices that pursue the "E" and "S" in ESG. Those practices range from gas emission reduction protocols to waste management and from supply-chain policies to health and safety protocols. In practice, however, many corporate sustainability reports include a wide array of topics beyond environmental and social issues.

Members of The Conference Board ESG (formerly Governance) Center saw an opportunity for corporate stakeholders to share their knowledge and experience of volitional sustainability disclosure outside the "four corners" of SEC filings. In collaboration with PwC, a working group was convened to discuss the current and desired state of integrated reporting by:

- Exploring trends in (financial and nonfinancial) corporate reporting, examples of innovative reporting, emerging standards, and stakeholder expectations;
- Understanding the legal, accounting, and other regulatory or market challenges that integrated reporting efforts face;
- Assessing key challenges companies are facing in meeting any identified trends;
- Discussing potential ways integrated reporting can continue to evolve to meet changing company and stakeholder needs;
- Discussing the current state of external assurance and sustainability data verification; and
- Building consensus on, and bringing clarity to, integrated reporting in a way that is understandable to internal corporate stakeholders and that addresses the growing expectations of institutional investors and other external stakeholders.

Rationale for Integrated Reporting

In Brief

- How value is calculated is changing, and it would be helpful for reporting norms to change accordingly
- Intangible items now dominate a company's asset value
- As business models become more people and tech centered, human capital will become increasingly valuable
- Integrated reporting provides a six-capital framework (financial, manufactured, intellectual, human, social and relationship, and natural) that allows for a more complete understanding of factors that affect value creation
- Integrated reporting is a tool for internal decision making (often referred to as integrated thinking) as well as externally communicating the effects of those decisions

At the heart of integrated reporting is an integrated model, which demonstrates how six types of capital represent the resources organizations use to create value.

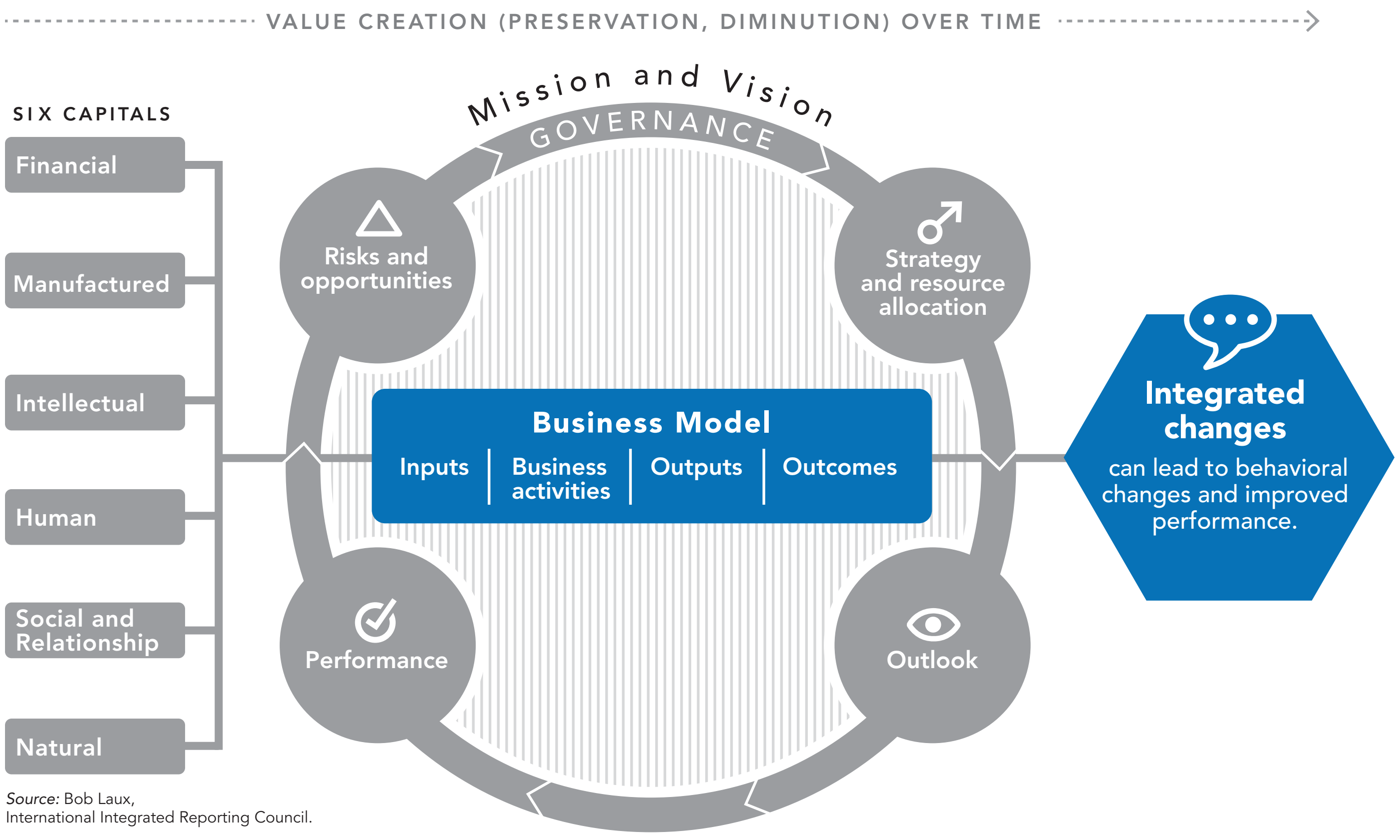
Table 1: **How six types of capital are used to create company value**

Types of Capital	Description	Value created
Financial	Money needed to seed and maintain a business	Dividends and earnings
Manufactured	Material goods and infrastructure owned, leased, or controlled by an organization that contribute to production or service provision (i.e., tools, technology, machines)	Reduced manual labor costs, increased productivity and efficiency
Intellectual	Organizational, knowledge-based intangibles, including intellectual property, tacit knowledge, systems, procedures, brand, and reputation	Market innovation, ability to stand out from competitors
Human	People's competencies, capabilities, experience, and motivation to innovate	Focus on human creativity, whether in process improvement, design and manufacture of products, or development of new or improved services
Social and relationship	Relationships with employees, communities, and other stakeholders	Values and behaviors, and the trust and loyalty an organization develops, builds, and protects with all stakeholders
Natural	Natural resources or environmental assets (such as soil, water, atmosphere, ecosystems) that provide a flow of useful goods or services, now and in the future	Resources for manufacturing as well as opportunities to protect and sustain earth's resources

While integrated reporting is often thought of as a framework for external reporting, its greatest benefit may be its internal impact. It fosters "integrated thinking," enabling a better understanding within companies of the factors that materially affect their ability to create value over time, especially if the process of integrated reporting is extended to and operates at the management and board levels. It can lead to behavioral changes and improvement in performance throughout an organization.

The Integrated Reporting Process

The primary purpose of an integrated report is to explain to stakeholders how an organization creates value over time. Each of the six capitals contributes to the company's current and potential value.



Source: Bob Laux, International Integrated Reporting Council.

Changes in How Value Is Calculated

Historically, US businesses and investors have calculated value by focusing predominantly on financial and manufactured capital or resources. This focus is pragmatic: companies' information systems are set up to comply with guidance from the Financial Accounting Standards Board (FASB) and with US Securities and Exchange Commission financial reporting rules and oversight.

Beginning late in the twentieth century, attention expanded to the environmental and social impacts of business, spurring the emergence of sustainability reporting. In addition, the rise of new business models and technology has led to the increasing need to understand the value of intangibles, in which human and intellectual capital are critical to business strategy and success. "Human capital" is defined as people's competencies, capabilities, experience, and motivation to innovate. "Intellectual capital" is organizational, knowledge-based intangibles, including intellectual property, tacit knowledge, systems, procedures, brand, and reputation.

Over the last 30 years, intangibles have increased to become a large majority of the value of public companies.[1] Such intangibles as intellectual property assets, e.g. patents, trademarks, copyrights, have grown to 84 percent of S&P 500 companies' market value in 2015. While investors still find financial performance disclosure important, they increasingly believe that a holistic view of the way a company creates and sustains value is also crucial for insight. Investors want to understand not only a company's immediate financial performance, but also the strategy of the business, the key resources, the assets (tangible and intangible) to which it has access, and how it intends to maintain access to these resources and maintain or improve its assets while appropriately controlling its liabilities. Companies are beginning to rethink their approach to managing and reporting on their intangible assets, many aspects of which don't show up on the balance sheet.

Human capital and its importance to other capitals

For many companies, human capital is the most important aspect of the ability to create value. However, traditional thinking has often seen human capital as merely one of the largest expenses on an income statement. To the contrary, companies that fully engage their workforce deliver enhanced results, not just financially but in improved customer relationships, higher innovation, fewer safety issues, and many other dimensions. It is often the most significant asset an organization has as business models become centered on people, intellectual capital, and technology. Moreover, recently, there have been downside risk discussions around human capital as it pertains to poor behavior by both management and line employees (e.g., harassment and toxic cultures). Such situations can become a reputational and financial risk for the company.

How an organization uses or affects human capital is a key part of its strategy and business model. Human capital is vital for all forms of innovation, whether in process improvement, the design and manufacture of products, or the development of new or improved services. The way people within an organization think or act differentiates one entity from another. Human capital is influenced by an organization's recruitment

1 Intangible Asset Market Value Study, Ocean Tomo, 2017.

policies and how it attracts new talent; the way it develops people's skills and capabilities (including desired ethical standards); the way it aligns behaviors with strategic goals, motivates its employees, and rewards performance; and the way it evaluates its potential human capital resources and requirements.

SEC Chairman **Jay Clayton** clearly recognizes the significance of human capital, as reflected in his remarks to the SEC Investor Advisory Committee:[2]

> Today, human capital and intellectual property often represent an essential resource and driver of performance for many companies. This is a shift from human capital being viewed, at least from an income statement perspective, as a cost. I believe our disclosure rules and guidance, and our issuers, should focus on the material information that a reasonable investor needs to make informed investment and voting decisions.
>
> Each industry, and even each company within a specific industry, has its own human capital circumstances. For example, I would expect that the material human capital information for a manufacturing company will be different from that of a biotech startup, and different from that of a large healthcare provider…
>
> Instead, I think investors would be better served by understanding the lens through which each company looks at their human capital. Does management focus on the rate of turnover, the percentage of their workforce with advanced degrees or relevant experience, the ease or difficulty of filling open positions, or some other factors?

Consistent with Clayton's comments, integrated reporting helps organizations both think internally and report to investors and other stakeholders about their strategy and plans in the context of the business impact resulting from their management of various capitals, including human capital.

Natural and social capital

Environmental and social matters have an impact on value creation. Investors, as well as those within companies, look to understand relative performance in the relevant environmental and social areas to understand how opportunity and risk are managed, and to determine how environmental and social components help companies drive critical success factors like growth, innovation, and talent retention. Companies with risk management practices that take into consideration broader industry, regulatory, and societal risks may be better prepared to drive greater shareholder value. Investors are increasingly looking to environmental and social matters to understand companies' strategies, and to support decisions ranging from portfolio construction to voting. They view environmental and social matters as important to understanding the full risk profile of a company and how prepared it is for the future.

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2 Chairman Jay Clayton, "Remarks for Telephone Call with SEC Investor Advisory Committee Members," US Securities and Exchange Commission, February 6, 2019.

Importance of a Longer-Term Focus

Short-term thinking in boardrooms, executive suites, and financial markets can impede companies from making the kinds of bold investments and implementing the future-focused strategies that sustainable growth and a vibrant economy require. The causes are many, including structural systems developed over decades focused on immediate performance. At the same time, companies and many investors desire longer-term perspectives on strategic planning. A broader view of performance can help companies demonstrate their unique culture, long-term thinking, and other highly relevant but intangible elements that collectively contribute toward long-term value creation.

Findings from McKinsey Global Institute research show that companies identified in the research as having a longer-term focus outperform their shorter-term peers on a range of key economic and financial metrics. From 2001-2014, the revenue of long-term firms cumulatively grew on average 47 percent more than the revenue of other firms, and with less volatility. Cumulatively, the earnings of long-term firms also grew 36 percent more on average over this period than those of other firms, and their economic profit grew by 81 percent more on average.[3]

The importance of a longer-term focus is echoed in the SEC's Strategic Plan for Fiscal Years 2018–2022.[4] Goal 1 of that plan is "Focus on the long-term interests of our Main Street investors." As indicated in the plan, "Today, significant numbers of Americans are nearing retirement age and living longer in retirement. This has put increased importance on the investment products that retirees rely on for stable income." The plan goes on to indicate: "Most importantly, as our markets change, we should deploy our resources in the way that most benefits the long-term interests of our Main Street investors."

Integrated Thinking

Today's organizations operate in a complex world, characterized by a multitude of internal and external drivers, the expectations of a variety of demanding stakeholders, and interdependencies and trade-offs that influence the process of decision making. Company management, overseen by the board of directors, is increasingly expected to navigate through these challenges by implementing a comprehensive approach to planning, measurement, and reporting.

As defined in a 2017 Chartered Institute of Management Accountants (CIMA) report, the term "integrated thinking" refers to "the conditions and processes that are conducive to an inclusive process of decision making, management and reporting, based on the connectivity and interdependencies between a range of factors that affect an organization's ability to create value over time."[5] Integrated thinking requires a clear, consistently held vision throughout the organization of what drives value. It involves boards of directors, senior management, and other employees proactively considering a broad range of capital beyond just financial and manufactured.

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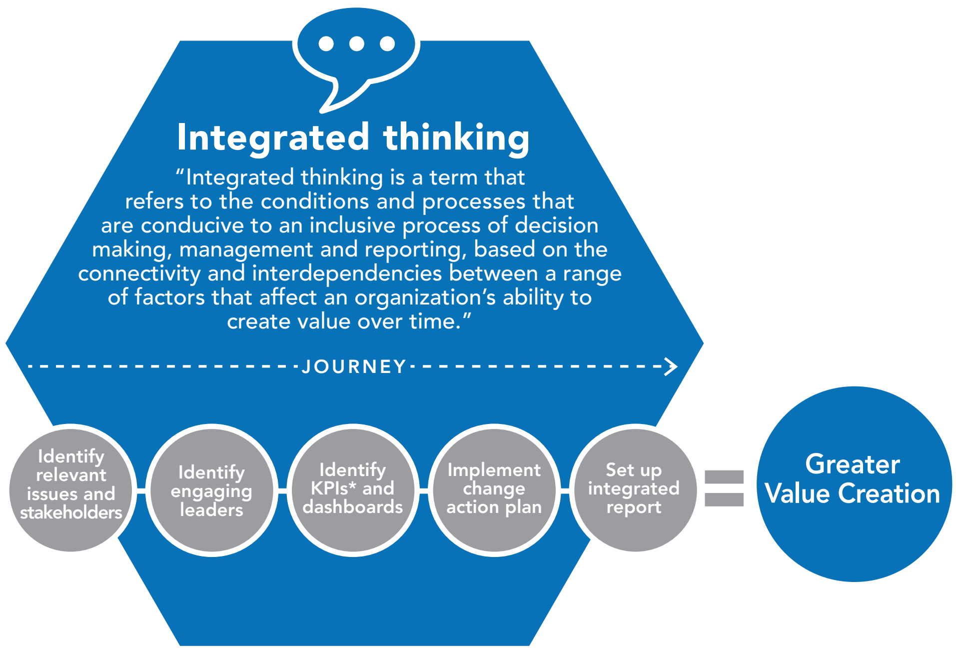
3 Dominic Barton, James Manyika, Timothy Koller, Robert Palter, Jonathan Godsall, and Joshua Zoffer, "Measuring the Economic Impact of Short-Termism," Discussion Paper, McKinsey Global Institute, February 2017.

4 SEC Strategic Plan Fiscal Years 2018-2022.

5 Cristiano Busco, Fabrizio Granà, and Paolo Quattrone, "Integrated Thinking," CIMA Global Academic Research Program, *CIMA Research Executive Summary* 13, no. 3, July 2017.

The added value of an integrated approach can only be realized with sufficient connectivity, achieved by breaking down internal silos and increasing the shared understanding of how value is created, which supports improved decision making, more focused reporting, and enhanced communication with stakeholders. Achieving integrated thinking is not easy; it involves understanding the connections among the various capital, both tangible and intangible, and different approaches to creating value through changes to business models. It requires an understanding of a variety of opportunities and risks, which in turn defines and connects the capitals used to create value. This level of integration depends on connecting people, functions, information, and systems.



* Key performance indicators, see pg. 27.

Sources: Busco et al., "Integrated Thinking,"CIMA, 2017; The Conference Board, 2019.

Integrated thinking should result in increased organizational alignment toward strategic goals and value creation in the context of the changing business environment, and thus greater confidence in making value-creating decisions based on relevant quality information and analysis, and robust and connected internal processes. The more that integrated thinking is embedded into an organization's activities, the more naturally information will flow into management reporting, analysis, and decision making. It also leads to better integration of the information systems that support internal and external reporting and communication.

On the journey toward integrated reporting, some will start with integrated thinking, and others will initially focus their efforts on the reporting alone. There is no one right way. For many organizations, innovating throughout the reporting process will provide clarity on specific steps that can be built into business practices. Integrated reporting helps businesses better understand the resources they need and focus on the proper inputs to create value. In other words, integrated reporting enables more integrated thinking, just as integrated thinking is the basis for integrated reporting.

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Critical Elements of Integrated Reporting

In Brief

- There is no one way to create an integrated report
- However, the most effective integrated reports generally address the company's business model, materiality of issues that affect value creation, and stakeholder engagement
- Recent Si2 research on integrated reporting by S&P 500 companies shows an uptick, but the practice is still nascent for most public companies

There is no one recipe to create an integrated report, but there are several features that contribute to a good integrated report. The critical elements of an integrated report address the company's business model, materiality of issues that affect value creation, and stakeholder engagement. In this section, we will look at some examples of how companies are applying the elements of integrated reporting in practice, and describe the current state of integrated reporting by S&P 500 companies.

Best Practices[6]

A business model in its simplest form is a road map for how the organization intends to create value. In the context of integrated reporting, a good visual representation of a business model allows organizations to provide the background and context to sustainability issues, and more specifically describe how they create, deliver, and capture value. The representation will typically include a description of the flow of capitals through various value creation components: inputs, business activities, outputs, and outcomes.

Materiality is about a well-defined process that identifies and focuses on issues that can affect value creation. A clear articulation of material issues will allow a company to demonstrate that it's aware of the most important issues in relation to value creation.

Stakeholder engagement represents the nature of the relationship an organization has with its stakeholders. Listening and being responsive to the most important needs and interests of key stakeholders is one of the core aspects of effective integrated thinking and reporting. Good practice entails providing a detailed overview of the process, including how stakeholders are identified, how they are engaged, how the relative importance of various issues is assessed, and how a company responds to stakeholder needs.

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6 "Leading Practices," Integrated Reporting.

EXAMPLE FROM PRACTICE

Royal DSM **How We Create Value**

Royal DSM, a global purpose-led, science-based company in nutrition, health, and sustainable living based in the Netherlands, includes a very clear and simple map of its business model in its integrated report.

The company's business model describes the flow of capitals through various stages and includes a supporting narrative for each of the six capitals, outlining how Royal DSM draws upon, manages, and creates value. The company also describes the organization and operating model and draws out its commitment to creating value and positive impact. The model also highlights the impact and demonstrates the contribution made to various UN Sustainable Development Goals.

* United Nations, Sustainable Development Goals

Source: Royal DSM Integrated Annual Report 2018, pp.32-33.

Solvay **Our Sustainable Value Creation Model**

Solvay, a Belgium-based advanced materials and specialty chemicals company, has summarized its value creation model using a simple graphic under four headings: (1) resources we use, (2) how we create value, (3) how we win, and (4) value we create. Each of these can be clicked to get further information and allows readers to consume information in a manageable format. Solvay has provided a short accompanying narrative that describes the areas that are most important in terms of sustainability and value creation and includes information on the financial contribution of these product areas. The company also points to its proprietary "sustainable portfolio management" tool—a framework that Solvay uses to guide strategic resource allocation and portfolio choices—as a way to integrate sustainability into decision-making processes. Integration is important to long-term sustainable value, and Solvay has referred to it in its business model overview.

1 Excluding the Polyamide business

2 Rate of accidents with medical treatment, with or without work stoppage 3 Recommended to the Shareholders meeting on May 14, 2

Source: Solvay 2018 Annual Integrated Report, pp. 27-28.

The Crown Estate **Performance**

The Crown Estate is an independent commercial business that manages property in the United Kingdom on behalf of the Queen. It articulates its performance against the defined targets in a clear and concise manner. The targets include both financial and nonfinancial metrics. The information is easy to read and connects the business model, strategy, performance, and future priorities concisely.

How did we perform this year?

2017/18 Target

5% annualised growth in net revenue profit on three-year rolling basis

A 6.0% p.a.*

Three-year rolling growth in net revenue profit on an annualised basis

*Excludes discontinued operations

Growth in annualised net revenue profit on a three-year rolling basis

2017/18	**6.0%***
2016/17	7.0%
2015/16	6.6%

Outperform our bespoke total return benchmark on an annualised three-year rolling basis

A 12% p.a.

Compared to our bespoke total return benchmark of 9.0%

Relative outperformance on three-year rolling annualised basis (percentage points)

2017/18	**2.8**
2016/17	2.5
2015/16	2.7

2017/18 Target

Outperformance of UK national benchmark for employee engagement (77%*)

*Willis Towers Watson

A 88%

Consider The Crown Estate to be a 'great place to work'

Annual employee engagement survey (2016/17: 84%)

2017/18 Target

Outperform the Institute of Customer Service benchmark of 78.1%

M 78.0%

Customer satisfaction rating

2017/18 Target

Improve carbon emissions intensity by 40% against 2012/13 baseline for property under direct control by 2022

O 10.8%△

Improvement in carbon emissions intensity on 2016/17 bringing us to a 22% improvement against the baseline

10% improvement in Incident Severity Score on 2016/17

A 12%

Improvement in the Health and Safety Incident Severity Score, representing a 2%△ outperformance of the target

Priorities for 2018/19

- Continue to meet our revenue target
- Outperformance of our bespoke total return benchmark
- Develop our vision for the portfolios and progress key asset management initiatives
- Deliver developments in our Regional portfolio and progress the development pipeline in Central London

- Outperform the UK national benchmark
- Continue our focus on learning and developing talent
- Invest in new skills and expertise, particularly around digital, placemaking and customer experience
- Realise the full potential of our new flexible, modern HQ

- Outperformance of Institute of Customer Service benchmark
- Deliver an evolving customer experience strategy that reflects the ongoing transformation of our business and the changing needs of our customers
- Embed customer experience across the business and establish stronger partnerships with customers and partners

- Improve carbon emissions intensity against 2012/13 benchmark for property under our direct control
- 10% year-on-year improvement in Incident Severity Score based on two-year average (moving to a three-year rolling average from 2018/19)

Source: The Crown Estate 2018 Integrated Annual Report, pp. 10-13.

EXAMPLE FROM PRACTICE

Eskom **Materiality Matters**

Eskom, a South African electric power company, clearly communicates its materiality determination process. It defines material issues as those that may influence decision making or affect its ability to create value in the short, medium, or long term. It considers a long list of topics that are collated through discussions with various stakeholders. Issues are ranked as being of high, medium, or low materiality depending on their impact on strategy and value creation, their level of concern for stakeholders, and the degree to which the company can control and influence the issue. Issues deemed to be material are included in the integrated report, which indicates whether each issue's impact on value creation is positive or negative and the time frame of the impact.

The following have been identified as material matters in this report.

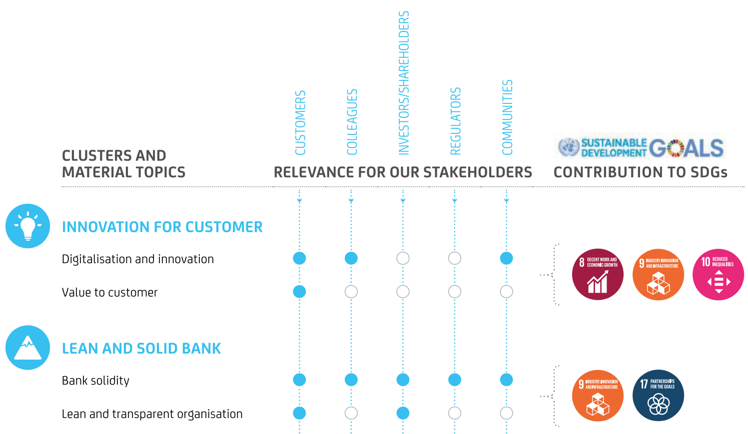
	Material matter	Associated strategic risk	Current impact on value creation	Time frame of impact
HC SRC	Poor governance and leadership instability, coupled with possible corruption and the prior year audit qualification on irregular expenditure	Breakdown in relations with recognised organised labour Further deterioration of Eskom's reputation, caused by acts of unethical behaviour by Eskom leadership and senior management, which will impact Eskom on multiple levels	Negative	Short to medium term
FC	Liquidity and funding, including credit ratings downgrades	Eskom saturating its borrowing capacity, coupled with credit ratings downgrades	Both positive and negative	Short, medium and long term
FC MC NC	Lack of policy and regulatory certainty, including the electricity price path and treatment of RCAs, as well as the long-delayed revised IRP	Market rules and long-term industry structure are unclear, coupled with the impact of revised IRP (or no) allocations, which may impact or alter our energy mix and flexibility	Negative	Short, medium and long term
FC	Financial sustainability and going concern, considering revenue adequacy and cost containment efforts	Declining levels of long-term profitability due to declining sales or limited ability to implement the growth strategy, inadequate price increases and unsuccessful cost containment initiatives	Negative	Short, medium and long term
FC	Declining or stagnant sales (utility death spiral), and pursuing opportunities for growth	Reduced demand for Eskom's electricity, coupled with increasing competition for end users, leading to revenue shortfall Declining levels of long-term profitability due to declining sales or limited ability to implement the growth strategy, inadequate price increases and unsuccessful cost containment initiatives	Negative	Short, medium and long term
FC SRC	Escalating municipal and Soweto arrear debt	Unreliable supply or increasing municipal debt driving away customers looking for reliable alternatives, thereby decreasing sales	Negative	Short to medium term
MC SRC	Ensuring security of supply through satisfactory plant performance, which would reduce the possibility of load shedding	Reduced demand for Eskom's electricity, coupled with increasing competition for end users, leading to revenue shortfall Unreliable supply or increasing municipal debt driving away customers looking for reliable alternatives, thereby decreasing sales	Positive	Medium to long term
MC NC	Coal and water security to ensure continued availability of power stations	Unreliable supply or increasing municipal debt driving away customers looking for reliable alternatives, thereby decreasing sales	Positive or negative	Short, medium and long term
MC NC	Environmental performance and compliance, including emissions and greenhouse gas reporting	Inability to meet climate change mitigation targets impacting our licence to operate Failure to implement climate change adaptation measures, which could affect plant performance	Positive or negative	Short, medium and long term
MC NC	Climate change, including energy mix and complying with carbon budgets	Inability to meet climate change mitigation targets impacting our licence to operate Failure to implement climate change adaptation measures, which could affect plant performance	Positive or negative	Medium to long term
MC HC	Ensuring adequate skills to execute our strategy and ensure optimal business performance, while transforming the workforce	Breakdown in relations with recognised organised labour Lack of adequate, available and affordable skills	Positive	Medium to long term

Source: Eskom 2018 Integrated Report, pp. 37-39.

EXAMPLE FROM PRACTICE

UniCredit **Stakeholder Engagement**

UniCredit, an Italian financial services company, has a thorough approach to engaging stakeholders. The guidelines adopted for the preparation of the stakeholder engagement information included in its integrated report are the GRI Sustainability Reporting Standards. It explains which issues are important to which stakeholder and describes how it engages with different stakeholder groups, the issues that stakeholders care about, and how it responds to their needs. It also cross-references the material issues to the UN Sustainable Development Goals.



Dialogue tools with Stakeholders

	Channels:	Key facts
CUSTOMERS	Customer satisfaction assessment Brand reputation assessment Mystery shopping Instant feedback Focus group, workshops, seminars	More than 300,000 clients and prospects interviewed for our **customer satisfaction surveys**
COLLEAGUES	People Survey of professional engagement Internal clients' perceptions of headquarters services Group Intranet Portal Departmental online communities	More than 80,000 colleagues answered to the ***People Survey***[A]
INVESTORS/ SHAREHOLDERS	Qtrly webcasts and conference calls to present results One-on-one and group meetings, calls Shareholders' meeting	More than 500 meetings and 27 roadshow days with **institutional**, **retail** and **socially responsible investors**
REGULATORS	One-on-one and group meetings, calls	Proactive engagement and contribution to the debate on the **regulatory framework**
COMMUNITIES	Surveys Social Media	Around 27,000 clients requests managed via **social media**

A. *People Survey* is a listening initiative carried out by UniCredit since 2003. Since *People Survey* is not carried out annually, data refers to the edition of 2017. Refer to the 2017 Integrated Report for more information.

Source: UniCredit 2018 Integrated Report, pp. 24-27.

ANOTHER BEST PRACTICE EXAMPLE

Intel publishes a full sustainability report, a summary document that integrates sustainability and financial information and includes a robust related discussion in its Form 10-K. Intel's 2017 sustainability report said that it followed IIRC's recommendations for the "Our Business" section of the report, discussing in detail how management incorporates sustainability into its business strategy and value creation framework. In addition, Intel's 2017 Form 10-K contained a section on "Corporate Responsibility and Sustainability" under a "Fundamentals of Our Business" heading, discussing its environmental responsibility, supply chain responsibility, diversity and inclusion, and social impact. The same discussion was in Intel's 2018 proxy statement, which noted the entire board is responsible for overseeing corporate responsibility, sustainability, and corporate governance matters, with particular oversight by the board's Corporate Governance and Nominating Committee.

Length of Integrated Report

A key characteristic of a good integrated report is that it provides sufficient context and useful information in a way readers are not burdened with less relevant information.

Average length of report	151 pages (2017:149)[7]
Longest report	297 pages
Shortest report	56 pages

Current State of Integrated Reporting by S&P 500 Companies

While integrated reporting is still nascent for many public companies, recent research by the Sustainable Investments Institute (Si2) shows there has been some progress in this area.

Below are highlights of Si2's The State of Sustainability and Integrated Reporting 2018, which assessed integrated reporting by S&P 500 companies as of mid-2018 and compared and contrasted the rare instances of integrated reports with the much more common practice of sustainability reporting.[8] The assessment also examined the extent to which companies incorporate voluntary information on sustainability in their SEC filings.

7 EY's Excellence in Integrated Reporting Awards 2018.

8 The study covered the S&P 500 as of May 2018—a total of 506 companies—and their 2017 annual revenue figures. The index at that point included a total of 505 companies; the study further separated out Dow and DuPont because each still had separate sustainability reporting practices—bringing the total number to 506. Information was sourced from company websites between June and August 2018.

While 78 percent of the companies that comprise the index issued formal sustainability reports with performance metrics in 2018, just 14—under 3 percent—issued an integrated report. This is double the number from 2013, when Si2 conducted an initial assessment for the IRRC Institute. Of those 14 companies, half offered their integrated report as their annual report, three published their integrated report in addition to their annual report, and the remaining four allowed their integrated report to serve as a sustainability report (those companies did not produce a separate annual report and only issued a 10-K filing with the SEC).

Aside from the specific findings about integrated reporters, the analysis found a notable share of companies are including sustainability information in their financial filings (annual reports, Forms 10-K, and proxy statements), indicating elementary but growing acceptance that sustainability information is material to investors. It can be required in SEC filings (e.g., required disclosure of climate change implications).

Key findings from Si2's 2018 report include:

Seven sectors out of 11 were in the group of integrated reporters. Health Care led, with four firms; Utilities and Industrials were next, with three each.

Seven (half) of the integrated reports obtained some form of external assurance for sustainability data; two of these reported they obtained "full" external assurance for their sustainability information, a much higher rate (14 percent) than sustainability reporters overall (3 percent). Five additional integrated reporters obtained "partial" external assurance (35 percent).

Some 38 percent of sustainability reporters in general indicated they obtained external assurance; 90 percent of this assurance was partial, mostly for greenhouse gas emissions. While 3 percent of reporters declared their reports "fully" assured, significant ambiguity exists about what this means.

Integrated reporters noted varying degrees of influence from existing sustainability reporting models. Most cited was the GRI, with 12 companies mentioning it; seven companies referenced CDP, and three provided an information index for the UN Sustainable Development Goals. References to integrated reporting frameworks were limited; four cited the Sustainability Accounting Standards Board and three cited IIRC; just two—Pfizer and Praxair—cited both SASB and IIRC.

A much higher percentage of integrated reporters (71 percent or 10 companies) had a board committee overseeing sustainability issues than did general sustainability reporters (51 percent or 201 companies of the S&P 500).

Eleven (79 percent) of the integrated reports addressed the concept of "creating shared value for all," the central tenet of IIRC. They addressed the increasing expectations of investors and other stakeholders about corporate ESG data disclosure. Most of the integrated reporters (11) said in some way that companies should create value for all stakeholders. (See Table 2)

The size of a company, measured in revenue, did not seem to affect decisions about integrated reporting. The reporters' 2017 revenues ranged from almost $4.0 billion (**Dentsply Sirona**) to $120.5 billion (**General Electric**) and averaged about $30.0 billion.

Exposure to international markets also did not seem to influence integrated reporting decisions. Si2 explored the hypothesis that increased preferences for integrated reporting in some international markets would prompt greater uptake by US firms with more international business. Four of the 14 companies with integrated reports did not derive any revenue from abroad in 2017, and another earned just 3 percent of its revenue internationally; the average percentage of international revenue for the group was about 31 percent. Available data suggest that just having a presence in international markets does not seem to significantly affect a company's decision to issue an integrated report.

Table 2 **Summary of Key Characteristics - Integrated Reporters of the S&P 500, 2018**

Company	*GICS Sector*	*2017 Revenue ($mil)*	*Intl. Income*[1]	*2013 IR?*	*Reporting Models Cited*	*External Assurance**	*SI in 10-K or AR*[2]	*SI in Proxy Statement*[3]	*Board Comm. on SI*[4]
General Electric	Industrials	$120,468	53%		GRI		10-K	Yes	Yes
Intel	Information Technology	$ 62,761	83%		GRI, IIRC & CDP	Partial	10-K	Yes	Yes
Pfizer	Health Care	$ 52,546	50%	Yes	GRI, SASB, IIRC & SDGs		AR		Yes
Allstate	Financials	$ 38,524	3%		GRI, SASB & SDGs		AR	Yes	
Medtronic	Health Care	$ 29,710	40%		GRI, SASB & CDP			Yes	
Eli Lilly & Co	Health Care	$ 22,871	44%		CDP & UNGC	Partial			
Southwest Airlines	Industrials	$ 21,171	0%	Yes	GRI & CDP		10-K		Yes
American Electric Power	Utilities	$ 15,425	0%	Yes	GRI, CDP & EEI			Partial	Yes
Ingersoll-Rand	Industrials	$ 14,198	35%	Yes	GRI	Yes	AR		Yes
Praxair	Materials	$ 11,437	47%		GRI, SASB, IIRC, SDGs, CDP	Partial		Yes	Yes
Entergy	Utilities	$ 11,074	0%		GRI & EEI	Partial	10-K	Yes	Yes
Clorox	Consumer Staples	$ 5,973	17%	Yes	GRI & UNGC	Yes	10-K	Yes	Yes
NiSource	Utilities	$ 4,875	0%		GRI & EEI	Partial	10-K		Yes
Dentsply Sirona	Health Care	$ 3,993	65%		CDP		10-K		

1 Share of 2017 revenues derived from markets outside the U.S. or North America, whichever figure was available.

2 Voluntary sustainability information (SI) included in Forms 10-K or annual reports (AR).

3 Voluntary sustainability information included in the proxy statement, outside executive compensation and board governance.

4 Formal governance of sustainability issues through a board committee.

* "Partial" credit for this indicator is because a company had a board committee dedicated to an issue too narrow in scope to deserve a full credit, such as a committee with oversight on "patient safety" at a pharmaceutical company.

Quotes on Shared Value Creation from Integrated Reporters

"Linking our strategy and business opportunities to important global trends creates long-term value for our people, customers and the world. Whether the challenge is climate change, urbanization or natural resources constraints, our expertise enables us to reduce energy demand and improve efficiency."

— **Ingersoll Rand**
(Page 8, *2017 Sustainability Supplement*)

"At Dentsply Sirona, we believe that being a responsible corporate citizen creates value for all of our stakeholders, including our shareholders. For the first time, we have decided to integrate our financial and sustainability reporting to increase awareness and transparency about our corporate social responsibility platform."

— **Dentsply Sirona**
(Chairman's letter, *2017 Annual Report & Corporate Social Responsibility Platform*)

"To continue creating prosperity, businesses must take on a bigger role in society. Let's be clear, a business needs to make an acceptable profit since this is a measure of how effectively it uses society's resources. Yet more is expected and needed from business. Eighty-seven percent of young Americans believe that businesses need to do more than make a profit. Companies also need to be held accountable for creating jobs, making sure free markets work and improving our communities."

— **Allstate**
(Chairman's Letter, *2017 Prosperity Report*)

"Our commitment to corporate responsibility and sustainability—built on a strong foundation of transparency, governance, and ethics—creates value for Intel and our stockholders by helping us mitigate risks, reduce costs, build brand value, and identify new market opportunities. We set ambitious goals for our company and make strategic investments to advance progress in the areas of environmental sustainability, supply chain responsibility, diversity and inclusion, and social impact that benefit the environment and society."

— **Intel**
(Page 5, *2017-18 Corporate Responsibility at Intel*)

Beyond SEC
Audiences for Integrated Reporting

In Brief

- When a company prepares to write an integrated report, one starting point should be a determination and prioritization of the audiences the report is intended to reach
- The primary audience will invariably be the owners of the company's equity and fixed income securities—institutional investors, securityholders and debtholders
- A fully realized integrated report will address the interests of other stakeholders as well—the company's employees, customers, suppliers, and the communities within the company's orbit
- The interests of the company's internal contributors and constituencies—the company's board of directors; the CEO and executive management; and the administrative and communication teams—must also be considered

By definition, the audience for integrated reports is the same as the audience for a company's regulatory filings, legally mandated disclosures, and other forms of communication. However, because integrated reporting is ultimately a means for companies to demonstrate "integrated thinking" and "integrated management" within the business enterprise, an integrated report takes an approach that goes beyond compliance with disclosure requirements. It does not replace the information traditionally included in SEC filings; it builds on it, selecting, prioritizing, and integrating information to create a story line that explains the company's business clearly and concisely. The goal is to rethink *what* a company's story is and *how* a company tells its story.

An important first step in preparing an integrated report is to carefully examine the audiences whose interests and expectations are relevant to the company's business.

For publicly traded companies, there are three likely categories of audience:

1. Institutional investors and small securityholders
2. Other external stakeholders
3. Internal contributors and constituencies

Institutional Investors and Other Securityholders

Institutional investors are a public company's largest, most powerful, and often most assertive group of owners. They have a well-defined agenda for their oversight of the portfolio of investments and their stewardship of the assets they manage. In addition to their primary role as investors and financial experts, many institutions, particularly public pension funds, have become leading advocates for corporate governance and accountability. In recent years, institutional investors have increased pressure on portfolio companies to provide more detailed information about governance policies, board effectiveness, corporate culture, corporate purpose, human capital management, social issues, environmental practices, and so-called nonfinancial factors that are material to a company's risk profile and financial performance. These topics are often referred to collectively as "ESG" or "sustainability." Institutional investors often expect the company to address all these topics in the context of its business strategy and financial performance (i.e., by providing an integrated narrative).

Institutional investors are the primary focus of engagement campaigns that have in recent years become an important supplemental path for corporate communications. Board members may play an active role in engagement, requiring them to demonstrate an understanding of how their policies are integrated with the company's business strategy and performance.

It is important to recognize that institutional investors are beginning to practice what they preach. As they demand more detailed information and an integrated narrative from portfolio companies, they are in turn increasing their efforts to broaden their financial metrics, analytics, and investment criteria to embrace sustainability and ESG risk factors. In effect, they are working toward an integrated approach to valuing portfolio companies. Integrated investment analysis and decision making by institutional investors will over time further increase pressure on companies to provide integrated reports. In fact, a recent survey of institutional investors that received responses from 46 global investors representing $33 trillion of assets under management revealed that 80 percent support the concept of integrated reporting.[9]

> Integrated investment analysis and decision making by institutional investors will over time further increase pressure on companies to provide integrated reports.

9 "Institutional Investor Survey 2019," Morrow Sodali, question 10, p. 15.

Other securityholders, principally small shareholders, are as important as large institutional investors when companies need their support. Every year the shareholder vote at the annual meeting acts in part, as a referendum on how well shareholders understand the company and how well the company has explained its policies, business operations, strategy, and performance. Since small shareholders are not expected to study disclosure documents with the same degree of attention as professional investors, an integrated report needs to tell the company's story in terms that all shareholders can understand.

This basic level of shareholder education becomes critical when a company is targeted by an activist. In situations where the activist is criticizing the company's performance and offering an alternate strategic plan for the business, the company must defend its performance and strategy on the merits. Last-minute communication is often insufficient and lacks enough credibility to win shareholder support on complex strategic questions. The ability of integrated reporting to raise the general level of shareholder understanding is also important when companies are dealing with market volatility or their stock price is undervalued.

Other External Stakeholders

For public companies in today's market, other stakeholders can sometimes be nearly as important as shareholders. Two parallel trends are responsible for the increasing focus on stakeholders. One is the demise of "shareholder primacy," a reductive theory that for decades defined corporate purpose narrowly in terms of profitability and stock price, making shareholders the only constituency that mattered. The second and countervailing trend is the growing requirement for companies to provide a clear statement of corporate purpose together with confirmation that ESG and sustainability are important indicators of financial health. Stakeholders, defined broadly to include all the individuals and groups affected by a company's activities, comprise an audience of particular concern to boards of directors. Policies and decisions that are the responsibility of the board—governance, social policy, environmental practices, risk oversight, human capital management, ethics, corporate culture—affect stakeholders directly. The usual list of stakeholders includes employees, suppliers, customers, local communities, regulators and even groups unrelated to the company's operations whose well-being may nevertheless be affected by the company.

Companies can use integrated reporting to reach and influence these stakeholders and any other group, including politicians and the general public, whose understanding matters to the company. Like small shareholders, stakeholders are generally not consumers of SEC filings. An integrated report that tells the company's story clearly and concisely is an effective way to make complex business decisions comprehensive to this group. The ability to keep stakeholders informed can be critical at times when a company must defend its purpose, character, and reputation.

Internal Contributors and Constituencies

If one goal of integrated reporting is to change the way companies think and are managed, internal contributors and constituencies cannot be overlooked. It includes the board of directors and, the CEO, management team, company employees, and investor relations and shareholder communications executives.

As the board oversees the company's culture and character, it must be the source of a firmwide commitment to integrated management and reporting.

The CEO and members of the executive management team are responsible for implementing board policies and establishing practices within the company's administration and operations that are necessary to make the integrated reporting culture a reality. Both the board and C-suite executives must be committed to thinking through how the business is organized and run before they can tell the company's story in an integrated report.

The company's most important internal audience is its employees. The human resources team can play an important role by educating and informing employees, and design key performance indicators (KPIs), compensation, and processes to reinforce the organizational schemes that break down internal silos, foster collaboration, and support integrated reporting.

> Both the board and C-suite executives must be committed to thinking through how the business is organized and run before they can tell the company's story in an integrated report.

Finally, investor relations and shareholder communications executives are among those ultimately responsible for gathering the data, financials, analytics, and strategic information needed to compose an integrated report that is based on policies and practices mandated by the board, implemented and enforced by management, and understood and embraced by employees.

Some companies have moved in the direction of integrated reporting by preparing separate reports on corporate social responsibility, environmental practices, or sustainability. This represents an important first step, but this is short of the complete integration of these activities into the company's organizational structure, business strategy, and performance metrics.

Debunking Myths and Surmounting Challenges

In Brief

- It is important to differentiate between myths and legitimate internal and external challenges
- Some of the most significant myths about integrated reports: investors lack interest in them; investors have strong or fixed expectations regarding the form of them; the current level of reporting is sufficient
- Internal and external challenges to implementing integrated reporting include the legal risk and materiality of the reports; getting sufficient buy-in from management; lack of market consensus around the framework, standards, and metrics used for the report

Although there are obstacles to implementing integrated reporting, it is important to differentiate between myths and legitimate internal and external challenges. These challenges are varied but not insurmountable, and companies can take a number of steps to overcome them.

Myths

Significant myths regarding integrated reporting include the following:

- There is a lack of investor interest in integrated reporting;
- Conversely, there is a strong or fixed investor expectation regarding the form of an integrated report; and
- The current level of reporting is sufficient.

Lack of investor interest

One myth is that if investors do not ask for an integrated report, they must not be interested in nonfinancial strategic topics or metrics. It is also argued in parallel that no generally accepted case has been made that nonfinancial factors actually affect long-term value creation.

In reality, many investors are concerned about the factors that will produce returns over the long term (i.e., a time horizon of five years or even more), and nonfinancial strategic topics and metrics affect these returns. While traditional ESG disclosures don't fully satisfy what is expected for an integrated report, investors have increased their focus on ESG or sustainability issues in recent years, as evidenced by public statements from institutional investors and an uptick in the number of shareholder proposals related to ESG and sustainability issues.[10] Moreover, although there is currently a lack of market consensus on a single framework for nonfinancial reporting, there is a growing and increasingly research-supported and empirically backed consensus around the importance of industry-specific nonfinancial factors that affect long-term value. There is also a growing consensus among stakeholders, including investors, of the importance of nonfinancial disclosure.

A companion argument that there is little investor interest proceeds from the fact that nonfinancial factors are rarely raised and discussed on quarterly analysts' calls at which financial results are discussed, yet those calls are often the events that produce the most pronounced stock price moves. The focus on quarterly financial results on those calls makes it unsurprising that other subjects are given short shrift. Moreover, the participants, predominantly sell-side analysts rather than asset owners and asset managers, also lead to the predictable focus on financial and short-term factors. There are strong indications that engagement by asset owners and asset managers with issuers includes increasing emphasis on nonfinancial strategic topics.

Investor expectations as to the form of integrated reporting

A second myth is that investors have a strong expectation and desire for an integrated report to be included in regulatory filings, for example in periodic reports with the SEC.

While US investors may have some preference for reporting in SEC filings, the more important reality is that investors fully understand and appreciate the current multiplicity of communications channels available to companies, and both asset owners and asset managers are fully capable of knowledgeably navigating those options. Among the possibilities for imparting material information are investor days, industry conferences, and stand-alone reports widely disseminated on company websites or otherwise. Investors are much more likely to be focused on the availability of information they seek, and on the reliability and comparability of that information, than on the location of such information, for example, in SEC filings.

Current reporting is sufficient

A final myth suggests that the current framework for company reporting focused on financial statements and other financial matters is sufficient. However, increased shareholder interest in ESG and sustainability issues and nonfinancial measures suggests the opposite: financial reporting alone may no longer be satisfactory. Shareholder proposals on ESG and sustainability issues have been on the rise in recent years, and so far during the 2019 proxy season, there have been five shareholder proposals that specifically invoked the new SASB reporting framework, as well as two proposals that called for integration of ESG metrics into financial reporting.[11] These numbers may appear small, but the trend is clearly increasing rather than decreasing.

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10 BlackRock's 2019 Letter to CEOs indicated that "profits and purpose are inextricably linked," that "environmental, social, and governance issues will be increasingly material to corporate valuations," and that one of its engagement priorities for 2019 would be environmental risk. Broadridge reported that shareholder proposals on ESG issues predominated proxy ballots during the 2018 proxy season, and that institutional shareholder support for ESG proposals has increased from 19% in 2014 to 29% in 2018.

11 Advance Auto Parts, CarMax, Dollar Tree, Essex Property Trust, and PACCAR received proposals invoking the SASB framework in 2019. The proposal at PACCAR was withdrawn by the proponent. Amazon and Tesla received proposals regarding the integration of ESG metrics into financial reporting.

Challenges

While the myths about integrated reporting should not be obstacles to a practical approach that satisfies investors and other stakeholders, companies considering whether to produce an integrated report will face several legitimate internal and external challenges.

Internal challenges

Internal challenges arise principally within the company's own organization, including:

> **Legal Risk and Materiality** Companies that produce an integrated report may be exposed to greater disclosure liability risk than companies that choose not to do so. Under current US law, public companies are not required to disclose all material information about the company to the public. Instead, companies are required to make specific disclosures mandated by the US securities laws and related rules and regulations, as well as the relevant generally accepted accounting principles as promulgated by the Financial Accounting Standards Board under SEC oversight (or for foreign private issuers, IFRS promulgated by the International Accounting Standards Board). Companies must also make material disclosures if failing to do so would constitute a misleading omission in light of the disclosures that are actually made and must disclose forward-looking information regarding known trends or uncertainties that are reasonably likely to eventuate and to be material. If a company elects to disclose additional information that is not mandated by law, such as some of the information included in an integrated report, under US law, the disclosure must be materially correct and must not omit any material facts that would make the company's disclosures misleading. This liability regime, which also requires that the faulty disclosure be intentional or reckless, exists regardless of whether a company's public disclosure is included in an SEC filing, posted on its website, or otherwise disseminated broadly to the public markets. Similar considerations apply in legal systems outside the US, in that voluntary disclosures of information that is not required to be disclosed generally expose a company to greater legal liability than silence, although considerations of legal liability, while increasing in certain respects (e.g., growing use of a "comply or explain" approach), are still generally less prominent outside the US. However, in Europe the EU is moving toward a more rigorous comply-or-explain model.

Buy-In and Governance Some level of board and management buy-in is of course required for a company to embark on any program of integrated reporting, which includes ESG, sustainability, or other nonfinancial reporting. More importantly, cogent integrated reporting on these subjects that reflects actual company strategy and priorities, as opposed to reports created in isolation from those who actually make strategic decisions, will require support from, and coordination among, a company's board, management, and other key internal stakeholders, including finance, legal, investor relations, internal audit, and operations. In practice, this type of support and coordination will be difficult to achieve without top management and board leadership to develop governance and reporting processes that address actual integrated thinking about strategic priorities. Moreover, an integrated report should accurately reflect the views of the company's board and management with respect to long-term value creation, rather than merely articulating general or unrelated disclosure principles. Finally, senior involvement and governance processes are important to ensuring the attention that is necessary for accuracy and reliability of reporting, including appropriate attention to verification and assurance processes. Thus, internal coordination and communication among relevant stakeholders (e.g., members of the board, senior executives, investor relations) will be critical to ensure accurate reporting that is of most relevance for investors.

Administrative Burden Integrated reporting can be administratively burdensome. Companies are required to report financial and other information on a periodic basis, and CFOs and controllers in particular currently spend a significant amount of time and effort on complying with these requirements. The creation of an integrated report that focuses on nonfinancial metrics can therefore place a burden and time pressures on these positions. The key challenge is that nonfinancial measures typically do not have the underlying systems and processes required to get to investment grade in the accelerated time required to integrate information into regulatory filings. In some cases, the nonfinancial information might not be available when a regulatory filing is due, thus slowing down that process. In addition, integrated reporting is costly, and smaller companies may lack the resources required to produce an integrated report. A bifurcated approach to reporting can alleviate some of the administrative burden. Unfortunately, however, there are no particularly helpful approaches to scalability of either frameworks or standards for integrated reporting.

External challenges

External challenges arise principally from external factors and stakeholders outside the company. The primary external challenge to producing an integrated report is the lack of market consensus around both the framework and the standards and metrics for integrated reporting. In particular, several different bodies have promulgated frameworks for enhanced nonfinancial reporting and the standards and metrics that should be followed in such reports, such as the International Integrated Reporting Council, SASB, the Global Reporting Initiative, and CDP (formerly the Carbon Disclosure Project), among others. There is currently no clear guidance as to which of these frameworks is the most desirable, and companies are free to choose the framework that best suits their industry, business, and stakeholder demands or their own framework tailored to their company. However, given that a company's integrated report will be generally accessible, there is a risk that some constituents may be dissatisfied and demand that the company provide more or different information.

> An integrated report should accurately reflect the views of the company's board and management with respect to long-term value creation, rather than merely articulating general or unrelated disclosure principles.

Building Trust and Quality

In Brief

- All third-party assurance practitioners should preferably be independent from the company management responsible for the nonfinancial information; this is important for raising the level of trust of users of the report to an investment grade
- Of the three levels of assurance available under existing standards, most US companies seeking assurance over their ESG/Sustainability information from a CPA firm choose "limited assurance"
- Most companies that seek assurance for their ESG/Sustainability information publish a separate Corporate Social Responsibility report that can include the independent accountant's report or a link to a website

Investors and a wide range of other stakeholders increasingly view nonfinancial data (including ESG data) as important information necessary for decision making. They need high-quality data they can rely on in order to effectively analyze a company's operations and assess management's progress on strategy execution. By subjecting nonfinancial data to independent assurance, companies clearly signal to their stakeholders that they have robust policies, processes, controls, and governance over this critical information—raising the overall level of trust.

What does assurance mean?

An independent, third-party view on the veracity of critical information needed for decision making by investors and other stakeholders assures the credibility of management's claims and elevates it to "investment-grade" data. This process is known as assurance.

What are the elements of assurance?

A key aspect of any third-party assurance engagement is independence of the practitioner from the company management responsible for the nonfinancial information. An unbiased evaluation of data can raise the trust of users to the level of investment grade. This is particularly important in emerging forms of corporate reporting like integrated reporting and stand-alone ESG/Sustainability reports, where users may be unfamiliar with new standards and reporting frameworks and therefore uncertain about quality. In the US, certified public accountants (CPAs) must comply with the American Institute of Certified Public Accountants (AICPA) Professional Standards, which include independence, ethical, and quality control standards, in addition to attestation standards for practitioners.

ESG/Sustainability information subject to assurance is typically reported today in the form of quantitative metrics representing measurement of certain activities over a period of time (e.g., Scope 1 GHG Emissions for a fiscal year) or at a point in time (e.g., Gender Diversity of the executive team and Board as of December 31, 201X). To be eligible for assurance under AICPA standards, ESG information must have certain characteristics, including:

- The subject matter must be appropriate;
- The criteria to be applied in the preparation and evaluation of the sustainability information must be suitable and be available to the intended users; and
- Sufficient evidence must exist and be available to the practitioner to arrive at an opinion or conclusion.

The effort to develop high-quality sustainability accounting standards in recent years by organizations like SASB and GRI has been, in part, to meet the rigors of external reporting and third-party assurance that the capital markets expect. Because of the current level of maturity of corporate reporting processes and controls in this space, practitioners often recommend pre-assurance reviews for new ESG metrics identified for assurance. In a pre-assurance review, the practitioner will perform process walkthroughs, interview responsible parties, and gain an understanding of available evidence, among other activities. Pre-assurance reviews help companies identify gaps or weaknesses in their data-gathering processes and application of standards and avoid the risk of a report qualification or disclaimer of opinion.

Different Levels of Assurance

Among the levels of assurance available under existing standards are: reasonable assurance (aka "audit" or "examination"), limited assurance (aka "review"), and agreed-upon procedures that may be provided by independent practitioners (i.e., a higher level of confidence), as well as internal audit and advisory-type reviews provided by subject matter experts who are not necessarily independent of the reporting company or subject to other professional standards (i.e., a lower level of confidence).

Currently in the US, most companies seeking assurance over their ESG/Sustainability information from a CPA firm choose "limited assurance" as a cost-effective way to increase trust in their voluntary nonfinancial reporting. In a limited assurance engagement, the practitioner performs analytical procedures and tests evidence supporting management's assertion. In a limited assurance engagement, the CPA issues a conclusion framed in the negative (e.g., "Based on our review, we are not aware of any material modifications that should be made to management's assertion in order for it to be fairly stated.").

By contrast, "reasonable assurance" (the market standard for financial statement audits) requires the practitioner to perform more extensive procedures with an objective of issuing a positive opinion (e.g., "In our opinion, management's assertion that the accompanying Schedule of Sustainability Metrics is presented in accordance with the criteria set forth in Note 1 is fairly stated, in all material respects.").

Value of External Assurance

As IRRC Institute/Si2 express it in a recent report: "The issue of external assurance is clearly a key pain point for investors, who have consistently complained about the lack of external verification of sustainability data.... Varying standards and the haphazard nature of the current state of external data verification hinders stakeholders' evaluation of company performance and gets in the way of more robust analysis of comparable metrics among peer groups."[12]

Today, most companies obtaining assurance over a portion or all of their ESG/Sustainability information publish a separate Corporate Social Responsibility report and either include the independent accountant's report within that report or provide a website link where the report is posted for public use. But as ESG/Sustainability information is increasingly recognized as important to understanding companies' long-term value creation prospects, ESG is being integrated alongside financial results and financial key performance indicators in Annual Summary Reports, company websites, and even regulatory filings on Form 10-K. That level of prominence raises the stakes for companies and increases their risk if errors are found in the ESG information being reported. Working with a trusted independent assurance advisor to obtain assurance allows management to embrace this kind of integrated reporting with confidence and should significantly mitigate liability concerns.

Investors and other stakeholders want to know whether a company is appropriately identifying and addressing risks. Performing an ESG/Sustainability materiality analysis, publicly reporting strategy and metrics, and obtaining assurance signals to investors that the company has strong governance and internal controls. ESG information is also increasingly used in management decision making and in setting performance targets (e.g., for incentive compensation), and assurance informs management about the reliability of this information.

> Performing an ESG/Sustainability materiality analysis, publicly reporting their strategy and metrics, and obtaining assurance strongly signals to investors that the company has strong governance and internal controls.

12 *The State of Sustainability and Integrated Reporting 2018*, IRRC Institute and Si2, 2018.

Appendix

A Look at the Integrated Reporting Working Group

The Integrated Reporting Working Group, representing a cross-section of investors, corporations, and service providers, kicked off in January 2018 and met five times over the course of a year. At the kick-off meeting, the working group members suggested topics and guest experts for subsequent meetings.

Participating member companies

BlackRock

CalSTRS

Cleary Gottlieb Steen & Hamilton*

Coca-Cola Company

Deloitte

General Motors Company

Latham & Watkins

Merck & Co.

Morrow Sodali Global*

PepsiCo

Pfizer

PulteGroup

PwC (Co-Chair)*

UnitedHealth Group

Weil, Gotshal & Manges

* *These member companies were part of the working group's drafting committee. They were joined by International Integrated Reporting Council (IIRC) and Sustainable Investments Institute (Si2).*

MEETING 1 KICK-OFF (January 8, 2018)

Identified key themes:

All participants recognized the increased investor appetite for enhanced corporate reporting; perhaps more importantly, all participants emphasized the desirability of aligning on a market solution before a regulated approach is brought to bear. (In 2017, the Non-Financial Reporting Directive (NFR Directive) came into effect in all EU member states. All 28 countries have since adapted the Directive into national law, and it's now up to companies to comply.)

One of the key roadblocks for enhanced disclosure flagged by participants was the lack of clarity around defining materiality broadly (especially over the medium and long term) and the perceived potential for increased legal liability.

Finally, there was immense appetite from participants to have examples of what good reporting looks like to make these concepts more concrete.

MEETING 2 PRIMER AND PERSPECTIVES FROM CORPORATIONS (April 3, 2018)

Guest experts:

Jamal Booker, Corporate Communications Manager, **Coca-Cola Company**

Bob Laux, North American Lead, **International Integrated Reporting Council (IIRC)**

Brandon Smith, Executive Counsel, Corporate, Securities & Finance, **General Electric**

Michel Washer, Deputy Chief Sustainability Officer, **Solvay**

In this meeting, Bob Laux (IIRC) provided the working group members with a primer on integrated reporting. He touched on the multicapital approach of integrated reporting and its role on focusing capital on the long term. In addition, participants heard from corporations that are already successfully implementing (or experimenting with) integrated reporting (Coca-Cola, Solvay, General Electric). The group discussed how the board should be involved in the integrated reporting process, considering that Solvay is an EU company and Coca-Cola and GE are US-based with different regulations.

MEETING 3 CONSUMER PERSPECTIVES (June 25, 2018)

Guest experts:

Rolando Morillo, Vice President, Sustainability & Impact, **Rockefeller Capital Management**

Laura Nishikawa, Managing Director, ESG Research, **MSCI**

Laura Segafredo, Vice President, Global Fixed Income - Responsible Investing Group, **BlackRock**

Ariane de Vienne, Head of ESG Strategy - Americas, **Institutional Shareholder Services (ISS)**

In this meeting, ESG rating agencies and portfolio managers shared their perspectives on integrated reporting, as well as sustainability and other nonfinancial metrics (e.g., if and how they use these metrics in their analysis and investment decisions). The presenters spoke to the pros and cons of integrated reports, as well as the importance of ESG disclosures from public companies.

MEETING 4 MATERIALITY DISCUSSION (September 25, 2018)

Guest experts:

Robert Boyle, (former) Counsel, **General Motors Company**

Paul Dudek, Partner, **Latham & Watkins**

Alyson Genovese, Head of North America, **Global Reporting Initiative (GRI)**

Jeffrey Hales, Chair, **Sustainability Accounting Standards Board (SASB)**

In this session, the working group focused on materiality from the perspective of enterprise value. It included presentations from a securities and transactions attorney as well as the Global Reporting Initiative and the Sustainability Accounting Standards Board. The speakers shared their insights on the importance of materiality in the disclosures that could end up in integrated reports from public companies.

MEETING 5 WRAP-UP (January 24, 2019)

Guest experts:

Catherine Ide, Managing Director, **Center for Audit Quality**

Bob Laux, North American Lead, **International Integrated Reporting Council (IIRC)**

Anuj Saush, Senior Sustainability Researcher, **The Conference Board**

Heidi Welsh, Founding Executive Director, **Sustainable Investments Institute (Si2)**

In this wrap-up meeting, the working group discussed the role and scope of the auditor. That is, whether or not the scope of the auditor should be broadened to include ESG and other nonfinancial factors that could reasonably be expected to have a material impact on enterprise value. In addition, the participants learned about the findings from The Conference Board survey on materiality practices, and discussed the current state of play of integrated reporting.

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