Integrated Reporting

<IR>

DRIVING AND COMMUNICATING VALUE CREATION

CNCC
COMPAGNIE NATIONALE DES COMMISSAIRES AUX COMPTES

ifaci
institut français de l'audit et du contrôle internes

“ **Integrated reporting** involves promoting a new international reporting framework that concisely combines financial and non-financial data. It helps companies to restore the confidence of investors as well as their various internal and external stakeholders through the publication of clearer information on long-term value creation. Integrated reporting is a way for companies to illustrate and promote not only their financial performance, but also their performance in relation to social, environmental and governance issues.

In March 2015, a survey conducted by Paris Europlace* on around 30 companies (half of which were listed on the CAC 40 index) showed that French companies lagged behind their foreign counterparts in terms of integrated reporting. While they were familiar with the initiative, which is led by the International Integrated Reporting Council (IIRC), only three companies said they were trying it out. Other companies reported that they were also working on the matter, but the list is very short. A big step was taken in France ten years ago with the introduction of the laws on new economic regulations (“lois de nouvelles régulations économiques” – NRE) as well as the “Grenelle” environmental laws. As a result, large companies are now accustomed to publishing non-financial indicators. However, integrated reporting is radically changing the end goal of such communications. The aim is not simply to gather information, but also to provide an intelligible, comprehensive vision of the company’s business model, strategy, organisational structure and governance using a limited number of indicators that are relevant to its ecosystem.

The IFACI and the CNCC have joined forces to **promote integrated reporting among French companies** as a means of driving and communicating value creation. The two organisations wish to emphasise the need for companies to innovate their external reporting practices and demonstrate how integrated reporting can help them to do so. They present a detailed review of the situation in France before addressing the issues that could discourage companies from embarking on the integrated reporting process. Lastly, they highlight the main criteria for a successful integrated reporting process. ”

PHILIPPE MOCQUARD
CEO, IFACI

JEAN BOUQUOT
MEMBER OF THE CNCC’S NATIONAL BOARD

* Survey conducted by Paris Europlace’s sustainable finance commission on Paris stock market issuer and investor expectations in terms of socially responsible investing (SRI) and corporate social responsibility (CSR) between July and November 2014. A sample of 69 issuers and investors (32 issuers, of which 18 CAC 40 companies, 22 asset managers and institutional investors and 15 banks and insurance companies) were surveyed and the results were published in late January by Paris Europlace.

Table of Contents

1

INTEGRATED REPORTING: why should companies innovate their external reporting pratices?

Companies have traditionally focused on financial information (audited annual financial statements, interim financial statements, quarterly information, etc.) and significant events (agreements, mergers and acquisitions, operating difficulties, etc.) in their investor communications. However, the importance of intangible assets and external relations in an evolving and interconnected environment is now undeniable.

Investors therefore expect a clear, accurate and comprehensive overview of a company's value creation enablers to help them make the right decisions.

More generally, organisations are becoming more actively accountable with regard to various issues in order to address the concerns of their different stakeholders.

> "It is estimated that one third of companies in every industry sector will be disrupted in the next two years. As they navigate this disruption, companies need to understand the role they play in people's lives. They need to take their stakeholders along with them on their journey."
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> **TURID ELISABETH SOLVANG,**
> CHAIR ecoDa (EUROPEAN CONFEDERATION OF DIRECTORS ASSOCIATIONS) AT THE ecoDa ECIIA-ACCA CONFERENCE ON "NON-FINANCIAL REPORTING: THE IMPACT ON THE RELATIONSHIP BETWEEN BOARDS AND AUDITORS", 15 MARCH 2016.

As a result, companies no longer limit themselves to publishing their financial statements and management report, which are already lengthy. They now produce other types of information, including reports on sustainability, quality, internal control, risk management and governance. This abundance of information, which is sometimes redundant, is far from being a source of efficiency for issuers and intended users of such reports.

> **Is publishing lengthy annual reports a French phenomenon?**
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> "In 2013, the average registration document was **30% longer** than in 2006, with **350 pages**. The shortest registration document was **130 pages** long, including 50 pages of financial statements, which is the average length of the annual reports published by US (150 pages) and British (132 pages) issuers."
>
> SEE P.16 OF INSTITUT MESSINE'S REPORT (JUNE 2015): "IS THE FINANCIAL INFORMATION OVERLOAD DETRIMENTAL TO FINANCIAL INFORMATION?"

In addition to volume, watered down information and a lack of focus on significant information – in particular relating to strategy – distort the purpose of these reports and call for new initiatives.

The strategic foreword, the first step towards efficient external communication.

Since October 2013, the UK Companies Act has required companies to disclose the main trends and factors (including social and environmental data) likely to affect the future development, performance and position of the company's business.

In the same vein, French think tank Institut Messine calls for "*a* ***'strategic foreword'****, in which management provides its analysis of the past financial year, its expectations for the current year and its strategic vision for the company. [...] The foreword would focus on optional items recommended by the regulator: key indicators (changes over time, comparison with peers and commentary), objectives, strategic outlook, main risks and goals, etc.*"

SEE INSTITUT MESSINE'S REPORT (JUNE 2015): "IS THE FINANCIAL INFORMATION OVERLOAD DETRIMENTAL TO FINANCIAL INFORMATION?"

This recommendation is in line with that of the Federation of European Accountants (FEE) concerning the **"CORE report"**, a comprehensive report or a summary offering a clear, fair insight into the company's main businesses, its key financial results and additional information that is considered to be relevant and material for the company's stakeholders.

SEE P.61 OF "THE FUTURE OF CORPORATE REPORTING – CREATING THE DYNAMICS FOR CHANGE" (OCTOBER 2015).

The need for innovation grows as companies publish increasing quantities of information while failing to ensure or to prove that it is consistent. What's more, the accumulation of different reports does not always answer the fundamental questions that their intended users are asking themselves:

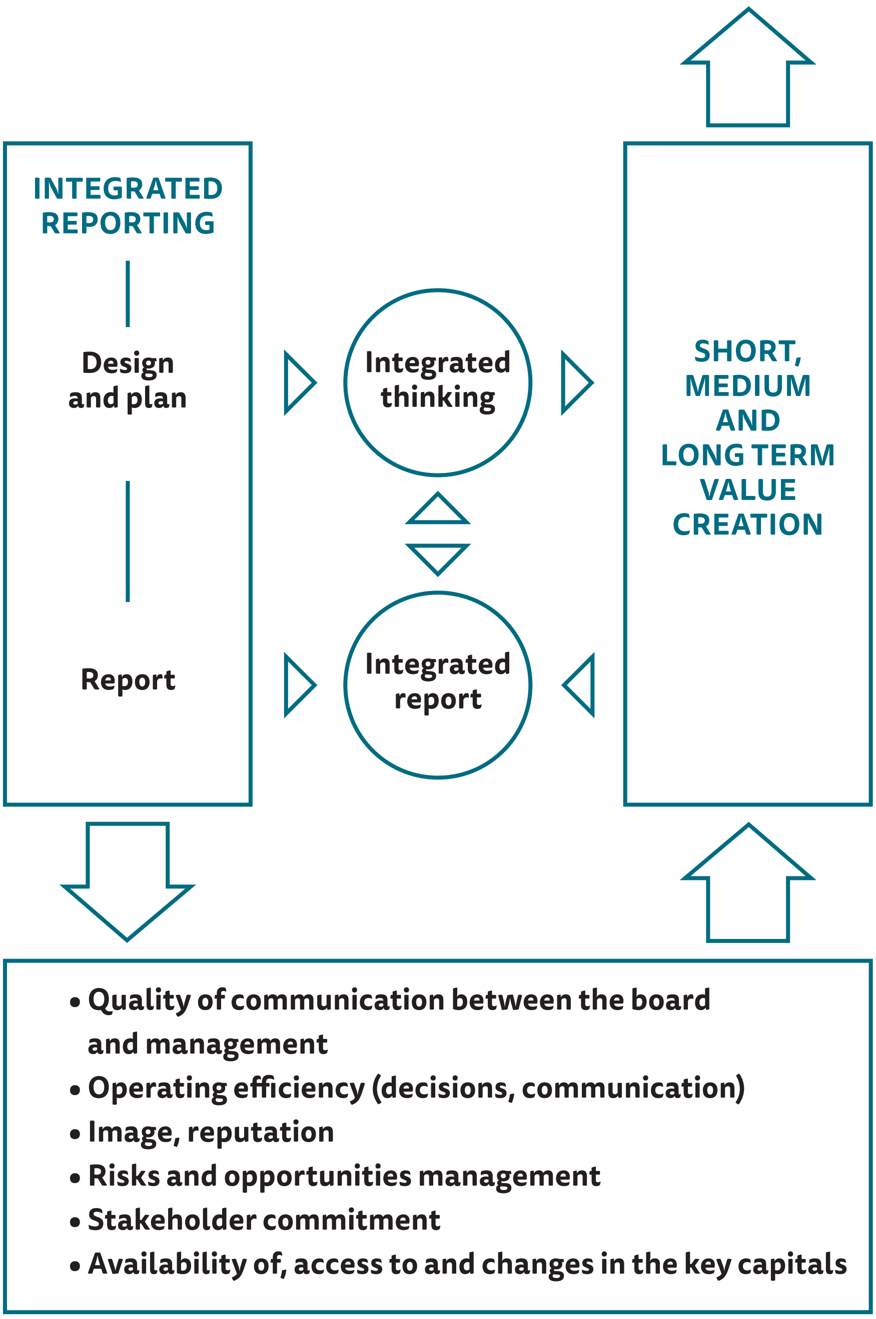
→ **How does the company's value creation chain work?**
→ **What is the company's short, medium and long term outlook?**

2

How does **INTEGRATED REPORTING** address this need?

In 2013, the International Integrated Reporting Council (IIRC) published an integrated reporting (**<IR>**) framework. This voluntary framework supports integrated thinking[1] as a means of producing an integrated report, i.e., **a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term.**

→ http://integratedreporting.org/the-iirc-2/



“Our integrated thinking reflects the strategy communicated to the market by senior management. It is based on financial indicators and other aspects such as customer relations and human capital.
These two capitals are monitored using quantitative indicators and their impact is described in our integrated report. We also take an integrated approach to meeting regulatory requirements such as those of Solvency II.”

MASSIMO ROMANO,
HEAD OF INTEGRATED REPORTING & CFO HUB AT GENERALI.

Built around the fundamentals of value creation, **<IR>** supports improved decision making with an approach dedicated to financial stability and a long term vision.

The benefits offered by **<IR>** include:

- → **relevant data** to enable the board to fulfil its responsibilities regarding strategic direction;
- → **a vision of the way the organisation manages and strengthens its main capitals** in line with its strategy, risks, opportunities and outlook;
- → **clarification of the value creation enablers** that help break down internal silos;
- → **a basis for increasing commitment** with respect to investors;
- → **a useful, consistent communication** for key stakeholders since it is centred on the company’s strategy and business model.

Aligning external reporting with the company’s short, medium and long term objectives improves the focus of all stakeholders by fostering innovation and sound governance.

[1] The active consideration by an organisation of the relationships between its various operating and functional units and the capitals that the organisation uses or affects. Integrated thinking leads to integrated decision making and actions that consider the creation of value over the short, medium and long term. See the International <IR> Framework glossary.
http://integratedreporting.org/wp-content/uploads/2013/12/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf

3

What is the current situation **IN FRANCE?**

France has been a pioneer in social and environmental reporting. But integrated reporting is about more than simply meeting the requirements of the "Grenelle laws" and the subsequent EU directives[2].

It ensures consistency between historical and projected financial, social, environmental information, information concerning strategy, risk management, the business model, governance, resource allocation, and more.

The performance presented is therefore no longer exclusively financial or non-financial, but reflects the achievement of strategic objectives and results in terms of their impact on the different "capitals"[3]. In addition, the guiding principles of the IIRC help to build trust and transparency and, as a result, improve the stakeholder engagement process.

<IR> KEY FIGURES

SOME 20 integrated reports in France

3,000 integrated reports published worldwide
(*OPTION FINANCE* N°1325)

1/3 of listed companies in the Netherlands are considering publishing an integrated report
(THE EUMEDION EVALUATION OF THE 2015 PROXY SEASON)

205 integrated reports published in Japan in 2015
(UP 46% COMPARED WITH 2014, SEE SURVEY OF INTEGRATED REPORTS IN JAPAN 2015 – KPMG)

[2] Directive 2013/34/EU as amended by Directive 2014/95/EU as regards disclosure of non-financial and diversity information. Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 as regards transparency requirements.

[3] The IIRC reference framework identifies six forms of capital: financial capital, manufactured capital, intellectual capital, human capital, social and relationship capital, and environmental capital.

4

PRACTICAL ISSUES:
when should an <IR> project be considered?

<IR> raises a number of questions[4], some of which may discourage companies from beginning an integrated reporting process:

Does publishing more information expose the company to competition and litigation, for example?

THE BUSINESS WORLD HAS CHANGED

- Growing expectations in terms of transparency and accountability.
- Regulatory requirements regarding non-financial information.
- Whistleblowers and social media have made inaction indefensible.

<IR>

→ Is voluntary. The company's governing bodies select which information to disclose.

→ Enables companies to prepare for, anticipate and manage stakeholder criticism.

Does gathering and publishing this additional information involve huge costs?

THE BUSINESS WORLD HAS CHANGED

- Information is a key capital of the new economy.
- Stakeholder relationships are changing. Companies need to be able to enhance their dialogue.
- Investors expect other information, particularly concerning the strength of a company's strategy, its ability to achieve its objectives and realise its full potential and that of its external environment.
- Directors must be able to fulfil their monitoring role.

<IR>

→ Does not generate more information, but more relevant information, which is put to better use in relation to the company's business model and ecosystem.

→ Requires companies to be selective regarding key information, which generally enables them to optimise opportunities and decision making.

→ Is virtuous in itself as it fosters internal communication and monitoring of clear objectives, which pave the way for value creation.

[4] See Eccles, Robert G., "Who Will Go First?", *Reporting Times: Die Zeitung des Center for Corporate Reporting*, no. 6 (May 2015), p 4

How can non-financial performance be measured when there are no specific standards?

THE BUSINESS WORLD HAS CHANGED

• Standards are being developed through a range of often voluntary initiatives. For example:

- the guidelines of the GRI (IIRC member),
- SASB (Sustainability Accounting Standards Board) standards,
- ISO 26000.

• Some companies have started sharing their internal model (e.g., http://www.kering.com/en/sustainability/methodology).

<IR>

→ Encourages financial and non-financial reporting standard setters to engage in dialogue.

→ Gives companies leeway as they are not bound by regulatory requirements.

→ Enables companies to focus on more relevant industry issues.

Can this type of approach be stopped?

THE BUSINESS WORLD HAS CHANGED

• It is no longer a question of whether or not to begin, so companies may as well get ahead of the game and go about it in a way that suits their own commitments.

<IR>

→ Is not compulsory.

→ Is designed to support the company’s business model. Stopping it would end the internal value creation (integrated thinking) dynamic, of which the report itself is simply a reflection.

→ Enables companies to set tolerance thresholds and commitment levels through corporate governance and risk management.

Would a decline in non-financial performance have an adverse impact on share price?

THE BUSINESS WORLD HAS CHANGED

• Even if the stock market does not react, such a decline will impact the company's overall medium term performance (if the indicators have been appropriately designed).

• Other stakeholders may react to the decline, thereby affecting the sustainability of the company's business model.

<IR>

→ Enables companies to select relevant indicators.

→ Is supported by integrated thinking, which enhances performance monitoring and the effectiveness of remediation measures.

Are investors interested in non-financial (or ESG) performance?

THE BUSINESS WORLD HAS CHANGED

• 73% of financial analysts that took part in a survey conducted by CFA Institute said that they take ESG (environmental, social and governance) criteria into consideration.

<IR>

→ Does not exclude financial performance, which is presented in context with other indicators.

→ Also supports dialogue with providers of other capitals that are key for the business model.

"This perspective on the future, however, is what investors and all stakeholders truly need, including, for example, how the company is navigating the competitive landscape, how it is innovating, how it is adapting to technological disruption or geopolitical events, where it is investing and how it is developing its talent. [...] Because boards have a critical role to play in strategic planning, we believe CEOs should explicitly affirm that their boards have reviewed those plans. [...] This review should be a rigorous process that provides the board the necessary context and allows for a robust debate".

LARRY FINK,
CHAIRMAN AND CHIEF EXECUTIVE OFFICER OF BLACKROCK, THE WORLD'S LARGEST ASSET MANAGER WITH $5,120 BILLION ASSETS UNDER MANAGEMENT IN OCTOBER 2016

5

What are the keys to a **SUCCESSFUL** integrated reporting?

The expected benefits of **<IR>** depend on a certain number of pre-requisites:

• TOP MANAGEMENT'S DESIRE TO INNOVATE

Governance is a content element of the integrated report, but that alone does not explain its importance. The involvement of the company's governing body (board of directors or supervisory committee) and senior management is vital, as they alone can drive innovation by:

- → providing strategic direction and breaking it down into a business model that they can monitor closely,
- → striking the right balance between the different components of the integrated report with regard to risks and opportunities,
- → ensuring that, in addition to visibility, the process uses effective differentiation enablers to create medium and long term value,
- → providing reassurance concerning the advantage of communicating with key stakeholders about new aspects (based on the thresholds and criteria they have validated),
- → fostering a trust-based environment conducive to a culture of transparency and constructive self-examination,
- → monitoring the process efficiency.

Without this leadership, the company will struggle to generate the cross-functional cooperation and commitment it requires from all of its members. The integrated report would be an empty concept without integrated thinking and, therefore, the dynamic that leverages all the expected benefits of **<IR>** both at company level and in stakeholder relationships.

> **"Several factors helped make the process a success. Firstly, the support of our governing and managing bodies (the Board of Directors, the Chief Executive Officer, the Chief Financial Officer), which supported the «Corporate Reporting Evolution» project aimed at adopting Integrated Reporting.**
>
> **The commitment of my colleagues (CSR, finance, investor relations, communications, strategy) was key to producing the report."**
>
> **MASSIMO ROMANO,**
> HEAD OF INTEGRATED REPORTING & CFO HUB AT GENERALI

• A SHARED VISION OF VALUE CREATION ENABLERS

The integrated report covers the creation – or, indeed, the destruction – of all of the financial and non-financial resources used by the company. However, the report is not a compilation of the company's existing reports (for example, combining the annual report together with the sustainability report is not sufficient). Driven by governing and managing bodies, integrated reporting is supported by a necessary review of the company's business model and capitals as well as the most relevant indicators for reporting in these areas. This review forms a natural part of the multi-year strategic planning process. It involves mapping out expectations of key stakeholders as well as conducting an analysis of the major risks and opportunities, not limited to short-term eventualities.

Integrated reporting therefore requires a real managerial transformation across all functions, not just accounting, finance and CSR. In other words, <IR> involves a shift from compartmentalised management to a multi-dimensional analysis of the company's value.

• APPROPRIATE IT SYSTEMS

Traditionally, financial communication IT systems are designed to compile historical accounting data expressed in monetary units in accordance with set accounting standards. Integrated reporting data are, by nature, heterogeneous, as they are designed and collected in accordance with external standards or with internal instructions. Given the different aspects that must be covered, **IT systems must be adapted to capture information that, although it may have already existed, was not necessarily gathered, stored, compiled or connected with other key indicators**.

In addition, IT systems must promote dialogue with stakeholders requiring more detailed information and prepare for the likelihood that by 2020 companies will be required to publish their corporate documentation online[5].

[5] See paragraph 3.b of http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32013L0050&from=EN: "With effect from 1 January 2020 all annual financial reports shall be prepared in a single electronic reporting format provided that a cost-benefit analysis has been undertaken by the European Supervisory Authority (European Securities and Markets Authority) (ESMA) established by Regulation (EU) N° 1095/2010 of the European Parliament and of the Council."

• RELIABLE, CONSISTENT INFORMATION

The reliability of the integrated report must live up to the goals of such a form of communication. The financial statements are already subject to checks and controls, both internally and externally, as well as recommendations concerning their reliability.

> "Your non-financial reporting needs to be linked to core business, to address aspects of real value, to be taken as seriously as a balance sheet, and to be owned and operated with the same rigour as financial reporting."
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> **TURID ELISABETH SOLVANG,**
> CHAIR ecoDa (EUROPEAN CONFEDERATION OF DIRECTORS ASSOCIATIONS) AT THE ecoDa ECIIA-ACCA CONFERENCE ON "NON-FINANCIAL REPORTING: THE IMPACT ON THE RELATIONSHIP BETWEEN BOARDS AND AUDITORS", 15 MARCH 2016.

The internal auditor helps to improve risk management and internal control procedures. The external auditor expresses an opinion in which he concludes that the financial statements provide a true and fair view of the entity or group's activities and financial position. Certain sustainability reports are also subject to similar verification procedures.

> 69% of respondents to the CFA Institute survey felt that external communications concerning ESG (environmental, social and governance) should be subject to independent verification procedures.
>
> SEE CFA INSTITUTE

Failure to carry out such verification procedures would create a paradox between the goals of <IR> and the strong expectations of new, relevant information to support business decisions on the one hand, and the risk that the published information could contain material misstatements as a result of fraud or errors, not to mention inconsistencies that could undermine its credibility and provoke strong reactions from stakeholders, on the other hand.

At every step of the process (review of the reporting framework, design and implementation of internal control procedures, verification and validation of data), several complementary approaches could be adopted by internal audit or the external auditor depending on the type of indicators published and the company's level of maturity. The need to conduct such verifications is all the more necessary given that some of this information is unconventional and difficult to collect, compile or quantify.

• RELEVANT COMMUNICATION

Given their operations, locations, products, regulatory and competitive environment, companies are complex structures. One of the greatest challenges of integrated reporting is to simplify and reflect this complexity in a format and language that are accessible to a wide variety of readers. Too much information can be as harmful as too little. **Therefore, if the scope of communication is to be widened, relevant indicators must be selected. Communication must be concise and effective.**

The integrated report must be tailored to each company using simple words and graphics (infographics, analytical charts, hyperlinks, etc.). Under the supervision of their governance body, companies must therefore make a balanced judgement in selecting information with a significant impact on their business model and capitals. Those responsible for preparing the report must organise this information by order of importance and put it into perspective, which includes using technology to facilitate access to more detailed information for relevant stakeholders.

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