



cutting through complexity

Integrated Reporting

Performance insight through
Better Business Reporting

Issue 2

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Foreword

Welcome to the second edition of Integrated Reporting, our publication focusing on the challenge of providing Better Business Reporting.

The world of corporate reporting needs to evolve. The gap between investors' needs for a more complete picture of value and the information currently being reported is not sustainable. Businesses are investing to develop and protect their long-term value in a changing world but CEOs are often left frustrated that these efforts don't get the recognition they deserve.

In the first edition of Integrated Reporting published in September last year, we presented a series of short articles by some of our experts to explain what Integrated Reporting is, why senior executives and non-executives should be interested and recent developments in the evolution of Integrated Reporting.

Since then, the consultation on the International Integrated Reporting Council's (IIRC's) Discussion Paper has closed and the IIRC has issued a summary of the responses¹, its Pilot Programme has gained momentum and the IIRC is moving forward with the development of an Integrated Reporting Framework which it intends to publish by the end of 2013.

In this second edition of Integrated Reporting, we start by explaining how Integrated Reporting can help organizations better explain their value creation story. We then review progress in South Africa where Integrated Reporting is already becoming a reality.

We also address some of the practical issues that companies may find on the Integrated Reporting journey. One of the most common questions raised by companies is "what does an Integrated Report look like?". Michael Bray provides insight to this question, whilst Matt Chapman and Wim Bartels address the particular issue of corporate responsibility reporting within an Integrated Report and Mark Hoffman explains how Integrated Reporting principles can, and are being, adapted for Public Sector entities. Nick Ridehalgh considers the relevance of Integrated Reporting to good corporate governance and we end with answers to some commonly asked questions.

Whether you are actively pursuing Integrated Reporting within your own organization or simply looking to improve your existing corporate reporting, we hope that these short insights will help you on your journey to Better Business Reporting.

If you would like to learn more please speak to your usual KPMG contact or one of our specialists listed on the back cover.

David Matthews
KPMG in the UK

¹ IIRC: Summary of Responses to the September 2011 Discussion Paper and Next Steps, May 2012.

Telling the **value creation** story

By Matt Chapman, KPMG in the UK



In brief:

- **There is a gap between the information currently being reported by companies and the information investors need to assess business prospects and value**
- **Integrated Reporting can help fill this gap by providing a basis for companies to explain their value creation more effectively to the capital markets**
- **Integrated Reporting can help readers look beyond companies' short-term results to form clearer views on long-term value**
- **Integrated Reporting can be applied by any company to improve the focus of their Annual Report**

Explaining ‘business as usual’ is not enough. Owners need the information to assess the value impact of business plans and changes in the business environment.

There is growing recognition that the range of issues and opportunities affecting long-term business value is much broader than can be reflected in a set of current year financial measures. Annual Reports should reflect this if they are to support investors’ capital allocation decisions effectively.

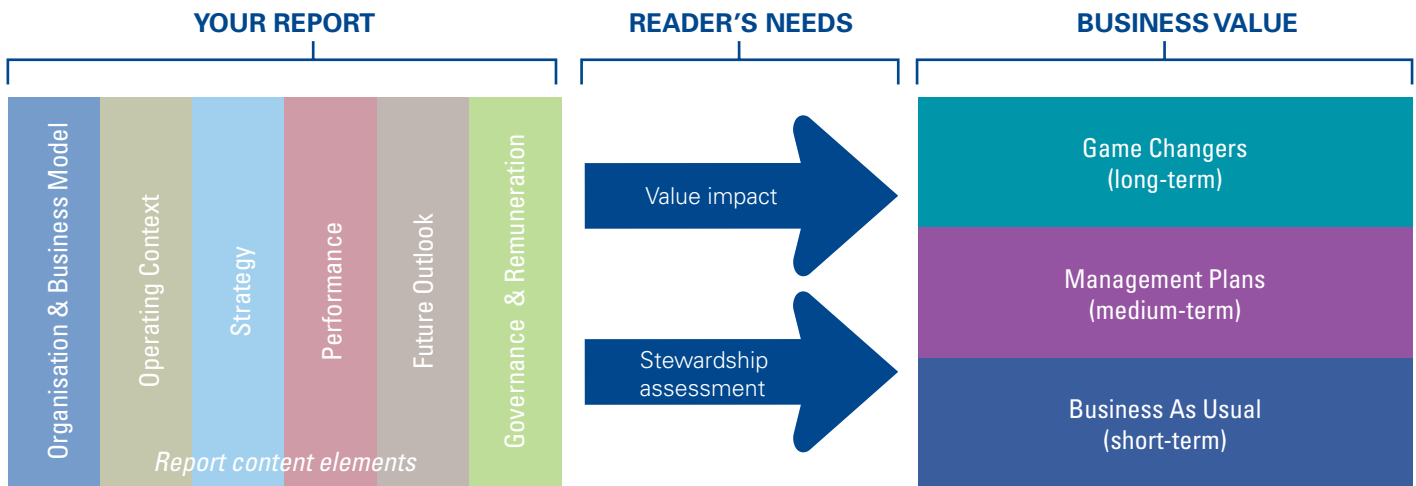
Integrated Reporting provides a basis to address this by re-focussing reporting around an organization’s business model and operational priorities. The aim is to reflect the critical opportunities and challenges that affect the business – the same issues that management are dealing with on a daily basis within the organization.

Although designed to support the preparation of dedicated Integrated Reports, this approach can be applied by any company preparing its Annual Report - or other elements of its corporate reporting.

For executives frustrated by apparent investor short-termism, this is an opportunity to provide a more complete picture of value, how it’s shaped by current and future events, and explain what management is doing to create and preserve it.

Ultimately this is about business making its case for capital in a more effective way – bridging the gap between management’s value creation story and investors’ assessment of business value and stewardship.

Explaining business value



The influence of stakeholders on business value and viability cannot be ignored in the current business environment.

An Integrated Reporting approach to **communicating business value**

Explaining business value

The backward looking focus of much corporate reporting has meant that the majority of reporting effort has gone into explaining the 'business as usual' element of value. This only tells part of the story. Generally there are three discrete elements that need to be explained:

1. 'Business as usual' – reflecting the current shape and performance of the business. Based on current year financial and operational performance. Readers will also want to understand how representative this is of the current state of the business.
2. The likely effect of management's plans, external issues and opportunities. Readers will want to understand both the context for the plans and the scale and uncertainties affecting them to form a view on how they impact value.
3. The long-term value of the business beyond its detailed operating-horizon. At this level it is the 'game changing' business opportunities and threats – loss of operating license, re-alignment of markets - that will affect the assessment. For many businesses this will represent a large segment of total value, yet the lack of reporting focus here can cause investors to fall back on industry level generalizations when assessing future value.

There has been some discussion about whether Integrated Reporting requires business to assign monetary values to intangible assets in order to provide a complete picture of value. We do not believe this information is necessarily useful to investors whose assessment of value will generally derive from modelling future cash flows. Effective reporting should help readers form their own views of the short, medium and long-term cash generation capability of the business.

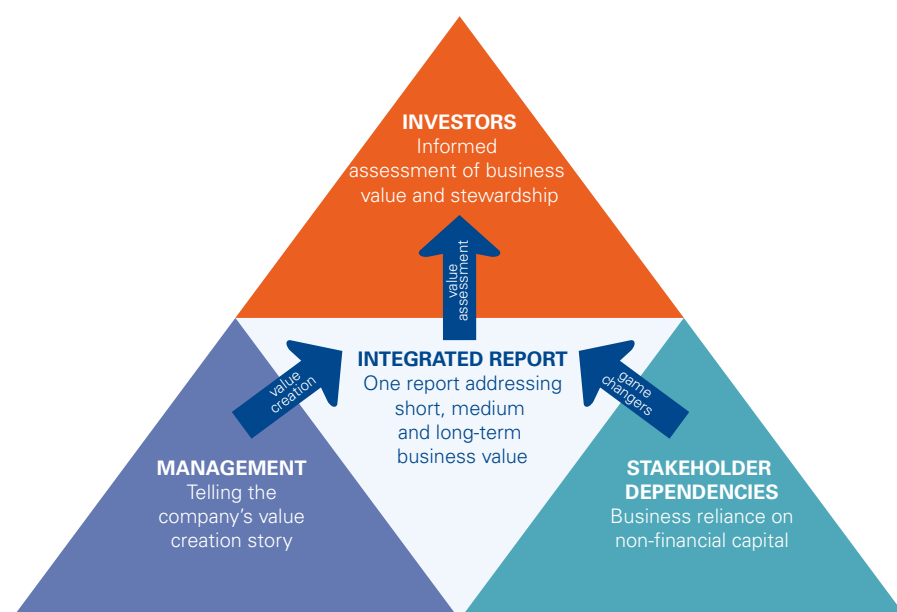
A more complete picture of business value

Integrated Reporting combines financial and non-financial information with a forward-looking perspective that's designed to help readers understand all the components of business value – and how they may be affected by future opportunities and exposures.

Taken together, these characteristics mean that it can provide a more complete perspective over business performance and value.

For executives frustrated by apparent investor short-termism, this is an opportunity to provide a more complete picture of value.

Bringing the three perspectives on business performance and value together



Source: KPMG International

Companies investing in the future of their business should welcome the opportunity to explain how they are creating and sustaining business value.

Telling the business's story

The gap between what companies are doing and what they're reporting needs closing. Integrated Reporting can help companies do this by letting them tell their story on their own terms. It places the responsibility for communicating the business's story on the reporter rather than a set of reporting rules.

This represents a cultural shift from a compliance driven focus to an approach led by business activity and user-needs. Two steps in particular can help to achieve this:

- Building the report around the company's business model, the context in which it operates, and its strategy to address the opportunities and challenges that it faces (these are the first three Integrated Reporting content elements).
- Demonstrating 'Integrated Thinking' in determining detailed content. Issues identified at the outset of the report relating to business model and operating context should feed through into the business strategy and ultimately the performance reporting and governance. This thread is central to explaining what management is doing and why. It also provides a basis for ensuring that the report remains focused on the issues that matter to the business.

Supporting a more informed assessment of value

The mismatch between current corporate reporting and business value has become increasingly apparent in the volatile business environment of the last five years. The focus on current year performance may go some way towards helping readers understand 'business as usual' but it is not enough to provide a complete picture of long-term value.

Identifying the content needed to explain how business issues and opportunities affect value will depend on the issues themselves but two steps should provide a basis for determining this:

- Understand how the business issues and opportunities reported will affect an investor's assessment of business value. Provide the information that supports this assessment. Some matters are relevant because they could change the shape of the business, others may have a more immediate impact such as a step change in productive capacity. The type of information that readers need for each will be different.
- Provide context (as well as performance and risk measures) so that readers can form their own views of potential value impacts. If the strategy depends on developing a particular market, help readers to understand its current and potential size rather than just explaining the strategy.

Addressing the key drivers of value

A small number of stakeholder issues may have a fundamental effect on business value. They may represent threats, such as possible loss of operating license or opportunities, such as the creation of major new markets. Reports should cover these issues to provide a more complete picture of value.

Corporate Responsibility reporting sometimes highlights the cost of managing these issues over the business benefit. A more complete picture is needed. Reporters should be looking to prioritize the most relevant issues:

- High impact issues should form part of the core business reporting flowing through the report in the same way as other strategically relevant business issues.
- For lower impact issues readers may simply need to see the relevant risk indicator and understand that the risk is being managed.

For many businesses these 'game changing' issues will represent a large segment of total value, yet a lack of reporting focus can lead to investors falling back on industry-level generalizations.

Integrated Reporting in practice: **The South African story**

By Mark Hoffman, KPMG in South Africa



In brief:

- **Companies listed in South Africa now need to adopt Integrated Reporting on an ‘apply or explain’ basis**
- **KPMG in South Africa’s experience is that many of the most successful implementations have been driven from the board and top management**
- **Successful Integrated Reporting is not just about reporting, but about co-ordinating different disciplines within the business and focussing on the organization’s core strategy**
- **The businesses which have gained most from Integrated Reporting have spent time and effort in building a continuous reporting approach**

The first annual cycle of Integrated Reporting in South Africa shows this has been a rewarding – though sometimes challenging – journey for the listed companies applying it. Through KPMG in South Africa’s involvement with more than 80 companies we can see the positive impact that the entire change in reporting ethos is having on companies’ strategic thinking. Our experience is yielding important lessons for companies already embarking on the Integrated Reporting journey as well as those who simply want to improve the quality of their reporting.

It is clear that the concept is bedding down and gathering momentum.

One year in

Companies listed on the Johannesburg Securities Exchange (JSE) were required to adopt Integrated Reporting from years commencing on or after 1 March 2010. The driver for this was the King Code of Governance Principles for South Africa 2009 (King III) becoming a JSE listing requirement. King III recommends that organizations should adopt Integrated Reporting on an ‘apply or explain’ basis.

There has been a generally positive and pro-active response from JSE-listed companies and a number of State-Owned Entities in South Africa which have embraced Integrated Reporting as part of their King III application programmes. The levels of application have varied, depending on the maturity, sophistication and approach by organizations to Integrated Reporting. Reporters typically fit into the following categories (and sometimes more than one): Early adopters & business-case driven; Compliance approach; Wait and see; and Laggards.

It is clear that the concept is bedding down and gathering momentum. Full adoption of Integrated Reporting is a journey and we think it could take most companies up to three years for it to become a fully established way of reporting the business strategy and performance. The journey duration depends on the departure point – the maturity and sophistication of existing reporting systems – and management’s energy and commitment to implementation.

We have had the privilege of working with more than 80 Integrated Reporting organizations. Below we share some of the key learning points observed in the first annual Integrated Reporting cycle, some of the challenges, and how businesses are tackling these.

Peer groups are establishing benchmarks and trends in terms of structure and content.

What have we learnt?

Driven from the top

The more successful Integrated Reporting implementation programmes have benefitted from close involvement of CEOs and executive committees. Well organized and committed steering committees and project-management teams are needed to drive the implementation process.

Integrated thinking and management

The key to successful Integrated Reporting implementation is the ability of the business to achieve integrated thinking and integrated management in the organization. This requires getting the different disciplines within the business to work together and break down the silos that are evident in many organizations. Some of the more successful Integrated Reporting teams have included the following functions:

Finance	Performance Reporting
Sustainability (Safety, Health & Environment)	Governance & Regulatory
Risk Management & Strategy	Operations Management
Corporate Communications & Investor Relations	Human Resources
Stakeholder Engagement	Information Technology

These functions can be structured in different ways in each organization but the key challenge for the Integrated Reporting project leader is to get buy-in and ensure involvement from all the main internal stakeholders. There needs to be 'one view' of the business and consensus on one set of material issues that need to be addressed through one combined strategy. For example the days of having a stand-alone sustainability strategy are gone, and we are increasingly seeing this incorporated into the core strategy of the business.

Ad hoc reporting versus continuous process

Given the often pressing reporting commitments and deadlines that businesses face, there needs to be a balance between preparing an ad hoc annual report and establishing an enduring integrated reporting process within the business. Shortcomings in the reporting process (such as reporting of risk management, stakeholder engagement, execution of strategy, performance and remuneration structures) often point management to deficiencies in underlying activities or processes. Management can fall into the trap of 'fixing the report' on an ad hoc basis rather than addressing the underlying issues.

The ideal state is achieved when the internal management reporting is aligned with external reporting thereby focusing on the activities most valued by investors. The story of the business is already understood, analyzed and told before the Integrated Report is prepared. Reaching this state takes away the huge effort typically observed in year-end reporting and moves towards a continuous reporting flow. We have seen businesses actively align their executive committee and board reporting to their Integrated Reporting process, and vice-versa. The result is that what gets reported is managed throughout the year so there are no surprises in the year-end reporting process.

Forward-looking focus

Integrated Reports should include a forward-looking perspective on the business corroborated by a look-back on performance against strategies and strategic objectives. This marks a shift in focus from short-term historical financial performance to providing an understanding of how management is driving the medium to long-term business prospects. The cultural change required from report preparers is substantial.

Business-case driven approach

Implementation of Integrated Reporting has mostly been a positive experience for corporates that have

Management can fall into the trap of 'fixing the report' on an ad hoc basis rather than addressing the underlying issues.

We have seen businesses actively align their executive committee and board reporting to their Integrated Reporting process, and vice-versa.

established a clear business-case driven approach to the task. Most organizations have built on their existing reporting practices and now are focussing on areas needing improvement.

What do users think?

It is early days and there has not been overwhelming feedback from users – yet. We believe this will take time as users get used to the new approach to business reporting and Integrated Reporting gathers momentum, and as more detailed content is provided around the broader range of issues being identified in the report.

A number of forums and interaction between reporters and stakeholders are taking place on a collective and individual basis. This ongoing interaction and feedback should start the stakeholder engagement that is required to more clearly define users' legitimate requirements and expectations from Integrated Reporting.

But it is not just about the users of the reports. There are clear benefits for underlying businesses adopting Integrated Reporting. Interestingly a lot of positive feedback comes from management teams who are finding that Integrated Reporting enables them to:

- Focus the business on the really material issues
- Achieve integrated thinking and integrated management
- Consider risks and opportunities more widely (including environmental, social and governance, and stakeholder engagement)
- Communicate strategy more effectively
- Enhance performance reporting
- Streamline reporting externally and internally

Where now for South African companies?

This has been a discovery process for the many first-time integrated reporters, and the first annual wave of reports got this project off to a good start. The International Integrated Reporting Council pilot programme is also adding international momentum.

The South African business community has responded positively to something that has been a long time in coming. Most businesses view it as a refreshing way of looking at and managing their businesses and reporting both internally and externally.

Peer groups are establishing benchmarks and trends in terms of structure and content as well as common material issues and performance measures. This has been particularly evident in the mining and banking sectors.

Most first-time reporters have identified areas of their Integrated Reporting process that can be improved, and we expect that report detail will improve as its value becomes apparent and the underlying reporting systems improve. Many of these developments will be addressed in the journey to better reporting that has been adopted and will become evident in new generations of Integrated Reports. Most importantly it should be recognized that Integrated Reporting is a way of achieving Better Business Reporting. It is being driven by businesses and their stakeholders as opposed to being simply another regulatory compliance exercise. The successes and better practice trends being developed as well as continued stakeholder engagement, thought leadership and drive by the business community will ultimately underpin the future success of Integrated Reporting.

The days of having a stand-alone sustainability strategy are gone.

Better Business Reporting in practice: **Challenges found** (and how you can overcome them)

Various common challenges and critical success factors emerged as we worked with clients in South Africa to tackle Integrated Reporting. Leading reports found innovative solutions and are establishing best practice trends in many of these areas, bringing creative thinking to the table. It is clear from the leading reports that Integrated Reporting in these companies was driven by the business – by its objectives, by its strategy, and by the different areas of the business working together to create integrated value across the organization as a whole. Leading companies also demonstrated strong interaction between reporters and stakeholders.

This approach has already started to pay dividends with the results looping back into the different areas of an organization and flowing through to its governance and continuing improvement of long-term strategy. As the Integrated Reporting process continues to mature, this interaction should generate increasing benefits for an organization and its value creation. Here we consider our findings so far on some of the challenges and success factors noted to date.

IFRS reporting in the financial statements remains a safe haven for objective reporting which can be reconciled to the analysis provided by management in the Integrated Reports.

Materiality

Materiality is applied at all levels of Integrated Reporting, particularly in risk and opportunity analysis but also in considering the impact of strategic focus areas and performance reporting and outlook.

Quantitative materiality thresholds can be defined using traditional concepts of reporting materiality but qualitative criteria need to consider issues including reputation, credibility, sensitivity and strategic relevance of matters. The structure of a well-designed Integrated Report provides a natural basis for determining the material qualitative issues.

Reporters who have applied the connectivity principle effectively have found that their report content naturally addresses the most material issues affecting business value.

Additionally, the stakeholder assessments that many companies went through as part of their reporting process has helped them to step back to identify a more complete picture of business challenges and opportunities. In this respect materiality has been much less of an issue than many had originally anticipated.

Assurance

Developing an appropriate assurance process over integrated reporting is a significant challenge for many organizations. A focus group has been formed in South Africa to address this challenge and develop guidance in consultation with regulators and other stakeholders.

A combined (internal and external) assurance approach is at the heart of an efficient and effective strategy. The assurance approach needs to combine the following:

- Governance – oversight and approval of the reporting strategy, structures and processes
- Processes – establishment of appropriate processes, systems and controls at all levels of the Integrated Reporting process, including internal audit and external assurance providers
- Data – assurance over quality of underlying data
- Use of judgment – assessments of risk and materiality

The first challenge for reporters is to build appropriate systems of controls over these new reporting areas. The size of this task should not be under-estimated given the volume of qualitative and quantitative data which has not previously been subject to a formal reporting process.

Once this has been achieved we expect that the assurance community (internal and external) will be ready to meet the demand for broader assurance in these areas by building on existing assurance standards for forward-looking and non-financial information.

Logical links and flows

Connecting elements of the report is critical to the success of effective Integrated Reporting. Appropriate structuring leads to good linkage and logical flow. Redundancies and irrelevant

content can be identified through an editing process that links content across the Integrated Reporting elements.

The ultimate test? *If it's not linked, it doesn't belong.*

Regulatory requirements and other reporting

Organizations in South Africa need to continue to meet their regulatory reporting requirements under King III, the Companies Act of 2008, International Financial Reporting Standards and the JSE Listing requirements. They may also wish to subscribe to certain non-mandatory frameworks (such as the Global Reporting Initiative, JSE Socially Responsible Index, Carbon Disclosure Project, United Nations Global Compact and Millennium Development Goals).

Many companies have found the most effective way of dealing with additional content that's not material in the context of the Annual Report itself has been by providing explicit links to other documents.

For example, often only abridged financial statements are provided with linkage to a separate document containing the full IFRS financial statements. This approach has worked well where the linkages have been clearly highlighted and are easy to follow.

Stakeholder engagement

Stakeholder engagement is sometimes overlooked or dealt with at a shallow level. Integrated Reports should reflect meaningful interaction and engagement with stakeholders, filtering to material issues and demonstrating responsiveness in the business strategy and ultimately performance.

Leading reports demonstrate that interaction actually took place and specify the issues arising from it rather than using generic stakeholder engagement avenues and themes.

Organizations that have addressed shortcomings in their stakeholder engagement processes find that a wealth of business intelligence lies in meaningful interaction with stakeholders across all spectrums of the business.

Providing a balanced view

Users of reports typically want a clear view of shortcomings and challenges businesses face. Most importantly, they want to understand how management is dealing with these issues.

Businesses tend to think that reporting these challenges can lead to a negative perception of the organization. Those charged with governance have a responsibility to ensure that the Integrated Report deals with all the organization's material issues in an objective manner, providing a balanced view of the organization.

Ultimately most businesses have developed what they consider to be the best strategy to deal with the challenges they face. *They have generally found it preferable to explain how they're managing the issue rather than retreat behind boilerplate disclosure that may leave readers with the impression it is not being addressed at all.* Similarly, organizations may benefit from highlighting the opportunities and competitive advantages they have achieved in successfully executing their strategies.

Stating the business strategy

Many reports only set out generic strategic themes or objectives for the organization. Businesses need to state the underlying strategies clearly so users can understand the essence of these plans and where they will take the organization. Only by understanding a strategy can performance be understood. Articulation of strategy usually requires an outline of the underlying activities, initiatives and processes linking to the associated targeted performance and aspirations.

Selecting the right KPIs

Key performance indicators presented in reports are only effective when placed in context.

It is important to link KPI's to underlying strategic imperatives as well as associated targets and trends that provide the required context. Some organizations have gone as far as benchmarking KPIs with their peer groups locally and internationally.

It is notable that the extractive industries and banking sector have been leaders in providing additional performance information. Peer pressure may be playing a part here, with participants reluctant to risk challenge over the completeness of their disclosures.

Financial performance analysis

Financial results included in Integrated Reports are often limited to summarized financial statements prepared on an abridged basis. Better reports provide analysis of drivers of volatility and sustainability of trends in financial performance and link them to underlying strategic initiatives. This could extend to providing management's perspective on sustainable earnings and identifying what are considered exceptional items in the financial results. *IFRS reporting in the financial statements remains a safe haven for objective reporting which can be reconciled to the analysis provided by management in the Integrated Reports.*

Targets and future performance

The forward-looking orientation of Integrated Reporting necessitates preparers to start providing meaningful insight into management's plans and aspirations. It does not necessarily require management to provide detailed projections or forecasts of financial performance. Ideally the uncertainties and non-controlled factors should be identified and their impact on performance outlined in sensitivity analysis. Management's aspirations and targets should focus on what they control from a strategic and operational perspective.

Reporters can be reluctant to provide targets and future performance aspirations in their external reports. Reasons given revolve around regulatory concerns on providing forward-looking information and creating expectations that may be used against management in future periods. *Often regulatory concerns and commercial sensitivities can be managed through careful presentation.* Without guidance on future performance goals, many users set their own implicit expectations – these can be equally damaging to management if not met.

What does an Integrated Report look like?

By Michael Bray, KPMG in Australia and Matt Chapman, KPMG in the UK

One of the questions KPMG member firms are most often asked in relation to Integrated Reporting is: what does an Integrated Report look like? Whilst some organizations have made significant progress in applying Integrated Reporting principles, they are all, in our view, still on the journey towards Better Business Reporting.

One of the distinguishing features of Integrated Reporting is that in contrast to compliance based reporting, there can be no model report – every report must be built around the unique business model of the preparer. This requires a very different mindset when looking at examples of good reporting. There are many good illustrations of how to report specific matters but examples can only provide a starting point for a company’s own reporting, not a template.

The starting point for understanding how Integrated Reporting works is considering the application of the content elements and guiding principles of the IIRC’s Integrated Reporting framework. We have not provided an example of an overall ‘perfect’ Integrated Report as it simply does not exist at this stage, although the experience in South Africa and the work of the IIRC pilot programme will take us in that direction in the future. What we have done instead is to show the elements that companies need to consider in building up their Integrated Reports, and give some examples of good practice to date.

Integrated Reporting building blocks

The IIRC has set out the content elements and guiding principles which underlie Integrated Reporting.

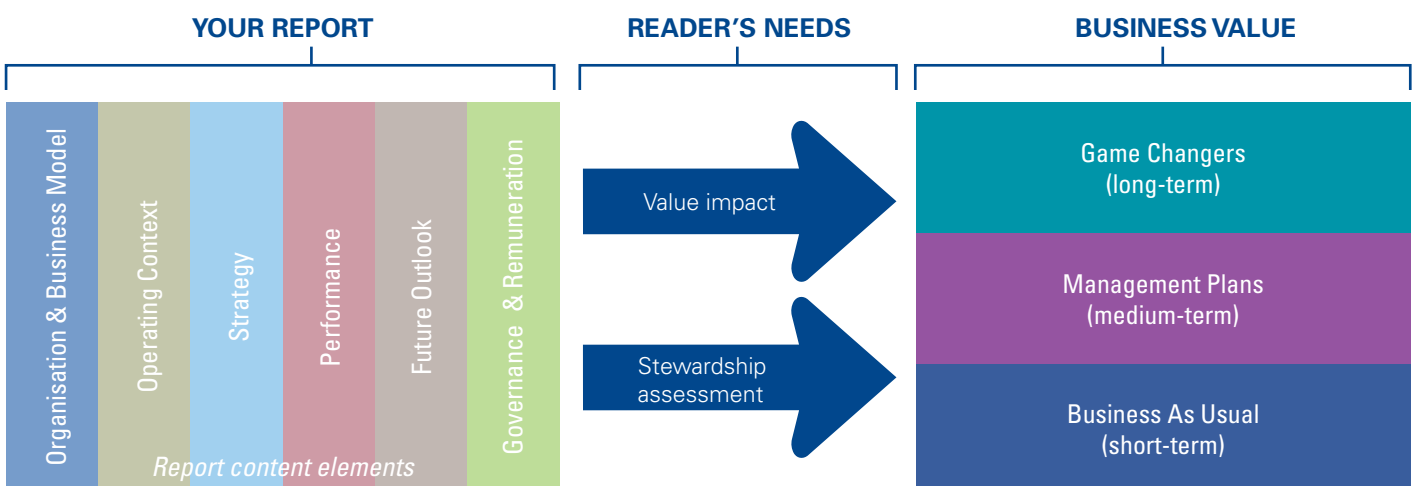
The Integrated Report should cover the six content elements using the five guiding principles to enable capital providers and other key stakeholders to make decisions about the business’s value and stewardship – the matters that shape its value for the longer term, its aspirations and plans for the medium-term, the business as it currently stands, and how it has delivered on its promises.

Guiding principles for Integrated Reporting

- Strategic focus
- Future Orientation
- Connectivity of information
- Responsiveness and stakeholder inclusiveness
- Conciseness, reliability and material

It is important to note that whilst the content elements provide a good overall structure, there is no need to assemble the report in a linear fashion. A consistent thread of key issues should run throughout the report – it should be possible to follow a strategic objective all the way through the report, from how that objective relates to the business model, through the associated risks and risk mitigation strategies, to the key performance indicators measuring progress in achieving these, and to the future outlook.

Applying the Integrated Reporting Content elements



Can I model it?

Ultimately good reporting is about meeting investors’ needs. For an Annual Report this comes down to answering two key questions. What does it tell me about the value of the business and what does it tell me about the management’s stewardship of the business? Some of the best examples of reporting help readers understand how to model value - how to structure a cash flow model of the business and how to form views on the key model judgments. Businesses that don’t do this risk greater capital markets volatility.

Tackling Integrated Reporting by element

On the following pages we consider each of the six content elements and the challenges that reporters have in addressing them. In doing so, we also highlight how the guiding principles apply across the content elements.

We set out the questions reporters need to ask themselves before moving on to give illustrations of good practice. In a publication of this size, we can only cover a limited number of examples: there are many more examples of ‘good’ out there. Some of these have come from South African public companies that are now preparing their second round of Integrated Reports. Other examples come from companies which have been working to improve their reporting without necessarily seeking to follow the Integrated Reporting principles.

Integrating with IFRS and other reporting frameworks

Many South African companies are rebranding their annual reports as ‘integrated annual reports’, with Integrated Reporting replacing the ‘front end’ of the annual report and IFRS-based financial statements either in the same document or published separately.

Existing Annual Report elements such as chairman’s statements, CEO reports and operational reviews are being re-focussed on specific Integrated Reporting content elements. Many companies are also continuing to produce GRI-based sustainability reports, usually in a separate publication or on-line.

Material information from the financial and sustainability reporting is being retained in the Integrated Report and supplemented with new ‘value-indicating’ KPIs. Other reporting may be reduced in volume and complexity by the renewed focus that Integrated Reporting can bring. The financial statements of UK company ITV provide an interesting example of how financial statements can be de-cluttered to provide a clearer report within the existing IFRS framework.

In the longer term, Integrated Reporting may become a self-contained, clear and concise articulation of business value and stewardship. Integrated Reporting may be distributed electronically, or even be an electronic repository from which readers can drill down to other reports for detail.

ANNUAL REPORT

Typical approach

- Structured around Integrated Reporting content elements
- Retains traditional components (Chairman’s statement etc) within the Integrated Reporting framework
- Incorporates the financial and non-financial data necessary to understand all components of business value
- No direct change to supporting reports such as the financial statements and corporate responsibility report (though there may be an opportunity to cut clutter from both)

FINANCIAL STATEMENTS

CORPORATE RESPONSIBILITY

OTHER REPORTS

What does it look like?

Organizational overview & business model.

This element of the report provides essential context to the report user. It provides the foundation on which the more specific disclosures elsewhere in the report are based. It is also the part of the report that users will fall back on to assess the headline impact of unexpected events on future cash generation in the absence of any specific management guidance.

Challenges:

- Is sufficient detail provided to understand the relative importance of each group of assets / activities to the value of the business?
- Is the analysis sufficient to put the elements of the business into context?
- Do the components of the business model described link through to the rest of the report?.

The starting point is an explanation of how the business works and the factors which affect the continued operation of the business model. Sasol and National Grid are among a growing number of

companies that have found a graphical presentation to be helpful.

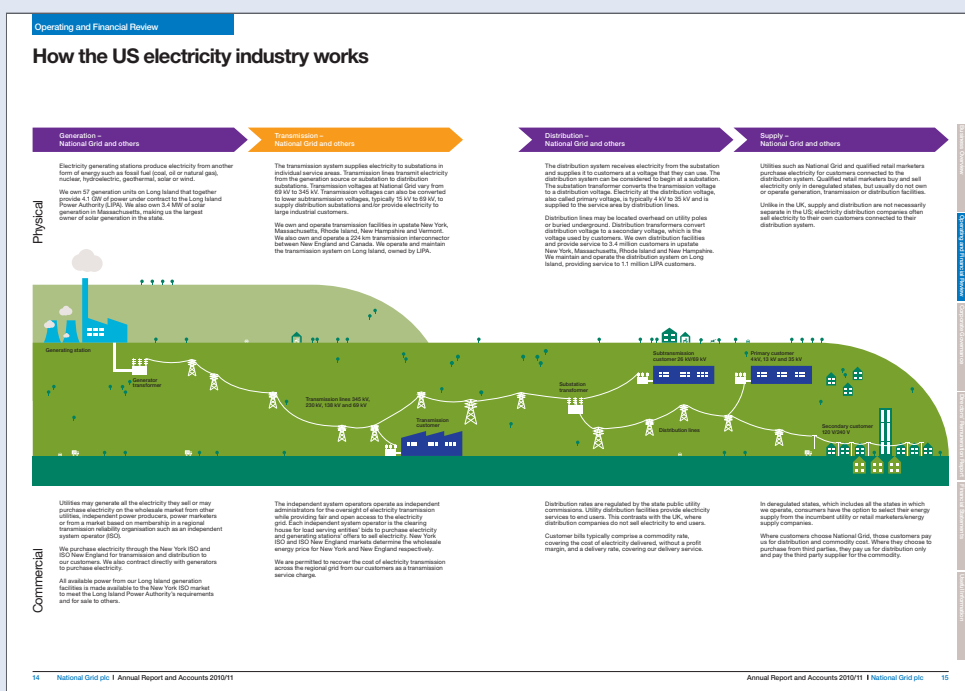
A high level view of the business model provides a starting point for readers to understand the business on its terms – in fact it should be the foundation of the report. However, it's not enough on its own. Detail is needed if readers are to use the business model description in their decision-making. The right detail will support two different perspectives on the business – readers will need both of these when making different judgments about the business:

1 Explaining business activity

A good description of the business model should provide a basis for explaining each aspect of the business operations – the suppliers it interacts with, the inputs on which it depends, the processes it undertakes, the outputs it produces, and the customers it sells to. For example, in their Sustainable Living Plan, Unilever identify their top 10 raw materials by volume. This helps readers understand the potential impact of strategic objectives around sustainable sourcing.

This is not to say that extensive disclosures are required in each area – the amount of detail only needs to be sufficient for readers to assess the impact of the material risks and opportunities identified elsewhere in the report.

Example – Explaining the business model



Source: National Grid plc Annual Report and Accounts 2010/11, pages 14-15

2 Explaining the business's resources

The business will generally depend on different resources at each stage in its process. Readers will want to understand the extent to which the business depends on these capitals and the impact it has on them. They will represent the key source of risk and opportunity for the business.

The frustration for many reporters has been that the cost of managing these resources is covered in traditional corporate reporting whilst the benefit is not.

The IIRC has identified six capitals: financial, intellectual, manufactured, social, human and natural. Not all will be significant for every reporter but some will be essential if readers are to understand the resources the business depends on and how it affects them.

The mining industry has been providing in-depth analysis of its natural resources for many years. The result is much greater visibility over how management of the productive capacity of the business is evolving. Other businesses will have different priorities – for example brand management – but they may well benefit from following similar reporting principles.

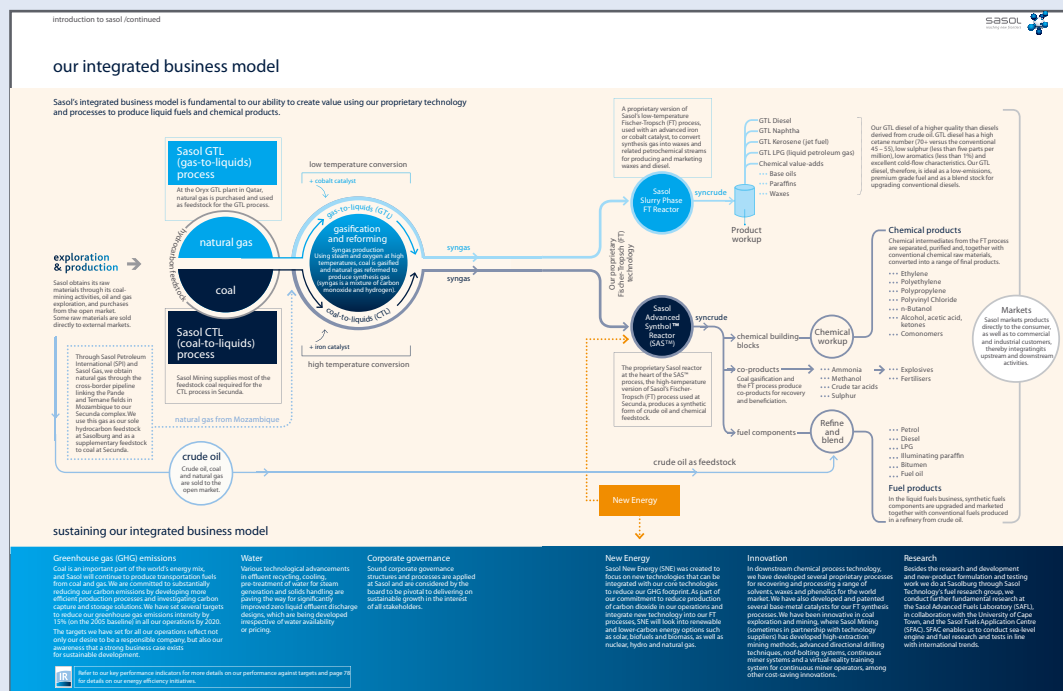
How well does your reporting explain your business model?

Would a reader agree with these statements?

- I understand the resources on which the business has access to, depends on, and how it affects them
- I can see what the business currently does and how it adds value
- I can see how management's plans will change the shape of the business
- I understand the high level assumptions that underpin the business model

Detail is needed if readers are to use the business model description in their decision-making.

Example – Explaining the business model



Source: Sasol Integrated Annual Report 2011, pages 8-9

All extracts from published reports should be read in conjunction with the full report itself including its notes.

What does it look like?

Operating context including risks & opportunities.

This part of the report describes the external factors affecting the business (both positively and negatively) and how the business identifies and responds to these factors.

Compliance led reporting has generally focused on the downside risks here but if a more complete picture of value is to be given, business opportunities also need to be addressed as they form a major part of the long-term value of many businesses.

Challenges:

- Does the description balance the focus between the long-term major risks to the business model and short-term operational issues?
- Is sufficient detail provided to understand the impact of the risk / opportunity? For example, what size of revenue segment does it affect?

Some reporters clearly put a great deal of effort into identifying potential risks. We believe readers will be more interested in gaining a deeper understanding of the smaller number of issues that could have a fundamental effect on business value.

Some companies provide a broad-ranging analysis of their risks and their management, explaining their risk management performance in some detail in terms of risk tolerance levels set by the board (risk area, aspirations, tolerance level, targets, and 2010 and 2011 performance). They also comment on their risk review process and risk management assurance.

The linkage of issues across the report can help keep it focused on the most material issues. If an issue is identified as a key risk or opportunity, linkage demands that the strategy and performance in managing it are also explained, together with future outlook and governance. If management find it difficult to explain these, they should ask themselves whether they are reporting on issues that are of only peripheral relevance.

Example – Risk management, strategy and performance

2.2 Risk management

Effective and integrated risk management sits at the heart of true business sustainability. Gold Fields has a well-established Enterprise Risk Management (ERM) process, which not only covers our 'traditional' operational and business risks, but also our environmental, social, health and safety risks.

The overriding purpose of the ERM process is to help Gold Fields become more resilient in the global business environment and achieve its strategic objectives – to grow Gold Fields, to optimise its operations and to secure its future. It also supports our efforts to achieve the highest levels of corporate governance, as well as full compliance with the risk management requirements of South Africa's King III Code.

The ERM process is comprised of two integrated and well-aligned components: operational risk management and strategic risk management (see Figure 2.8). It is aligned with the ISO 31000 international standard on risk management.

During the year, our international operations were surveyed by the IMU (International Mining Industry Underwriters) and our South African mines by Zurich Risk Engineers, part of Zurich Re. Both agencies noted continued improvement in risk management at these operations and all of the mines are placed in the top quartile of the approximate 400 mines assessed.

Gold Fields has operated for 11 years without making a property claim into the insurance market.

Additional content online
www.goldfields.co.za

During 2011, the ERM process at Gold Fields was reviewed by PricewaterhouseCoopers, which found that:

- The ERM process is fully compliant with the risk management requirements of King III
- All the key principles of the ISO 31000 risk management guidelines have been adopted
- Gold Fields has established a mature risk management process that is leading many of the approaches in the non-financial sector

Figure 2.8: Enterprise Risk Management process – definition

Figure 2.9: Risk management review process

Figure 2.10: Risk, strategy and performance (within the tolerance levels set by the Board)

Risk Area	Aspirations	Tolerance level	Targets	2010	2011
Optimise our assets					
Safety	Zero Harm	Zero Harm	IFR - Zero	0.11	0.12
			SFR - 25% less ¹	2.22	2.64
			LTR - 25% less ¹	4.39 ²	4.69
			MTR - 25% less ¹	7.16 ³	5.68
Health	Zero Harm	Zero Harm	2013 MTRC milestones for Silicosis & NHL	On track	On track
Environment	Zero Harm	Zero Level 4 and 5 incidents	Zero	Zero	Zero
Gold Delivery	Stakes by 2015	95% compliance	3.8kGcs	2.5	3.5
	NCE 25%		NCE 15% - 20%	16%	25%
Securing our future					
Human Resources	Pipeline of scarce and critical skills	60% - successor cover ratio for top 200 employees	60%	50%	70%
Licence to operate	Global leader in sustainable gold mining	Full compliance with all legal and community commitments	Full compliance	100%	100%
Ethics and Corporate Governance	Full compliance - SOX and substantial compliance to King III	No material / significant failures	No material / significant failures	Nil	Nil
Growing Gold Fields					
Capital Projects	Project delivered on time / budget	7% - 10% overrun	South Deep, Chuquapata, FLS, AMP, Barlolla	On track	On track
Mergers & Acquisitions	Proper assessment of risk and return commensurate with the risk	IRR 1.5% - Near mine	As per IRR	On track	On track
Exploration	Appropriate balance between geological potential & political risk	Learning towards greater geological potential in high risk areas	As per GBAR ⁴	On track	On track

■ Targets achieved
 ■ Improved on previous year
 ■ Targets not achieved

¹ South Africa only - other regions are subject to a 20% reduction target for SFR, LTR and MTR. ² Internal Rate of Return ³ Global Business Area Rating system

⁴ Reinvestment - LTR previously reported as 4.38 and MTR previously reported as 7.29. Please see pg 4 for explanation.

Risk review process

The multi-stage strategic risk management process starts with quarterly strategic risk management assessments at each of our mines and service divisions. In addition, all sites regularly conduct operational risk assessments compliant with standards set by Simrac Safety in Mines Research Advisory Committee) in South Africa and the AUNZ Standard 4360 in Australasia. Key strategic risks are identified and analysed, and mitigating actions are put in place (or reviewed if already in place). The regions' top risks are forwarded to the regional executive committees, which review the risk register and decide on appropriate mitigating actions.

The Group's top strategic risks are then reviewed by the Gold Fields Executive Committee (ExCo) on a biannual basis. Mitigation strategies are developed on the basis of this review, which are presented at the Audit Committee's dedicated risk meetings and reviewed after six months.

The Board and company management are responsible for risk governance and management. Nevertheless, the integral involvement of all line managers in the process is essential to ensure the effectiveness of the system.

Risk management assurance

Our Risk Management Charter provides for four levels of ERM process assurance: (1) Financial Internal Controller's review mitigating strategies on a regular basis to ensure they are being implemented. These reviews must be captured in the Curis risk management software system; (2) Internal Audit conducts an annual review on the effectiveness of the risk management process; (3) Internal Audit provides assurance to the Board that the risk management plan is integrated into the daily business activities of Gold Fields; (4) Internal Audit conducts an annual review of the mitigating strategies of the top risks in the risk registers to ensure they are being implemented.

Source: Gold Fields Integrated Annual Review, 2011, pages 36-37

The linkage of issues across the report can help keep it focused on the most material issues.

Many South African reporters have used stakeholder interaction as a basis for providing the assessment of operational and strategic risk. This approach can help to balance focus on the major long term risks and opportunities that can transform business value with the more immediate operational challenges on which management focusses on a daily basis. This distinction between long and short-term is particularly important in this part of the report – readers need to understand both.

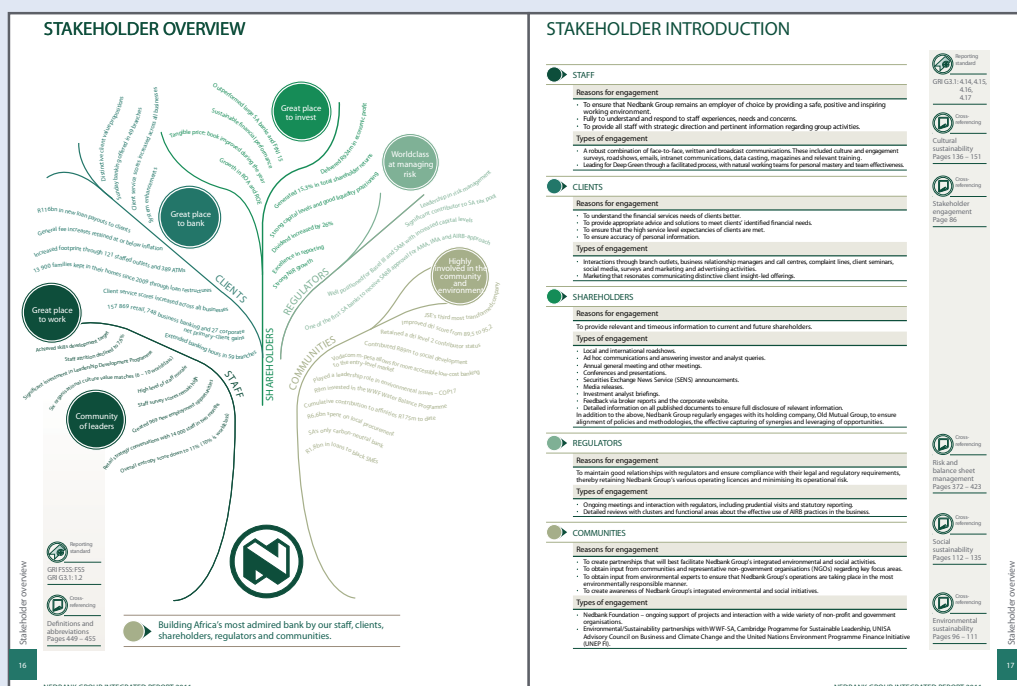
Nedbank overviews its various key stakeholders and their key issues, introducing each of them, explaining the importance of each and why they need to be engaged and how they have been engaged. Nedbank pays particular attention to its individual key stakeholders. For example, in relation to regulators it reviews relevant objectives, summarizes the strategy for 2011 and self-assesses performance. It ties this to strategic objectives for 2012 and beyond, and comments on feedback and resultant actions. It also cross-references / links to other reports.

How well does your reporting explain the operating context of the business?

Would a reader agree with these statements?

- I understand the risks and opportunities associated with the resources on which the business depends on
- I can see how the business affects (positively and negatively) the providers of the resources that it depends on
- Management has explained the assumptions around future business environment on which the organization's plans are based; I understand the change in resource required to deliver this plan
- I understand the current risks and opportunities faced by the business and how they are managed

Example – Stakeholder engagement



Source: Nedbank Group Integrated Report 2011, pages 16-17

All extracts from published reports should be read in conjunction with the full report itself including its notes.

What **does it** look like?

Strategic objectives

This part of the report should explain the vision of how the organization will look in the future and how it will get there. There should be a natural link between the operating risks and opportunities identified elsewhere in the report and the strategy for dealing with them. The result should be a mix of information covering both short-term operational strategy and the long-term strategic vision for the business.

Challenges:

- Are the consequences (good and bad) for the organization’s resource requirements and availability clear – and does analysis in the rest of the report support this understanding?
- Are the consequences of the strategy visible in both the performance and outlook sections of the report?
- Does the content describe a long-term vision for the business or near-term tweaks to business operations?

An effective description of strategy should have three key elements: vision, starting point and delivery:

1 Vision

Where are we trying to get to? Focus on what the business should look like after management has implemented its strategy. Help readers understand the rationale for following the vision (including any changes to previous strategies) and the assumptions about the future on which it is based.

2 Starting point

This is the base from which the business is starting its journey, including its strengths and exposures, focussing on those aspects of the business that are directly relevant to the strategy. A good description here provides a basis for understanding how business activities and resources will need to change as a result of following the strategy.

3 Delivery

Leading reports help readers understand the milestones on the journey to delivering the change, and an explanation of how the key risks and opportunities are being managed and the impact they could have on the strategic goal. This should form the basis for identifying the operational performance indicators that show readers how the business has progressed in delivering the strategy.

The following example from ITV demonstrates the unique aspects of its business strategy.

Example – Explaining business strategy

The screenshot shows a report page titled "Transforming ITV". A large green box highlights a strategic objective: "3 Drive new revenue streams by exploiting our content across multiple platforms, free and pay". Below this, it lists goals: "Enter pay TV", "Transform itv.com", "Own customer relationships on connected platforms", "Total Value approach to brand exploitation", and "Build addressable advertising capabilities". The main text of the report discusses developing a channel portfolio, driving forward sponsorship and product placement, and transforming navigation and viewing experience. It also mentions growing revenues from the SDN business and restructuring sales teams.

Source: ITV plc Report and Accounts 2010, pages 17-18

It is important to demonstrate the unique features of the strategy. After all, this is management’s opportunity to explain how it is enhancing the business model. Reporters who don’t do this, risk falling back on generic industry-level objectives such as market leadership. This adds little value, and in reality may be creating operational goals that the business has little hope of achieving. In contrast, ITV’s description of its strategy ran to some 19 pages in its 2010 Annual Report, providing readers with a clear picture of how the business is expected to change under management’s plans.

This is management’s opportunity to explain how it is enhancing the business model.

How clearly does your reporting explain the business strategy?

Would a reader agree with these statements?

- I understand where the company is on its journey towards its strategic vision
- I understand how the business will change in the short-term as it develops towards its strategic vision
- I can see the operational milestones in implementing the business strategy
- I can see in broad terms how the business plans to evolve to meet changes in its operating environment; I understand its strengths and weaknesses as it prepares to meet this challenge
- I understand how the long-term strategy will be delivered

Example – Explaining business strategy

Our strategy continued

3
Reduce complexity and cost.

- Continually improve key areas of customer service
- Converge and simplify processes and ensure disciplined expense management
- Upgrade our technology with a multi-year program that will make us a more agile, efficient and competitive business by simplifying banking, finance and risk systems, processes and tools

2011 HIGHLIGHTS

- Simplified our product ranges
- Progressed simplification of the mortgage process for our customers and our frontline bankers
- Progressed technology upgrades in infrastructure, network, re-platforming program and customer process

FOCUS GOING FORWARD

- Continue to progress the upgrade of operations and replace ageing infrastructure
- Responsible management of costs within growth

MLC & NAB WEALTH

A core priority at MLC & NAB Wealth is to create meaningful return capability for financial advisers and customers. There are significant benefits for both our business and our customers in enabling more transactions to be completed online, including faster turnaround times and improvements to customer service, accuracy and efficiency.

“MLC Online applications are available at any time, eliminating the need for paperwork, and enable new accounts to be set up on MLC’s system instantly, which reduces potential errors associated with manual administration. Collectively, this has enabled advisers spend more time actually speaking with clients.”
Chris O’Rielly, MLC Financial Planning

Banking cost to income ratio

Year	Ratio (%)
2009	100
2010	100
2011	100

Simplified our product ranges and closed more than 100 products.

Our business | Our strategy

“NAB’s strategy for fair exchange of value has been reinforced by a number of Personal Banking initiatives including competitively priced products and services, leading the industry by abolishing early exit fees.”
Cameron Clyde, Group CEO

4
Enhance our reputation.

- Improving our customer outcomes
- Invest in our people – leadership and skill development, diversity and volunteering
- Address our broader responsibility in society – education, inclusion and environment

2011 HIGHLIGHTS

- Awarded ‘Best Low Fee Bank Account’ for NAB Classic Banking by CHOICE for the second consecutive year
- Removed mortgage exit fees and introduced fairer credit card charges
- Awarded ‘Most Satisfied Customers’ of the Major Banks by Canstar Blue
- Awarded ‘Best Career Development Program’ for the Academy NAB’s learning and development centres in the 2011 Australian Banking and Finance Awards
- Contributed over 25,000 volunteer days to the community, worth more than \$8 million
- Included in the Dow Jones Sustainability Index (Asia Pacific) index top ten leaders and the World Index, and the Carbon Disclosure Project Performance and Disclosure Index
- Published our third Reconciliation Action Plan, setting out 22 commitments for the year ahead

FOCUS GOING FORWARD

- Continue delivering our promise of ‘More Give, Less Take’ to show we stand for fairer and better banking
- Achieve our Greenhouse Reduction and Beyond Carbon Neutral targets by 2013
- Create a more diverse workforce through initiatives that help achieve our disclosed diversity targets
- Continue to focus on issues of inclusion, hardship and education in our wider community

Customer satisfaction Personal Banking Australia
Key of early satisfied (%)

Open Saturdays.

PERSONAL BANKING

By listening to our customers and maintaining our commitment to ‘do the right thing’, we have enhanced our reputation and expanded the NAB Family. MS Shevkar, from Forest Hill in Victoria, broke up with Weispace after 10 years.

“I just got sick of paying this extra money each month and just felt I wasn’t getting the personal service.” **Ms Shevkar**, new NAB customer

Source: National Australia Bank Annual review 2011, pages 12-13

All extracts from published reports should be read in conjunction with the full report itself including its notes.

What **does it** look like?

Performance

This part of the report describes current levels of performance both as a basis for assessing progress in delivering management's strategic targets and as a base for understanding the future outlook for the business.

Challenges:

- Is the analysis of performance on a basis consistent with to the operational reality of the business and on a basis that can be projected forwards by the reader by applying a set of operational assumptions?
- Have all aspects of corporate strategy been addressed?
- Does 'underlying performance' provide a balanced perspective from which the future outlook can be assessed?

If the foundation of the report has been well designed (covering business model, operating context, and strategy), the material areas for performance reporting should naturally follow. However, care needs to be taken in selecting the right measures to report. The performance indicators selected need to support readers' decision-making processes. This means recognizing that different types of measures are relevant to different judgments.

The following four key areas should help readers form a clearer view of business value and stewardship:

1 How has the 'asset' base changed and how has it been managed?

Businesses investing in their asset base can be frustrated that financial reporting rules often class their investment as a cost rather than an asset. It is in both companies' and investors' interest that a broader view be provided. The six capitals (financial, intellectual, manufactured, social, human, natural) outlined by the IIRC should help preparers provide a more complete picture of investment in (and consumption of) the asset base, and ultimately help readers understand whether the productive capacity of the business has declined or been enhanced.

In some instances, it may be possible to report on specific outcomes – for example brand recognition scores. In others, reporting on investment in the asset may be more appropriate – for example research investment. In all cases it is important to focus on investment that has a direct benefit to the business.

Woodside Petroleum shows how the creation of new oil and gas reserves can be reported.

2 How has the business performed against its operational objectives?

Operational objectives cover both the management of risk and the delivery of performance milestones. The measures that are reported on here should follow naturally from the description of operating context (management of risk) and business strategy (performance milestones). If these parts of the report have a clear focus there should be a relatively small number of key operational performance indicators that are aligned with measures that management is itself using to run the business.

The example below from Marks and Spencer Group plc shows operational performance against management's plan.

3 What underlying return is being generated by the business?

The starting point for most valuation models will be the current earnings generation capacity and growth of the business. A consequence of this is that, without adjustment, small earnings fluctuations can have a magnified effect on valuation assessments leading to share price volatility.

Companies have long reported adjusted earnings figures that can help provide a more stable base for this assessment than raw financial data. There is however a distinction between the backwards-looking adjustments that are typically reported, and the more forward-looking analysis needed to help readers understand the current earnings run-rate. As an illustration, the results of acquisitions are often excluded from underlying earnings – this provides a basis for comparison of business performance against targets but it does not help readers understand the earnings generation capability of the business post-acquisition earnings. To understand this, readers will need to see the impact pre-acquisition earnings would have had on statutory earnings.

4 What does current performance say about the prospects of the business?

As well as providing a basis for understanding underlying business return, current performance information also helps readers understand the implications for future performance – but the information needed for this is different.

The focus here generally needs to be on identifying and explaining performance variances – in particular variances against the strategic objectives management has set itself. The relevant measures will often be operational rather than financial in nature. A balanced view, written from an operational perspective, is important here – the logic of

The performance indicators selected need to support readers' decision-making processes.

Integrated Reporting means that any gaps in the reporting of strategically important performance will be immediately apparent to readers. Most businesses respond quickly to areas of operational under performance. The opportunity to explain this response should be preferable to leaving readers to assess the implications for themselves.

The quality and depth of the business model description will be important in helping readers relate the implications of operational performance variances to overall business performance and value. In a well designed report, detail provided in the business model should follow the same operational structures as the performance analysis. So, for example if one segment of the customer base is performing ahead of expectations, readers can look to the business model to understand the relative size of that base and ultimately form their own judgment on the implications for future earnings.

How well does your reporting explain business performance?

Would a reader agree with these statements?

- I can see the extent to which the productive capacity of the business has been retained / enhanced
- I can see the extent to which management is delivering on its short, medium, and long-term change programme
- I can see how successful the business is in generating value
- I understand the capacity of the business to generate value
- I have sufficient visibility over the key short-medium, and long-term risk indicators to assess whether its current direction and ability to generate financial returns is sustainable

Example – Reporting operating performance

Overview

Reserves statement

Contingent resources increased 322.7 MMboe primarily due to positive revisions in the Greater Browse fields and exploration and appraisal success in the Greater Exmouth and Greater Pluto regions.

2011 Key performance highlights

The three year organic Proved reserves replacement ratio remains above 100%.

Proved reserves life is 20 years.

Net contingent resources in the Greater Browse region increased 291.5 MMboe.

Net contingent resources in the Greater Exmouth region increased 21.8 MMboe.

Net contingent resources in the Greater Pluto region increased 66.8 MMboe.

Woodside's reserves* overview

	2011	2010	Change%	
Proved**	MMboe	1,292.4	1,262.5	11.2
Proved plus Probable**	MMboe	1,850.2	1,680.1	10.2
Contingent resources**	MMboe	2,128.5	1,815.8	17.2

Key metrics

	Proved	Proved plus Probable	
2011 reserves replacement ratio**	%	75	110
Organic 2011 reserves replacement ratio**	%	76	108
Three year reserves replacement ratio	%	64	57
Three year organic reserves replacement ratio	%	102	88
Reserves life	Years	20	25
Annual production**	MMboe	63.7	63.7
Net acquisitions and divestments	MMboe	61.6	12.3

Proved reserves

Proved reserves have remained steady over the past five years.

Proved plus Probable reserves

Proved plus Probable reserves have increased steadily over the past five years.

Proved reserves annual reconciliation by product*

	Oil	Condensate	Gas	Total
Reserves at 31 December 2010	6,462	123.3	34.8	13,320.1
Revision of previous estimates**	105	2.6	13.7	34.5
Extensions and discoveries**	72	1.1	6.8	15.7
Acquisitions and divestments	(5)	(0.0)	(0.1)	(0.6)
Annual production**	(218)	(0.7)	(18.9)	(85.7)
Reserves at 31 December 2011	6,469	119.2	31.4	13,264.4

Best estimate contingent resources annual reconciliation by product

	Oil	Condensate	Gas	Total
Contingent resources at 31 December 2010	6,238	246.9	111.2	1,815.8
Transfer to reserves	(28)	(0.9)	(0.3)	(0.3)
Revision of previous estimates	1,249	38.1	65.8	252.2
Extensions and discoveries	315	5.7	21.9	20.0
Acquisitions and divestments	(46)	(1.6)	(0.5)	(11.9)
Contingent resources at 31 December 2011	9,188	288.6	135.7	2,128.5

*Refer to page 18 for Notes to the Reserves Statement.

Source: Woodside Petroleum Ltd Annual Report, 2011, page 16. The above disclosures reflect the Group's position as at 31 Dec 2011

Our performance

Financial performance

Group revenue

	2011	2010	2009	2008	2007
UK	3,061.7	6,101.8	6,329.2	6,242.2	6,242.2
International	1,722.1	2,821.1	2,821.1	2,821.1	2,821.1
Total	4,783.8	8,922.9	9,150.3	9,063.3	9,063.3

Underlying Group operating profit

	2011	2010	2009	2008	2007
UK	621.9	621.9	701.2	621.9	621.9
International	198.4	198.4	162.7	162.7	162.7
Total	820.3	820.3	863.9	784.6	784.6

Performance against our plan

Focusing on the UK

UK market share clothing and footwear

11.7% vs 12.3% (vs 10.5% in 2010)

UK market share food

3.9% vs 4.1% (vs 3.5% in 2010)

UK mystery shopping programme

A score of 78% (vs 75% in 2010)

Average weekly footfall

20.7m (vs 20.1m in 2010)

Annual space growth

1.4% (vs 1.2% in 2010)

Source: Marks and Spencer Group plc Annual Report and Financial Statements 2011

All extracts from published reports should be read in conjunction with the full report itself including its notes.

What does it look like?

Future outlook

This part of the report should provide a basis for readers to form their own views on the long-term prospects of the business. The information in this section is central to readers’ understanding of business value. But businesses have traditionally been wary of sharing this type of information. This is understandably a difficult area given the legal and regulatory environment in which businesses operate. We believe the approach outlined below can make it easier for businesses to manage these concerns.

Challenges:

- Are assumptions expressed in sufficient detail that readers can understand the impact of flexing them? Does the description of existing operations also support this?
- Does the outlook help readers form their own views – to the extent possible – on the long-term elements of a valuation assessment as well as the short-term?

1 Help readers form their own views of the future

Don’t assume that explaining the future outlook requires a financial forecast. If enough clarity is provided over your existing operations, readers should be able to build their own judgments around management’s expectations for the operational performance of the different parts of the business rather than relying on high level financial forecasts. For example, AstraZeneca provide information on both research progress and future patent expiries.

2 Don’t take responsibility for assumptions you can’t control

Financial forecasts and projections inevitably involve significant assumptions that are beyond management’s operational control. Help readers to understand these assumptions by explaining them. BHP Billiton plc achieves this by providing a sensitivity analysis to metals prices based on current year performance.

3 Stay at the right level

Commercial sensitivities are a natural concern for many businesses when looking to the future. However, the information needed for shareholders to assess future business value is generally at a much higher level to that which would be relevant to a competitor. For example shareholders may be looking to understand growth in a particular market but are less likely to need to know the

Example – Patent development and expiries

Patent expiries for our key marketed products

Key marketed product	Country	Year of expiry	US Revenue (\$)
All key marketed products	US (Federal)	2010	2,237
		2011	2,205
		2012	2,504
		2013	2,640
		2014	2,130
		2015	454
		2016	108
		2017	276
		2018	183
		2019	20
		2020	29
		2021	10
All key marketed products	EU (Central and some major EU)	2010	1,582
		2011	2,254
		2012	1,782
		2013	1,792
		2014	1,422
		2015	807
		2016	858
		2017	778
		2018	744
		2019	611
		2020	726
		2021	761
All key marketed products	Japan	2010	602
		2011	669
		2012	650
		2013	590
		2014	520
		2015	331
		2016	305
		2017	297
		2018	285
		2019	277
		2020	277
		2021	277

Patent expiries
The tables above set out certain patent expiry dates and sales for our key marketed products. The expiry dates relate to the basic substance patent relevant to that product unless indicated otherwise. The expiry dates shown include any PTE and Paediatric Expiry periods.

Data exclusivity
In addition to patent protection, Regulatory Data Protection (RDP) or data exclusivity is an important IP right which arises in respect of data which is required to be submitted to regulatory authorities in order to obtain marketing approvals for our medicines. Significant milestones in required to generate such data for example, through conducting global clinical trials and the use of this proprietary data produced from use by third parties (such as generic manufacturers) for a number of years in a limited number of countries. The period of such protection and the extent to which the right is respected differs significantly between these countries. We believe in enforcing our rights to RDP and consider it an important protection for our investors, particularly as patent rights are increasingly being challenged.

Compulsory licensing
Compulsory licensing is the overruling of patent rights to allow patented medicines to be manufactured and sold by other parties (which are not the original holder of the patent) and is increasingly being included in the access to medicines debates. We recognise the right of developing countries to use the facilities in the World Trade Organization’s Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) including the Doha agreement in certain circumstances, such as a public health emergency. We believe that this should apply only when all other ways of meeting the emergency needs have been considered and where healthcare frameworks and safeguards are in place to ensure that the medicines reach those who need them.

Business Review

Key – showing movements since 27 January 2011

- Addition
- ▲ No change
- ◄ Progression
- New filing
- Launched
- ◄ Reclassified

AstraZeneca Annual Report and Form 20-F Information 2011

Pipeline by Therapy Area at 31 December 2011

Therapy Area	Phase I	Phase II	Phase III/Registration	Line Extensions
Cardiovascular	> AZD5363 ♦	> AZD5363 ♦	> Brilinta/Brilinta ♦ > dapagliflozin ♦	> Astra ♦ > Brilinta/Brilinta ♦ > PEGASIV/MSI ▲ > Crestor ▲ > dapagliflozin ♦ > dapagliflozin ♦ > dapagliflozin ♦ > dapagliflozin ♦
Gastrointestinal	> trabectedin ♦ (OTC)			> Entocort ♦ > Entocort ♦ > Motegrity ♦ > Motegrity ♦
Infection	> AZD5099 ♦	> AZD5099 ♦	> AZD5099 ♦	> Fampur/Rezeu ♦
Neuroscience	> AZD1440 ♦	> AZD2023 ▲	> AZD1775 ▲	> Dantrolene ♦
Oncology	> AZD1440 ♦	> AZD1775 ▲	> AZD1775 ▲	> Folicor ♦ > Folicor ♦ > Folicor ♦ > Folicor ♦
Respiratory & Inflammation	> AZD1115 ♦	> AZD1115 ♦	> AZD1115 ♦	> Zila ♦ > Zila ♦ > Zila ♦ > Zila ♦

Key – showing movements since 27 January 2011

- Addition
- ▲ No change
- ◄ Progression
- New filing
- Launched
- ◄ Reclassified

AstraZeneca Annual Report and Form 20-F Information 2011

Source: AstraZeneca Annual Report and Form 20-F Information 2011, pages 35 and 57

Readers should be able to build their own judgments around management's expectations.

Example – Explaining results sensitivities

Estimated impact on FY2011 profit after taxation of changes of:	US\$M
US\$1/bbl on oil price	43
US¢1/lb on aluminium price	20
US¢1/lb on copper price	18
US¢1/lb on nickel price	1
US\$1/t on iron ore price	80
US\$1/t on manganese alloy	0.5
US\$1/dmtu on manganese ore	138
US\$1/t on metallurgical coal price	22
US\$1/t on energy coal price	24

Source: BHP Billiton Annual Report, 2011, page 86

At this level, explanations of future performance should focus more on the overall shape of the business rather than detailed operational considerations. For example, recognizing that one part of the business is likely to grow faster than others can help readers to adjust their expectations of overall margins earned.

How well does your reporting explain the future outlook for the business?

Would a reader agree with these statements?

- I can see what effect management's plans will have on the future productive capacity of the business
- I can see how changes to the business environment together with management's plans will affect the ability of the business to generate financial returns
- I can see how the 'game changing' issues affecting the operating environment could affect productive capacity and ability to generate returns
- I have enough information to form my own views about how the issues and opportunities identified in the report might affect the business

technical details of a planned new product launch; the track record of past launches may be more helpful to their assessment.

4 Help readers understand the long-term prospects

The long-term prospects of the business are, of course, hugely subjective – so is there any value in explaining these? We believe there is, but the focus of the explanation should be different. Irrespective of whether management provides this information, anyone looking to value the business will need to form a judgment over its long-term prospects. This is likely to represent a significant proportion of overall value.

Example – Explaining targets and aspirations

Report by the Managing Board

Management of 2011
DSM in motion: driving focused growth
 Sustainability
 Stakeholder engagement
 People in 2011
 Profit in 2011
 Profit in 2011
 Growth
 Innovation
 External recognition

Strategic and financial targets

Profitability targets 2013	
- EBITDA	€ 1.4 - 1.6 bn
- ROCE	> 15%

Sales targets 2015	
- Organic sales growth	5-7% annually
- China sales	from USD 1.5 bn to > USD 3 bn
- High-growth economies sales	from ~32% toward 50% of sales
- Innovation sales	from ~12% to 20% of sales

Aspiration regarding Emerging Business Areas for 2020

- EBA sales	> € 1 bn
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Sustainability aspirations 2011-2015

Dow Jones Sustainability Index	Top ranking (SAM Gold Class)
ECOs (Innovation)	Ratio of patents in ECOs*
ECOs (Running Business)	From approximately 34% toward 50%
Energy efficiency	20% improvement in 2020, compared to 2008
Greenhouse-gas emissions	20% (absolute) by 2020, compared to 2008
Employee Engagement Survey	Toward High Performance Index
Diversity and People	To be updated in 2011

* This means a total score of at least 75% and within 5% of the DSM sector leader
 - See page 224 for a definition of ECOs.
 - The High Performance Index (HPI) is the composite of the top 20% employee responses of the selected external benchmark organizations.

In terms of the sales targets established for this strategy period, DSM comfortably exceeded the organic sales growth target and demonstrated solid growth in sales in China in 2011. DSM saw a growth in sales in high-growth economies as a percentage of overall sales to 39% in 2011, bringing the company closer to its announced goal of moving from approximately 32% toward 50% of total net sales. Innovation sales – measured as sales from innovative products and applications introduced in the last five years – reached 18% of total net sales in 2011, close to the company's 2015 target of approximately 20%.

Further progress was made in the Emerging Business Areas (EBAs). The EBAs are DSM Biomedical, DSM Bio-based Products & Services and DSM Advanced Surfaces.

For the period 2011-2015 capital expenditure can be expected at a level comparable to that in the 'accelerated vision 2010' period (€ 500-550 million per year on average). For the total period, capital expenditure is expected to amount to € 2.5-2.7 billion, of which approximately USD 1 billion in China. In addition, DSM aspires to keep working capital as a percentage of annualized net sales below 15%. At the end of 2011 working capital as a percentage of annualized net sales amounted to 20.2%.

In 2010 DSM set a number of ambitious sustainability aspirations for 2015, and in 2011 the company made good progress toward meeting them. The highlights can be found on page 27.

High-Growth Economies: from 'reaching out' to being truly global

A key element of DSM in motion: driving focused growth is for DSM to move from being a European company reaching out to the world to being a truly global company. All the evidence indicates that fast-growing economies such as China, India, Brazil and Russia and other emerging areas will be the major growth engines for the world economy over the next decade. DSM's market penetration in the high-growth economies has increased from just 22% of sales in 2005 to 39% now, the target for 2015 being to move toward 50% of sales. DSM expects over 70% of its growth in the period to 2015 to come from high-growth economies.

DSM has a clear focus on China, where the company has set a target to double sales to a level of at least USD 3 billion by 2015. In 2011 DSM made good progress toward this target. China sales increased 23% to USD 2.0 billion. To support this growth DSM intends to invest USD 1 billion in China in this strategy period. DSM will also increase its presence in other markets, doubling or even tripling revenues in India, Latin America and Russia.

Source: Royal DSM Integrated Annual Report 2011, page 29

All extracts from published reports should be read in conjunction with the full report itself including its notes.

What **does it** look like?

Governance & Remuneration

In many regions there are already extensive compliance-based disclosures covering governance and remuneration reporting. Nevertheless, there is still scope for companies to use an Integrated Reporting approach to improve their reporting within their local compliance framework.

Challenges:

- Compliance requirements can lead to generic disclosure offering little that is specific to the organization. Disclosures need to stay focussed and relevant to the company and its business value.
- Setting a tone that reflects the importance the board places on the maintenance and enhancement of long-term shareholder value.
- Demonstrating the connection between the decision-making processes and the business's priorities, as set out in the rest of the report.

Below we highlight three areas where the Integrated Reporting principles can help to improve governance reporting:

1 Demonstrating the relevance of the board's experience

Shareholders will expect the composition of their board to reflect the needs of the company's business model. Reporters can help demonstrate this by explaining the rationale for the board's composition, linking the individual appointments (including the strengths and benefits that individual board members bring to their roles) with an explanation of the overall positioning of the board as a whole. Readers should be able to understand why any board members who are up for re-election should be re-elected in terms of their individual contribution in the context of the business model and how they link with the rest of the company's governance network.

For example BHP Billiton provide a summary of Directors' skills and experience covering the composition of each of the main board committees.

2 How governance works within the company

Readers need to know how strategic decisions are taken. The focus should be on how governance links to the risks identified and their mitigation strategy, with the challenge in ensuring that there is a link made between the decision-making process and the business's priorities – its strategy and opportunities as identified elsewhere in the report. At the same time reporters should ensure there is not an excessive focus on the governance process at the expense of concentrating on the practical execution of the board's responsibilities and substance of its decision-making.

3 Performance and remuneration

One of the challenges of board remuneration reporting has been the potential mismatch between the short term financial performance of the business and its long-term value. Integrated Reporting attempts to address this by building reports that amongst other things highlight the delivery of operational performance milestones against the strategic objectives of the business. The potential is an improved basis for remuneration reporting that's aligned with the business mission and value creation.

How well does your reporting explain the governance over the business?

Would a reader agree with these statements?

- I can see that key management decisions were subject to due process and scrutiny by the board; I can see the extent to which decisions affecting long-term value feature in the process
- I can see that the board is focussed on the issues that matter and has the expertise to address these
- I can see that the board understands and engages with potential stakeholder issues, threats and opportunities
- I understand the amount and basis for board remuneration and the link between remuneration and the delivery of business strategy and value

The potential is an improved basis for remuneration reporting that's aligned with the business mission and value creation.

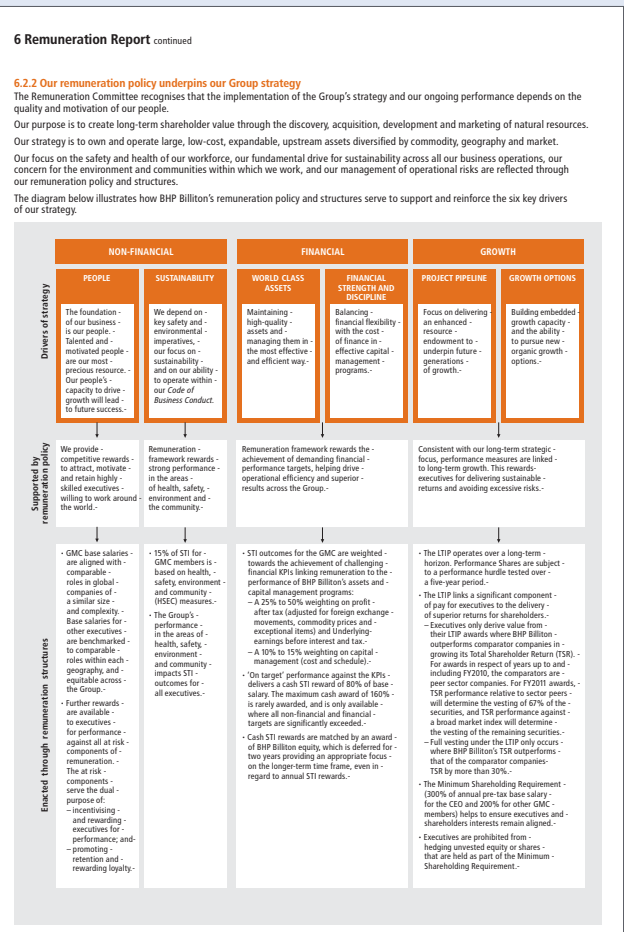
Example – Linking skills and remuneration to strategy

5 Corporate Governance Statement continued

5.3.3 Skills, knowledge, experience and attributes of Directors continued

Skills and experience	Board	Risk and Audit	Nomination	Remuneration	Sustainability
Managing and leading Sustainable success in business at a very senior level in a successful career.	11 Directors	3 Directors	3 Directors	3 Directors	3 Directors
Global experience Senior management or equivalent experience in multiple global locations, exposed to a range of political, cultural, regulatory and business environments.	12 Directors	4 Directors	3 Directors	3 Directors	3 Directors
Governance Commitment to the highest standards of governance, including experience with a major organisation, which is subject to rigorous governance standards and an ability to assess the effectiveness of senior management.	12 Directors	4 Directors	3 Directors	3 Directors	3 Directors
Strategy Track record of developing and implementing a successful strategy, including appropriately probing and challenging management on the delivery of agreed strategic planning objectives.	12 Directors	4 Directors	3 Directors	3 Directors	3 Directors
Financial acumen Senior executive or equivalent experience in financial accounting and reporting, corporate finance and internal financial controls, including an ability to probe the adequacies of financial and risk controls.	12 Directors	4 Directors	3 Directors	3 Directors	3 Directors
Capital projects Experience working in an industry with projects involving large-scale capital outlays and long-term investment horizons.	10 Directors	3 Directors	3 Directors	2 Directors	3 Directors
Health, safety and environment Experience related to workplace health and safety, environmental and social responsibility, and community.	11 Directors	4 Directors	3 Directors	2 Directors	3 Directors
Remuneration Board remuneration committee membership or management experience in relation to remuneration, including incentive programs and pension/superannuation and the legislation and contractual framework governing remuneration.	12 Directors	4 Directors	3 Directors	3 Directors	3 Directors
Mining Senior executive experience in a large mining organisation combined with an understanding of the Group's corporate objective to create long-term value for shareholders through the discovery, development and conversion of natural resources.	4 Directors	1 Director	0 Directors	0 Directors	2 Directors
Oil and gas Senior executive experience in the oil and gas industry, including in depth knowledge of the Group's strategy, markets, competitors, operational issues, technology and regulatory concerns.	4 Directors	1 Director	2 Directors	2 Directors	1 Director
Marketing Senior executive experience in marketing and a detailed understanding of the Group's corporate objective to create long-term value for shareholders through the provision of innovative customer and market-focused solutions.	10 Directors	3 Directors	3 Directors	3 Directors	3 Directors
Public policy Experience in public and regulatory policy, including how it affects corporations.	12 Directors	4 Directors	3 Directors	3 Directors	3 Directors
Total Directors	12 Directors	4 Directors	3 Directors	3 Directors	3 Directors

<p>Director qualifications</p> <ul style="list-style-type: none"> Business/Finance, 7 Directors Engineering and Science, 2 Directors Science, 2 Directors Engineering, 1 Director 	<p>Non-executive Director locations</p> <ul style="list-style-type: none"> US, 3 Directors Australia, 5 Directors UK, 2 Directors South Africa, 1 Director
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Source: BHP Billiton Annual Report, 2011, pages 112 and 130

There is still scope for companies to use an integrated reporting approach to improve their reporting within their local compliance framework.

All extracts from published reports should be read in conjunction with the full report itself including its notes.

Better Corporate Responsibility Reporting

By Matt Chapman, KPMG in the UK and Wim Bartels KPMG in the Netherlands



In brief:

- **Integrating corporate responsibility reporting demonstrates the connection with business operations and strategy**
- **Reporting should be driven by the business model and linked to strategy and potential for future value creation and defence**
- **Different reporting approaches and performance measures are needed depending on the nature of each issue**
- **Every issue and opportunity needs to be put into a business context with enough detail for readers to understand the potential implications for business value**



In our recent publication *Expect the Unexpected: Building business value in a changing world*¹ we set out a system of 10 sustainability mega forces that will impact each and every business over the next 20 years. As a result of these mega forces, the resources on which business relies are becoming more difficult to access and more costly. Infrastructure and natural systems are coming under strain as patterns of population, economic growth and wealth change. Physical assets and supply chains will be affected by the unpredictable impacts of a changing climate. And businesses will have to deal with an ever more complex web of sustainability legislation and fiscal instruments.

These sustainability mega forces can have a fundamental effect on business value. Shareholders need the information to assess these impacts and to understand how the business is addressing them. Corporate reporting needs to adapt in order to answer these questions. If it does not, the investment businesses have made in managing these challenges and opportunities may not be recognized by the capital markets.

It is not enough to incorporate existing corporate responsibility reporting into the Annual Report. This is simply 'Combined Reporting'. The information provided needs to be tailored to shareholder needs.

We explain how Integrated Reporting principles can be used to explain an organization's corporate responsibility approach, challenges and opportunities more effectively to its shareholders – and ultimately produce a better corporate report that will be of interest to all its stakeholders.

Context is essential if readers are to relate the issue being reported to their decision-making process.

¹ KPMG International, 2012

Businesses that report their corporate responsibility activities separately from their routine operations send the message that they see them as separate from the core business.

Focus on what matters to the reader

A key first step is to recognise that Annual Report readers have specific information needs depending on the implications of each responsibility issue. Some issues cut to the heart of business value; others are of less immediate interest to shareholders – unless something goes wrong.

We suggest four categories as a basis for ensuring that reports focus on supporting readers' decision-making processes.

Each category requires a different reporting approach:

- **Game changers**

Issues and opportunities of core importance to the long-term shape or viability of the business model. These can include the potential loss of an operating license, and loss of access to key resources.

Identification of these issues together with the efforts and progress being made to manage them should be central to corporate reporting, not on the periphery. This means providing a basis for readers to understand the potential impacts, and the progress being made in managing them.

- **Direct impact issues**

These are less significant in terms of scale but still of interest because of their direct consequence on the business's underlying performance.

Readers want to understand the material consequences and need specific information to do this. For example, reporting global carbon emissions does not help readers understand the potential impact of a localized carbon tax – regional emissions analysis is needed instead.

- **Hygiene factors**

There are some issues that, if not managed effectively, could severely damage business performance. Shareholders need to understand whether these issues are being well managed.

For the most significant issues this may mean reporting risk indicators, such as levels of maintenance expenditure or customer satisfaction. For less significant issues, reporting may simply need to show there are adequate governance procedures.

- **Other**

Some issues don't have a material bearing on business value but may interest specific stakeholder groups other

than the Annual Report reader, or be required by specific reporting frameworks. Detailed information addressing these issues can be linked to and reported in a separate Corporate Responsibility Report if necessary. Including this information in an Annual Report may obscure more important messages.

If a corporate responsibility issue is strategically important, say so. Be open about the investment you are making in managing it and be clear about the operational benefit – your readers want to understand this. If it's not relevant to understanding business value and stewardship, take it out of the Annual Report. You can report on it separately to those that are interested.

Opportunities are relevant too

A major part of business value typically lies in how the organization develops and exploits its long-term opportunities. Corporate responsibility information is central to explaining this. Where a key part of long-term business strategy or value is derived from exploiting a sustainability megatrend, readers will want to understand the trend and the business strategy and progress in exploiting it. Many reporters need to rebalance their emphasis from corporate responsibility downsides to looking ahead to how management plans to exploit the opportunities.

The value of context

Context is essential if readers are to relate the issue being reported to their decision-making process. Annual Report readers want to understand what shapes the financial value of the business, typically through cash flow modelling. They need sufficient background information to understand how each issue might influence future cash flows.

For example water stress may be an issue in some areas, but not in others. To understand the operational impact readers will need to see how much production depends on water-stressed assets. Simply providing statistics on the management of total water consumption is not enough. Neither will illustrations of water-saving projects meet readers' needs.

Ad hoc illustrations of corporate responsibility investment alone do not explain management performance. These illustrations emphasise the cost of the activity without showing its benefit. This is why current corporate responsibility reporting often fails to connect with investors.

The right detail at the right level

Readers need different information depending on the scale and nature of each issue. It helps here to think of three types of key performance measure: risk, performance, and reward. Each measure has a different purpose and different information is needed to explain the issue to the reader - illustrated in the table below. Reporting can lose focus and become ineffective when this distinction is ignored.

It is rarely appropriate to lump all corporate responsibility issues together under reputational risk. The implications of not managing them properly can be much deeper than this, and will be specific for each issue.

In our 2011 survey of corporate responsibility reporting¹ we noted a growing trend towards restatement of previously reported information. We see this as a positive. Why? It indicates the growing level of attention to this area, and that the quality of information and reporting is improving. This is essential as the information becomes increasingly central to readers' decision-making in an Integrated Report.

Of course where re-statements, re-definitions and changes of targets and measures are made, good reporting practice requires that these changes are explained in a way that the reason for the change is understood and comparisons with past performance can still be made.

Demonstrate relevance with genuine integration

If corporate responsibility is central to your business model it should have a central role in your reporting too. Businesses that report their corporate responsibility activities separately from their routine operations send the message that they see them as separate from the core business.

But genuine integration goes further than simply recognizing that corporate responsibility should have a place in an Annual Report. The logic of Integrated Reporting is that all reporting content should be driven by the business model, operating context and business strategy through to its performance, governance and future outlook. This means addressing corporate responsibility matters alongside other operational matters rather than in a separate corporate responsibility section. A segmental review of operational performance is not complete unless it includes the relevant corporate responsibility measures.

We believe that corporate responsibility reporting has an essential role to play in communicating a more complete picture of business value. Over 95 percent of the 250 largest companies in the world¹ report on their corporate responsibility activities. Now that this type of reporting is firmly established, the next step for many companies is integrating it into their mainstream corporate reporting. The Integrated Reporting principles can show the way to do this.

KPI	Purpose and focus	Reporting illustrations
Risk	<p>Reports on issues that should not have a major impact on the business, provided they are managed effectively.</p> <p>Reader interest focusses on trends or relative measures rather than absolute outcomes.</p>	<ul style="list-style-type: none"> • Operating maintenance spend for an airline • Industry workplace safety ranking for a construction company • Staff turnover for a retailer
Performance	<p>Reports on issues the business knows it needs to change as part of its core strategy.</p> <p>Reader interest lies in the progress made in implementing this change - have specific operational targets and milestones been met?</p>	<p>Possible targets in the business strategy:</p> <ul style="list-style-type: none"> • Water consumption in stressed areas for a chemicals company • Mix of ethically sourced raw materials for a consumer goods manufacturer
Reward	<p>Measures that demonstrate direct value to the business. These help the reader understand the actual or potential investment returns.</p>	<p>Possible outcomes in the business strategy:</p> <ul style="list-style-type: none"> • Market share in a new segment (e.g., green energy generation) • Brand rankings

¹ KPMG International Survey of Corporate Responsibility Reporting 2011

Applying Integrated Reporting principles in the public sector

By Mark Hoffman, KPMG in South Africa



In brief:

Many public sector bodies are tasked with providing service delivery and governance excellence in a financially, economically, socially and environmentally sustainable manner. Integrated Reporting can help to balance reporting of these often conflicting objectives.

- Integrated Reporting can provide a framework for public sector organizations to focus their reporting on their principle objectives
- Integrated Reporting can help public sector bodies explain their strategies; operational model and governance, and show how their performance can be assessed against these strategies
- Stakeholder engagement can help organizations show how they have balanced the often conflicting needs of different stakeholder groups
- Integrated Reporting offers organizations the opportunity to align their reporting with their risks and opportunities and management accountabilities

Public sector organizations are under constant pressure to develop better reporting. Integrated Reporting principles provide a potential solution that can be readily adapted to their broader goals. A wider range of stakeholders with varied expectations have an interest in the performance of public sector organizations. An Integrated Reporting approach can help to address these factors.

Organizations need to engage with their key stakeholder groups effectively.

A business approach to public sector reporting

There is a growing social and regulatory drive for public sector organizations to provide performance reporting that can be used to assess the delivery of organizations’ strategies. This pressure comes not only from government in its oversight capacity but from all interested key stakeholders.

Integrated Reporting introduces a business approach to reporting in the public sector that fully embraces stakeholder inclusivity and the critical need for financial, economic, environmental, social and governance sustainability.

A public sector organization’s value lies in its ability to meet its service delivery and governance objectives in the short, medium and long-term, just as a private sector organization looks for sustainable, profitable growth. Stakeholders seek a change in management or ultimately a new political solution if inappropriate strategies are targeted or poor performance results, just as capital markets choose to divest in listed companies.

In South Africa the positive response by a number of State Owned Entities to Integrated Reporting under the King Code of Governance Principles is encouraging and reflects a good fit for Integrated Reporting in these organizations. The alignment of Integrated Reporting to Performance Information initiatives, as contemplated under the South African National Treasury reporting requirements, points to Integrated Reporting as the direction for future public sector reporting.

Below we explore some of the observations arising from the practical application of Integrated Reporting elements to public sector organizations.

Stakeholder engagement and material issues

Relationships and interactions with key stakeholders are at the heart of every public sector organization. Typical major stakeholders include:

Government	Regulators
Direct & Indirect customers	Financiers, banks & rating agencies
Public & communities	Suppliers, business partners & PPPs
Employee & trade unions	NGOs, forums, media & interest groups

Public sector organizations need to engage with their key stakeholder groups effectively, and to understand the needs and concerns, and trends and developments in these groups in order to respond pro-actively in their strategies. Experience shows that stakeholders have varied and often conflicting needs and concerns. Focused and innovative management is required to deal with this challenge. The benefit of an Integrated Report is the opportunity it provides to explain how competing objectives have been balanced.

When confronted with a list of stakeholder needs, it is important to stay focussed. Proportionality is key. The amount of weight attached to each stakeholder’s needs will depend on both the organization’s priorities (which should be clearly explained in its business model) and the impact that these stakeholders have on the organization itself.

Ultimately, stakeholder engagement can help the organization identify material issues – risks and opportunities – that it should respond to and address.

The benefit of an Integrated Report is the opportunity it provides to explain how competing objectives have been balanced.

Example – risks & opportunities

Risk	Opportunity
Inability to meet customer demand through unexpected growth & urbanization trends	New technologies present opportunities to rapidly install capacity
Loss of public confidence through service delivery shortcomings	Increased population densities enhance viability of new projects and technologies

An Integrated Report provides a platform for the organization to contextualize its risks and opportunities against the current trends and constraints that it faces.

Strategy

The description of strategy will need to address and reflect the conflicting needs and expectations of different stakeholders and other constraints that the organization faces.

For example, most organizations need to meet pressing service delivery expectations in the short-term whilst developing and investing in new technologies and infrastructure to meet their medium to long-term objectives in a financially, economically and socially sustainable manner.

Example – balanced strategy for a public sector utility

Meet pressing short-term electricity demand using sub-optimal technologies in terms of carbon efficiency; Address carbon-efficient technologies through medium to long-term capital projects.

Many public sector organizations need to show how their strategy aligns with national priorities and how they work collaboratively with other organizations to achieve common goals.

What was originally seen as a private sector initiative has clear relevance and application to public sector organizations.

Performance measures

In our Better Corporate Responsibility Reporting article we have highlighted the three different types of performance indicator (risk, performance, reward) that should be addressed by businesses. The same indicators are relevant in the public sector, however 'reward' measures will often be expressed in terms of operational targets rather than financial targets (though some financial measures will remain relevant to the funding stakeholder). In order to provide a clearer perspective on the strategy, performance indicators and associated targets in the short, medium and long-term need to be set out clearly.

Performance targets need to be put in context, showing which parts of strategy execution they relate to and distinguishing between lead (input) and lag (output indicators).

Example – performance targets in context

Pro-active maintenance programme	Capital projects capacity expansion programme
% on-time maintenance inspections and overhauls (lead indicator)	Capital expenditure spend & project completion on time statistics (lead)
Number of breakdowns > 5 hours down time (lag)	Capacity installed to volume demand projections (lag)

Governance and remuneration

Stakeholders are growing increasingly demanding over the quality of governance, transparency and accountability from public sector organizations. Integrated reporting provides insight into how the organization is governed and, importantly, what informed the decision-making process and how management are held accountable for performance.

Where next?

What was originally seen as a private sector initiative has clear relevance and application to public sector organizations. The principles of Integrated Reporting have been readily adapted to the 'managing for outcomes' approach to demonstrate accountability for service delivery by a number of South African organizations.

We look forward to seeing this approach spread in South Africa and the Rest of the World.

Active Governance: the core of Better Business Reporting

By Nick Ridehalgh, KPMG in Australia

In brief:

- **The profile of corporate stakeholders and their ability to influence business has changed. Companies must demonstrate they are managing the interests of all their capital providers in order to show that they have a sustainable business model**
- **Boards have a duty to maximise a company's overall economic value and ensure best use of all types of capital. They need to report openly on the companies' achievements and challenges**
- **Boards need to take responsibility for driving the organizational change towards integrated thinking and for ensuring the content of their corporate reporting meets capital provider's information needs**

The world in which companies operate is changing. Businesses are facing capital constraints from a broader range of resources than just finance. Boards are responsible for addressing these capital requirements in a sustainable manner for a company's long-term success.

We consider why boards need to provide active governance, how Integrated Reporting helps, and the board's vital role in driving the changes needed from the top down for Integrated Thinking to become embedded in the organization's culture.

A new focus for 21st century companies

The key providers of capital in much of the 20th century were wealthy families with a single bottom-line agenda – to make money. Today the providers of financial capital are largely ordinary people investing through their pension funds. Often these same investors are also the company's employees, customers and impacted communities. So even though these 'universal investors' still require financial returns (and security in their retirement), those returns need to be made over the long-term with a positive (or at least neutral) impact on, amongst other things, the environment and community in general.

The result is that companies are dependent on and must manage a much broader range of capitals – the continued availability of intellectual, manufactured, social, human, and natural capitals cannot be taken for granted.

Obligations of the 21st century board

Directors need to work together to identify and assess changes today and potential changes over the short, medium and long-term that may materially influence the company's strategy and longer-term success. They have to make decisions based on best available information and an honest application of the collective mind of the board operating in the best interests of the company. In doing this, the directors must try to maximise the company's total economic value (not its book value) for shareholders whilst meeting other stakeholders' needs.

To do this, boards need to embed Integrated Thinking into every decision made by them, the organization's management and its staff. All decisions should consider not just returns on financial and manufactured capital, but also on the organization's human capital, intellectual capital, natural capital and social capital.

Shareholders recognise that long-term business viability depends on providing a balanced return across all capitals over time, and are telling boards to provide visible oversight and leadership in ensuring the required cultural change is embedded into business-as-usual at all levels of the organization. Progress has to be candidly reported through to the board and ultimately to the shareholders.

Readers' information needs

Shareholders have varying time and abilities to read and analyze long company reports. Companies all over the world complain about the regulatory reporting burden and users complain about the length, complexity and boiler-plate nature of the documents produced. No-one in the reporting supply chain is satisfied with the totality of information available to help them make and monitor their capital allocation decisions.

They need different types of information at different stages of their decision making:

- Due diligence phase – when the investor, supplier, customer, employee, banker, etc. undertakes an initial investigation into a specific organization in deciding whether to invest, supply, purchase, join or finance the company.
- Ongoing monitoring phase – the user undertakes a regular review of the organization's performance and prospects to ensure nothing material has occurred that might change the original decision.

In order to meet due diligence information needs, the company must provide a broad suite of information about the organization.

However, once due diligence has been undertaken and a decision made, then the shareholder or other user only requires information that explains:

- Material changes to governance, strategy and future outlook, including changes to key directors and executives, the company's risk profile or appetite, the business environment or external factors; and
- Performance against strategic objectives to confirm delivery against strategy to date across key value drivers, and an explanation of any proposed changes to key value drivers based on experience to date and/or changes to strategy, risk and future outlook.

Much of the information required for due diligence is standing data that can be provided on the company's website and updated from time to time, as improvements and other changes are made. Only changes that are potentially material to stakeholder decisions should be reported in company reports produced for the monitoring phase, with reference to website amendments where appropriate (subject, of course, to any regulatory constraints).

An Integrated Report, in which the organization tells its own value creation story, aims to provide the information investors require for their ongoing monitoring needs. By addressing these needs we expect that it will meet many if not all of the material needs of other stakeholders.

So why are companies not providing this Integrated Report now? Many jurisdictions allow for this kind of report in the Review of Operations & Financial Condition (OFR) or Management Discussion & Analysis (MD&A). However, 20th century corporate reporting was driven by boiler-plate imposed frameworks, complex rules, aversion to litigation risk and an over-reliance on the 'commercially sensitive' argument over-riding full and transparent reporting.

The board must drive Integrated Reporting

The board's role in corporate reporting has sometimes been too little, too late. Although certain key reports are approved at board meetings, there is often too little time for any major overhaul of the content.

In the Centro case (2011) in Australia, in which errors and omissions found in the annual filings led to a significant loss of economic value, the Federal Court's judgement reminded directors that they take overall responsibility for the content of the financial report and directors' report. (Mr Greg Medcraft, ASIC Chairman, June 2011).

The findings of the Centro case, combined with the expectations and challenges of managing a broader set of stakeholders, mean boards must be more involved – and involved at an earlier stage – in developing the structure and messaging of key reports, such as the OFR or MD&A.

Indeed, if the Integrated Report provides the annual 'monitoring' information required by shareholders and other stakeholders, then directors must be involved not only in

developing the structure of this reporting framework, but also for more detailed internal reporting (to the board and executive management) which focusses on the key value drivers and performance, and provides a clear assessment of material future risks and opportunities to longer-term value creation.

Practical Concerns

The 21st century board must take the lead in controlling the information it receives and communicates. In driving development of a candid and concise strategy-aligned Integrated Report, it must actively debate and contest management's claims that some material is 'commercially sensitive' or 'not legally required'. If the information is potentially material to the decisions of capital providers, is the Board prepared to take the responsibility for not reporting it?

What if directors are concerned about their own liability if a future event does not turn out as expected? Professor Mervyn King, Chairman of the International Integrated



Reporting Council, suggests companies should maintain an Explanations Register setting out the due diligence undertaken by the company and the board's rationale in making the decision/ disclosure based on best available information. Different permutations of such a register, and potentially other safe harbour provisions, will need to be developed for specific jurisdictions to protect directors who are taking care and diligence and making educated decisions using the best available information.

There is growing global regulatory focus on broader based reporting. Integrated Reporting is now required for listed companies in South Africa on an 'apply or explain' basis. Many other companies throughout the world are starting to adopt Integrated Thinking in day-to-day business decision-making, and are quite transparent in their public disclosures, but many others follow regulatory-driven boiler-plate disclosures in their public reporting. It is up to 21st century directors to take positive action to meet their reporting obligations to their stakeholders through more active governance.



Action points for boards

Active governance requires positive action and candid disclosure by boards to meet the material information needs of their capital providers. Directors should ask themselves whether they are satisfied with the following:

- Are the board and management's **strategic planning activities**, including the impact on strategy and strategic objectives, being communicated effectively?
- Is the board's **assessment of strategic risks and external factors** (including going concern) being communicated properly? Does this communication include an explanation of what has changed and the consequential impact, including any changes to the organization's risk profile?
- Have **executive and staff** incentives been discussed? Is the link to integrated thinking, cultural change and effective implementation of short and longer-term strategies explained?
- How have **one-off reportable events** been handled? Has there been continuous disclosure? Does disclosure include board activity, speed and accuracy of response, and consequences/outcomes?
- Has the **content of the Integrated Report** been discussed regularly? Have the directors been involved in the structure and design of the primary report, other public reports and other board papers?
- Have **changes to standing data** been properly explained? What about the implications of the changes on the business model, strategy and risk?

Some common questions answered

Can the Integrated Reporting principles be applied to an Annual Report

Yes - whilst some companies will opt for full Integrated Reporting, many more are likely to use the principles to develop their existing Annual Reporting.

The IIRC's content elements can be used as 'chapter headings' into which the traditional elements of an Annual Report can fit. This evolutionary approach will be attractive to companies who simply want to improve their current reporting (though they will need to guard against retaining content not material to an Integrated Report).

Who is the intended user of an Integrated Report?

Investors are the primary audience of an Annual Report, and this is reflected in the IIRC's initial focus for Integrated Reporting. However, information which satisfies the reasonable needs of investors should satisfy many, if not all, of the needs of other stakeholder groups.

An Integrated Report will be relevant to anybody interested in the strategy and performance of the company. But this does not mean that it will necessarily provide *all* of the information which might be desired by *all* interested stakeholders. To meet all of these needs in a single report would neither be reasonable nor sensible.

Will Integrated Reporting replace existing reporting?

It would be logical to assume that as long as an Integrated Report meets the needs of investors, then it will become the company's main report. Other reports may continue to provide additional information to address other shareholders' needs.

However, while many preparers and users of corporate reports would welcome a reduction in the volume of information that is provided, in the short-term it is unlikely that there will be any relaxation of regulations which lessen the reporting burden.

How long is an Integrated Report?

The simple answer is: as long as it needs to be and no longer. Factors such as diversity of operations (in both geography and nature) and the complexity of the business will clearly influence its length. There may also be opportunities to reduce length through a clearer focus on materiality and elimination of reporting clutter.

In practice, some companies may seek to fulfil their regulatory reporting obligations through their Integrated Report. Depending on the regulatory environment, this could mean including information that goes beyond that set out in the principles of the Integrated Reporting Framework such as that required by financial and sustainability reporting frameworks.

Is an Integrated Report a single document?

A single document is not a pre-requisite, but companies that seek to use their Integrated Report to meet regulatory obligations are likely either to produce a single document or incorporate links to other information.

Other elements of corporate reporting should benefit from applying Integrated Reporting Principles consistently across the range of corporate reports.

...Information which satisfies the reasonable needs of investors should satisfy many, if not all of the needs of other stakeholder groups...

Are there any examples of Integrated Reports available?

The perfect Integrated Report has yet to be produced but our research shows that there are many examples of the Integrated Reporting principles being applied to individual reporting elements. Many examples come from companies in South Africa looking to produce a dedicated Integrated Report. Others come from companies who are simply looking to provide a clearer picture of their business and its value. We have provided a small selection of these examples in this publication.

Will the Integrated Reporting Framework provide clarity on measurement issues?

The Integrated Reporting Framework will provide a set of principles for identifying matters which should be communicated within an Integrated Report but it will not – at least at the outset – address how individual items should be measured. This will remain the domain of existing standard-setting bodies.

In brief:

- **Integrated Reporting provides a basis for organizations to explain their business story more effectively to the capital markets**
- **Any organization can apply Integrated Reporting principles to improve their Annual Report**
- **Reporting is built around the business model to provide a more complete understanding of long-term business value**
- **Reports do not replace existing financial and sustainability reporting though they may link to or incorporate it where relevant**
- **The IIRC is developing a detailed reporting framework though the principles can be applied now**

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