KPMG INTERNATIONAL

Better Corporate Responsibility **Reporting**

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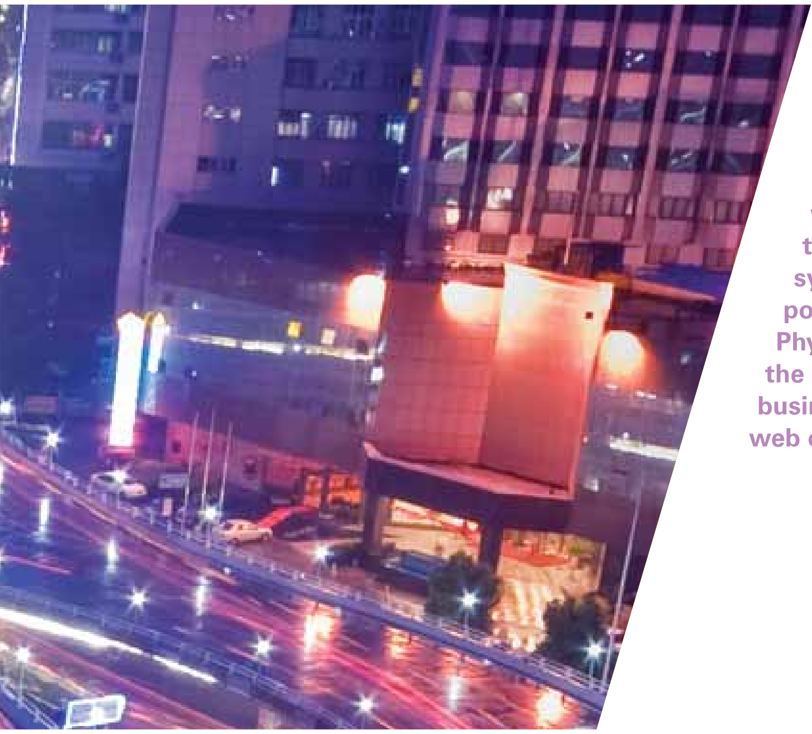
In brief:

- 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.

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1 KPMG International, 2012

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Focus on what matters to the reader

A key first step is to recognize 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 reporting[1] 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 world[1] 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	Reports on issues that should not have a major impact on the business, provided they are managed effectively. Reader interest focusses on trends or relative measures rather than absolute outcomes.	• Operating maintenance spend for an airline • Industry workplace safety ranking for a construction company • Staff turnover for a retailer
Performance	Reports on issues the business knows it needs to change as part of its core strategy. Reader interest lies in the progress made in implementing this change - have specific operational targets and milestones been met?	Possible targets in the business strategy: • Water consumption in stressed areas for a chemicals company • Mix of ethically sourced raw materials for a consumer goods manufacturer
Reward	Measures that demonstrate direct value to the business. These help the reader understand the actual or potential investment returns.	Possible outcomes in the business strategy: • Market share in a new segment (e.g., green energy generation) • Brand rankings

1 KPMG International Survey of Corporate Responsibility Reporting 2011

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