

# The Sustainable Development Goals, integrated thinking and the integrated report Summary report

By **Carol A Adams**

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## Author

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## Acknowledgments

This document draws heavily on concepts in the International <IR> Framework which was developed by the IIRC through a broad range of global stakeholders.

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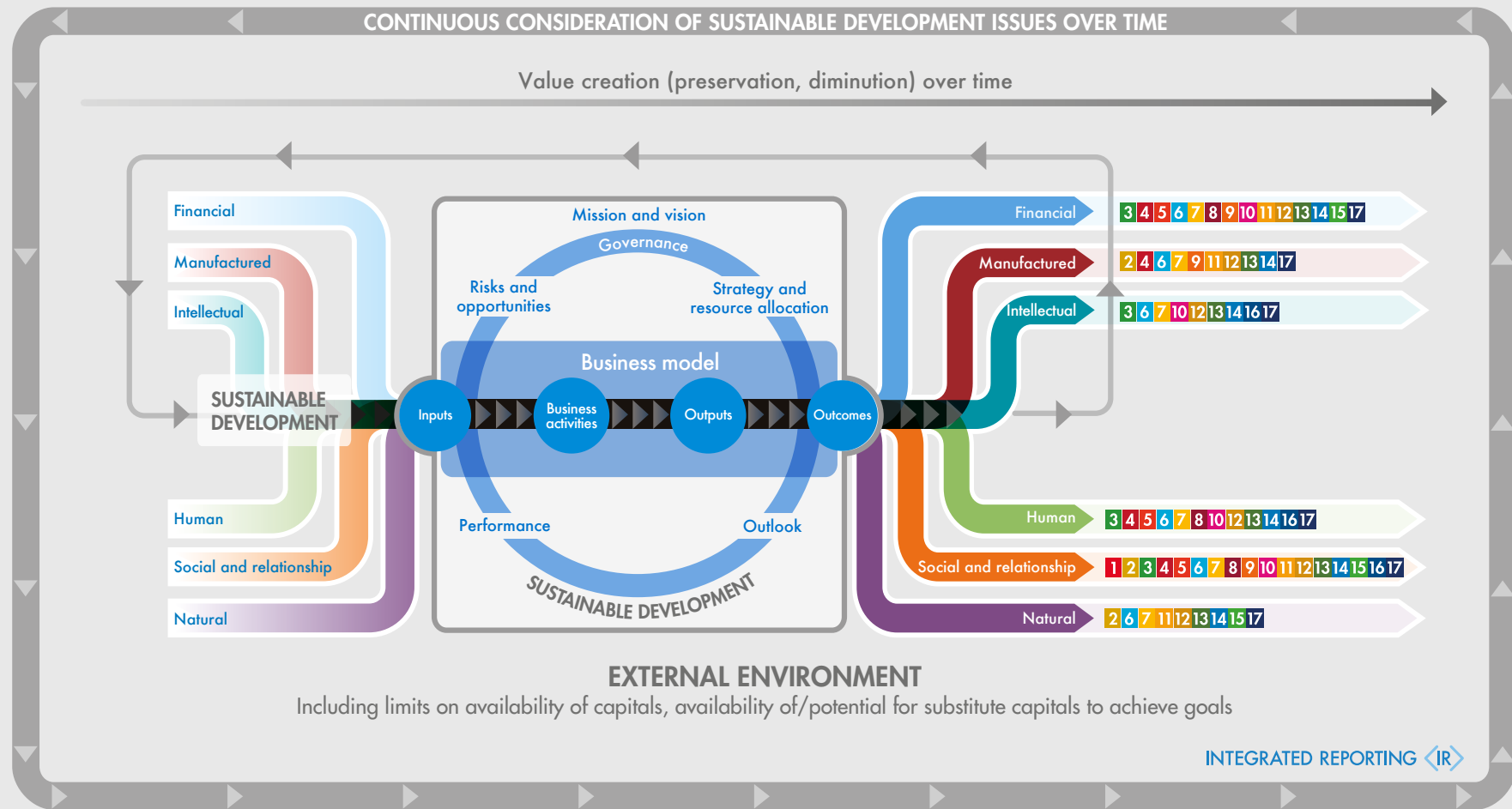
The Advisory Group met twice during the development of this document to review and comment on drafts.

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1. <https://drcaroladams.net/>

# Aligning the SDGs with the value creation process



### Financial

Financial capital may be related to fourteen of the goals

### Manufactured

Manufactured capital may be related to ten of the goals

### Intellectual

Intellectual capital may be related to nine of the goals

### Human

Human capital may be related to twelve of the goals

### Social and relationship

Social and relationship capital may be related to all seventeen of the goals

### Natural

Natural capital may be related to nine of the goals

## SUSTAINABLE DEVELOPMENT GOALS



# A framework for contributing to the SDGs through the <IR> value creation process

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This section considers how the value creation process set out in the <IR> Framework can facilitate a focus on sustainable development. It sets out a framework comprising five steps which reporters can take to contribute to the SDGs consistent with the <IR> Framework. It also considers how contributions to the SDGs can be linked with outcomes for the six capitals of <IR>.

## The value creation process

<IR> is particularly helpful to increasing understanding of the importance of sustainable development issues to value creation because of its: multi-capital approach; long term focus; guiding principle of connectivity; and, requirement for board involvement (Adams, 2015b; 2017). The importance of identifying and responding to sustainable development and other risks is increasingly recognized by regulators through calls to disclose significant risks and strategy. Examples are the requirements for UK companies to present a Strategic Report and for Australian companies to provide an Operating and Financial Review (OFR)<sup>2</sup>. Further, <IR> helps organizations understand (and articulate to their investors) the relationship between the value it creates for others and the value it creates for itself. It provides a framework for shifting the way individuals think about sustainable development issues and value creation.

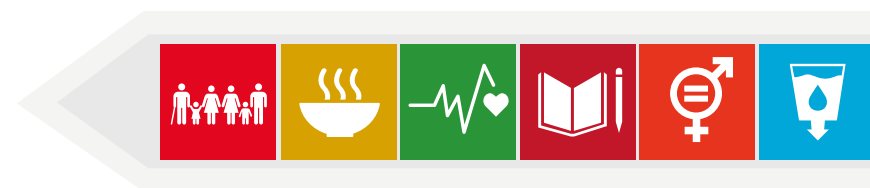
The conceptualization of the corporate value creation process in Figure 1 draws on prior research, theorizing and interviews with board directors and chairs of some of the largest companies in South Africa and Australia (see Adams, 2017). It can be considered in three parts:

1. The external contextual factors (the green rectangle), increasingly include sustainable development risks and opportunities, which are internalised in developing and delivering on long-term strategy;
2. The ability of strategy to be delivered requires an organisation to respond to ESG risk and opportunity in order to create value (increasingly regarded as being more than accumulated financial capital). This process within the organization is represented by the lighter blue rectangles. It is tempered by individuals and

leadership, particularly whether they accept a more holistic view of value, and the extent to which their cognitive framing allows them to incorporate this into decision making.

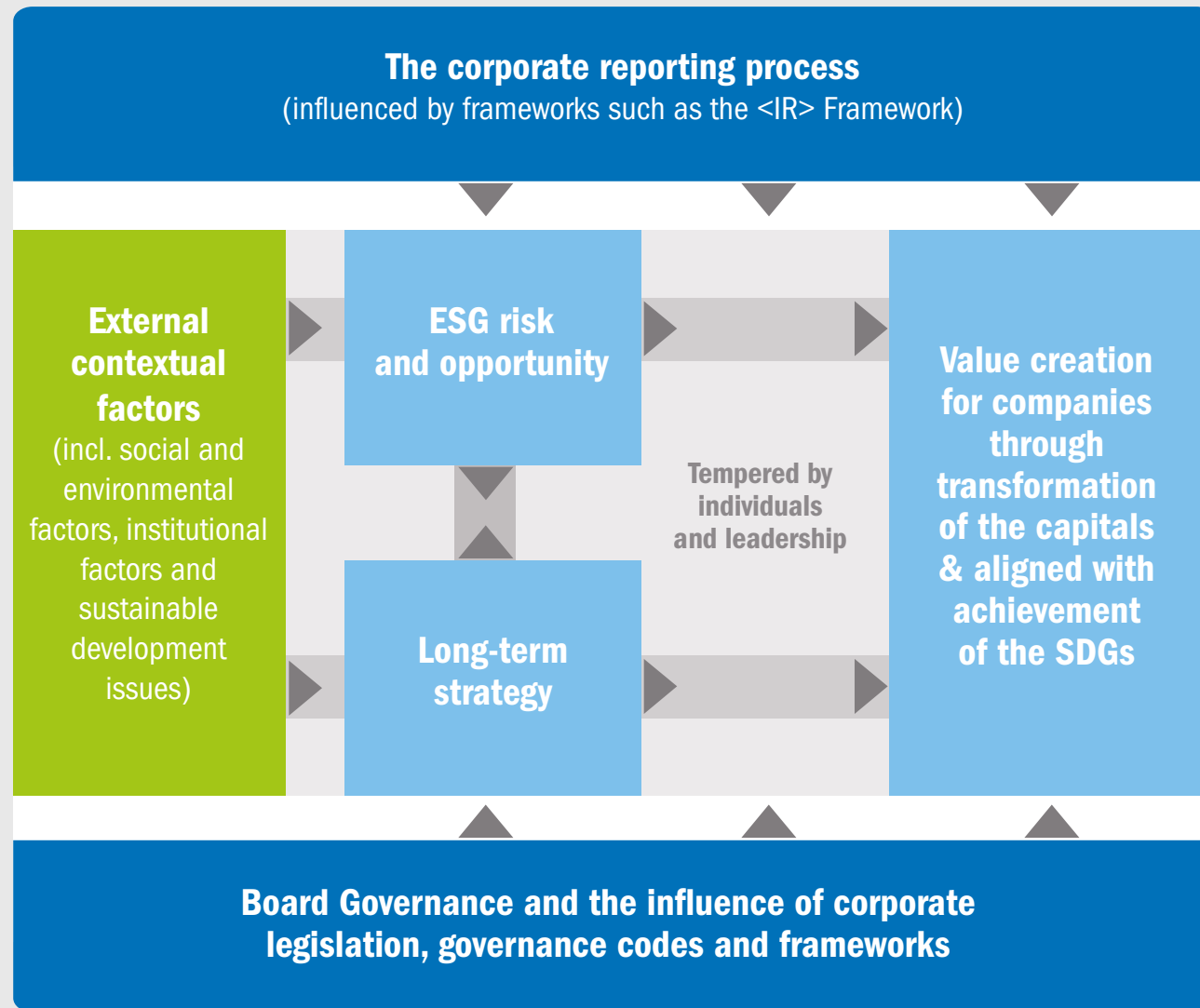
3. The process is hindered or facilitated by corporate reporting processes and board governance and the regulations, codes and Frameworks which influence them (the dark blue rectangles). The <IR> Framework has been found to have a positive influence.

Figure 1 conceptualizes what is referred to as ‘integrated thinking’<sup>3</sup> in the context of contemporary market, society and organizational dynamics. The interviews demonstrated<sup>4</sup> that Integrated Reporting, with its broader view of value creation, increased integrated thinking and awareness of the interconnectedness of social, environmental and financial performance issues.



2. The Australian Securities and Investment Commission (ASIC) Regulatory Guide 247 (ASIC, 2013) requires listed companies to prepare an Operating and Financial Review (OFR) which discusses (amongst other things) environmental and other sustainability risks which could affect the company's financial performance (RG247.63). RG247.62 contains a forward looking disclosure requirement pertaining to the likelihood of risks increasing or decreasing and their potential impact on the company's prospects.
3. This diagram has a different purpose from 'The value creation process' diagram on page 13 of the <IR> Framework which depicts the value creation process at the level of the organization.
4. See Adams (2017) for interview details.

**Figure 1:** Conceptualization of the corporate value creation process



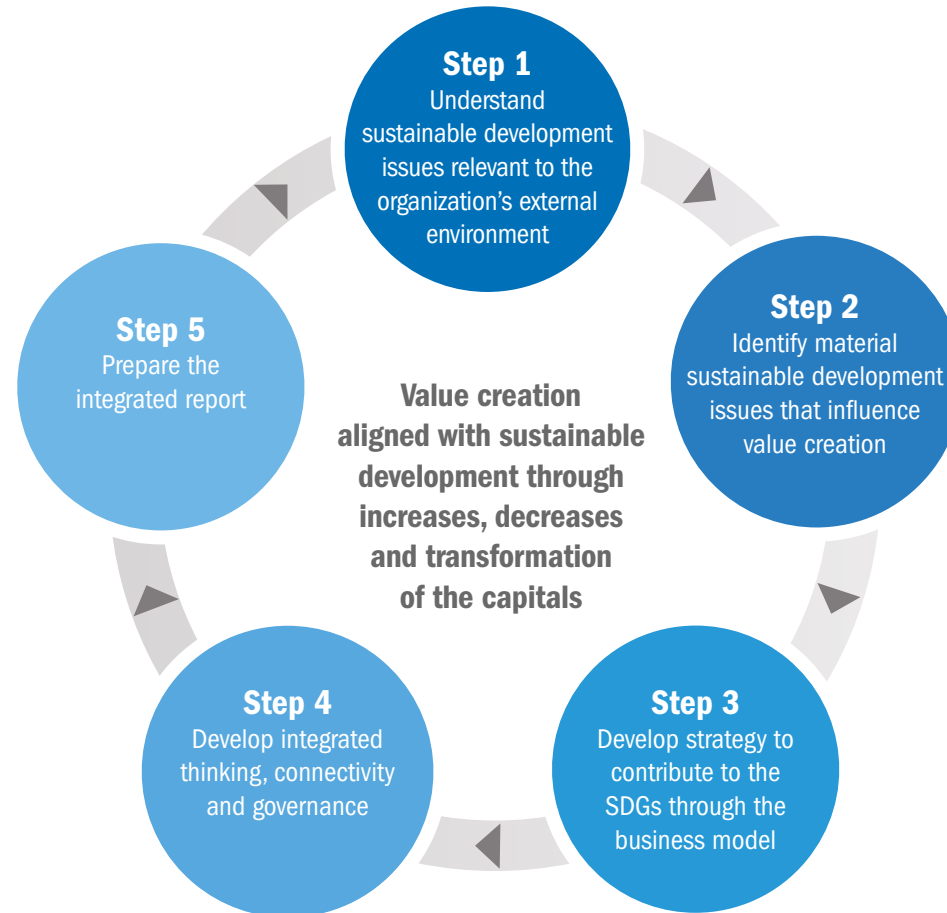
Source: Adapted from Adams (2017)

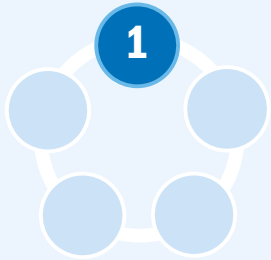
## A framework for contributing to the SDGs through the <IR> value creation process

The <IR> Framework (IIRC, 2013) provides an opportunity for organizations seeking to respond to the Sustainable Development Goals (SDGs) to get board level attention for integrating them into strategy and reporting.

This section identifies five steps for contributing to the SDGs through the <IR> value creation process set out in the <IR> Framework. Whilst it is expected that most organizations will start at step 1, it emphasizes that this is a continuous process and organizational responses to each step are expected to deepen with each new cycle.

**Figure 2:** Aligning the SDGs to the value creation process





## Step 1: Understand sustainable development issues relevant to the organization's external environment

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The sustainable development issues that the SDGs address impact on the organization's ability to create value for itself and its stakeholders. The <IR> Framework requires consideration of significant factors affecting the external environment and the organization's response (para 4.5). These factors may increase or decrease value created either directly (e.g., by creating new business opportunities) or indirectly (e.g., through the quality of relationships with stakeholders or by influencing the availability, quality and affordability of a capital that the organization uses or affects). Therefore, **consideration of the SDGs, and the sustainable development issues that they address, should be incorporated into the wider consideration of the external environment relevant to the organization's ability to create value.**



### Link with the <IR> Framework

The external environment should be considered in the value creation process (para 2.21). Examples of relevant external environmental factors identified in the <IR> Framework are: societal issues, such as population and demographic changes, human rights, health, poverty, collective values and educational systems; environmental challenges, such as climate change, the loss of ecosystems, and resource shortages as planetary limits are approached (para 4.7). These relate directly to a number of SDGs.

Strategy and resource allocation plans are influenced by/ respond to the external environment and the identified risks and opportunities (para 4.35). They are also influenced by the availability, quality and affordability of multiple capitals (4.36, 4.37) which are in turn influenced by sustainable development issues.

The capitals are stocks of value that are increased, decreased or transformed through the activities and outputs of the organization (para 2.11) which influence the availability of capitals in the future. At times, costs or other effects on the capitals are externalized, i.e., relate to capitals that are not owned by the organization

(para 2.7). Such externalities may ultimately increase or decrease value created for the organization and therefore providers of financial capital need information about them in order to assess their effects and allocate resources accordingly (para 2.8).

The board has responsibility to create an oversight structure to support value creation (para 2.22) in light of the external environment.

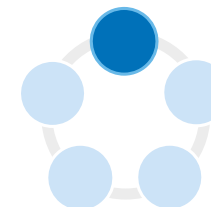
### Practical implementation

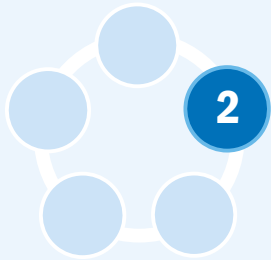
Organizations typically scan the external environment to identify short, medium and long-term risks and opportunities which need to be considered when developing strategy and evolving the business model. This process should include the identification of risks and opportunities associated with sustainable development. For example, inequality and poverty are a risk factor in some countries in that they limit the market for products and services. The threat of rising prices for fossil fuel energy sources poses an energy security risk which may challenge manufacturing companies (for example) by periodically shutting down operations. Fossil fuel energy consumption presents a risk to natural capital

through CO<sub>2</sub> emissions. It also presents an opportunity in developing renewable energy sources.

In practice, the identification of relevant external factors including those relevant to the SDGs, which will vary considerably from sector to sector and by geographical region, should involve stakeholder engagement and should draw on the expertise of the board/governing body. Organizations should consider how they can contribute to the sustainable development issues that the SDGs address through their own operations. For example, organizations can contribute to SDG 5 on gender equality and SDG 13 on climate action by improving opportunities for women and reducing their carbon emissions respectively. This will have a positive impact on the future availability and quality of human and natural capital.

Integrated reporters should identify how transformations of the capitals impact on, or contribute to, SDG targets. This might be achieved by reference to the ongoing work of the Business and Sustainable Development Commission, Global Reporting Initiative, UN Global Compact, WBCSD or UNCTAD.





## Step 2: Identify material sustainable development issues that influence value creation

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The materiality process for Integrated Reporting involves identifying, evaluating and prioritizing matters based on their ability to affect value creation in the short, medium and long term. Value is created for the organization and for others through increases, decreases and transformation of the capitals. Therefore, **when planning their approach to the SDGs, organizations seeking to reassess their mission and purpose and/or to reduce corporate risk and increase opportunities arising from sustainable development issues should identify, evaluate and prioritize which sustainable development issues maximize outcomes for the six capitals and hence their contribution to the SDG targets<sup>5</sup>.**

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5. Targets for each goal are available at <http://www.globalgoals.org/#the-goals>

### Link with the <IR> Framework

Value is created for the organization and for others through increases, decreases and transformation of the capitals (para 2.4).

The ability of an organization to create value for itself is linked to the value it creates for others (para 2.6).

The <IR> Framework requires integrated reports to provide insight into how the organization responds to the legitimate needs and interests of stakeholders (para 3.10) noting that value is created through relationships with others (para 3.11). Economic, environmental and social issues which are important to stakeholders can also affect the ability of the organization to create value (para 3.12).

The materiality determination process involves identifying, evaluating and prioritizing matters based on their ability to affect value creation (para 3.18). Further, the principle of completeness requires that an integrated report includes all material information, both positive and negative (para 3.47).

### Practical implementation

Few organizations can or should aim to contribute to all 17 SDGs. Not all SDGs will be material to an organization's value creation process. An organization will not make a material contribution to (or negative impact on) the achievement of all SDGs.

Further, a number of the SDG targets will not be applicable to some types of organizations.

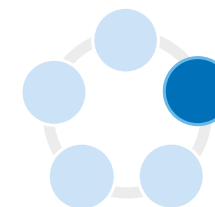
The process of identifying, evaluating and prioritizing matters that materially affect value creation involves engaging with external and internal stakeholders.

Organizations typically engage with external stakeholders in identifying appropriate sustainability and other disclosures. Some organizations develop a materiality matrix (showing materiality to both value creation and stakeholder groups) which might include sustainable development issues relevant to the SDGs, other social, environmental and governance issues and other trends impacting on their sector (such as, for example, digitization or an aging population). Some leading practice examples of materiality can be found on the <IR> Examples Database<sup>6</sup>.

This process can be used as an input to engaging with senior executives and board members to identify, evaluate and prioritize sustainable development and other issues which present material risks and opportunities for value creation. Other inputs to that process might include industry association reports, national government deliberations and outputs of the work of international bodies such as United Nations agencies. The process of engaging with internal stakeholders should involve consideration of sustainable development issues and outcomes for the SDGs in terms of multiple capitals.

Sound governance is critical throughout this process in order to ensure completeness with respect to both positive and negative issues (see also Step 4).

Indicators used by an organization to measure transformation of the capitals caused by its outputs and activities might also measure outcomes for one or more SDGs.



6. <http://examples.integratedreporting.org/home>



### Step 3: Develop strategy to contribute to the SDGs through the business model

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The organization's strategy identifies how it intends to mitigate or manage risks and maximize opportunities. **Organizations should set out their strategic objectives and strategies to support relevant and significant SDGs through their business model. This should incorporate resource allocation plans and specific, quantified short, medium and long-term targets.**

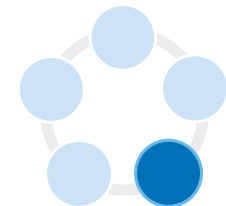
**Link with the <IR> Framework**

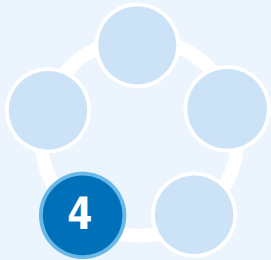
The organization's strategy should relate to its ability to create value in the short, medium and long term and to its use of and effects on the capitals (para 3.3). An organization's ability to create value is influenced by the external environment (see Step 1) which may pose risks and opportunities to the availability of one or more capitals.

The organization's strategy identifies how it intends to mitigate or manage risks and maximize opportunities. It sets out strategic objectives and strategies to achieve them, which are implemented through resource allocation plans (para 2.27).

**Practical implementation**

Having identified sustainable development issues relevant to an organization's external environment (step 1) and material issues that could affect value creation (step 2), an organization should develop a strategy that addresses them. This should align with the business model and enable identifying inputs and outcomes in terms of the capitals, and how outputs (in terms of products and/or services) and key activities of the organization affect those capitals. Resource allocation plans can then be developed to ensure achievements of the strategic objectives, including outcomes for the SDGs.





## Step 4: Develop integrated thinking, connectivity and governance

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**The <IR> Framework calls on organizations to link their strategy to changes in the external environment including evolving societal expectations and natural resource limitations.** Further, it emphasizes the importance of responding to the legitimate needs and interests of stakeholders because value is created through its relationships with others. It recognizes that these interests can be in conflict and may require trade-offs. **Those charged with governance are required to acknowledge their involvement and responsibility for this process. Those charged with an organization's governance should satisfy themselves that:**

- **the processes of building relationships with stakeholders will: identify material sustainable development issues; that these are incorporated into strategy; and, that appropriate goals and targets have been developed.**
- **the organization develops and nurtures relationships with and between stakeholders in order to enhance collective well-being;**
- **the organization's business model considers all material sustainable development issues impacting on inputs and outcomes in terms of the six capitals;**
- **the organization's strategy and business model evolve to reflect past performance with respect to the SDGs.**

### **Link with the <IR> Framework**

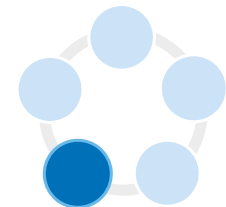
Connectivity involves (amongst other things) “linking the organization’s strategy and business model with changes in its external environment, such as increases or decreases in the pace of technological change, evolving societal expectations, and resource shortages as planetary limits are approached” (para 3.8).

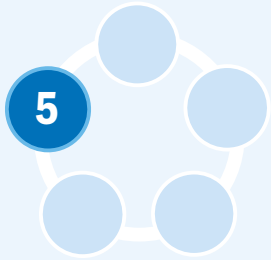
Integrated thinking is defined on page 2 of the Framework. It “...takes into account the connectivity and interdependencies between the range of factors that affect an organization’s ability to create value over time, including: The capitals that the organization uses or affects, and the critical interdependencies, including trade-offs, between them; ...How the organization tailors its business model and strategy to respond to its external environment and the risks and opportunities it faces...”. Further, para 4.56 recognises that trade-offs between capitals may influence value creation over time and provides the example of creating employment through an activity that has a negative impact on the environment.

Those charged with governance are called on to acknowledge “their responsibility to ensure the integrity of the integrated report” and that they have “applied their collective mind to the preparation and presentation of the integrated report” (para 1.20).

### **Practical implementation**

This step includes ensuring sound governance with respect to the processes set out in steps 1-3. It also includes embedding material SDG considerations (identified through Steps 1 and 2) and resulting strategies and expected outcomes (Step 3) into the fibre of the organization through integrated thinking. Governance processes should be able to deal with conflicting stakeholder needs, the interrelationship between capitals relied upon and the interdependency of the SDGs. This involves integrated thinking mechanisms (such as an appropriate culture, communication systems and training) leading to an enhanced understanding of the relationships set out in Figure 1. (See also Adams, 2015b; 2017.)





## Step 5: Prepare the integrated report

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Organizations should report on key sustainable development issues which impact on stakeholders and the organization to influence value creation in the short, medium and long term. **Organizations should report their contribution to SDG targets alongside their outcomes with respect to the six capitals.**



### **Link with the <IR> Framework**

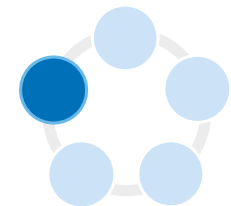
The <IR> Framework requires organizations to consider and report on how the external environment (and explicitly social and environmental issues) influences value creation. It requires organizations to identify and prioritize issues and engage with stakeholders in that process. Organizations should disclose their strategy which should address the risks and opportunities that external environmental issues give rise to. Section 4 of the <IR> Framework is particularly relevant here. It sets out the content elements of an integrated report (para 4.1), how the organization should report on the external environment (paras 4.6 and 4.7), what should be reported with respect to governance, risks and opportunities, performance and strategy and resource allocation.

Section 2 of the <IR> Framework discusses the role of multiple capitals in value creation noting the complexity of the increases, decreases and transformation of capitals in the process of value creation. Organizations are not expected to report on all six capitals (rather only those that are material to them) and quantification of the capitals is not advocated by the IIRC. Rather, organizations are encouraged to think about all forms of capital they use and affect through their business model (para 2:17). This facilitates broader thinking about what value is and how it is created. Contributing to the SDGs affects the stock of capitals available to an organization. In the same way as transformation of the capitals is complex with numerous interdependencies across the capitals, so too is the process of contributing to the SDGs where organizations need to consider the interdependencies across the SDGs and the trade-offs between them.

### **Practical implementation**

This involves the preparation of an integrated report which discusses the process the organization has followed with respect to the SDGs (i.e. how it has implemented steps 1-4 above). It should say how sustainable development issues limit the availability of one or more capitals, how they have been considered in the development of strategy and how they impact value creation.

The integrated report should report on how the business model delivers outcomes (positive and negative) for multiple capitals and how this makes a contribution to the SDGs. That is, organizations are encouraged to report on material contributions to the SDGs, identifying which capitals are being increased, decreased or transformed in the process. For example, an organization might: describe how it has contributed to SDG 17 (Partnerships for the Goals) and how this has increased social and relationship capital; report its gender pay gap and note how that has enhanced human capital and will lead to a medium- and/or long- term increase in financial capital.



## The SDGs and the six capitals

The activities and outputs of organizations represented in their business models require inputs in terms of the six capitals and they produce outcomes with respect to the six capitals. Sustainable development issues may limit the availability of one or more capitals.

In contributing to the SDGs companies and other organizations will increase or decrease the availability of various capitals.

The capitals transformed during this process of contributing to the SDGs will be identified through the five-step process of aligning the SDGs with <IR>. As noted in step 2, when planning their approach to the SDGs, organizations should identify, evaluate and prioritise sustainable development issues which maximise outcomes for the six capitals and hence their contribution to the SDG targets.

“The goals and targets integrate economic, social and environmental aspects and recognize their interlinkages in achieving sustainable development in all its dimensions.”

**(Report of the Open Working Group of the General Assembly on Sustainable Development Goals, UN General Assembly, 2014, para 18, p9).**

Contribution to particular SDGs will depend on:

- The company's/organization's process of identifying, evaluating and prioritising SDG targets and related externalities based on their ability to affect value creation.
- The industry in which the company operates<sup>7</sup>.
- The specific targets the company chooses to contribute to as part of its value creation process<sup>8</sup>.

Following the five steps above should facilitate improvements in reporting on multiple capitals and increase organizational accountability for contribution to the SDGs and negative impacts on their achievement. Contributing to any SDG target is likely to involve increases or decreases in more than one capital. Where material to value creation such increases, decreases or transformation of the capitals should be disclosed in the integrated report. Appropriate indicators should disclose material changes in the capitals and contributions to, and material negative impacts on achievement of, the SDGs.



7. For example: with respect to SDG 3, a company training health professionals in developing countries might increase financial and human capital; with respect to SDG 2, a bank might increase financial and social and relationship capital by investing in small farming businesses and providing financial literacy training.

8. For example, with respect to SDG 4, a developed country university might choose to focus on providing scholarships to students in a developing country where they run courses.

# The IIRC, ICAS and Green Economy Coalition collaboration

SDG 17 calls for global partnerships for sustainable development: “Urgent action is needed to mobilize, redirect and unlock the transformative power of trillions of dollars of private resources to deliver on sustainable development objectives. Long-term investments, including foreign direct investment, are needed in critical sectors, especially in developing countries.”<sup>9</sup>

The IIRC, ICAS and the Green Economy bring together the interests of investors, companies, standard setters, regulators, accountants, NGOs, research institutes and trade unions.

IFAC (2016) argues that the skills of accountants (“including in governance, risk management and control, business analysis and decision support”) “will become increasingly in demand as the SDGs gain traction”. (page 7). It identifies 8 SDGs for the global accountancy profession to contribute to: 4 5 8 9 12 13 16 17. “Integrated thinking and reporting provide the means and additional incentives for CFOs, and their finance teams, to focus on the information and the decisions that matter to a company and its potential success.”

**(IFAC, 2016, page 20)**



ICAS is a professional body of Chartered Accountants with more than for more than 20,000 members working in more than 100 countries around the world. It was created by Royal Charter in 1854. ICAS has a strong focus on professional ethics and its Sustainability Panel is working to raise awareness of the role of accountants in sustainable development.

## INTEGRATED REPORTING <IR>

The International Integrated Reporting Council (IIRC) is a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs promoting communication on value creation beyond financial profit. The IIRC’s vision is to align capital allocation and corporate behaviour to wider goals of financial stability and sustainable development through the cycle of integrated reporting and thinking. The IIRC’s mission is to establish integrated reporting and thinking within mainstream business practice as the norm in the public and private sectors.



The Green Economy Coalition (GEC) is a network of organizations and sectors from NGOs, research institutes, UN organizations, business to trade unions that have come together in recognition that our economy is failing to deliver either environmental sustainability or social equity. Its vision is of a resilient economy that provides a better quality of life for all within the ecological limits of the planet and its mission is to accelerate the transition to a new green economy.

9. From <http://www.un.org/sustainabledevelopment/globalpartnerships/> (Accessed 15th March, 2017)

