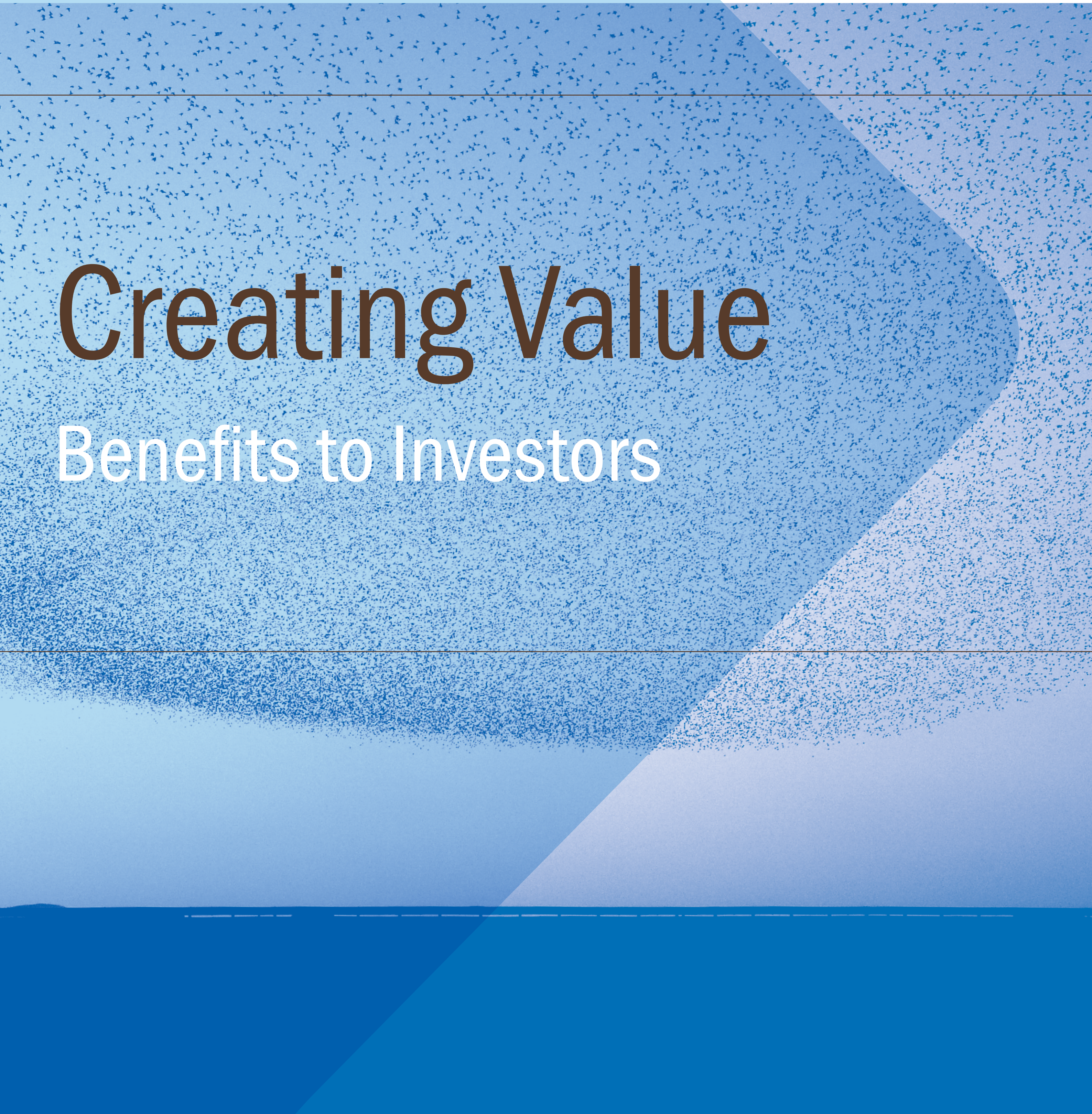
INTEGRATED REPORTING <IR>



Creating Value

Benefits to Investors

Investor statement

We, the undersigned, support the statement below. We have made this statement to help companies understand that, if they deliver relevant and useful information, we will use it.

"As major investors in the world's financial markets, we are fiduciaries for millions of individuals. To perform this role, we need to understand the long-term return prospects of the businesses in which we invest. We need to build a view of how they might perform, both in the short-term and over many years ahead, and to understand the risks they might encounter, not just in the next quarter but over the coming years or decades.

To do this we need to understand not only their immediate financial performance, but the strategy of the business, the key resources and assets to which it has access and how it intends to maintain access to these resources and maintain or improve its assets.

This gives rise to a need for businesses to explain their business models and strategies so that we understand how they earn their returns. We need them to tell us about the key resources on which they rely, to understand the cost of maintaining or growing them or, where necessary, of switching to alternatives. We need to understand what they do to maintain their access to those resources, and how they fulfil the needs of their staff or customers.

Many businesses already do some of this: clearly explaining their business model, their strategy and how this is applied in practice, helping us to understand the key stakeholders on which their business relies, and the utility of the most important assets, including those not visible on the balance sheet. We recognise that businesses are under continuing regulatory pressure both in reporting to investors and others, and we support clarity and conciseness in reporting. Nevertheless better reporting and effective communication of how the business works in the long-term, through Integrated Reporting or other approaches, is valued by us and is important in how we allocate capital.

We also believe that embedding such practices into the management and reporting of businesses will help to drive improved governance and stewardship practices through more comprehensive identification and management of current and future opportunities and risks. This will help businesses to move the focus on decision-making and capital allocation from the short-term to the strategic issues, risks and opportunities that determine future performance in the medium and longer term. This shift will facilitate more sustainable development and stable businesses in the longer term and the growth of more transparent and robust capital markets which will benefit us all."

Aberdeen Standard Investments

Achmea Investment Management

Aegon Asset Management

Cbus Super

Eumedion

Evenlode Investment

Hermes Investment Management

Martin Currie Investment Management

NN Investment Partners

PGGM Investment Management

Triodos Investment Management

VicSuper

Foreword

Creating Value: Benefits to investors

I am delighted to write this foreword to this edition of *Creating Value*: benefits to investors. CFA Institute fully supports the IIRC's aim of aligning capital allocation and behaviour with a balanced view of investment and returns across all time frames: short, medium and long. In the four years since the International Integrated Reporting Framework's publication in 2013, both recognition and the evidence of the benefits of adoption have, as you will see in this report, moved forward substantially.

This report captures the unique strengths of the International Integrated Reporting Framework in linking and demonstrating the benefits of and need for carefully assessed investment in all material capitals. If companies successfully apply the principles of integrated thinking and reporting and we, as investors, foster and encourage this behaviour, it should make a real contribution to a better future for our clients and society, and to increasing our public value as a profession.

I am pleased, too, to note that Integrated Reporting, and the principles behind it, are gaining traction not just in Europe, Japan, South Africa and the US, but increasingly in high growth markets such as Brazil, India and Malaysia. The greater transparency and clarity of understanding of businesses which the principles of Integrated Reporting can offer create a great opportunity for the professional investment community to encourage stronger investment and better capital allocation as these regions grow in importance to the world's capital markets and economy.

I ask CFA Institute's members and other investors reading this to look at these results critically, to challenge themselves on whether they can see opportunities here to use new information effectively, to recognize and encourage those companies which succeed in demonstrating good stewardship of the resources under their care, and to ask those which appear not to, to explain themselves.

Paul Smith, CFA
President and CEO, CFA Institute

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Introduction

This latest report in our *Creating Value* series highlights what the International Integrated Reporting Framework aims to deliver to investors and how it helps to meet their demands for better information from investee companies. It aims to show that integrated reports can deliver that better information – and that investors recognize this benefit.

In this, we draw on the increasing amount of academic research on integrated reports. Academic activity has grown as more companies and countries adopt the <IR> Framework and their proficiency at implementing it increases with experience. There is now evidence of significant links between adoption or better implementation of <IR> and improved outcomes in capital markets, whether demonstrated by stronger operational performance, higher and more accurate valuations or stock market performance.

While we cannot claim to provide a complete overview of the available evidence, we believe this report will help you to understand why you should support companies that have adopted the <IR> Framework, encourage them to implement it effectively and support more widespread adoption.

We thank all the investors taking part in the surveys referenced and their organizers, as well as the academics who have applied their time and resources to the study of this field.

The aim for investors

The International Integrated Reporting Framework (the <IR> Framework) has investor needs at its core. It encourages organizations to improve their reporting by focusing information more clearly on the business model and how the company creates value for capital providers. It promotes the provision of a broader range of financial, non-financial and qualitative information to explain the performance of the business and its ability to create value over time.

Investors have signalled that important information:

- focuses on measurable factors such as cost and risk or explains how the business model works
- clearly explains the links between the organization's environmental, social activities and similar intangible investments and expectations of future performance or risk
- allows comparisons to be made between companies in the same sector
- sets out sustainable competitive advantages.

The goals of the <IR> Framework reflect the fact that the investment community was involved in Integrated Reporting at its outset. The panel that drafted the <IR> Framework included representatives of Eumedion (the Dutch association of investment institutions), the DVFA (the German investment professionals' association), Caisse de dépôt et placement du Quebec, Deutsche Bank Wealth Management, Zurich Insurance Group and Kepler Cheuvreux.

In a recent speech[1], Hans Hoogervorst, chairman of the International Accounting Standards Board, said, "So what information is missing in the financial statements? Users will need information about a company's intangibles–strategy, business model or technical know-how–many of which currently are not recognized in the financial statements. Users also want to know about the external environment–competition or economic developments–in which a company operates. Generally, users seek more forward-looking information than the financial statements currently provide. These elements are often included in Integrated Reporting."

Some of this information (or much of it, in the best examples of corporate reporting) is already available in annual or integrated reports or their equivalents. Additional elements are available in other parts of the information ecosystem, whether from the reporting entity itself or other sources.

The limitations of traditional financial reporting do not detract, however, from its importance. High-quality financial reporting is a key pillar supporting and integral to the <IR> Framework. The IIRC therefore works with the IFRS Foundation to promote improved coherence, completeness, efficiency and effectiveness in reporting practices.

The ultimate goal is to give investors a more coherent and complete view of the business. Integrated Reporting pursues this through locating key information, both financial and non-financial, in one place, following a structured approach to providing such information, and linking it effectively, through the organization's business model, with current and future financial results and value creation.

Integrated Reporting is not prescriptive about what measures should be provided, but asks that management explain how their performance measures relate to the key inputs and outputs and outcomes of their business model. This will help investors to understand the performance, risks and opportunities of the organization and its resilience in times of adversity. Successfully identifying information material to investors also facilitates more concise reporting and focuses the organization on providing the right information to appropriate stakeholders based on their value or importance to the business.

Better reporting should lead to better understanding of investee companies and, as a result, more accurate valuation, leading to a lower cost of capital and better capital allocation in aggregate. In addition, better understanding of the business allows better engagement on management quality and coherence, and on the maintenance of the goodwill of the business, which can be of particular importance to passive investors.

What investors have asked for

Investors and others have long called for better corporate reporting. The desire for improvements in management and the reporting of management's performance was reflected in the report of the Cadbury Committee in the UK in 1992 and the foundation of the International Corporate Governance Network (ICGN) in the US in 1995. The IIRC has called, jointly with the ICGN, for alignment between corporate reporting and governance to drive long-term value creation (see *Dialogue for longer-term value creation*[2]).

Over time, the initial focus on governance as a process has broadened to include the reporting of both other qualitative information and a broader set of performance and risk measures. Reporting is now recognized as a key pillar of governance, leading to transparency and information disclosures that help investors to understand companies and lead to better investment decisions.

70% agree or strongly agree with the statement

"I would like to see clearer links between the financial results and the business model, risk and strategy information in the annual report/10-K/20-F."

"Investment professionals told us that they consider ESG information to be an incredibly important and developing area of performance communications."

PwC: It's not just about the financials. A series of interviews with investment professionals[3]

Recent calls for further improvements have focused on both qualitative and quantitative information.

Qualitative issues: Business models, strategy and avoidance of short-termism

Investors have called for clearer reporting on business models, strategy and growth plans to offset an excessive focus on short-term performance. We see this in BlackRock's annual letters to CEOs in 2015 and 2016 calling for a framework for long-term value creation and then for an understanding of the board's strategic response to changes in circumstances. In the Japan Life Assurance Association's 2016 survey[4] 60% of investors called for greater clarity in strategy and planning, while the Financial Reporting Council's Financial Reporting Lab in the UK has reported on the strong interest from investors in clearer disclosures about business models.

Another issue frequently attracting comment is short termism, with much debate about how businesses can be encouraged to manage and report with a greater emphasis on the long term. Legal & General Investment Management, for instance, one of the UK's largest investors states, "We use our scale as a major investor to encourage the companies in which our clients invest to develop resilient strategies, think longer-term and consider their stakeholders."

"The primary reason survey respondents (senior investment professionals from mainstream investment organizations rather than SRI funds) consider ESG information in investment decisions is because they consider it financially material to investment performance."

Why and how investors use ESG information: Evidence from a global survey[5]

Potentially quantitative issues not well recognized by financial statements

Some business resources or aspects of performance are widely reported in narrative sections of annual reports, analysts' presentations or elsewhere. Relevant, accurate measures enable investors to model companies financially. Examples include capacity measures such as room numbers and categories for hotel companies, customer retention for mobile phone or insurance companies, and volume measures in many consumer industries. Some other business resources or performance aspects, however, although recognized as important, are less well reported on. Intellectual property assets or the benefit of workforce know-how or loyalty, for instance, are often key assets of the business but frequently remain unrecognized in balance sheets.

Environmental, social and particularly governance matters have also become far more important to mainstream investors. Broadly this can be attributed to:

- the direct interests of investment managers' clients (demand from the investing public and asset owners such as pension funds for funds to demonstrate a contribution to wider goals than pure financial return),
- government and regulatory pressure – most notably stewardship codes, and
- an increasing belief (particularly among fundamental investors) that some ESG issues can be important indicators of investment risk and sustainability (in the sense of ability of a company to continue in business in the long term).

Most large investors now have a statement of their expectations of corporate governance in their investee companies. BlackRock, for instance, the world's largest investor, states, "We believe that the best companies strategically manage all aspects of the business – it's a matter of operational excellence. ESG considerations are integral to our investment stewardship activities. Our clients are long-term investors and it is over the longer term that ESG risks and opportunities tend to be material and have the potential to impact financial returns. The best companies ensure that their investors, as well as other constituents of the company, have enough information to understand the drivers of, and risks to, sustainable financial performance."

61.8%

of over 300 report preparers and users believe that the use of Integrated Reporting would make Malaysian businesses more attractive to investors.

MIA-ACCA Integrated Reporting Survey[6]

63%

of investment professionals agree or agree strongly that business success in the 21st century will be defined by more than financial profit.

PwC: Global Investor Survey 2016[7]

> ***"MFS seeks to understand all factors that could impact our clients' investment returns. We believe that material environmental, social, and corporate governance ("ESG") factors may impact investment returns, so we integrate our analysis of material ESG issues into our security selection process.***
>
> ***We encourage the SEC to specifically require investor-actionable disclosures on material ESG factors ..... This should contain a concise, analytical assessment of only the ESG topics that are material to the issuer's business, with supporting data points to assist investors in the evaluation of those topics. When possible, the Commission should encourage comparability of quantified sustainability data points within industries. Regardless of the disclosure option selected, we encourage the commission to disallow "boilerplate" disclosure that lacks appropriate quantification of the risks identified."***
>
> *MFS Financial – response on consultation on regulation S-K 2016*[8]

> ***"We are asking that every CEO lay out for shareholders each year a strategic framework for long-term value creation.***
>
> ***But one reason for investors' short-term horizons is that companies have not sufficiently educated them about the ecosystems they are operating in, what their competitive threats are and how technology and other innovations are impacting their businesses."***
>
> Larry Fink, *BlackRock: Letter to CEOs 2016*[9]

Do integrated reports deliver?

There is clear alignment between the aims of Integrated Reporting and investors' needs. The aim is right, so are reporters delivering a product that helps investors?

Surveys regularly refer positively to the <IR> Framework, as these recent examples show:

- Integrated Reporting's contribution to improvements in reporting is noted in Deloitte's Annual Report Insights report on UK companies for 2016[10].
- Integrated reports were rated second only to annual reports (some of which are integrated or, in the case of the UK, follow the Strategic Report guidance which is well aligned with the <IR> Framework) in EY's 2017 global survey of investors (*Is your non-financial performance revealing the true value of your business to investors?*[12]). EY's report noted that 57% of those surveyed rated integrated reports as essential or very useful. Many of the interviewees referred approvingly to Larry Fink's call for companies to report on their long term strategy.
- Integrated reports were listed as second only to direct interaction with the company as the most important source of information on sustainability and corporate governance issues in the Independent Research in Responsible Investment/Extel survey (IRRI Survey 2016)[11].

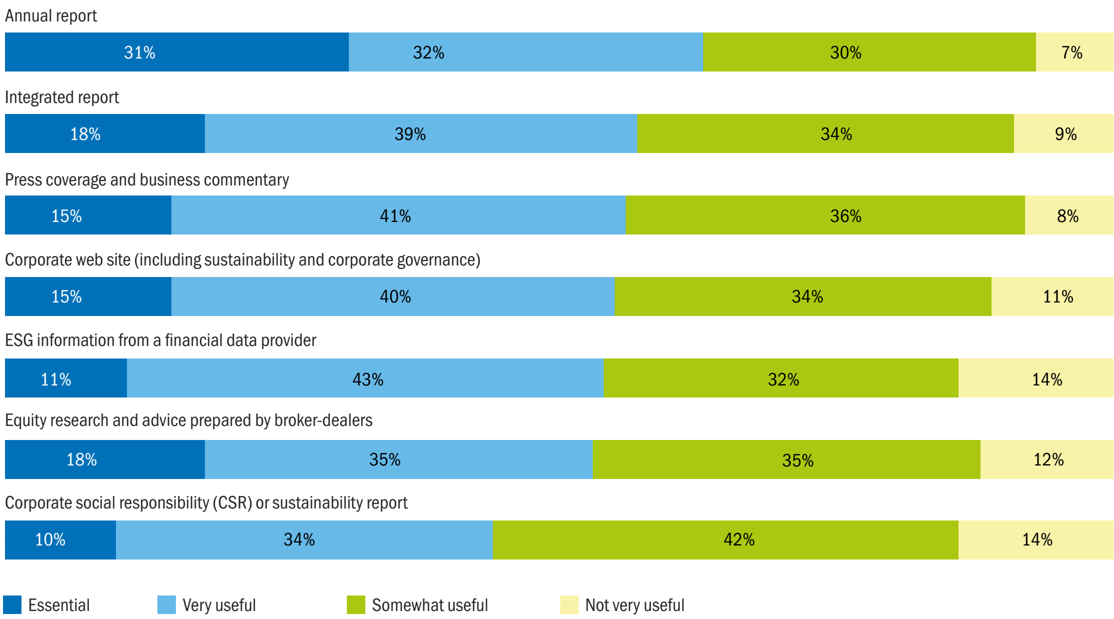
Integrated reporting

"<IR> by focusing on long-term value creation is often seen as a useful framework to explain a company's broader contribution and impact. 71% of companies in our survey are now telling their value creation story compared with 54% the previous year, furthermore 33% discussed how they were creating value for variety of stakeholder groups. UK companies are using the principles and ideas of <IR> to innovate rather than following the IIRC Framework dogmatically. For example the number of companies presenting information similar to <IR> capitals when discussing their business model is up from 53% to 70% in the year and 23% provided a meaningful discussion of corporate culture, an area where the FRC are currently undertaking a project."

Deloitte *Annual Report Insights 2016*[10]
Survey of 100 UK listed companies

Investors read widely in search of valuable non-financial information; no single source dominates decision-making

How useful do you find the following sources of nonfinancial information when making an investment decision?



Adapted from EY's 2017 survey of global investors[11] shows integrated reports ranked second after annual reports (which will include some containing a strategic report) in importance as a source of information for decision making.

92%

92% of investors agree or strongly agree with the statement that

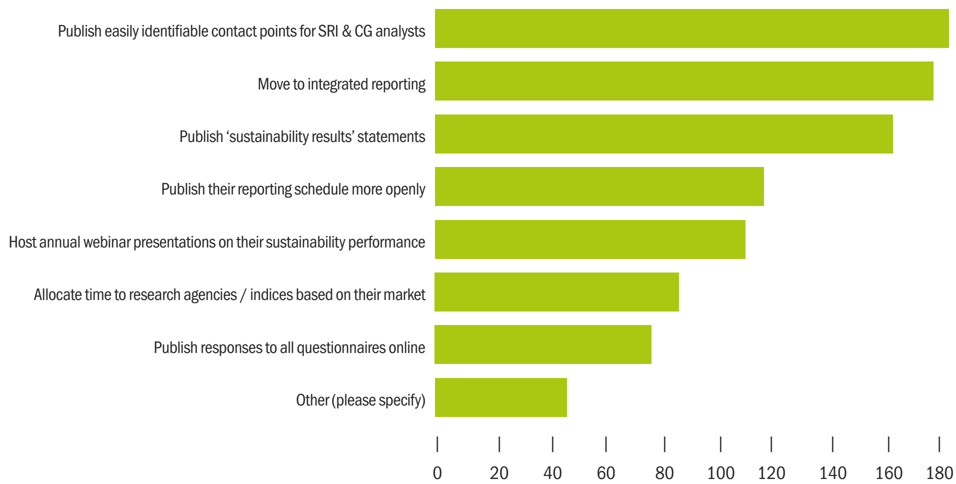
> ***"Public company CEOs should lay out an explicit strategy each year for long-term value creation and directly affirm that the company's board has agreed it."***

EY Global investor survey 2017[12]

Improving communications

How could companies improve their communications to you on sustainability and corporate governance issues?

IRRI's survey, in partnership with Extel[12], shows Integrated Reports as the second most important option for improving communications with research providers, with the first placed source – identifying key contacts – being a rather different and largely complimentary type of solution.



Integrated Reporting is, however, a relatively new approach to reporting – the <IR> Framework was launched in December 2013. As might be expected, not all adopters achieve all the aims of the <IR> Framework and examples of concerns can be seen in these quotes.

PwC's 2016 report "It's not just about the financials: The widening variety of factors used in investment decision making"[3] drew on interviews with a group of professional investors on non-financial reporting.

Several interviewees noted benefits of Integrated Reporting:

"One of the things good Integrated Reporting brings that connects our judgements to our financial analysis is the focus on intellectual capital and social capital."

"What I like about Integrated Reporting, is that it is principle-based, and focuses on providing a narrative. Twenty pages of KPIs typically results in missing the forest for the trees."

Joyce Haboucha, Senior Portfolio Manager and Director of Sustainability and Impact (S&I), Rockefeller & Co.

"We think Integrated Reporting can enhance the approach that portfolio managers take. The key benefit is the way companies articulate their business models and link the inputs and outputs. The best integrated reports focus on the specifics."

Professor Christian Strenger, Board Member, Deutsche Asset Management

"We are aware of many more ESG issues than we were in the past, but the ESG ratings we have today still really only give you a general feeling of performance, not a direct financial cost or benefit. We need companies to take the information behind those ratings and make the links to value creation or destruction. Companies that lead the way in developing the quality of this communication will be much easier to model, and I think can really help."

Susana Penarrubia, Deutsche Asset Management

"We see that companies that are committed to <IR> have been improving the quality of their reports every year. Therefore it is important for companies to commit to <IR>, rather than procrastinate their engagement silently."

Martijn Bos from Eumedion in *Deloitte Integrated Reporting moving towards maturity*[13]

There were, however, some cautions on the quality of execution.

"That really depends on the quality. Recently we visited a number of companies who said they were doing integrated reports, but in reality they were not all of a good enough quality, so they are not as helpful as they could be. In these cases we will need other sources of information."

Angeli van Buren, PGGM Vermogensbeheer on Integrated Reports

Integrated Asset Management

Any or all of the key dependencies and elements of performance: financial, environmental, social or from the other capitals, can be important separately for a given business, but investment managers believe that they will only capture the full benefit of information in these areas when they can be brought together and considered as a whole. An Integrated Report should aim to deliver this information, both on each individual capital and on the links between them and how they fit into the business model so as to facilitate such an approach.

Which of the following ESG strategies do you believe improve or reduce investment returns compared to a market benchmark?

ESG strategies	**% moderately/ significantly positive**	**% moderately/ significantly negative**
Full integration into individual stock valuation	61.2%	5.8%
Negative screening	39.1%	28.2%

Amel-Zadeh and Serafeim: Why and how investors use ESG information[5]

Evidence of benefits

The IIRC and investors would like to see the improved information and evidence of superior management and integrated thinking delivered by Integrated Reporting demonstrated in better understanding of integrated reporters by their investors. This should lead to lower risk for the market overall, better understood risk for individual organizations, and superior investment performance.

Proving such linkage is not easy, however, because outperformance through integrated thinking and reporting is expected to take time to emerge (an issue for a young method of reporting with relatively few adopters in the early days). In addition, analysis of reporting quality necessarily has a subjective element, and adoption of Integrated Reporting might be driven by a wide range of factors, several of which (e.g. available resources or strong investment in and reporting on ESG factors more generally) might also have an effect on future performance.

A lack of awareness, and concerns about the measurability and connectivity of the capitals model[*], were noted in a report by Richard Slack of Durham University, supported by the ACCA[14]. Reports from ACCA on volunteer companies from the IIRC's own international business network[23] and Deloitte on listed companies in the Netherlands[13] outline similar concerns. Encouragingly, however, there is evidence of improvement over time. Deloitte's report, which rates companies on the basis of compliance with the principles of Integrated Reporting whether or not they are adopters, notes this and highlights the importance of commitment to the <IR> Framework's principles in driving continued improvement.

From an academic perspective, Lai and Melloni[15] find strong evidence that companies adopting the <IR> Framework are not merely attempting 'greenwash'. In fact this paper shows they have, on average, higher Bloomberg ESG disclosure scores than non-adopters.

There is, however, less positive evidence from Melloni[16] that, in the presence of weak financial performance, integrated reports tend to be significantly longer and less readable, and that companies with weak social performance tend to produce less concise reports on this aspect of their performance. Such tendencies are also well documented among non-integrated reporters, but unfortunately this study did not compare integrated and non-integrated reporters in this respect.

[*]For more detail see the Framework at www.integratedreporting.org/resource/international-ir-framework/

A number of academics have risen to the linkage challenge. Our previous report on *Value to Investors*, issued two years ago, cited two studies (KPMG and National University of Singapore, "Towards Better Business Reporting", 2015[17], and Nanyang Business School, 2015[18]) that showed improved risk-adjusted returns in Asian markets for integrated reporters and a positive relationship between integrated report quality and valuation in South Africa respectively.

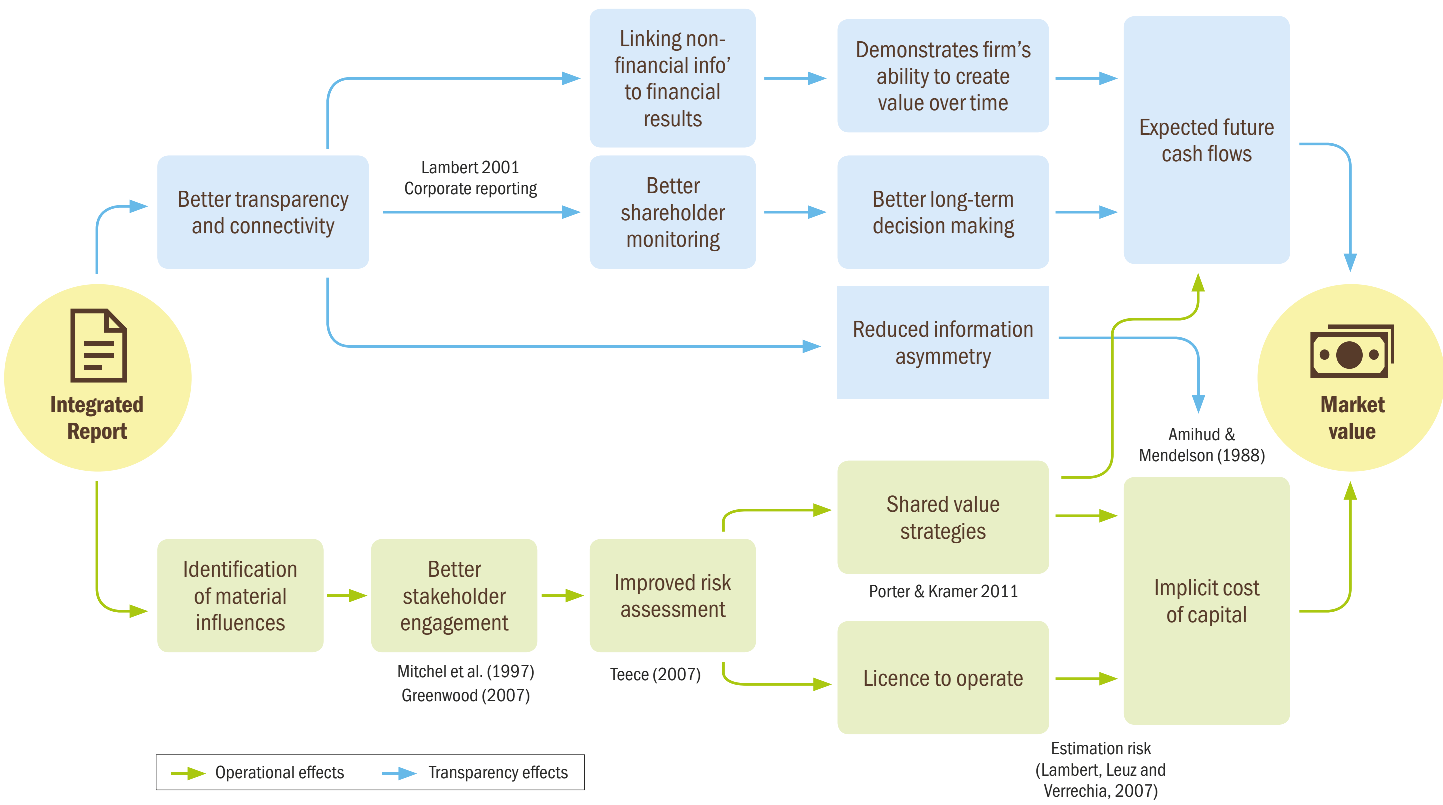
More recent research has also looked at the benefits to investors of Integrated Reporting. The following examples focus particularly on quantitative studies looking at the effects of improved quality of Integrated Reporting and at the differentiation between Integrated Reporting (and its key features) and broader sustainability reporting.

Improved forecasts of future cash flows and valuation:

A recent paper[19] by Carlos Martinez looks at how a sample of firms which adopted Integrated Reporting between 2011 and 2015 change over time compared to a matched sample of non-integrated reporters that do, however, produce a CSR or similar report so that their ESG performance can be tracked. He presents a useful summary of how Integrated Reporting might affect the valuation of a company. Figure 1.

His work suggests that the firms that adopted Integrated Reporting showed greater improvement in future cash flow estimates and higher market to book values than non-adopters of similar size and in the same industries.

Figure 1. How could performance benefits arise?



Adapted from: Martinez, Effects of Integrated Reporting on the Firm's Value: Evidence from Voluntary Adopters of the IIRC's Framework 2017

Better <IR> alignment leads to more accurate forecasts and lower cost of capital

Does Integrated Reporting Matter to the Capital Market? 2017[20]

Researchers found that, in the South African market, better alignment with the <IR> Framework is linked to more accurate forecasts by analysts and to a lower cost of capital, particularly, in the latter case, for companies with fewer analysts following them. Results are adjusted to control for financial transparency and stand-alone CSR reports. The authors note this suggests that higher quality integrated reports (those better aligned with the <IR> Framework) provide better information to market participants.

Higher Integrated Reporting quality associated with higher valuation and better investment decisions in the South African Market

The Economic Consequences Associated with Integrated Report Quality 2017[21]

Authors show higher integrated report quality is associated with higher market value in the South African stock market and examine how this value increase is achieved. They use a quality measure developed by EY which focuses on whether the integrated report gives readers a sense of the firm's strategy and value creation process. They find that firms with higher quality scores have higher valuations, and also that increased scores over the period of the study (2011-2014) result in an increase in valuation. The findings suggest that the difference between the lowest and highest quality scores of the sample would drive a 25% increase in their chosen valuation measure (Tobin's Q). Bid ask spread, which is used as a measure of liquidity, also decreases (i.e. improves) with increasing quality. The researchers attribute the higher valuation to greater expectations for future cash flows and higher liquidity rather than lower cost of capital. In particular they associate higher reporting quality scores with better investment decisions.

Investing in material sustainability factors beats investing in immaterial sustainability factors

Corporate Sustainability: First evidence on materiality 2015[22]

This report, although it doesn't refer to the <IR> Framework, explores the effects of focusing investment on factors material to investors. Materiality is, of course, a key focus of Integrated Reporting. The study finds that firms with good ratings on material sustainability issues significantly outperform firms with poor ratings on these issues. In contrast, firms with good ratings on immaterial sustainability issues do not significantly outperform firms with poor ratings on the same issues.

Effect on financial returns, annualized alpha

	Low Performance on Immaterial Issues	High Performance on Immaterial Issues
High Performance on Material Issues	4.8%	1.5%
Low Performance on Material Issues	–2.2%	–0.4%

Khan, Serafeim and Yoon, Corporate Sustainability: First Evidence on Materiality[22]

Conclusion and call for support

Integrated Reporting aims to deliver information useful to investors – and that aim is being achieved. Surveys show that integrated reports are important sources of information.

Companies that have adopted the <IR> Framework or its principles are regarded by investors as generally producing better reports. Academics have produced studies demonstrating significant links between adoption or quality of Integrated Reporting and performance or valuation.

While this is very encouraging progress, there is more to do. The existence of a range of scores for alignment in Barth's study[21], Deloitte's Netherlands survey[13] or ACCA's report *"Insights into integrated reporting"*[23] show that merely claiming adoption of the <IR> Framework does not automatically create a coherently managed company or a best-in-class report.

We ask investors to encourage current and potential investee companies to adopt Integrated Reporting. A group of progressive investors from the UK, Netherlands and Australia have already indicated their support for Integrated Reporting and have signed up to the statement printed in the front of this report that their investment processes require information on business models, strategy, and the resources on which these rely. They have confirmed their belief that better reporting on the key resources of a business, which Integrated Reporting can deliver, is important to their understanding of businesses and their allocation of capital. They also believe that the management processes reflected in this reporting can drive the development of more sustainable and stable businesses in the longer term. If you would like to join this group please contact us at: info@theiirc.org

We also ask that you engage with companies when you feel their reporting does not match what you expect from an integrated report and encourage you to collaborate with companies on leading practice for reporting, both in quantitative and qualitative areas.

Extra online resources

The <IR> Examples Database
www.examples.integratedreporting.org/home

The database contains examples of emerging practice in Integrated Reporting that illustrate how organizations are currently reporting concise information about how their strategy, governance, performance and prospects, in the context of their external environment, lead to the creation of value over the short, medium and long term.

The Investor Knowledge Base
www.integratedreporting.org/resource-type/investor-value-creation/

The *Investor Knowledge Base* is a dedicated section within the IIRC website that contains a wealth of information for investors on integrated reporting and value creation.

INTEGRATED REPORTING <IR>

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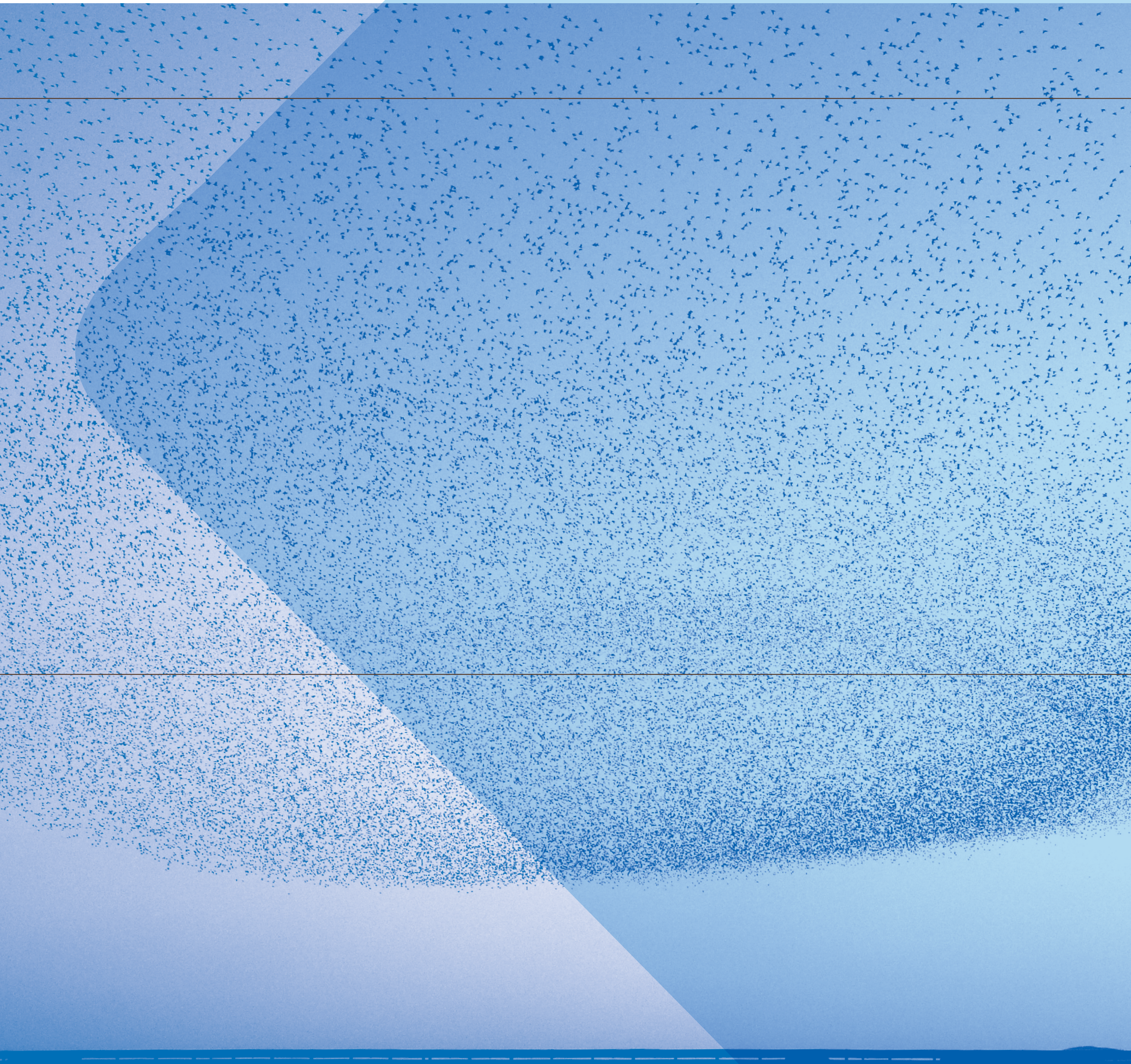
The International Integrated Reporting Council (IIRC) is a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs. Together, this coalition shares the view that communication about value creation should be the next step in the evolution of corporate reporting.

The International <IR> Framework has been developed to meet this need and provide a foundation for the future.

Further information about the IIRC can be found on its website integratedreporting.org

Contact: info@theiirc.org

INTEGRATED REPORTING <IR>



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