

Dear International Integrated Reporting Committee,

We, as a concerned group of sustainability professionals and scientists, would like to respond to your discussion paper '*TOWARDS INTEGRATED REPORTING - Communicating Value in the 21st Century*' released in September 2011. We hope that you find our comments and suggestions useful in revising your discussion paper. We are ready to discuss any of the issues further if deemed helpful.

Yours sincerely,

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OVERVIEW

The authors of this note would like to commend the discussion paper '*TOWARDS INTEGRATED REPORTING - Communicating Value in the 21st Century*' released by the International Integrated Reporting Committee. Its integrated reporting guidelines support the information needs of long-term investors, by showing the broader and longer-term consequences of decision-making: they provide the framework for disclosing the interactions between ecological, social, governance and financial performance. In particular, we would like to praise the following recommendations:

- Connectivity of information (p. 13);
- Conciseness, reliability and materiality (p. 13).

However, recent evidence suggests that sustainability reporting is falling far short of providing the detailed sustainability information needed by the institutional investment community for investment decision-making (Matison et al., 2011; Solomon et al., 2011). There is, for example, very little evidence of any serious attention paid to biodiversity and ecosystem services³. Indeed, institutional investors are being forced to supplement sustainability reporting with private reporting on climate change and other ESG factors (Solomon & Solomon, 2006; Solomon et al., 2011).

Accordingly, the potential for integrated reporting to be successful depends on the quality of the existing sustainability reporting and its comparability with the financial reporting with which it is to be integrated. This is why we would like to highlight a number of issues which we believe could be better addressed by the IIRC discussion paper:

- 1- The meaning of integrated reporting and the need for standardized integrated disclosure formats;
- 2- The incorporation of Biodiversity and Ecosystem Services (BES) considerations into integrated reporting;
- 3- The disclosure of the reporting entity's Sustainability Profit & Loss (P&L) statement.

³ *The benefits firms get from nature (MA 2005).*

1- The meaning of integrated reporting and the need for standardized integrated disclosure formats

‘An Integrated Report shows the connections between the different components of the organization’s business model, external factors that affect the organization, and the various resources and relationships on which the organization and its performance depend.’ (p. 13). To effectively reach this goal, we believe an additional principle should be added to section 2.2: i.e. **Integrated Disclosure**.

Integrating Reports should be much more than the compilation of financial statements and sustainability Key Performance Indicators (KPI) within the same annual report. Wherever possible, disclosed financial and extra-financial information should also be presented in an *integrated format* so that to allow stakeholders to quickly grasp the sustainability implications of assets, liabilities, revenues and expenses.

By building on the principles of Environmental Management Accounting and Environmental Financial Accounting (IFAC 2005; Jasch 2009; Schaltegger et al., 1996), Integrated Disclosure would push reporting entities to develop integrated financial and sustainability information systems by tracing sustainability KPI back to the events giving rise to accounting journal entries (in reference to IFRS’s asset and liability recognition criteria): e.g. sales, expenses, asset acquisition or loan. For instance :

- An Integrated Statements of Financial Position would include additional columns for *accumulated GHG emissions* and *water consumption* (i.e. per asset and liability class) (**Table 1**).
- An Integrated Statement of Financial Performance would disclose Green House Gas (GHG) emissions and water consumption for the year under review, ideally disclosing simultaneously such information for previous years (**Table 2**).
- Additional tables could provide detailed sustainability KPI for all material assets and liabilities : e.g. carrying amount and accumulated depreciation of a plant with its associated annual and accumulated waste generation, GHG emissions and water consumption.

	ZAR / US\$ (2010)	Accumulated GHG emissions (t CO ₂ equivalent)	Accumulated Water consumption (L)
Current Assets			
Cash & Cash Equivalent			
Receivables			
Inventories			
Non-Current Assets			
Land & Building			
Plant & Equipment			
Intangible Assets			
Financial Assets			
Goodwill			
Total			
Current Liabilities			
Accounts Payable			
Current portion of Loans Payable			
Current Tax Payable			
Short-Term Provisions			
Non-current liabilities			
Loans Payable			
Deferred Tax Liabilities			
Long-Term Provisions			
Others Lease Obligations,			
Shareholders' Equity			
Share Capital			
Retained Earnings			
Total			

Table 1: example of disclosure format for an Integrated Statement of Financial Position disclosing accumulated GHG emissions (Carbon Footprint) and water consumption (Water Footprint)

	2010			2009			2008		
	ZAR / US\$	GHG emissions (t CO ₂ equivalent)	Water consumption (L)	ZAR / US\$	GHG emissions (t CO ₂ equivalent)	Water consumption (L)	ZAR / US\$	GHG emissions (t CO ₂ equivalent)	Water consumption (L)
Operating Items									
Gross Revenues									
Operating Expenses									
Cost of Goods Sold									
General and Administrative Expenses									
Amortization / Depreciation									
Non-Operating Items									
Other Revenues or Gains									
Expenses (Tax, finance costs)									
Irregular Items									
Net Income									

Table 2: example of disclosure format for an Integrated Statement of Financial Performance disclosing GHG emissions (Carbon Footprint) and water consumption (Water Footprint) for years 2008, 2009 and 2010

2- The incorporation of Biodiversity and Ecosystem Services (BES) considerations into integrated reporting

We believe the IIRC discussion paper should make explicit reference to all key sustainability issues. This implies going beyond the mere reference to the GRI guidelines as these have been criticized by many stakeholders (e.g. Hubbard 2009; Moneva et al., 2006 ; Richard 2009), notably for the lack (1) of contextual (i.e. product or asset specific) ecosystem performance KPI and (2) of a global sustainability performance indicator (see point 3 thereafter). More specifically, the IIRC guidelines should mention the need for reporting entities to disclose:

- How they address their ecosystem services dependencies and impacts (Hanson et al., 2008 ; Houdet 2008; Houdet et al., 2010; MA 2005; TEEB 2010⁴), and promoting the development of an ecosystem approach to governance, business operations and financial performance (i.e. transversal / integrated analysis of BES risks and opportunities instead of piecemeal climate change, waste and water policies, action plans and KPI).

- Their Biodiversity Footprint (Houdet 2010), BES benefit-sharing policies (including but not limited to genetic resources) and practices, biodiversity offset policy⁵ and actual performance⁶; which would include disclosing (a) their biodiversity assets and associated recognition criteria (Wentzel et al., 2009), as well as (b) recurring statements for changes in natural habitats, flora and fauna on controlled land assets and adjacent landscapes (in particular for critical species ; Jones, 1996; Jones & Mathews, 2000; Jones, 2003), by building on the current GRI's biodiversity guidelines (Table 3) but with KPI demonstrating on-the-ground performance of measures undertaken (e.g. Tucker 2006).

To design context-relevant KPI, reporting entities may refer to a wide variety of (a) BES guidance resources and (b) BES measurement tools in various stages of development: e.g. Houdet et al., 2010; Van Der Lugt et al., 2010; Waage et al., 2010.

CORE	EN11 Location and size of land owned, leased, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas.
CORE	EN12 Description of significant impacts of activities, products, and services on biodiversity in protected areas and areas of high biodiversity value outside protected areas.
ADD	EN13 Habitats protected or restored.
ADD	EN14 Strategies, current actions, and future plans for managing impacts on biodiversity.
ADD	EN15 Number of IUCN Red List species and national conservation list species with habitats in areas affected by operations, by level of extinction risk.

Table 3: core and additional performance indicators on biodiversity (GRI 2006, p. 9)

⁴Global issues and trends (e.g. exchange rate fluctuations, commodity prices, climate change and demographic developments), as well as local issues and trends (e.g. broad-based black economic empowerment, HIV/Aids and socio-economic inequality)' (p. 13).

⁵ The Economics of Ecosystems and Biodiversity (TEEB) study is a major international initiative to draw attention to the global economic benefits of biodiversity, to highlight the growing costs of biodiversity loss and ecosystem degradation, and to draw together expertise from the fields of science, economics and policy to enable practical actions moving forward. Its outputs include several reports, including one targeting the business community ; <http://www.teebweb.org>

⁶ 'Natural resources' is an obsolete concept which helps promote the confusion between biological non-renewable fossil resources (e.g. hydrocarbons) and renewable biological resources (e.g. vegetables, fish, wood, genes) (Houdet et al., 2009).

⁷ The Business and Biodiversity Offset Program (BBOP) provides precise guidelines as regards to the design of no-net-loss biodiversity offsets; <http://bbop.forest-trends.org/guidelines/>

⁸ Both for projects requiring environmental impact assessments and for pre-existing non-current tangible assets (land, building, plant and equipment).

3- The disclosure of the reporting entity's Sustainability Profit & Loss (P&L) statement

For many years research has emphasized the importance of non-financial compliance with standards defined outside of reporting entities (Gray et al., 1987; Huizing & Dekker 1992; Milne 1996; Richard 2009): this is because they may be legitimately used as 'yardsticks' to judge their sustainability performance. Such an approach to sustainability reporting calls for the design of KPI which are context-based: i.e. which express use levels and impacts relative to sustainability performance standards or sustainability thresholds.

To date, three distinct environmental reporting approaches targeting external stakeholders have been identified (Houdet 2010; Houdet et al., 2010):

- **Environmental Financial Accounting (EFA)** which constitutes an extension of conventional Financial Accounting: it aims to differentiate commercial, economic or legal events of an environmental nature which have a direct financial impact, present (expenses, sales) or future (long-term liabilities, provisions), on the reporting entity (linked to environmental disclosure due diligence);

- **Extra-Financial Environmental Reporting (EEFR)** involves reporting corporate performance with non-monetary KPI: according to ISO 14031, a standard which describes processes and methods for measuring environmental performance, three main types of environmental indicators may be used by firms to that end, i.e. indicators of business-induced environmental change (e.g. impact or pressure indicators), process-based indicators (e.g. degree of implementation of environmental management system) and results-based indicators (e.g. eco-efficiency indicators⁷).

- **Disclosure of Environmental Externalities (DEE)** involves disclosing the negative environmental externalities⁸ of the reporting entity because these externalities do not satisfy the recognition criteria for recording liabilities: they imply sacrifices of future economic benefits to other agents the reporting entity is not required to make. The 1990 environmental report of BSO / Origin provides a good illustration of what may be done to that end (Huizing and Dekker, 1992). Quantitative environmental accounts (atmospheric emissions - CO₂, NO_x, SO₂, solid waste, wastewater) were converted into monetary values via economic valuation methods. This allowed BSO / Origin to produce a net added-value, representing the difference between conventional value-added and value-lost; the latter amounting to the costs of BSO / Origin externalities less its impact mitigation expenses (Table 4). More recently and from a similar perspective, PUMA (sports brand) released the 2011 Sustainability P&L of its supply chains as regards to both their carbon and water footprints⁹.

⁷ The concept of eco-efficiency links monetary and physical EMA for decision making in a systematic manner. An eco-efficiency indicator relates 'product or service value', in terms of turnover or profit, to 'environmental influence' in terms of energy, materials and water consumption, as well as waste and emission in terms of volumes (Verfaillie and Bidwell, 2000).

¹⁰ US\$2.15 trillion of environmental damages were caused by the world's 3000 largest publicly-listed companies in 2008 (Mattison et al., 2011).

⁹ These first results have revealed that the direct ecological impact of PUMA's operations translates to the equivalent of €7.2 million of the overall impact valuation. An additional €87.2 million falls upon four tiers along the supply chain. In total, this leads to an overall environmental impact of GHG and Water Consumption of PUMA's operations and the supply chain of €94.4 million. By putting a monetary value on the environmental impacts, PUMA is preparing for potential future legislation such as disclosure requirements. Though these costs will serve as a metric for the company when aiming to mitigate the footprint of PUMA's operations and all supply chain levels, they will not affect PUMA's net earnings (<http://safe.puma.com/us/en/2011/05/puma-announces-results-of-unprecedented-environmental-profit-loss/>).

In order to produce reliable integrated reports, notably with respect to ‘Future performance objectives’ (section 3.6, p. 15), these three reporting approaches need to be combined in an integrated way for both the social and environmental dimensions of reporting entities. This would involve the systematic disclosure of (Houdet and Germaneau, 2011) :

		In million Dutch guilders
1	Value added	255,614
2	Value lost (3-4)	1,993
3	Costs of externalities	2,209
4	Impact mitigation expenses	0,216
5	Net value added (1-2)	253,621

Table 4: calculation of net value added for BSO / Origin in 1990 (Huizing and Dekker, 1992)

I. The up-to-date status and trends of ecosystems within which the reporting entity operates: i.e. spatiotemporal information for all directly and indirectly-controlled assets (including joint-ventures) so as to ensure that stakeholders have reliable socio-ecological reference points prior to any potential impact, accident or development; which would imply collaborating with research bodies, public institutions or NGO’s for collecting, processing and diffusing the relevant ecosystem data sets (**EEFR approach**);

II. The sustainability footprints and associated externalities¹⁰ of the reporting entity, with respect to its dependencies and impacts on all ecosystem services (e.g. climate regulation – i.e. GHG emissions, water consumption, biodiversity) for its assets, products / services, supply chains and subsidiaries (Houdet et al., 2010) ; including the corresponding non-monetary dependency / impact indicators and economic valuation methods (e.g. Huizing and Dekker, 1992; value-loss approach versus replacement / restoration cost approach - Boyd 2010) (**DEE approach**);

III. All assets and liabilities, revenues and expenses of an environmental and social nature (**EFA approach**), calculation methods at the basis of these financially-recognized accounting events, and explanations for the potential gaps between such preventive / corrective measures and estimated externalities (e.g. business-induced changes in ecosystem health);

IV. The reporting entity’s **Sustainability Profit & Loss (P&L) Statement**, in support of the findings of the United Nations – Principles for Responsible Investments’ report “*Why environmental externalities matter to institutional investors*” (Mattison et al., 2011) : i.e. **net added-value**, representing the difference between *conventional value-added* (Revenues less Expenses) and *value-lost*, the latter amounting to *sum of externalities less impact mitigation expenses*.

V. Qualitative and quantitative, context-relevant, performance targets as regards to the reporting entity’s future sustainability endeavors, including the associated (a) *budgeted costs* and (b) *expected reductions of externalities* or *increases in stakeholder value creation*.

¹⁰For recurring impacts and exceptional accidents.

To conclude, we welcome the concept of integrated reporting as a necessary, forward-looking evolution of sustainability reporting. Care needs to be taken however in attempting to merge two very different strands of reporting which are at very different stages of development. Sustainability reporting is still in development and differs greatly between companies in quality and content – combining such inconsistent information with financial reporting requires care. The assurance function needs to be resourced and reinforced in order to ensure the information to be integrated is of the highest quality. Furthermore integrated reporting should not be about loose, general environmental and social impacts but detailed specific guidelines and KPI on critical issues such as the reporting entity's performance in managing its dependencies and impacts on biodiversity and ecosystem services.

This is the detailed information required by the institutional investment community.

This is the type of reporting which allows companies to discharge effectively their accountability to all stakeholders.

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¹¹ For recurring impacts and exceptional accidents.

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