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Integrated Reporting

Integrating environmental, social and governance issues
in the annual report

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Preface

The origin of this paper was our attempt to combine our studies and interests in accounting and reporting as well as in sustainability and Corporate Social Responsibility. The evolvement of annual reporting into integrated reporting, combining financial and sustainability reporting, caught our interest. With this paper we hope to raise interest among students, researchers and practitioners within financial and sustainability or CSR reporting for the current development of integrated reporting and inspire further research and practical implementation.

We would like to thank our respondents Daniel Oppenheim at KPMG, Maria Flock-Åhlander at Ekobanken and Fredrik Ljungdahl at PwC for taking their time to share their expertise and answer our questions. Moreover, we would like to thank our tutor Jon Williamsson for valuable feedback and encouragement in our writing process.

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Abstract

Background and Problem: Separate reporting of financial information and information on environmental, social and governance (ESG) issues has led investors to not include ESG aspects in their analyses. Investors now demand better access to information on ESG issues. During 2010 financial and sustainability reporting organizations started to develop a new standard on integrated reporting. The challenges are many. There is yet no common definition, and only a few companies have started to integrate ESG and financial information in the annual report. However, integrated reporting is an emerging field of great interest for those interested in new developments within financial and sustainability reporting.

Purpose: To present and discuss reasons for the development of integrated reporting, how it can be implemented and what the potential challenges are.

Methodology and Research Design: Being a new field the study was explorative and descriptive to its nature. Qualitative data was collected through interviews with practitioners within auditing and banking. Furthermore, examples of integrated reporting were collected through studying annual reports.

Findings: Based on the results we can conclude the companies already practicing integrated reporting still faces the challenge of how to relate ESG information with the financial performance. Moreover it is challenging to make ESG information fulfill the same characteristics as financial reporting. However, we can conclude that access to ESG information would benefit investors, companies and their stakeholders, as well as society at large. We believe integrated reporting could allow a better balance between the financial, social and environmental dimensions.

Suggestions for further research: Integrated reporting requires further research, such as the development of a new standard, internal systems to make ESG data reliable and accessible, and new measures linking ESG and financial data.

Key words: Integrated reporting, sustainability reporting, ESG, CSR, sustainability, IIRC, IRC, IASB, IFRS, GRI

Acronyms

A4S	The Prince's Accounting for sustainability Project
CEO	Chief Executive Officer
CKRG	Corporate Knights Research Group
CRF	Connected Reporting Framework
CSR	Corporate Social Responsibility
ESG	Environmental, Social and Governance
GIIRS	Global Impact Investing Rating System
GRI	Global Reporting Initiative
IASB	International Accounting Standard Board
IFRS	International Financial Reporting Standard
IFAC	The International Federation of Accountants
IIRC	International Integrated Reporting Committee
IRC	Integrated Reporting Committee (South Africa)
KPI	Key Performance Indicator
KRI	Key Risk Indicator
NGO	Non-governmental Organizations
SRI	Socially Responsible Investments
SROI	Social Return on Investment

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1. Background

Increasing pressure on companies to take corporate social responsibility (CSR) and to improve their sustainability performance has led to the development of sustainability and CSR reporting, complementing companies' annual reporting of financial performance. Between the years 2005 and 2008 the share of the worlds largest companies presenting CSR reports increased from 52 % to 79 %. (KPMG, 2010) While the reporting of sustainability and CSR has increased, sustainability and CSR reports are most often not included in the annual report which causes investors and analysts not to take such non-financial information in to account (Bäckström and Oppenheim, 2011). The auditing firm KPMG states;

"(...) reporting on CSR should be a part of mainstream reporting, as a logical outcome of the integration into daily business. It seems time for a transformation in corporate reporting: from a focus on financial information to a concept where all types of relevant information for assessing and evaluating a company's quality, performance, value and impact are reported in a comprehensive way." (KPMG, 2010)

Furthermore, investors have been rather late in their integration of environmental, social and governance (ESG) aspects into their analysis and decision making, according to the financial information company Bloomberg (Peeva and Noetzel, 2009). Reasons to this might be short-termism as well as a lack of long-term empirical evidence linking ESG issues to financial results. Bloomberg also stresses the difficulty for investors to access comparable and reliable ESG data and few investment professionals capable of evaluating companies on ESG criteria. However, the interest and importance of ESG factors are increasing rapidly. Bloomberg argues that ESG factors are new intangibles having effect on company valuation. The challenge is how such factors can be evaluated and quantified to better understand risks and opportunities linked to investments. (Peeva and Noetzel, 2009)

Today the financial sector is at the forefront demanding access to ESG information in order to get a correct image of companies' operations (Lennartsson, 2011). Since

2006, over 850 investors have signed the UN Principles for Responsible Investment (PRI) (PRI, 2011a). The principles demand investors to incorporate ESG issues into investment analysis and decision-making, e.g. by developing ESG-related tools, metrics, and analyses. To do this the principles further ask investors to ask for disclosure of ESG issues by entities in which they invest, for example by asking for standardized reporting on ESG issues and their integration into annual reports. Initiated by investors the principles acknowledge that their duty, to act in the best long-term interests of their beneficiaries, includes consideration of ESG issues since such issues can affect the performance of investment portfolios. Moreover, the principles state that their application could improve investors' alignment with broader objectives of society. (PRI, 2011b) Different examples of socially responsible investments (SRI) have become more common, and are now taken further by so called impact investors. Impact investors argue that investments should not only be made responsibly but also to actively create positive social and environmental impact (GIIRS, 2011). Social or sustainable banks, e.g. Ekobanken in Sweden and Triodos based in the Netherlands, are examples of banks who transparently report their lending which is targeted at projects yielding an added value to society at the same time as it is financially sustainable.

Against the background of an increasing interest and demand for ESG information, a range of practitioners and actors within the field of sustainability and financial reporting argue for the development of integrated reporting. For example, Bäckström and Oppenheim (2011) argues that financial information, in being separate from non-financial information, gives the impression of sustainability issues being separated from the company and being treated differently than financial information. Moreover, sustainability reports often lack the connection between the company's goals and strategies. By integrating sustainability reporting, companies can show that sustainability is prioritized and internalized in operations. (Bäckström and Oppenheim, 2011) Eccles and Krzus (2010) discuss that inclusion of information on environmental performance could address the externalities which companies cause the society, e.g. pollution of water, CO₂ emissions or ecosystem degradation. They exemplify this by quoting Ernst Ligteringen at Global Reporting Initiative; *"Yesterday's externalities are tomorrow's assets and liabilities. It is obvious that carbon accounting is just the beginning of more fundamental change in what is*

material to a company's accounts." (Eccles and Krzus, 2010, p.23). Further, the International Federation of Accountants (IFAC) identifies that there is a need; *"to incorporate environmental issues into financial statements in a way that supports an organization's stewardship role and enables users to make economic decisions regarding environmental and social impacts on assets, liabilities, income, and expenditure."* (IFAC, 2011)

Companies' annual reports have traditionally primarily focused on reporting information related to financial performance, targeting the owners or investors. To assure the quality and reliability of financial reports, the reporting has developed based on generally accepted principles. Since 2004, the International Financial Reporting Standard (IFRS), developed by the International Accounting Standards Board (IASB), has become a widely accepted reporting framework (Deloitte, 2011). Today, 90 countries have fully conformed to the IFRS required for domestic listed companies (IFRS, 2011). According to Ramona Dzinkowski at IFAC, the adoption of IFRS as an international standard can allow a uniform framework for environmental and sustainability accounting to emerge, tying information on environmental costs and benefits and sustainability to financial statements. (IFAC, 2011)

The process to integrate ESG issues into financial reporting has begun. In 2010, an International Integrated Reporting Committee (IIRC) was formed with the mission; *"to create a globally accepted integrated reporting framework which brings together financial, environmental, social and governance information in a clear, concise, consistent and comparable format. (...) to meet the needs of a more sustainable, global economy."* (IIRC, 2011a) The IIRC was initiated by the Prince's Accounting for Sustainability Project (A4S) and the Global Reporting Initiative (GRI) (IIRC, 2011b). The IIRC includes representatives from accounting and reporting (e.g. IASB, IFAC, KPMG and PwC), companies implementing integrated reporting (e.g. Novo Nordisk), networks (e.g. PRI), regulators and NGOs. (IIRC, 2011a) IIRC is expected to present the first draft framework on integrated reporting to the G20 meeting in November 2011. (WSBI and ESBG, 2011)

1.1 Definitions

There is not yet a common definition of integrated reporting. However, we have chosen to include examples of different definitions to help the reader understand the concept. The IIRC defines integrated reporting as follows;

“Integrated Reporting demonstrates the linkages between an organization’s strategy, governance and financial performance and the social, environmental and economic context within which it operates. By reinforcing these connections, Integrated Reporting can help business to take more sustainable decisions and enable investors and other stakeholders to understand how an organization is really performing.” (IIRC, 2011c)

In the draft framework on integrated reporting for listed companies in South Africa, integrated reporting is defined as *“a holistic and integrated representation of the company’s performance in terms of both its finance and its sustainability”* (IRC, 2011a) . The GRI states; *“An integrated report presents information about an organization’s financial performance with information about its Environmental, Social and Governance (ESG) performance in an integrated way.”* (GRI, 2011a)

Integrated reporting is not limited to annual reporting of companies alone, but could be used in all types of organizations. However, we have chosen to use the term company, since it can be interpreted in wider terms. Although the terms sustainability and CSR might be more widely recognized, we have chosen to primarily use the term ESG since it covers a wider range of issues and more clearly states what type of information should be reported. However, if necessary we will use sustainability or CSR, for example if referring specifically to sustainability or CSR reporting.

1.2 Existing frameworks and previous research

1.2.1 The Global Reporting Initiative

The Global Reporting Initiative (GRI) guidelines, first released in the year 2000, have become the most common guidelines used within sustainability reporting (GRI, 2011b). The GRI envisions that reporting of economical, environmental and social performance shall be as widely accepted and standardized as financial reporting

(Larsson and Ljungdahl, 2008, p.63). The GRI Standard Disclosures guide companies on main topics to be covered in the report, such as Strategy and Analysis, Organizational Profile, Report Parameters (e.g. scope and content), Governance, Commitments and Engagement, Management Approach and Performance Indicators. There are also detailed disclosures on what and how to report Economic, Environmental and Social aspects. (GRI, 2011c) By using the GRI guidelines when communicating information and measurements of an organization's ESG impact and activities, comparison of organizational performance over time becomes possible. (GRI, 2011b)

1.2.2 The Connected Reporting Framework

A more extensive research project of interest to integrated reporting is the Prince's Accounting for Sustainability Project (A4S), initiated in 2004. The A4S is the main initiator behind the International Integrated Reporting Committee (IIRC) established in 2010. Prior research conducted under A4S resulted in the development of a Connected Reporting Framework (CRF). (Hopwood, Unerman and Fries, 2010) Based on this research, Hopwood et al (2010), concluded that reported information should show and explain the connection between the organization's strategic objectives and its context, risks and opportunities, key resources and relationships and governance and remuneration structures. The A4S CRF guides companies to define what and how to report the connection between a company's strategy, financial performance and regard of social and environmental issues. (A4S, 2011) However, the CRF was presented as a separate framework, building on IFRS and GRI. Hopwood et al (2010) concludes there is a need for a new connected and integrated reporting model supported by governments, the finance and accounting community and other stakeholder groups.

1.2.3 The draft framework for integrated reporting in South Africa

On January 25th 2011 the Integrated Reporting Committee (IRC) of South Africa released a discussion paper on "The Framework for Integrated Reporting and the Integrated Report" (IRC, 2011b). South Africa is on the frontier of integrated reporting by demanding all listed companies to publish integrated reports for financial years starting on or after the March 1st 2010 (or to explain why their report is not integrated). The framework recommends the use of the GRI guidelines and suggests

similar main elements, with the addition of e.g. identification of risks and opportunities, strategic objectives and performance measured by key performance indicators (KPIs) and key risk indicators (KRIs), remuneration policies and forward looking information. (IRC, 2011a)

1.2.4 Previous research

Integrated reporting certainly builds on the experiences and research on sustainability reporting. However, integrated reporting also entails new types of challenges and is a new field not yet covered by much research. During 2010, new books and reports on integrated reporting were released. The e-book “Landscape of integrated reporting” includes a number of short articles discussing different perspectives on integrated reporting. Eccles and Krzus (2010) released the book “One report” presenting arguments and examples of integrated reporting. KPMG and PwC, amongst others, have presented reports on integrated reporting bringing up a number of arguments, interesting aspects and challenges.

2. Problem statement and research question

Environmental, social and governance (ESG) information being presented separately in sustainability or CSR reports has led to criticism of that ESG information is not being given the same priority and relevance as financial information, e.g. by investors. Moreover, separate reporting of financial and ESG performance makes it difficult for the users to see how these are related and how they influence each other. As a response to these challenges, calls have been made for the integration of ESG information in companies' annual reports.

During 2010, the issue of integrated reporting started to get a lot of attention; academia and practitioners met in workshops, new books and studies were published and the International Integrated Reporting Committee (IIRC) were founded to draft a first framework of an integrated reporting standard. Recent research and reports presented on integrated reporting bring forward arguments to integrated reporting as well as problems and challenges. Cheng (2010) identifies the understanding of how ESG information and financial performance can be related, and how synergies between them can be created, as one of the main challenges. These challenges and arguments to integrated reporting need further exploration to enhance the practical implementation, which is still very limited. Thus, being a new and emerging field there is still a lot of research needed on the topic.

Against this background, we want to present arguments for why ESG information should be integrated in the annual report, how it could be implemented and what the challenges and their possible solutions are. Our research aims at describing and discussing;

1. Why should ESG information be included in an integrated report?
2. How can ESG issues be integrated in an annual report and be related to the financial performance?
3. What are the potential challenges to integration of ESG information?

2.1 Purpose

The purpose of this thesis is to help the reader understand some of the reasons behind the development of integrated reporting. Furthermore, we want to present examples of how to integrate environmental, social and governance (ESG) aspects in annual reports. More specifically, we want to discuss how to visualize the relation between ESG performance and financial performance. Finally, we discuss the potential challenges related to including ESG information under the same conditions as financial information in the annual report, while meeting demands from many different stakeholders.

2.2 Delimitations

Trying to combine our backgrounds in financial accounting and environmental management respectively, we decided to primarily focus on how ESG information can be related to financial information in the annual report. However, the consequence of our choice of focus is that a range of aspects of integrated reporting has been left out. We have chosen not to include research on the development of integrated reporting as a standard, e.g. the IIRC process, since this process has not yet come far and can only be evaluated after the first draft is presented in November 2011. Moreover, integrated reporting is not limited to the integration and relation of ESG and financial information in the annual report. It also includes integrating ESG issues, or sustainability and CSR, into all aspects of an organization, its strategy and objectives, management and operations. To facilitate integration and reporting of ESG issues, internal systems for the implementation and data collection, such as environmental management systems, accounting systems etc., are crucial. Within accounting, different practices trying to include aspects of ESG such as environmental, social and sustainability accounting have evolved (Schaltegger et al, 2006). These practices could prove useful to the development of integrated reporting. However, the topics mentioned above would require a far more extensive study and are not further discussed in this thesis.

3. Methodology

3.1 Initial research

To help us define the scope of our study we discussed potential topics to study with scholars and practitioners within the field. Moreover, we collected information from various Internet sources to find relevant concepts, organisations and frameworks. Through this initial research we learnt about the current development of integrated reporting and found this to be an interesting field of research.

3.2 Research method

The development of integrated reporting is a rather new phenomenon and there is yet no consensus on what integrated reporting is or how it should be done. In such a situation an exploratory study could be conveyed trying to find out what is happening and to understand the precise nature of a problem (Saunders et al, 2009, p.139). In addition to this, we also wanted to briefly describe reasons for integrated reporting and how it could be implemented. Such questions could be answered by conducting a descriptive study (Zikmund, 2000, p.50). Therefore, our study will be both exploratory and descriptive to its nature. Moreover, by combining qualitative data collected via e-mail and telephone, with qualitative content analyses of documents, our study could be seen as a cross-sectional qualitative study (Bryman and Bell, 2007, p.71).

Initially questions were sent out via e-mail to 25 respondents, mainly international, including researchers and practitioners involved in the development of integrated reporting. Unfortunately, we got only three responses, of which none proved useful to the study. We believe the lack of response could be due to several reasons. First of all, the limited time of our study only allowed respondents two weeks to respond, of which one week was Easter holidays. Moreover, many of the respondents are in high positions within IIRC, GRI, universities etc. and might not have had time to respond during the short time given. We can conclude e-mail was not a useful method, however we saw no other way due to time limitations and holidays. Finally, we managed to reach three persons, relevant to the study by their involvement in integrated reporting and experience from sustainability reporting and auditing. Two

respondents chose to respond to our questions via e-mail. One respondent was available for a telephone interview. Empirical data could then be collected in a structured manner, previously prepared and following a certain sequence (Björklund and Paulsson, 2003, p.68), by sending questions (see Appendix) to two of the respondents. The telephone interview was conducted in a semi-structured manner following the same template (see Appendix), which allowed us to vary the sequence of questions and follow up on interesting aspects and ask further questions (Bryman and Bell, 2007, p.213). The telephone interview was recorded, and loud speaker was used to allow both of us to listen, take notes and ask questions. The purpose of the interviews was to get different practitioners' views on the practical implementation of integrated reporting as well as challenges and implications. Interviews were compiled and used as qualitative input, rather than quantitative input.

To strengthen our study and help us answering how integrated reporting could be implemented we chose to complement the interviews with qualitative content analyses of two annual reports presented in an integrated manner. The first company, Novo Nordisk, was selected on the basis of being an often referred example of integrated reporting. The second company, Ekobanken, was selected on the basis that the company had chosen a different approach to integrated reporting and that it represented a very different sector.

A larger empirical scope would of course have strengthened the credibility of our study and increased the validity of the results (Bryman and Bell, 2007, p.40ff). However, we believe the information given by our respondents, combined with the analyses of two annual reports, still allowed us to analyse a wide spectrum of aspects related to our research questions. Moreover, a larger scope of data to compile and analyse might proved difficult to manage within the give timeframes of this study.

The empirical findings were analyzed and discussed from different perspectives. We decided to include standards and guidelines used in financial and sustainability reporting since its principles and characteristics set the boundaries of what to include in the annual report. These frameworks were combined with stakeholder theory and theories on value maximization and the purpose of the firm to enable analyses the benefits and implications of the inclusion of ESG information in the annual report

4. Literature review

Two different theoretical perspectives have been used as the basis for the analysis and discussion of the results; basic theory of financial accounting and reporting, and stakeholder theory. These theoretical frameworks can help identifying some of the aspects integrated reporting has to relate to and which potentially could entail obstacles and challenges when integrating and relating environmental, social, governance and financial information within one integrated report.

4.1 Financial and non-financial reporting principles and characteristics

The draft framework on integrated reporting presented by the South African Integrated Reporting Committee suggest that the characteristics and principles provided in IFRS by IASB on financial reporting and by GRI on non-financial reporting should be considered when developing an integrated report. Frank (2010) argues that the quality and reliability of both ESG and financial data need to be at a similar high level. Therefore ESG data, as well as financial data, must rest on an accounting framework (Frank, 2010, p.227). By using these characteristics and principles the quality of reported information can be ensured and a balanced and reasonable picture can be provided (IRC, 2011, p.8ff). Against this background we have chosen to include and briefly describe the characteristics and principles, which we consider are the most relevant to our analysis.

4.2 Financial reporting

According to the conceptual framework of the International Accounting Standards Board (IASB) the objective of financial statements is to provide information about a company's financial position, performance, and changes in its financial position in a way that is useful to a wide range of users when making economic decisions. (Nandakumar, Kalpesh, Ghosh et al, 2010, p.11). According to Smith, the shareholders take an exceptional position among the users of financial reports because they are directly affected by a company's net income or loss. Other users could be customers, competitors, employees, government and creditors such as banks. The challenge is to select which information is useful to different users and to decide what should be included in the report. (Smith, 2010, p.17f) The IASB defines

four qualitative characteristics to make the information in financial statements useful to users (Nandakumar et al, 2010, p.12). These characteristics can provide guidance in accounting issues and for interpretation of the content in as well as the differences between annual reports. Furthermore, the qualitative characteristics help the standard setters in the creation and revision of accounting standards (Artsberg, 2003, p.166). The qualitative characteristics by IASB are; Understandability, Relevance, Reliability and Comparability (Nandakumar et al, 2010, p.12).

4.2.1 Understandability

Financial statements should provide information to the user in an understandable manner. The information is required to be understandable to a user with a reasonable knowledge of business and economic activities and accounting and who is willing to put a reasonable diligence in studying the information. (Nandakumar et al, 2010, p.13)

4.2.2 Relevance

Relevance is the main determinant of which information should be included in financial reports. The information is relevant when investors see the usefulness of the information. (Smith, 2010, p. 25) Information is also relevant if it can influence the users' economic decisions and if it helps them to evaluate past, present or future events, or correcting or confirming past evaluations. This implies that information also needs to be provided in a timely manner. Furthermore, information needs to have characteristics of predictive value (predicting future profitability and cash flows), and confirmative value (confirming prior expectations). The concept of relevance is also linked to the concept of materiality. The IASB framework describes the concept of materiality as a threshold for information whose omission or misstatement could influence decisions taken on basis of the financial statement. (Nandakumar et al, 2010, p.13)

4.2.3 Reliability

Reliable information needs to be neutral (free from bias), free from material error and complete (within the boundaries of materiality and cost) (Nandakumar et al, 2010, p.13). Moreover, the information from a company needs to be in faithful representation, providing a correct picture of the financial statement of the firm.

(Artsberg, 2003, p. 170) For information to be reliable it also has to be valid and verified (Smith, 2010, p.26ff).

4.2.4 Comparability

The notion of comparability implies that the information needs to be comparable between companies and that the information needs to be comparable over time. For comparison to be possible, accounting principles need to be used in a consequent manner. Therefore, it is also important that principles and rules are uniform, and that there are standards allowing similar activities and information to be treated in a similar way (Artsberg, 2003, p.173).

4.3 Non-financial reporting

By GRI co-leading the IIRC, the GRI framework on sustainability reporting will have substantial influence on the structure and integration of ESG content in integrated reporting (GRI, 2011a). Therefore, we will briefly describe the part of the GRI guidelines, which defines how to report ESG information. The GRI framework sets out principles and performance indicators that organizations can use to measure and report their ESG performance. The GRI Performance Indicators are divided into Core Indicators (identified to be of interest to most stakeholders and assumed to be material unless deemed otherwise on the basis of the GRI Reporting Principles) and Additional Indicators (if determined to be material). Within reporting of social aspects LA7 is one of the Core Indicators, included under Labor Practices, and reports; Rates of injury, occupational diseases, lost days, and absenteeism, and total number of work-related fatalities, by region and by gender. Further, the environmental performance indicator EN5 is an example of an Additional Indicator and reports; Energy saved due to conservation and efficiency improvements. The indicators assist companies when deciding on what data to gather and report. (GRI, 2011c) The four main principles to define report content are materiality, stakeholder inclusiveness, sustainability context and completeness. According to the GRI guidelines a sustainability report should contain information on all entities causing significant impacts on sustainable development, and/or of which the organization has control or significant influence as regards financial and operational routines and policies. Therefore, the scope and boundaries of the report must be clearly stated. (GRI, 2011c)

4.3.1 Materiality

Materiality can be seen as a threshold, which needs to be exceeded for an issue to be included in the report. According to the GRI guidelines, material issues are those where the company is causing significant environmental, social and economic impacts on its surroundings. Different to financial reporting the threshold of what is material can seldom be expressed quantitatively or monetary but needs to be defined by internal and external criteria such as expression of stakeholder interests, risks, values or expectations. (Larsson and Ljungdahl, 2006, p.68ff).

4.3.2 Stakeholder inclusiveness

The principle of stakeholder inclusiveness emphasizes that interests and expectations from a company's stakeholders are important to determine the scope and content of a report. The stakeholders are those that can influence the company's possibilities to make business or those who are influenced by the company's services, products or operations. (Larsson and Ljungdahl, 2006, p.70ff) GRI stresses that having the right information about stakeholders interests and reasonable expectations, e.g. through engaging stakeholders in different activities, can help organizations to report information which relevant to its stakeholders. Amongst their stakeholders, organizations can encounter differences in demands and expectations and not all stakeholders will read the report. Organizations should therefore explain how they have balanced different stakeholder interests, between the main users of the report and the broader stakeholder interests. If the demands on information needed to achieve clarity differs, GRI argues the expected users should be prioritized. (GRI, 2011c)

4.3.3 Sustainability context

The principle of sustainability context demands of the company to relate its objectives, strategies and performance to trends and developments in the economy, society and environment in a local as well as a global setting (Larsson and Ljungdahl, 2006, p.72).

4.3.4 Completeness

Finally, the principle of completeness should ensure that the reader can get a picture of the company's material economic, environmental and social impact during the time covered by the report (Larsson and Ljungdahl, 2006, p.73).

4.4 Research on indicators and KPIs useful to integrated reporting

Heaps (2010) argue the starting point of integrated reporting is to identify “what” and “how” to report ESG issues. Key Performance Indicators (KPI) are presented as a useful way to relate ESG performance with financial performance (Heaps, 2010). Therefore we have found it useful to include research on KPIs related to integrated reporting in this thesis. KPIs are quantifiable, critical success factors that accurately provide an image of the organizations goals and performance; therefore KPIs usually do not change often over time for the company. Which KPIs are relevant varies between companies and depends on goal, purpose and which type of sector the company operates in (Reh, 2011). A review undertaken by Corporate Knights Research Group (CKRG) aimed at identifying which ESG metrics were being used by investors. Although KPIs normally vary between companies, the CKRG review found 60 universal indicators of which 10 universal KPIs were selected representing the (at the time) best attainable balance between universality, availability of data and materiality. (Heaps, 2010) The ten universal KPIs identified by the CKRG are;

- 1) Energy Productivity (Sales / Total direct and indirect energy consumption (gigajoules))
- 2) Carbon Productivity (Sales / Total CO₂ and CO₂ equivalents emissions (tonnes))
- 3) Water Productivity (Sales / Total Water use (cubic metres))
- 4) Waste Productivity (Sales / Total amount waste produced (tonnes))
- 5) Leadership Diversity (percent of women board directors)
- 6) CEO-to-Average Worker Pay (Ratios of highest paid officer's compensation to average employee compensation (3-year average))
- 7) Percent of Tax Paid (% of reported tax obligation paid in cash (3-year average))
- 8) Sustainability Leadership (Composite score of whether there is a sustainability committee in the company and whether a director is on it)

9) Sustainability Pay Link (Whether or not at least one senior officer has his/her pay linked to sustainability)

10) Innovation Capacity (R&D/sales (3-years average))

Transparency was added as an additional KPI measured by the percentage of data points on which the company provides data and its level of GRI disclosure (Heaps, 2010).

However, these universal KPIs do not correspond completely with the six indicators identified as the most valuable for investors; 1) Gigajoules of total energy consumed, 2) Total cubic meters of water consumed, 3) Metric tons of total CO₂ emitted, 4) Metric tons of total waste produced, 5) Company's total number of injuries and fatalities including no-lost-time injuries per one million hours worked, 6) Payroll for entire company. According to Heaps (2010), the discrepancy between the universal KPIs and the six indicators identified by investors, is due to the fact that the level of public disclosure is not sufficient to allow comparison between companies, e.g. number of injuries, even though such data is reported internally in companies. Moreover, the information is not presented in a format allowing investors to integrate it into their valuation models. (Heaps, 2010) If a set of meaningful sustainability metrics would be available, Heaps (2010) argues this would allow more optimized forward-looking investments. A ranking of companies against scores defined for industry groups, would allow the most sustainable companies to attract the most capital and earn the best returns (Heaps, 2010).

4.5 Stakeholder theory, shareholder primacy and the purpose of the firm

In a compilation of articles on integrated reporting, Kinloch Massie (2010) argues that the purpose of integrated reporting is to surface previously invisible ESG issues that could effect the value of the organization, from the theory of shareholder primacy. On the other hand, Cheng (2010) argues the traditional view on shareholders alone, as the users of financial and non-financial information outside of the organization, needs to be broadened. A presentation of perspectives on shareholder

theory and stakeholder theory could therefore be useful for our analysis of integrated reporting.

Milton Friedman was one of the most influential economists of late 20th century. Friedman's view of the role of companies was simple; to make money for the shareholders. The job of the management was only to care for the shareholders' interests (Freeman, Harrison, Wicks, 2010, p. 203). In the article "The Social Responsibility of Business is to Increase its profits", published in The New York Times Magazine 1970, Friedman argued companies' only social responsibility was to maximize profits. Other types of social responsibility Friedman (1979) saw as forcing shareholders, customers and employees to contribute to social causes against their will and compared it with imposing "taxes" and misusing shareholders' money and interests. (Friedman, 1970) Friedman argued that it was morally wrong for the management to address corporate responsibility, worker well-being and social welfare, unless it coincided with the shareholders' interests (Freeman et al, 2010, p.203). However, Friedman (1970) also recognized that companies needed to conform to laws and ethical customs, being the basic rules of society.

Although initially considered radical, Friedman's writings on social responsibility and the purpose of the firm became viewed upon as the correct perception (Freeman et al, 2010, p.202). In this context, stakeholder theory emerged, providing evidence that the purpose of the firm not only should be to serve a larger social interest, but also that firms have responsibilities towards different stakeholders rather than only the shareholders (Freeman et al 2010 p.203). In 1984, Freeman defined stakeholders as "any group or individual who can affect or is affected by the achievement of the activities of an organization". Freeman argued for redistribution of the power over decision-making and benefits from shareholders (investing the money) to stakeholders. (Stieb, 2008, p.401ff) Early stakeholder theorists at Stanford Research Institute were first to recognize that support from stakeholders, by integration of their interests, could be vital to firm success (Hitt, Freeman and Harrison, 2001 p.190f). Moreover, Eccles and Krzus (2010) argue that companies not paying attention to the increasing expectations by "non-share-owning stakeholders" are exposing themselves to business risks such as losing competent staff or negative media exposure. Further, they argue that companies have started to move from managing

the downside of CSR issues to exploring the opportunities which CSR can provide. (Eccles and Krzus, 2010, p. 30)

In a stakeholder perspective the core purpose of the organization is to create net gain for all stakeholders of the firm, the firm being a complex entity that relies upon multiple resources, such as financial, human and natural capital. The management role is therefore to achieve the proper sequence and balance of actions. (Kinloch Massie, 2010) Advocates of stakeholder theory argues the theory provides a more nuanced view of how companies contribute to both social and economic values and that consideration of ethics and morality are necessary in this value creating process (Freeman et al, 2010, p. 248).

Jensen (2002) criticises stakeholder theory but recognises that an enlightened stakeholder theory could be useful. Jensen (2002) argues that companies, despite having many stakeholders, can only have one objective and calls this enlightened value maximization (Jensen, 2002). According to Jensen (2002), value maximization (or value seeking, seeking to maximize profits) is the single objective helpful to guide managers taking decisions for increasing the total long-run market value of a company, while leading to an efficient social outcome. Thus, if all companies in society would maximize the total market value, the social welfare will be maximized. (Jensen, 2002) However, Jensen (2002) argues companies cannot maximize value if it ignores stakeholders' interests. Instead he argues that the real conflict is not the matter of shareholders' versus stakeholders' interests, but whether a company should have one, or multiple objectives. Stakeholder theory can, according to Jensen (2002), be useful as a structure of how to create good relations to stakeholders (necessary to create long-term value). This can provide processes and audits to measure and evaluate how the company performs in its stakeholder relations (Jensen, 2002). Jensen (2002) criticises stakeholder theory for the lack of performance criteria, which makes it difficult to evaluate managers in a principled way, potentially playing in the hands of the managers' self-interest. He also criticises Freeman (1984), amongst others, on the account that stakeholder theory does not specify how to make trade-offs between different stakeholders' interests nor does it provide guidance or measurement on how to value success. Further, Jensen (2002) argues that it is not logical or possible to make value maximization on both market share and profit at the

same time. Therefore he criticises the balance scorecard method, as a tool for management control system, by asking managers to maximize in more than one dimension at the same time.

Jensen (2002) argues enlightened value maximization would utilize an enlightened stakeholder theory but keep value maximization, being the maximization of long-term market value, as the single measure of success. However, Jensen (2002) admits the value maximization criterion does not maximize social welfare in a situation where externalities exist (a situation where the decision-maker does not bear the full cost of her or his choices). In such a situation government have to step in since Jensen (2002) believes externalities cannot be solved by companies merely on a voluntary basis. He admits markets might not always have the full information or understanding of the implications of companies' policies on the long-term market value. In such situations Jensen (2002) argues a company must lead the market until it understands the full value of its policies and wait for the market to catch up and recognize the real value of its decisions. (Jensen, 2002)

5. Results

The result consists of a compilation of interviews, examples of integrated reports and existing frameworks and measures providing examples of how ESG information can be integrated into annual reporting.

5.1 Interviews

The primary data collected from respondents are compiled and summarized below. All respondents have experience from sustainability reporting and are involved in the development of integrated reporting. Fredrik Ljungdahl is the director of Sustainable Business Solutions at the auditing firm PwC in Stockholm, Sweden. Maria Flock Åhlander works as a credit manager/business adviser and sustainability manager at Ekobanken in Järna, Sweden. Daniel Oppenheim works with Climate Change and Sustainability Services at the auditing firm KPMG.

5.1.1 Users and beneficiaries of integrated reporting

Investors and owners, and members in the case of Ekobanken being a cooperatively owned bank, are identified by the respondents as the main potential users of integrated reports. Ekobanken also identifies a wide spectrum of other users such as co-workers, the bank's representative assembly, authorities and actors within the social economy. The internal use and effects of integrated reporting are also emphasized by the respondents. According to Ljungdahl, integrated reporting could result in increased internal focus on those indicators being most relevant, resulting in demands on how these are measured and reported. Oppenheim argues the companies' board of directors and owners should be interested in all relevant data being presented.

Flock Åhlander mentions that the increasing number of signatories to the UN Principles for Responsible Investments (PRI) and the development of Socially Responsible Investments (SRI) have resulted in an increasing demand among investors to access ESG data. She argues integrated reporting could be very useful in combination with the use of stakeholder models helping companies to report the right information and save time and resources both for investors and for the companies spending time on answering many different questionnaires. Both

Ljungdahl and Oppenheim believe integrated reporting could provide investors with a better picture of a company as a basis for analysis or investments. Oppenheim emphasizes that non-financial data being reported under the same conditions as financial information could provide a fairer picture of opportunities and risks, rather than excluding one type of information. Ljungdahl argues in a similar manner that integrated reporting is about visualizing and focusing aspects, rather than providing all new information.

5.1.2 Examples of how ESG and financial performance could be related

All respondents mention performance indicators or ratios as a practical way to link ESG performance with the financial information in integrated annual reports. Oppenheim gives two examples of how to relate ESG and financial performance. For companies using a lot of materials and energy it could be useful to visualize economic effects of measures to increase efficiency (such as new technology). For example the GRI indicator EN5 “Energy saved due to conservation and efficiency improvements” could be linked to financial information. Another example could be staff turnover and health-aspects, which could indicate healthy and happy co-workers achieved by a well developed health program and safety measures. These could in turn be linked to the financial information. An indicator of health aspects could be GRI LA7 “Rates of injury, occupational diseases, lost days, and absenteeism, and number of work-related fatalities by region”. If this indicator is linked to and expressed in monetary terms this could provide a more integrated view of how such aspects influences profitability. Ljungdahl argues that there are a large number of examples of ratios relating ESG and financial information, for example CO₂ / sales. He believes it is necessary to develop this type of ratios and argues that it is difficult to see other ways to link ESG to the financial information since the data is developed through different reporting systems.

Flock Åhlander believes key performance indicators (KPI) can be one way to help develop sustainability and integrated reporting in organizations. To be of use to the companies she argues KPIs must be useful as management control measures and that they need to be comparable over time to allow follow up. She stresses the question of whether there can be KPIs universal and general enough to be used by many different companies, whilst complemented by more sector specific KPIs (e.g. GRI

sector supplements). Flock Åhlander also sees the need for new key ratios. Ekobanken now reports in narrative form on which projects and companies the customers' money are lent to. However, Ekobanken would like to report the social, economic and cultural effects their lending has on society, but the bank still lacks the measures and resources to do so, according to Flock Åhlander. Flock Åhlander mentions that European social banks now try to develop key ratios for measuring the impact their lending have on society (e.g. measuring the value created to society, in terms of biodiversity as an ecosystem service, by a loan to organic farming). Flock Åhlander also mentions there is potential to other types of models to measure social impacts from investments, such as Social Return on Investment (SROI). She says such models are often criticized for not being economically correct, but argues we cannot continue with the current types of management control, a new, or developed, business model is needed.

5.1.3 Potential challenges as identified by the respondents

Oppenheim identifies several challenges to integrating ESG into financial reporting. First of all, integrated reporting is a new and undefined term. Further, Oppenheim emphasizes that it is challenging to make the different stakeholders understand the long-term value and the consequences of working with environmental and social issues. According to Oppenheim, many companies find it challenging to integrate sustainability efforts into their business, which often becomes visible in the annual report. Ljungdahl also sees several challenges, first of all he believes not all have realized what a totally integrated report is. He states it is not just about adding ESG information in the annual report, the quality of reporting, the follow up and the extent of the auditing process needs to be considered. Furthermore, he believes integrated reporting will increase the demands on companies, change the issues, which should be prioritized and potentially even challenge the main purpose of the firm.

Other obstacles, identified by Oppenheim, concern the integration and use of ESG data. First, financial analysts lack sufficient knowledge about non-financial information, such as environmental and social aspects, which results in such information not being used for evaluation. Secondly, the difficulties to quantify non-financial information make judgements more complex. Oppenheim argues that GRI

indicators are useful, but that the reporting of the relationship between financial and non-financial information needs to be developed. Flock Åhlander also argues that GRI can be a great tool, e.g. for companies to reduce negative impacts and improve sustainability. However, she argues the current GRI indicators are not sufficient to report and visualize positive impacts by companies where sustainability is core to their business model (e.g. Ekobanken creating positive social impacts through their lending). Reporting of such impacts would also require an increased collection of customer data, and require customers to develop data, according to Flock Åhlander.

5.1.4 Integrated reporting and the future of reporting

In the short-term, Oppenheim argues integrated reporting does not provide any big changes since there are different professionals in companies and auditing firms handling financial and non-financial information respectively. In the long run, there will be experts capable of handling both types of information. However, Oppenheim raises the question of what auditors' reports should look like to meet more integrated reports. Oppenheim believes integrated reporting could influence the general field of reporting. Further, integrated reporting of a company's operations could be useful to external investors and analytics by providing a more comprehensive overview of opportunities and risks related to the economic, environmental and social perspectives.

Ljungdahl argues integrated reporting is potentially one of the most significant changes within reporting in the near future. Future reporting and auditing requires a broader definition of what to measure, by whom and in what way. He believes we can no longer regard only financial information but need to consider a broader spectrum of issues and indicators of results. The expectations on integrated reporting are high; therefore Ljungdahl believes that there is a risk of disappointment when the IIRC first guidelines will be presented in November 2011. Flock Åhlander argues that not only reporting as such need to evolve but that a wider spectrum of ways to measure revenues and costs needs to be developed.

5.2 Two examples of companies integrating ESG issues

We will here describe two different examples of integrated reporting based on their annual reports and relevant literature. Our summaries do not cover all aspects brought up in the very extensive reports. Moreover our focus being primarily ESG metrics and KPIs, other aspects of ESG integration are only briefly mentioned.

5.2.1 Novo Nordisk

Novo Nordisk is a pharmaceutical company and a leader in diabetes care employing over 31 000 employees over the world. The headquarters is situated in Denmark. (Novo Nordisk, 2011a) Novo Nordisk states that their business philosophy is to balance financial, social and environmental considerations, using a triple bottom line approach. (Novo Nordisk, 2011b)

Novo Nordisk has been working with sustainability reporting since 1994 and with the GRI guidelines since 2002. The company is often seen as a leader in sustainability reporting. Novo Nordisk has in recent years developed their own approach of creating an integrated report which is not just about including ESG factors in the annual report but also to fully integrate sustainability in the business strategy. (Hopwood, et al 2010, p. 215) The company's annual report is a combination of financial and non-financial information and is prepared according to IFRS standards and the GRI G3 guidelines (Novo Nordisk, 2010c). The published annual report is available in pdf-format and a more extensive version is also available in web-based format. The web-based annual report presents a clear overview of the main headings Performance, Social, Environmental, Governance and Stakeholders and Reporting. The Performance section foremost provides an overview of environmental and social performance allowing the user to choose the level of detail. (Novo Nordisk, 2010d) Users interested in financial information are directed to the published annual report. Novo Nordisk states that the objective of its reporting efforts is to increase accountability to all stakeholders (shareholders and other stakeholders) as well as to increase the internal accountability. Novo Nordisk defines its stakeholders as any individual or group that may affect or may be affected by the company's activities. (Novo Nordisk, 2010e)

In the published annual report Novo Nordisk begins with presenting a number of key figures and targets that in an integrated manner includes both financial information and non-financial information. The non-financial performance indicators presented here are for example donations, the number of least developed countries where Novo Nordisk sells insulin at a different pricing policy, energy consumption (Gigajoules) and total waste (tons). (Novo Nordisk, 2010c) Novo Nordisk states that one of the reasons why it introduced integrated reporting was to explore the relationship between financial and non-financial performance (Novo Nordisk, 2010d). However, the non-financial indicators are currently not connected to financial performance (Hopwood et al, 2010, p. 218).

Furthermore, the chair's statement includes comments on improving governance (but nothing on sustainability) and the CEO statement mentions both social and environmental aspects. Later in the report Novo Nordisk presents performance highlights from 2006 to 2010 including a more comprehensive list of ratios for financial, environmental and social performance. Amongst social performance information, a measure of company reputation with external key stakeholders, could be found. However, the published annual report does not include all performance indicators mentioned in the web-based version, for example frequency of occupational injuries. Under environmental performance they present quantitative indicators of input of energy and water and output of CO₂ emissions, wastewater and waste. The ratios for environmental performance are presented as changes to energy and water consumption and CO₂ emissions in percentage. (Novo Nordisk, 2010c)

Novo Nordisk has established long-term targets for financial, social and environmental issues of importance to the organization, for example the environmental issues are linked with the production and include targets on water consumption, CO₂ emissions and energy consumption. (Novo Nordisk, 2010c) The web-based version of Novo Nordisk's annual report includes a section on integrated reporting. Here the company states its commitment to reporting leadership and continuous improvements. This includes to report sustainability information based on its importance to the company's strategy and impacts on key business activities, demonstrating connections between financial and sustainability performance for critical business activities. Further, performance should be reported against targets

and include an explanation of the targets strategic intent. Reporting should also include information on risk reduction as well as how the company can earn profits by sustainability-focused management. Finally, metrics used should be clear and transparent, ideally also standardised and comparable with companies in and outside of their industry. However, Novo Nordisk states the need to develop meaningful and useful indicators for measuring performance in areas where there is yet no corporate precedence for reporting. Further, the company identifies the challenge of good quality data in regions where monitoring of health care quality is not standard. (Novo Nordisk, 2010d)

In previous research on the Novo Nordisk approach to integrated reporting, Hopwood et al (2010) emphasize that Novo Nordisk's integrated reporting is only part of a wider strategic approach to integrate sustainability into business practices, dating back to the early 1990's. Novo Nordisk's complex internal management system, the Novo Nordisk Way of Management, is therefore key to the understanding of their integrated reporting. The internal system includes management tools such as the balanced score card and KPIs directly related to the bonuses of different managers. (Hopwood et al, 2010, p.215ff) The Novo Nordisk Way of Management could provide useful experiences and keys to integrated reporting, however this would require a thesis in itself.

5.2.2 Ekobanken

A different approach to integrated reporting is presented in the annual report of Ekobanken, a cooperatively owned bank and Sweden's only social, or sustainable, bank. In the annual report Ekobanken defines social banking as a bank that considers and reports its social and environmental impacts (Ekobanken, 2010a). In comparison with the four largest banks in Sweden, Ekobanken is a very small bank. Nevertheless, Ekobanken represents an interesting approach to integrated reporting and is part of a trend of social banking and social finance and increasing interest amongst bank customers. During the financial crisis of 2007-2010, the European social banks did, in contrast to ordinary banks, not lose any money. On the contrary, they made their highest gains in their history. Assets increased with growth rates of 20-25 % per year during 2006-2008. At the peak of the financial crisis in 2009 the average growth rate was about 30 %. (Benedikter, 2011, p.42)

Ekobanken aims at creating ecological, social or cultural added values by only lending to projects falling within these categories. It states transparency is the bank's most important instrument to show its stakeholders how the bank operates and therefore includes narrative descriptions of all companies, cooperatives, organizations and projects the bank has lent money to. (Ekobanken, 2011) Ekobanken strives for a multi-dimensional view recognising the equal value of People, Planet and Profit, also referred to as the triple bottom line. (Ekobanken, 2010b)

The fact that social and environmental sustainability is integrated in the organization becomes visible through the integration of sustainability issues throughout the annual report, e.g. the chair and CEO statement, strategy, policies and objectives. In an overview of Ekobanken's performance from 2005 to 2010, presented in the beginning of the annual report, Ekobanken includes financial key ratios together with CO2-related metrics. This includes CO2 emissions from staff travels and climate compensation (CO2 offset). On the following page Ekobanken presents an overview of its lending to different categories, e.g. Ecology and Fair trade, Healthcare and Culture, in percentage of their total lending. The annual report is compiled based on the GRI guidelines and principles. GRI level C (and some indicators above this level) is stated, followed by a note that many indicators in the GRI guidelines are not applicable to Ekobanken's operations. The report targets different stakeholders such as owners/members, customers and other stakeholders like co-workers, organizations and authorities. (Ekobanken, 2010a)

Narrative descriptions of the bank's lending projects are included in the annual report. This way the bank reports its indirect impacts, which the bank includes amongst its responsibilities in its sustainability policy. Ekobanken tries to limit its negative indirect impacts and contribute to the creation of positive impacts by having a lending policy that demands evaluation not only from an economic, but also a societal, environmental, ethical and cultural perspective. (Ekobanken, 2010a)

6. Analysis and discussion

6.1 Why should ESG information be included in an integrated report?

By applying our theoretical framework on the empirical results we will here present some arguments to why companies should integrate environmental, social and governance (ESG) information in the annual report. First of all, integrated reporting would solve the dilemma of ESG information being presented separately and not being included in analysis and decision making. We agree with Ljungdahl that integrated reporting would help visualize and focus ESG issues. Our initial research indicated investors are a driving force behind integrated reporting by demanding access to ESG information, something also stressed by our respondents. Investors could therefore be seen as the main beneficiaries of integrated reporting by providing them a more complete picture of a company. Furthermore, integrated reporting could help reduce time spent by investors to find and demand ESG data from companies. Thus, making ESG information more available could also reduce costs for companies. Improved access to ESG information would be of great help to investors committed to the UN Principles for Responsible Investments (PRI) or Socially Responsible Investments (SRI).

Since many investors have started to recognize the usefulness of ESG information and are considered the main users of annual reports, we argue that ESG information is relevant and material from an accounting and reporting perspective. Further, as Oppenheim argues, ESG information is relevant by being related to risks and opportunities. The IASB framework states that materiality, defined as a threshold for information which omission or misstatement could influence decisions taken on basis of the financial statement, is closely linked to the concept of relevance (Nandakumar et al, 2010, p.13). In cases where ESG issues could cause material impacts and such information could influence decisions taken by investors or other users of annual report such information should then be included. The recognition of a globally changing climate we believe could state an example. Already climate related incidents have caused affected companies financial impacts, and the potential future effects of climate change could have material impacts on companies'

operations and provide future risks. At the same time, some companies have realized the business opportunities and developed climate related products. Therefore, we would argue ESG information could be considered relevant both by its confirmative and its predictive value, compared to the IASB definition. We agree with Oppenheim that ESG data being provided under the same conditions as financial information, rather than being excluded, would allow a more fair presentation of risks and opportunities. Relevance is therefore a strong argument for ESG information to be integrated in the annual report. Novo Nordisk has already recognized the aspects discussed above by stating their integrated reporting should include information both on measures taken to reduce risks, but also on potential profits to be made through management being focused on sustainability issues.

Although investors might be the main and direct beneficiaries of integrated reporting, we have found that Novo Nordisk and Ekobanken both recognize their accountability to a wider set of stakeholders. Furthermore, they both use the GRI guidelines, which demands stakeholder inclusiveness in the reporting of ESG issues. Against this background, we argue that integrated reporting could be of great benefit to other stakeholders by recognition of their interests. Therefore, integrated reporting, from a stakeholder perspective, could be seen as broadening the view of users of the annual report, in line with Cheng's (2010) argument. Further, we found Novo Nordisk's definition of stakeholders as any individual or group that may affect or may be affected by the company's activities, to be very similar to the definition of stakeholder theory by Freeman 1984. This broad stakeholder recognition together with Novo Nordisk's triple bottom line philosophy provides a strong incitement for Novo Nordisk to present an integrated report. Similarly, Ekobanken, recognizes value seeking in multiple dimensions, People, Planet and Profit, thus integrating all dimensions in the annual report is logical. However, in the case of Ekobanken these values are fully integrated into its business model and the bank provides innovative bank products, which we believe could be compared with Eccles and Krzus (2010) argument that more companies explore the opportunities CSR can provide. Based on the examples of Ekobanken and Novo Nordisk we would argue integrated reporting could also be seen as a natural evolution of companies' reporting as a response to the recognition of CSR and accountability towards a wider set of stakeholders and society at large. Jensen (2002) would probably argue the involvement of

stakeholders is only a means to achieve a more enlightened and long-term value maximization. However, we would argue that if CSR is interpreted as companies' responsibility for their social and environmental impacts, this could be seen as an acknowledgement that externalities exist. In that case, Jensen's (2002) argument that value maximization, as the only logical objective function of the firm, leads to maximal social welfare, does not hold. According to Jensen (2002) voluntary measures does not work to solve externalities. However, we believe integrated reporting (if proper measures can be found) could allow the market to understand the true value of both negative and positive externalities. This could help investors and other stakeholders to demand companies to avoid or reduce negative externalities and instead find opportunities to create positive externalities. Integrated reporting could then be of great benefit to the public and the society at large. This could be supported by the stakeholder perspective arguing that the core purpose of the firm is to create net gain for all its stakeholders (Kinloch and Massie, 2010). Freeman's call for redistribution of power and benefits from shareholders to stakeholders (Stieb, 2009), could be contrasted by Friedman's (1970) opposition to [corporate] social responsibility. At the same time Friedman (1970) stated that companies should conform to basic rules of society, whether stipulated as law or being part of ethical custom. We would argue integrated reporting could be seen as both a development of ethical custom to include CSR and the recognition of stakeholders, rather than shareholders alone. Therefore, ESG information, corresponding to stakeholder interests should be integrated in the annual report.

Moreover, we believe there is an interesting trend towards creation of positive externalities, rather than only managing the negative external impacts. Ekobanken, provides an example of how social banking, move beyond the notion of responsibility to the creation of added values in a wider set of dimensions, not only financially. Again, this would be in line with Freeman's call for redistribution of benefits (Stieb, 2009). Seen in this perspective we believe integrated reporting could contribute to, or be part of a redefinition of the purpose of the firm, from value maximization benefitting shareholders to value maximization providing benefits to a wider set of stakeholders and society at large. However, Jensen (2002) and Friedman (1970) would probably still argue for value maximization in one single dimension, let us come back to this later.

6.2 How can ESG issues be integrated in an annual report, and related to the financial performance?

Similar to the draft framework for integrated reporting in South Africa and the connected reporting framework, mentioned in the background, we also found integrated reporting require ESG issues to be fully integrated in all parts of the annual report. Examples of such integration could be found in the annual reports by Novo Nordisk and Ekobanken, including ESG issues in the narrative parts of their reports, such as the CEO statement, objectives and strategy, and among performance measures and indicators.

Both Novo Nordisk and Ekobanken use the GRI guidelines as a basis for inclusion of ESG information in their integrated annual reports. Flock Åhlander argues the GRI framework can be a useful tool for companies to improve on sustainability issues and that the GRI indicators, despite some limitations, can provide guidance on what to report. Based on our results, we believe the GRI framework is a very important key to integrated reporting, both to standardize ESG reporting and to provide guidance in the practical implementation of integrated reporting. The indicators and indicator protocols included in the GRI framework could provide guidance on which ESG data to collect and how it should be measured and collected, thus allowing such data to be available and more reliable. GRI demands inclusion of different stakeholder interests, and completeness of reporting on material financial and ESG issues. This also implies integrated reports risks becoming very complex and extensive. However, Novo Nordisk provides an example of how the use of Internet can facilitate integrated reporting by allowing more interactive access to data and meet the different interests of a wider spectrum of stakeholders. By presenting integrated, easily understandable overviews, while allowing users to access detailed information being relevant to them, complexity can be reduced and information overload can be avoided.

To realize the full potential of integrated reporting ESG information should be directly linked to the financial performance. Our results indicates that the visualization of how ESG issues impact the financial performance is key to the users valuation and understanding of ESG issues. We found that key performance indicators (KPIs) and GRI indicators are common ways to present ESG performance.

Moreover, we found that such ESG indicators could be combined with financial information to create ratios. Novo Nordisk are presenting KPIs on ESG performance among their key figures, making the user of the annual report understand the company prioritizes the issues. Furthermore, a great number of more company specific performance indicators and measures are presented later in the report. However, as Hopwood et al (2010) emphasize the Novo Nordisk's KPIs are not financialized, sensing that the ESG related KPIs and indicators are not directly put in relation to the financial performance, other than that they are presented together. Novo Nordisk does present performance indicators similar to those CKRG presented as the most valuable to investors, e.g. Gigajoules of energy consumed, tons of CO2 emitted and tons of waste. Such measures of ESG performance could be used to compare the company's performance over time and for benchmarking between companies. However, we would argue that if KPIs and performance indicators lack monetary value, or direct linkage to the financial information, investors and users are forced to make their own analysis and valuation of the financial impacts of the ESG information.

As a conclusion from our interviews, KPIs are a useful way to relate ESG and financial information. ESG data collected on the basis of the GRI guidelines can be used in combination with financial information. For example, Oppenheim argues social or environmental information presented among GRI performance indicators could be related to financial information. Oppenheim's example of GRI indicator LA7 which includes rates of injury (among other aspects), is similar to the 5th indicator, identified as valuable information to investors in the research by CKRG, which covers total number of injuries and fatalities. Ljungdahl mentions a KPI on CO2 related to sales, which is similar to the 2nd universal KPI, Carbon Productivity, identified by CKRG. The universal KPIs presented by CKRG show that the relation between ESG and financial information could be created rather easily by combining ESG data with existing information from the financial statements. According to Heap (2010), most information needed for the universal KPIs and indicators presented by CKRG are being available. Thus standardized reporting indicators and metrics could be provided at a small cost for the companies while creating a considerable improvement for investors, allowing more accurate valuations. However, as identified by Heap (2010) there is a discrepancy between the indicators investors find most useful and the KPIs identified as universal. According to Heaps (2010) this is due to

lack of disclosure of data, e.g. in the case of injuries, which we noticed was not included as a KPI in Novo Nordisk's published annual report.

However, we would argue that the notion of universal KPIs might be difficult in itself since KPIs are supposed to be indicators of performance that are key to a specific company. Moreover, we believe the universal KPIs identified by CKRG might also be more relevant and easier to apply within some industries. For example, Oppenheim argues that for companies using a lot of energy and materials it could be useful to visualise the economic effects by measures taken to increase efficiency. Novo Nordisk, being a producer of pharmaceuticals using large inputs of energy and water, could be such an example. For this type of company we believe the universal KPIs, such as carbon (CO₂) efficiency or energy efficiency, can be key to evaluate ESG related performance. However, service companies, and companies that similarly to Ekobanken play a more intermediary role, might not find these KPIs as useful if their direct output of CO₂ etc. is only a limited part of their impacts. If the major part of their impact is caused indirectly, outside of their own operations, it is not visualized through KPIs measuring only direct impact. For example, the annual report of Ekobanken only includes measures of CO₂ emissions related to staff travels, being an important yet limited environmental impact, while the largest impact is caused by the operations of projects they lend money to. Ekobanken's solution to this is to include indirect impacts in their sustainability policy and report information on what type of projects they lend to. This narrative reporting does not yet include ESG performance indicators due to lack of useful measures and data being hard to access. However, we consider this an innovative approach, since it is presented in an easily understandable manner and does provide the users of the annual report with a better picture of the company and its impacts.

6.3 What are the potential challenges to integration of ESG data?

As identified by Frank (2010), the integration of ESG information and financial information requires ESG data to rest on an accounting framework and fulfill the same level of quality and reliability. It is therefore hopeful to see that the development of a new standard on integrated reporting is building on existing standards and frameworks, such as IASB, IFRS and GRI. The GRI principles are similar to the characteristics of IASB, but adds the sustainability and stakeholder dimensions.

However, combining the two into a standard on integrated reporting is a huge challenge. As stated by Ljungdahl, the expectations are high, and the IIRC presentation of a first draft in November 2011 risks being a disappointment.

That ESG data have to meet the same requirements as financial data means it needs to fulfill the characteristics stated in the IASB framework provides a challenge. First of all ESG issues might not be of the same measurable nature as financial data. Oppenheim stresses the difficulties to quantify ESG data. Furthermore, he emphasize it is not just about adding ESG data but that the quality of reporting must be ensured. The difficulties to quantify and measure ESG data might impact the reliability of ESG information. This challenges the relevance of ESG data since all data included in annual reports should be reliable in order to be useful to the users. This challenge of reliability of data can be found in our examples. In the case of Novo Nordisk they describe the challenge to get quality data on health care indicators from all regions where they operate. Ekobanken wants to measure the indirect impacts but would then be dependent on data provided by the customers. This dependence on secondary sources could provide a challenge to the reliability of reporting data. Flock Åhlander discusses the specific challenges facing Ekobanken when striving to measure and report social, cultural or environmental values generated. She stresses the need to develop new ways of measuring both impacts and positive values created. Furthermore, the GRI indicators need to be developed to be of better use to companies having sustainability incorporated in their business model. However, the challenge is not only lack of measures, but also the collection of ESG information, and the resources to do this. Ekobanken's innovative, yet challenging approach, to move beyond the GRI guidelines and include information on indirect impacts caused by entities outside of their control, challenges the view of reporting scope and boundary.

With the notion that ESG data should be reported under the same conditions as financial data, it should also meet the IASB characteristics of comparability. Comparability of ESG information, over time and between companies, is necessary in order to allow follow up on ESG performance indicators, as stressed by both Oppenheim and Flock Åhlander. Ekobanken allows comparison over time on CO₂ emissions. Novo Nordisk's annual report allows comparison over time on CO₂ emissions, energy efficiency improvement, water efficiency improvement and

frequency of accidents etc. In this case, comparison between the two companies becomes difficult since the companies operate in very different sectors and Ekobanken does not yet use a wider set of ESG KPIs. Even in the case that the exact same indicators were reported it might still be difficult for the user of the annual report to assess whether a comparison is possible since the data might have been collected in different ways and under different conditions. Comparability of ESG data could be improved by the use of universal KPIs, however finding KPIs general and universal enough to be useful to all companies seems challenging, something also identified by Flock Åhlander.

Integrated reporting also faces the challenge of ESG information to fulfill the characteristics of understandability. This aspect is also related to the knowledge expected by the user of the annual report. KPIs in the form of ratios might be of use to investors, but as Oppenheim emphasizes, investors and analysts might lack sufficient knowledge about social and environmental aspects resulting in that ESG information, although available, is not used for evaluation. We believe this lack of knowledge about ESG issues among practitioners and users is an important challenge to overcome. Furthermore, to make linkages between ESG and financial information understandable, we believe it should not only be presented in the form of ratios, but the relation between ESG and financial performance should be included in strategy and objectives and explained and presented in a more easily understandable manner in the narrative part of the annual report.

Another difficult challenge, identified by Oppenheim, is to make different stakeholders understand the long-term value and consequences of companies' efforts to improve on environmental and social issues. Jensen (2002) states that in situations when the market does not have the full information or understanding companies must lead the market to understand the long-term value of its policies or efforts. The initiatives by Novo Nordisk and Ekobanken, to integrate sustainability into strategies and policies and report in an integrated manner, well before there is any standard in place or regulatory demand, could be seen as an example of this. When a standardization process to formalize integrated reporting now have begun we would argue this could be seen as a sign that the market have started to understand the real value related to ESG issues, similar to Jensen's (2002) argument. Therefore, we

believe integrated reporting could visualize how ESG aspects could impact a company's long-term market value and thus provide the market information aiding the understanding of the often more long-term values related to ESG efforts, risks and opportunities.

One challenge that integrated reporting could result in is how to handle different interests and objectives. As discussed above, Jensen (2002) argues that value maximization is the only logical objective to make it possible to measure success and evaluate managers' performance. Further, Jensen (2002) argues a negligent use of stakeholder theory would result in multiple objectives, and thus not provide any guidance on how to make trade-offs between different interests. Jensen (2002) does provide evidence that multiple scores or objectives are not logical, since it is not possible to maximize in more than one dimension at the same time. We agree that multiple value maximization might not be possible, but argue that value seeking, balancing the multiple dimensions of financial and ESG performance, seems to be possible. Novo Nordisk's triple bottom line-approach, or Ekobanken's reference to People, Planet and Profit, balancing financial social and environmental considerations, challenges Jensen's (2002) view on value maximization as the single objective function. Despite having multiple objectives Novo Nordisk is a successful multinational company. Ekobanken is also growing, using a multidimensional approach in to their business model and products.

However, to follow the GRI guidelines and develop reports relating to the sustainability context while including and balancing different stakeholder interests is not an easy task. The recommendation by GRI is to be clear and open about the process to decide what issues are considered material and how the scope of the report has been defined. Furthermore, GRI states that if a trade-off need to be made between different interests the users should be prioritized. If the main users of integrated reports are considered to be investors we believe trade-offs might be made at the cost of other stakeholder interests. For the users of integrated reports to be sure of completeness on material ESG issues and that no important stakeholder interests have been excluded, we believe it is crucial that the auditing process and competence covers ESG issues.

7. Conclusions

Integrated reporting recognizes the relevance of including information on environmental, social and governance (ESG) issues in an integrated manner in the annual report. We conclude that integrated reporting could create many benefits. Investors could improve their analyses by access to ESG information related to companies operations, risks and opportunities. Companies could use integrated reporting to allow the market to understand the long-term market value of their ESG efforts. Other stakeholders, affected by a company's environmental or social impacts, could have their interests better visualized and recognized. Society at large could benefit by ESG issues being better addressed by companies. Moreover, improved reporting of ESG issues would increase transparency of companies operations and impact on the environment and society.

Furthermore, we can conclude that the implementation of integrated reporting requires companies to fully integrate ESG issues throughout their annual reports. However, to fully utilize integrated reporting, the relation between ESG performance and the financial performance needs to be visualized. Based on our results, we have found that GRI indicators and ESG key performance indicators (KPIs) is a common way to present ESG performance. These ESG indicators can be combined with financial information to create ratios. We have found such ratios included in a list of universal KPIs, e.g. carbon efficiency. We believe this type of ratios could be a way to facilitate comparison and analysis. However, we have found that, such ratios are not yet used by the companies we have studied, and it is difficult to find general KPIs useful to all types of companies. Moreover, for KPIs and ESG information to be utilized there is a need for a broader competence amongst financial experts allowing them to analyze all dimensions of companies' operations and impacts. We believe the lack of ESG knowledge is a challenge for practitioners as well as educational institutions to take on.

The results also indicates that ESG information is not accessible in the same way as financial information and that several aspects can be hard to quantify and measure, such as social impacts or ecosystem services. This provides a challenge when integrating ESG information in a way that meets the IASB characteristics of

reliability, comparability, relevance and understandability. We therefore raise the question if all types of ESG information can be included in the annual report under the same requirements as financial information.

Moreover, we have found that Ekobanken, as an example of social banking, provides an innovative and interesting example of how integrated reporting can challenge the GRI and IASB concept of what, and how, to report. By attempting to report and measure a broader set of values created to society, recognizing that the lending of money contributes to significant impacts on sustainable development, we argue that social banking also challenges reporting in the bank sector at large by taking transparency in annual reports to the next level.

The companies included in our study recognizes their accountability to a wider set of stakeholders and state their strive to balance values in more than one dimension. We therefore believe that integrated reporting could be beneficial to a wider set of stakeholders and contribute to a broadening of the users of annual reports. This recognition of accountability also implies the recognition of a wider corporate social responsibility (CSR), possibly changing the purpose of the firm from financial value maximization to include contributing to larger social interests. Further, recognizing that companies do cause externalities to the society, this would challenge the theory that companies by maximizing financial value maximizes societal welfare. Integrated reporting would allow externalities, being potential future assets or liabilities, to be visualized as stated by Ligteringen (see the quotation in the background).

Despite the limited scope of our study we believe integrated reporting has the potential to have great influence on the field of accounting and reporting. Hopefully, a standardized framework on integrated reporting, utilizing the potential of the Internet, could increase access to reliable and relevant ESG information, useful to different types of stakeholders. By allowing better access to ESG information, we believe integrated reporting could help investors to find companies performing well on ESG issues and put a pressure on other companies to improve and report on their ESG performance. Integrated reporting could then contribute to value seeking balancing the financial, social and environmental dimensions.

7.1 Reflections

In combining our different backgrounds in financial accounting and environmental management, we found it interesting to analyze integrated reporting from two different theoretical perspectives. However, combining these two perspectives proved challenging in our analysis. To fully understand integrated reporting, being a new field under development, we have found it necessary to keep a broad approach. We therefore decided to answer three different research questions. However, it might have been wiser to focus on a more limited scope and deepen the analysis further. At the same time, we hope our broad approach can provide inspiration and ideas for further research.

7.2 Suggestions for further research

Further research on integrated reporting, based on a larger qualitative as well as quantitative empirical scope, is needed. Our study indicates KPIs linking ESG and financial data are useful and available, however there is a gap between the KPIs suggested by researchers and the actual KPIs used in companies. The factors behind this gap could be interesting to study in order to aid implementation of useful integrated reporting. Our study also indicates new measures are needed to visualize companies' external impacts on its surroundings and stakeholders, especially in terms of positive added values created to society. Furthermore, it could be interesting to include a cost-benefit perspective on integrated reporting, e.g. on the collection and inclusion of ESG data. Collection of ESG data also depend on the development of internal systems helping to ensure ESG data is reliable and accessible, a challenge for practitioners as well as for researchers. Finally, the development of a new standard on integrated reporting faces great challenges and requires extensive research in itself.

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Appendix

Respondents initial interviews

Bert-Ola Bergstrand, Gothenburg University, School of Business, Economics and Law

Conny Overland, Gothenburg University, School of Business, Economics and Law

Marina Grahovar, Gothenburg University, School of Business, Economics and Law

Thomas Polesie, Gothenburg University, School of Business, Economics and Law

Maria-Flock Åhlander, Ekobanken

Respondents interviews

Daniel Oppenheim, KPMG

Fredrik Ljungdahl, PwC

Maria Flock- Åhlander, Ekobanken

Question template

1. Which stakeholders and decision-makers do you think could find integrated reporting useful?
2. Could integrated reporting have influence on the evaluation of companies prior to decisions on e.g. investments?
3. How could ESG factors (environmental, social, governance) be related to the financial information in annual reports?
 - a. Can you provide any examples?
 - b. Is there any tool, measure, ratio or similar that could be useful?
 - c. What do you think of the potential and usefulness of these within integrated reporting?
4. What obstacles or challenges are there to the development of integrated

reporting?

5. How could the current standardization of integrated reporting (e.g. the work by IIRC) influence the field of accounting and reporting?