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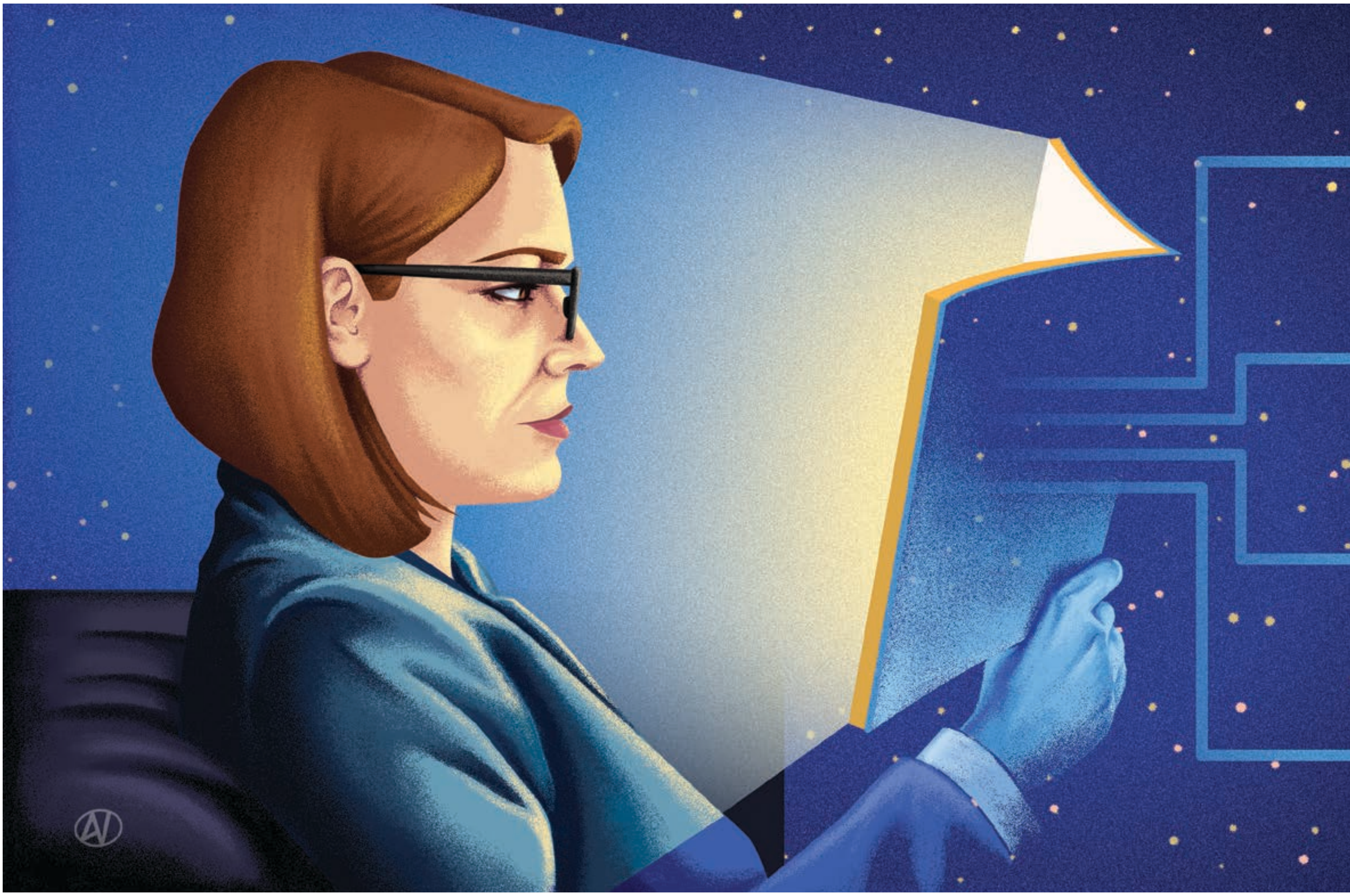


Illustration by Angelo Vlachoulis

CORPORATE REPORTING GOES INTEGRATED

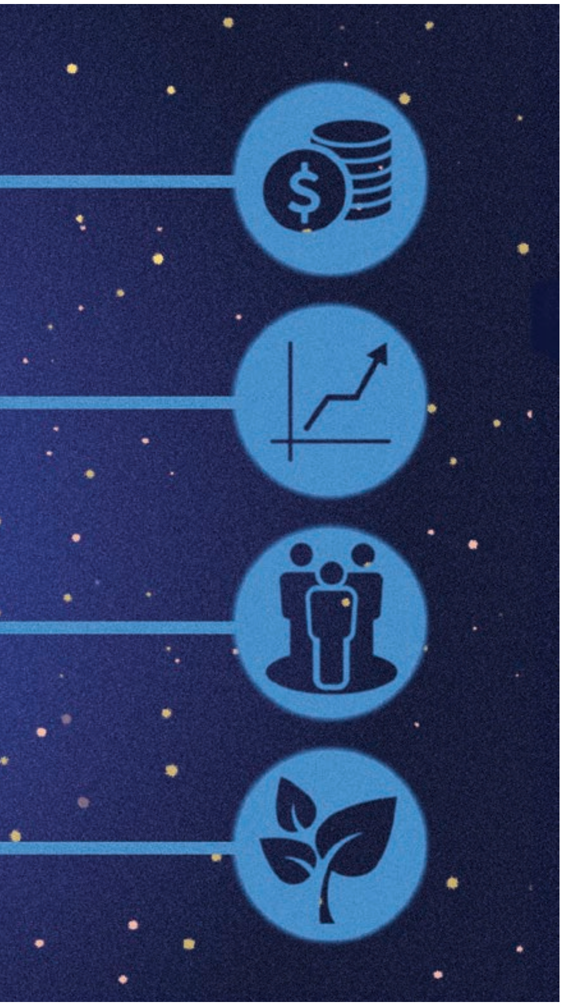
The way companies communicate their risks and opportunities is changing thanks to new guidelines and shifting investor expectations.

By Alexandra Cain

Markets are always hungry for information. Now, changes to ASX's Corporate Governance Principles and Recommendations around how companies report certain data are shifting investor expectations about what listed companies report.

Against this backdrop is an environment of uncertainty, in which dynamics including technologies such as artificial intelligence and electronic and autonomous vehicles are prompting enormous change, opportunity and risk. This is helping to drive the integrated reporting movement.

The International Integrated Reporting Council (IIRC) has developed a framework that promotes making balanced decisions about a company's impact, rather than focusing too much on financial performance. It encourages businesses to report information on underlying value drivers like customer and employee



perspectives and their influence on brand, reputation and intellectual capital, as well as community acceptance of their operations. It also takes into account climate change, population movements and technological disruption.

"Integrated reporting considers the company's external environment including markets, competition, regulation and megatrends that may affect the business's ability to deliver its strategy," explains Nick Ridehalgh, who leads KPMG's Better Business Reporting Group.

Other factors integrated reporting takes into account include external and internal risks and opportunities, and their likely affect on the availability and affordability of resources now and into the future.

"The board and management are then asked to explain how they are managing risks and realising opportunities to create or at least preserve longer-term value," Ridehalgh says.

The maturing of non-financial issues from nice to have to necessary is a value-creation opportunity, says Deloitte partner Chi Mun Woo.

"Integrated reporting allows businesses to examine how they create value, taking into consideration social, knowledge and natural capital," says Woo.

This gives them an opportunity to consider the intended and unintended negative and positive impacts associated with this. They can subsequently reconcile this analysis with strategy and the firm's priorities in relation to its products and services.

This then sets the tone for conversations about why the company's approach is responsible, commercially-sensible and environmentally-sensitive, taking into account shared value with the community and the supply chain.

"It's important to get that narrative right. We're moving into a space where it's not good enough for companies to say, 'we're purpose-driven and these are our values'. You've got to be able to point to really meaningful KPIs and demonstrate your performance in relation to those KPIs marries up with your promise," says Woo.

Practicalities of reporting

The integrated report can be the operating and financial review in the directors' report in the annual report, something businesses such as Lendlease are already doing.

Says Ridehalgh: "The integrated report provides a better understanding about how the organisation has created value, not just profit, and how it is positioned at the balance date to create value into the future. Investors are presented with insights into how the organisation has managed its material underlying drivers of value.

"For example, R&D and speed to market with new products and services to address new or changed customer needs is an indicator of future value. This provides investors and other readers with a better understanding of future prospects," he says.

Many of these underlying value drivers can be directly built into investor valuation models, for instance a price on carbon, or at least into the discount rate used on expected future cash flows.

There's evidence to back this up, with academics identifying benefits such as market value and cost of and access to capital as benefits of integrated reporting. Ridehalgh notes Stanford University academic Professor Mary Barth's research identified real cash flow improvements from integrated reporting.

The investment community is also encouraging integrated reporting's adoption. "We are seeing long-term investors such as industry and superannuation funds drive integrated reporting, as they invest money today to pay pensions in 20 years," says Ridehalgh. Some industry funds like cbus and VicSuper are applying integrated reporting to their own business and also require their investee companies to report using the framework.

Future focus

There's much work to be done to encourage wider adoption of integrated reporting. As a priority, listed businesses must understand the changes required by the fourth edition of ASX's Corporate Governance Principles and Recommendations.

"Action is required now – these new principles and recommendations are focused on underlying business drivers and risks. For many organisations, this will require changes to policies, practices, processes and systems, which will take some time," says Ridehalgh, noting the effective date for these recommendations starts on or after 1 January 2020.

"Recommendation 4.3 requires identification of the company's periodic corporate reporting portfolio. The board needs to explain how it verifies that the information contained in those reports is accurate and balanced, where it has not been subject to external audit or review. Work is required now to determine what information is material for investors, and the 'line of defence' on which the board is comfortable relying. Work may be required over the next few months," Ridehalgh says.

"Companies should be reviewing their external reporting strategy to reduce the volume of information and enhance its relevance for stakeholders," he adds.

The message to listed businesses is clear: now's the time to form a perspective on the company's approach to non-financial reporting, because it's becoming increasingly important for investors and other stakeholders.

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Communicating blue sky

Newcrest Mining is one listed business that recognises non-financial information can indicate material impacts down the track.

"For a mining company, long-term risks range from community, environmental to political issues. They are not always quantifiable today and can develop over a long period," says Chris Maitland, Newcrest Mining's head of investor relations and media.

"They can also include technological changes, changes in government regulation and shifts in community expectations," he explains, adding, "the things we do today may not be acceptable in the future."

Sourcing of power from a coal fired power station is one example, with community expectations moving towards a preference for renewable energy sources.

"We discuss these issues in our annual and sustainability reports, looking at social risks, changing government policy and even investor expectations. Investors are more ESG-focused. That's a trend that is becoming increasingly more important. We have to be able to address these concerns," Maitland adds.

Tailings dams, which store mining bi-products, are a particular concern for mining businesses at the moment. "These are very long-long term risks because they could last for hundreds of years. We need to make sure that even when the mine is long gone, it won't pose a threat to the environment or the local community. We're seeing increased regulatory responses globally."

For instance, due to the country's geology, Brazil has banned the construction of a style of tailings dams called upstream lifts. "We use upstream lifts for some of our tailings dams in Australia. We're not expecting regulations to change, but there's always the potential they could in the future," says Maitland.

Communicating this to shareholders requires a deft hand. For instance, Newcrest spends time explaining its approach to tailings dams in its annual report, results presentations and web site. It lists all its tailings dams, where they are and how they are constructed.

Maitland notes mining is a constantly-evolving area. As such, consistent open communication with shareholders is paramount.

"Carbon, energy and energy pricing are big issues for us. The cost of energy is going up in Australia because we don't have an energy policy in this country. Coal-fired power stations are being closed, with nothing to replace them. That has the effect of driving up the cost of energy for everybody. Investors expect us to communicate what we're doing to manage that risk. They want to make sure we're aware of that risk. So, we talk about alternative plans. For example, we're looking at building our own solar power plant to get an understanding of how that could work."

Power interruption is another concern, he says. "There's a risk of brownouts if we don't build more power stations. If it's a hot summer day and there's a risk people won't be able to have air conditioning on at home, the government will approach us and ask us to shed energy, which may mean closing down our production. It's not happening today. It's not happening in the very near future, but you don't want to be caught when it does happen and you haven't got something else in place."

Newcrest reports against the Taskforce for Climate-related Financial Disclosures (TCFD) and the Global Reporting Initiative and aims to issue its sustainability report concurrently with the annual report. But this can cause a resourcing and capacity issue as both reports have to be audited and there are considerable logistical issues releasing all this the data at one time.

"Recording all the information that is required can be a challenge. We have very well developed, sophisticated systems to report financial information and we're developing our environmental and social reporting capabilities. We already have well-developed measurement systems for environmental compliance purposes around water flows and energy consumption. But we're still developing less regulated parts of reporting, for example the social side. It's a question of building that data as you go."

Maitland says investors have mixed perspectives on non-financial information. "Some investors are very heavily focused on it. For some investors, it's a question of whether you're compliant with environmental and social standards? So there's is a *de minimus* level you have to meet to be investible. On the flip side, if you go to the gold standard, some investors don't ascribe value to it. So not everyone is prepared to pay a premium. But they want the data. There are funds that are restricted in what they can buy. So they end up having to pay a premium to companies that fully comply with environmental and social standards."