

**Submission to the International Integrated Reporting Committee
Towards Integrated Reporting: Communicating Value in the 21st Century**

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Domini Social Investments is a New York-based investment adviser focusing exclusively on socially responsible investing. We welcome the opportunity to offer comments on Towards Integrated Reporting: Communicating Value in the 21st Century (the “Discussion Paper”).¹

Integrated Reporting is still at a very early stage, although the momentum toward the integration of financial and sustainability data in corporate reporting is clear to us, and long overdue. For many years, we have argued that the capital markets do not adequately take into account corporate—and investor—impacts on society and ecosystems. The system recognizes the existence of “externalities,” but largely chooses to ignore them. This form of myopia has resulted in misallocations of capital, poor risk management, extractions of wealth from communities and environmental devastation. Much of this stems from a reporting framework that is issuer-focused in a world of systemic risks. We cannot adequately manage these systemic risks, including climate change, deforestation, depletion of natural resources, global poverty and other human rights abuses if companies are not required to consider and report on externalities. We have therefore been strong long-term advocates for improved corporate sustainability reporting, and supporters of the Global Reporting Initiative reporting framework, not least for its multi-stakeholder governance structure and its externally focused view of materiality. We also continue to seek mandatory corporate sustainability reporting at the Securities and Exchange Commission.²

We believe there are some key questions to work through that will determine whether IR is merely an improvement on financial reporting, or whether it can actually drive sustainability performance and greater corporate accountability as well.

Although we understand that the intent of IR is to supplement, and not replace, sustainability reporting, we are concerned that companies will in fact use the IR as their sole report, and eliminate additional sustainability reporting. If an integrated report is provided as a company’s sole report, it is critically important to ensure that the framework is adequately designed to incorporate the full range of risks and opportunities each company faces, and presents.

¹ For Domini’s contributions to the Harvard Business School ebook on Integrated Reporting, providing our views on the use of Key Performance Indicators and materiality, see Steve Lydenberg and Jean Rogers, [Integrated Reporting and Key Performance Indicators](#), and Adam Kanzer, [Toward a Model for Sustainable Capital Allocation](#), from The Landscape of Integrated Reporting: Reflections and Next Steps, published by Harvard Business School (November 2010).

² See Rulemaking Petition seeking mandatory sustainability reporting submitted by US SIF (formerly known as the Social Investment Forum), July 21, 2009, at <http://sec.gov/comments/265-25/26525-13.pdf>

The Focus on Investor Needs

In its most recent World Energy Outlook, the International Energy Agency spoke of a global “carbon budget” that cannot be exceeded if we are to remain within the two degree Celsius limit in global temperatures that scientists believe is necessary to avoid dangerous climate change. The IEA notes:

“The implications for global energy markets of this budget are profound, as it implies that less than half of the remaining proven fossil-fuel reserves can be used over the next 40 years.”³

This calculation points to a tragic misallocation of capital, driven by investment models that ignore real-world outcomes, and the implications of investment decisions. The exclusive focus on shareholder value that led to this misallocation of capital points to at least two possible outcomes – a very significant class of stranded assets, or a social, ecological and financial catastrophe. A similar analysis could be provided that aligns the world’s largest companies by market capitalization with their human rights records. Globally, investors are allocating capital without regard to these issues.

Similarly, we hear regularly that mainstream analysts never ask companies questions about social or environmental factors during quarterly analyst calls, and rarely, if ever, read corporate sustainability reports.

The Discussion Paper suggests that the problem is the lack of reliable data. Although we would certainly agree that vast improvements could be made to corporate reporting, we cannot agree that insufficient data exists to allow us to make investment decisions, as we use social, environmental and governance data to make investment decisions every day.

We believe there is a broader problem that IR can help to solve, but only if it recognizes this problem and faces it squarely. We are therefore somewhat concerned to see the investor focus that is outlined in the Discussion Paper, and would suggest that the IIRC be extremely cautious in tailoring IR to investor needs and current investment models that have been sorely tested by the ongoing financial and sustainability crises.⁴

As discussed throughout these comments, we believe the promise of IR hinges on its approach to materiality and value creation.

If the definition of materiality retains its sole focus on impact to the company, as opposed to the company’s impact on society and the environment, we will be left with only one part of the picture. As diversified investors, we need a broader view of risk and opportunities, and other stakeholders need that information as well.

³ Excerpt from the World Energy Outlook 2011, International Energy Agency. Available to purchase at: <http://www.worldenergyoutlook.org/>. See also, *Unburnable Carbon – Are the world’s financial markets carrying a carbon bubble?*, Carbon Tracker Initiative, at www.carbontracker.org/carbonbubble

⁴ For more perspective on Domini’s views on the shortcomings of Modern Portfolio Theory, see, Amy Domini, [Saving Capitalism from Futile Diversification](#) (*OECD Observer* No. 279, May 2010), and Steve Lydenberg, [Markets at Risk: The Limits of Modern Portfolio Theory](#), published in conjunction with the *2nd Summit on the Future of the Corporation* hosted by Corporation 20/20 (June 2009).

There is a very real risk that what's hard to measure will get left out, in IR's push to remove "clutter" from corporate reporting. Ironically, this will not serve investors' interests, as whole categories of risk will consequently be left out as well.

Certain important sustainability issues, such as working conditions in global supply chains, for example, may not align with or be 'material' to corporate strategy, particularly for a broadly diversified company.

The IIRC faces an important challenge to present a broader conception of value creation and of materiality in order to fulfill the full promise of Integrated Reporting.

Q1. (a) Do you believe that action is needed to help improve how organizations represent their value-creation process? Why/why not?

Yes. It is critical for companies to understand and disclose how the various capitals described in the Discussion Paper contribute to long-term corporate success, and how the corporation both enriches and diminishes these forms of capital (concerns regarding the definitions of these 'capitals' is provided below). Ideally, we would like to see corporate reporting focused on a broader conception of 'value creation' than shareholder value. Corporations must create value for all of their stakeholders in order to thrive. In addition, and perhaps more importantly, society has become increasingly dependent on good corporate stewardship of these relationships.

Q1. (b) Do you agree that this action should be international in scope? Why/why not?

Yes. The sustainability challenges we face are global in scope, and the risks presented to companies and by companies emerge internationally and are felt on a global basis.

Q2. Do you agree with the definition of Integrated Reporting on page 6? Why/why not?

As discussed throughout these comments, we encourage the IIRC to explicitly embrace a broader conception of value creation and materiality. As we read the Discussion Paper, these concepts are still unclear.

Below, we outline some concerns about the company-centric focus of IR as currently defined, and its focus on corporate strategy. We would also recommend that more emphasis be placed on reporting as a mechanism for accountability.

Q3. Do you support the development of an International Integrated Reporting Framework? Why/why not?

Yes. For all of the reasons discussed in these comments, we do support the development of an IR Framework, although we are concerned that IR may displace sustainability reporting, and have a number of open questions about the direction of IR.

Q4. (a) Do you agree that the initial focus of Integrated Reporting should be on reporting by larger companies and on the needs of their investors? Why/why not?

We agree that it makes sense to begin with large companies, as they face the most significant sustainability challenges, although we do believe IR should apply equally to all publicly traded companies, regardless of size. We have expressed a number of concerns throughout these comments about the focus on the needs of their investors.

Q4. (b) Do you agree that the concepts underlying Integrated Reporting will be equally applicable to small and medium enterprises, the public sector and not-for-profit organizations?

We do believe that IR is equally applicable to small and medium enterprises that prepare public reports, but at this stage it is difficult to understand the application of IR, with its focus on investor needs and materiality, to public-interest organizations and public sector entities.

Q5. Are: (a) the organization’s business model; and (b) its ability to create and sustain value in the short, medium and long term, appropriate as central themes for the future direction of reporting?

Why/why not?

There are important elements to these themes. An explicit focus on short, medium and long-term timeframes is critical. As stated above, the definition of value creation should be clearly defined as “value creation for society and the company’s stakeholders”, or firms will adopt the more traditional “shareholder value” focus.

With respect to the focus on the company business model, the company should explain and defend its business model in terms of its contribution to broad-based societal or ecological wealth. The company should be prepared to change its business model to address these broader goals.

Reporting that focuses on how the various forms of capital contribute to the success of the company, rather than how the company impacts them (positively and negatively) only provides a portion of the picture we need to see.

At Domini, we define key performance indicators at the sub-industry level in order to assess how each company is addressing the key sustainability challenges it faces, within the context of its business model. These indicators range from specific metrics (percentage of revenues derived from natural gas production, for example) to broad areas of concern (supply chain labor standards compliance, for example). Our indicators are divided between sustainability challenges generated by the core business model, and stakeholder relations. Our approach focuses on the company’s ability to identify and address these challenges in furtherance of our ultimate investment goals – environmental sustainability and universal human dignity.⁵

Q6. Do you find the concept of multiple capitals helpful in explaining how an organization creates and sustains value? Why/why not?

Yes, but with qualifications. This concept is helpful to the extent that it helps companies understand the importance of its relationships with employees, communities, etc. It also raises concerns, however. Use of

⁵ More information is available at <http://www.domini.com/GlobInvStd/index.htm>

this common denominator may also make for simpler accounting, but it does not provide an accurate view of the world, which cannot be reduced to a set of ‘capitals’ that exist to provide inputs to corporations.

The notions of ‘human’ and ‘natural’ capital are particularly reductive. Human beings, human communities and ecosystems are not merely forms of capital provided to companies in order to be drawn down or built up. They have inherent value that cannot be quantified, and harm to them cannot be justified according to a financial materiality analysis. These realities are implied by the Discussion Paper’s use of the terms ‘human rights’, ‘stewardship’ and ‘eco-system health.’ Nevertheless, conflicting messages are sent by the notion that natural capital, for example, is merely “an input to the production of goods or the provision of services.” Based on this definition, accompanied by a focus on ‘materiality to company strategy’, a company may conclude that it is appropriate to exhaust a particular natural resource in order to capitalize on a short-term strategic objective. A company, of course, may also choose to avoid exploiting a particular resource in order to allow it to replenish itself, to ensure the availability of future supply. The notion of “no-go” zones, however, may be difficult to translate.

It is a step forward to convince companies that their success is dependent upon the health of society and the environment, but ultimately corporations must understand that these ‘inputs’ are more than mere forms of capital, and must be respected in their own right. Some companies, for example, recognize that worker health and safety comes before meeting production targets. Some do not. Corporate impact on human beings and ecosystems creates obligations that override any notion of financial materiality. When public reporting is also viewed as an accountability tool, rather than merely a tool for investment decision-making, the notion of materiality must change.

To take just one example of how a company-centric view of the world can create risk for companies, there is an ongoing debate about the definition of Free, Prior and Informed Consent (FPIC). Quite cynically, in our view, many have replaced the word “consent”, which is used in the international human rights instruments, with another “c” word – “consultation.” The acronym remains, but the meaning is very different.⁶ The two terms reflect very different views of the world, and the corporation’s place in it. It is *prudent* risk management for a company to “consult” with local communities before engaging in potentially damaging operations, but it is *required* for a company to receive the “consent” of communities that carry the right of self-determination. When the company places itself at the center of this analysis, it misapprehends the nature of the risks it faces and raises the risk of loss of license to operate. These can be very costly miscalculations for both corporations and communities.

If IR can help companies establish a more accurate vision of their place in the world, better risk management and more beneficial capital allocation decisions should follow.

Q7. Do the Guiding Principles identified in the Discussion Paper provide a sound foundation for preparing an Integrated Report – are they collectively appropriate; is each individually appropriate; and are there other Guiding Principles that should be added? Why/why not?

⁶ The International Finance Corporation (IFC) has recently adopted the word “consent” in its recently issued revised performance standards. See, e.g., <http://www.csrandthelaw.com/2011/08/articles/financing/the-ifc-performance-standards-and-consultation-with-communities/>

It is very important for the IIRC to clearly define its terms, and to re-define certain key terms that are in common use. In particular, the terms “value” and “materiality” need clear definitions.

We agree that corporate reporting should focus on what matters, but are concerned that the communication of “what is important to the company from a strategic perspective” may fail to include information that is critically important to communities and ecosystems that are affected by corporate operations and to investors that are seeking a broader picture of corporate performance. The IR should provide investors with sufficient information to assess whether the company’s strategy is the right one for the long-term. If materiality is focused around corporate strategy, however, investors and other stakeholders may not be provided with sufficient information to assess the weaknesses of that strategy.

Similarly, an organization’s “ability to create and sustain value” should be clearly defined. What does it mean to create and sustain value, and for whom?

Most importantly, the concept of materiality is used repeatedly throughout this section and the Discussion Paper generally, but is not defined. In this context, it is important to note that sustainability factors that may impact corporate financial performance are generally already required to be disclosed.⁷ What additional disclosure will IR provide?

If the IIRC is contemplating broader conceptions of materiality and value creation – and we strongly encourage you to do so – companies will need clear guidance along that path.

Q8. Do the Content Elements identified in the Discussion Paper provide a sound foundation for preparing an Integrated Report– are they collectively appropriate; is each individually appropriate; and are there other Content Elements that should be added? Why/why not?

There is considerable value in both the Guiding Principles and the Content Elements. Our concerns about the Elements stem from the same concerns expressed about the Guiding Principles – the centrality of the company, and definitions (or lack thereof) of “value” and “materiality.”

For example, companies are asked to identify “the extent to which sustainability considerations have been embedded into its strategy *to give it a competitive advantage.*” (emphasis added) This is important. But we would also like to understand how these considerations allow the company to address the key sustainability challenges it faces, and how these considerations allow the company to create value for its stakeholders.

A broadly diversified global company may be able to turn certain sustainability challenges to its advantage (by offering energy efficiency technology, for example), while ignoring others that are not likely to have a material impact on its business (human rights abuses at the base of the supply chain of one of its business divisions, for example). The challenges that are ignored because they do not pass the materiality test may, in fact, be material to affected communities, they may create material risks for other issuers, and they may ultimately become financially material for the company itself.

⁷ See, e.g., Commission Guidance Regarding Disclosure Related to Climate Change, Release Nos. 33-9106; 34-61469; FR-82 (Feb. 8, 2010), available at <http://www.sec.gov/rules/interp/2010/33-9106.pdf>.

We were very pleased to see the “organization’s impacts (both positive and negative) on the resources and relationships on which it depends” listed among key performance elements. The reference to risks “up and down the value chain” is also helpful. Again, however, the traditional notion of materiality here is implicit, and this focus on impacts *to the company* is insufficient. Companies should also be asked to report on material impacts to third parties and ecosystems, whether or not the company depends on those relationships (or, perhaps more accurately, whether or not the company *believes* that it depends on these relationships). Stakeholders need this information, as do broadly diversified investors in order to acquire a 180 degree view of risk that covers both risks to the company and risks created by the company that may be felt by third parties, including other issuers, and ultimately the company itself should society seek redress.

The inclusion of “real risks that could have extreme consequences, even though the probability of their occurrence might be considered quite small” is very important.

Q9. (a) From your perspective: Do you agree with the main benefits as presented in the Discussion Paper? Why/why not?

Q9. (b) From your perspective: Do you agree with the main challenges as presented in the Discussion Paper? Why/why not?

Q9. (c) From your perspective: Do you agree that Integrated Reporting will drive the disclosure of information that is useful for integrated analysis (from the perspective of investors)? Why/why not?

As discussed above, we believe that investors need a broader view of risk and value, even if most investors do not yet recognize this, and that IR can be an important catalyst to shift the markets towards greater sustainability. The IIRC’s definitions of “value” and “materiality” will be critical drivers of this transformation.

We believe the IIRC would agree that the focus on value needs to go far beyond shareholder value, but that point needs to be made far more explicit, and expanded upon.

If the balance and the emphasis is right, we believe that IR can provide the following important benefits:

- analysts will be unable to ignore sustainability, leading to better risk management and more beneficial capital allocation decisions;
- better stewardship of the environment and management of externalities by corporations.

Q10. (a) Do you agree that the actions listed in the Discussion Paper should be the next steps undertaken by the IIRC? Why/why not? Are there other significant actions that should be added?

Q10. (b) What priority should be afforded to each action? Why?

Q11. Do you have any other comments that you would like the IIRC to consider?

As discussed throughout these comments, we believe the IIRC should prioritize the developments of clear definitions, with appropriate guidance, of the terms “value creation” and “materiality”, and we would

recommend that this be a multi-stakeholder process with the involvement of civil society organizations and socially responsible investors. This process will be important to gaining broader support for IR.

We also encourage the IIRC to move forward on the measurement of externalities, as noted in the Discussion Paper.

Additional questions:

I have provided feedback that reflects:

Interest of an organization, please provide the name of the organization:

Domini Social Investments LLC

Which best describes your involvement with sustainability reporting?

Reporter (prepare a report for my own organization): X (UNPRI report)

Report reader (read reports for the purpose of evaluating or analyzing organizations) X

Please indicate how many years of experience you have with sustainability reporting:

More than 5 years X