

# Cases on the Diffusion and Adoption of Sustainable Development Practices

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# Chapter 7

## Sustainability Reporting and Financial Reporting: The Relevance of an Integrated Reporting Approach

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### EXECUTIVE SUMMARY

*In the business world, there are issues such as globalisation, environmental awareness, and the rising expectations of public opinion which have a specific role in what is required from companies as providers of information to the market. This chapter refers to the current state of corporate reporting (financial reporting and sustainability reporting) and demonstrates the need for evolution to a more integrated method of reporting which meets the stakeholders' needs. This research offers a reflection on how this development can be achieved, which notes the ongoing efforts by international organisations in implementing the diffusion and adoption, as well as looking at the characteristics which are needed for this type of reporting. It also makes the link between an actual case of a company that is one of the world references in sustainable development and integrated reporting. Whether or not the integrated reporting is the natural evolution of the history of financial and sustainability reporting, it still cannot yet claim to be infallible. However, it may definitely be concluded that a new approach is necessary to meet the needs which are continuously developing for a network of stakeholders.*

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## **ORGANIZATIONAL BACKGROUND**

The recent global crisis has raised a number of questions about the functioning of capital markets and extent to which current business reporting mechanisms reveals systemic risks and actual business costs. It is becoming increasingly evident that the long-term success of an organization is equally dependent on traditional business practices as well as macroeconomic factors such as human rights, working conditions and environmental stewardship (Carrol & Buchholtz, 2011). Therefore in reaction to globalization, increased environmental awareness and mounting cry from the public for transparency and accountability, companies are increasingly required to provide information to the market beyond that of the long-established balance sheet (Oyhanarte, 2012).

The debate on corporate responsibilities and accountability started back at the beginning of 20<sup>th</sup> century. “The idea about the ‘socially responsible corporation’ which emerged in the 1930s and rose to prominence in the decades after the Second World War was markedly more radical than contemporary ideas about corporate social responsibility (CSR)” (Ireland & Pillay, 2010, p. 77, as cited in Monciardini, 2012). Going back to that period, CSR was more linked to questions such as the governance of the company, the principle of shareholder primacy and the corporate duties to its employees, consumers, creditors and to society. Nowadays and for the last decades, the approach has changed and corporate sustainability has realigned its concerns – it became shareholder-centred.

The way of reporting also changed. From the beginning of the 21<sup>st</sup> century sustainability reporting became more significant, which reflected in a clear growth in voluntary corporate sustainability reporting and in the success of global regulatory networks, such as the Global Reporting Initiative (Monciardini, 2012). The 21<sup>st</sup> century has seen a significant growth in corporations voluntarily reporting sustainability initiatives. This is evidence by the success of global regulatory networks/agencies such as the Global Reporting Initiative.

While business reporting becoming increasingly long and detailed, the information is biased towards financial data, accompanied by a proliferation of stand-alone sustainability reports. However, these developments have occurred in a disconnected way. In spite of the extensive disclosure, they have not been able to demonstrate, in an integrated way, the interdependence of critical points in the performance of organisations, particularly regarding the interactions between financial and non-financial factors.

Stakeholders need a more concise, less extensive and integrated type of reporting – something that brings together detached and disconnected reports disclosed by the company, a document that collects information about corporate governance and business sustainability, not simply concatenating them, but presenting them in such a way that the connections between these two dimensions are evident.

## ***Sustainability Reporting and Financial Reporting***

Responding to the increasing demand for more comprehensive reporting from the market, the regulators or civil society justifies the existence of a document that provides in itself the most important information already disclosed in other independent reports. The reports are presented in a coherent and integrated way, and demonstrate the company's ability to create value over time. This is integrated reporting.

Integrated reporting is a consequence of the sustainable development of businesses. Sustainable development was described by the World Commission on Environment and Development, in 1987, as the development that gives an answer to the expectations of society today, without putting in question the needs of generations in the future (Bruntland, 1987, as cited in Siddique & Quaddus, 2011). Sustainability is having an increased focus on companies' management and sustainability reporting is the way that companies have to show that their businesses are becoming more responsible and more accountable, yet still operate in a profitable way. Corporate sustainability and CSR arise from goals of sustainable business (Siddique & Quaddus, 2011). It is all about the sustainable development of business. Corporate sustainability and CSR make companies and their decision-makers more conscientious with regards to the present social and environmental demands and promote the accomplishment of a sustainable development in the future.

Until a few years ago, the accepted trend was to report financial and sustainability performance separately, with sustainability reporting becoming more visible, more autonomous and more consistent year after year (Tagesson, Blank, Broberg & Collin, 2009). But the trend is changing and it is already noted that producing standalone reports on each one of those issues does not reflect the real performance of the company. Financial and non-financial dimensions interact in a way that only an integrated strategy of disclosure can reveal. So far, only financial reporting is mandatory. Sustainability reporting still remains voluntary in the majority of countries. There are, however, countries where mandatory sustainability reporting already exists (e.g. Denmark and Sweden) and countries with mandatory integrated reporting (e.g. France and South Africa). But these are the exceptions because the current practice is voluntary disclosure (Iannou & Serafeim, 2012).

Despite the efforts of international organisations in the diffusion and adoption of integrated reporting, the process is still at a latent level in the majority of countries. As seen before, with the exception of South Africa and, more recently, France, integrated reporting adoption is happening in an unregulated and voluntary way. Various initiatives are occurring in order to create more visibility to integrated reporting, namely with the inclusion of the subject on the agenda of the G20 meeting – France, November 2011 – and the Earth Summit – Rio de Janeiro, June 2012 (Eccles & Serafeim, 2011).

Nevertheless in the voluntary nature of integrated reporting, we find that there already numerous successful cases. The majority of the companies are from Europe, but there are also companies from all over the world (and, of course, from countries where integrated reporting is already required). This includes over seventy reporting organisations from across the globe and an investor network with over twenty institutional investors which have joined the Integrated Reporting Pilot Programme based on the International Integrated Reporting Framework of International Integrated Reporting Committee.

Through this pilot programme the principles, substance and practical use of integrated reporting are being developed, tested and verified by the participants. This is happening over a period of two years and is expected to end in October 2013, after which a framework will be published. Besides institutional investors, it includes companies that already have adopted integrated reporting. The project started in October 2011 and it is anticipated that the interaction among the participants will provide an opportunity to discuss technical material, test its application and share knowledge and experiences. The participants include: Microsoft Corporation and The Coca-Cola Company, both from the United States of America; Natura from Brazil; Volvo Group from Sweden; PriceWaterhouseCoopers and Ernest & Young from the Netherlands; Novo Nordisk from Denmark; KPMG International from Switzerland; the Marks and Spencer Group and Deloitte from the United Kingdom; and Danone from France.

Whether or not integrated reporting is the natural evolution of 150 years of financial reporting and 15 years of sustainability reporting, is yet to be seen. However, it can be concluded that a new approach is necessary to meet the growing demand from the market. As a corollary of the role played by stakeholders at the dawn of the twenty-first century, companies will have to embark on new ways to communicate and learn to compromise. In this regard integrated reporting is, without doubt, a key tool to achieve this.

Therefore, this chapter intends to refer to the current state of corporate reporting (financial reporting and sustainability reporting). Also, it aims to demonstrate the need for more integrated and targeted reporting that meets stakeholders' needs in terms of access to information. There is a particular concern about how this development will be achieved. There is concern especially in consideration of the on-going efforts by international organisations. The specific characteristics needed for this type of reporting as well as the ability to indicate the requirements that ensure the credibility of the information transmitted are all crucial to the success of the integration technique.

This chapter also makes the link to an actual case of a company that is one of the world's references in sustainable development and integrated reporting. The company is the Danish diabetes care company Novo Nordisk. Its business is managed using

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the triple bottom line principle which means that the organisation is committed to operate in a way that is financially, environmentally and socially responsible. Managing the business by applying the triple bottom line principle makes it easier for the company to balance short-term profitability with long-term societal interests.

The remainder of this chapter is organized as follows. First, a methodology section which explains the procedures of our research. Secondly, a background research where discussion is done on the changes which occurred in the business paradigm and the analysis of the background of financial reporting and sustainability reporting in the business world. It is followed by a theoretical reflection and the findings where we try to understand whether or not integrated reporting is a natural evolution in financial and sustainability reporting and analyse the diffusion and adoption of integrated reporting in business. In this section, we give particular emphasis to the study of a company, which is world leader and pioneer in integrated reporting. The chapter closes with conclusions and future research directions.

## **METHODOLOGY**

To better understand whether integrated reporting is the natural evolution of financial and sustainability reporting, we researched a plethora of resources. Besides the theoretical research based on what has been scientifically published on this matter, we also collected and analysed information disclosed by the “mainstream” international organisations working on sustainability reporting. These organisations were selected based on their work in promoting the diffusion and adoption of sustainable business practices and, specifically, their efforts in the development and dissemination of integrated reporting. They are the Global Reporting Initiative, the International Integrated Reporting Committee, the United Nations Global Compact and Accountability. This way we acknowledge the ongoing trends of corporate reporting and have obtained information related to the earlier reporting steps. We also understand the difficult process of planning the future of integrated reporting and have captured future directions.

Finally, the study is enriched by an actual case of integrated reporting adoption. The company chosen is one of the world leaders in integrated reporting and also one of the pioneers. With the analyses of Novo Nordisk reporting practices, it was possible to realise how effectively an integrated reporting process is, its procedures and its implications into business management. Since the company freely discloses a large amount of information on its website, there was a lot of material available for this case study. It was essentially information which is contained in its annual reports and additional information which is also provided on the website.

## **BACKGROUND RESEARCH**

### **Changing the Business Paradigm**

The idea that a company will be successful if it is good at what it does has fallen into disrepute. The truth is that many companies show positive results even with poor performance. Evidence such as creative accounting, unfair labour practices and negative externalities can be disguised in organisations that, in the end, have positive financial performance.

Fortunately, however, this situation is changing. The collapse of the financial system and the global economic crisis that started in 2008 served as a warning to the status quo of business reality. It has been proven that it is not possible for apparently successful companies to survive when they are based on unsustainable practices.

This crisis and its consequences went far beyond the recession inflicted on the world economy. This was also a turning point in the trajectory of corporate management. For example, to overcome the bad image of the financial system it was not enough to inject new capital to calm the markets. It was and still is necessary to adopt a new role model.

The public, forced by circumstances, became more observant and began to analyse the performance of organisations more closely. Large companies are now more exposed to external scrutiny and are facing increased pressure to disclose information that goes beyond their financial performance. For a few years now, globalisation, the evolution of the media, the civil society movement and, more recently, the global crisis have changed the way we look at companies. Stakeholders have assumed a leading role in decision-making processes and their scrutiny has become a constant concern for managers. Key stakeholders have a particularly critical position and the engagement between them and their related company is the nerve centre of sustainable business management. Key stakeholders are business partners such as customers, employees, shareholders, suppliers and investors.

In the business world, communication with stakeholders began to go beyond accountability to include other information that companies know will be of interest to them. This kind of disclosure gives transparency to the reporting process and serves as a way of legitimising the organisation's performance (see, in this respect, stakeholder theory (Freeman, 1984), legitimacy theory (Lipset, 1961) and positive accounting theory (Watts & Zimmerman, 1978)).

## **Background into Financial Reporting and Sustainability Reporting in the Business World**

In business management, a business model still prevails that is characteristic of the twentieth century. This model is based on the company structure, where the core business objective is to maximise value for its capital holders and all of the management efforts are directed to meet this goal (Smith, 1998). This theory is developed based on the question of property rights. Shareholders have this role because they have the right to claim the residual value of the organisation after all the borrowed funds have been paid. This right comes from their position as capital owners and the risk they take when they invest in the business (Massie, 2010). In a system where management is primarily thought of as a way to achieve the objectives of the shareholders, it is natural conclusion that the most important component of corporate reporting is addressed to them: the financial reporting in its format of annual report serves the purpose of informing shareholders on corporate governance.

This shareholder theory coexists with the existence of a theory of stakeholder primacy. It may eventually be a target of criticism because of the conceptual incompatibilities the fact remains that they have coexisted in the business world for several decades. History says that, in the middle of the last century, there was the spark of what is the modern era of corporate social responsibility (Bowen, 1953). Companies gradually began to be seen in a more comprehensive way: in addition to the owners – the shareholders – organisations began to include other groups with an interest in the development of their business – the stakeholders.

No longer merely seen as business units, companies started to incorporate into their lexicon and their performance the issue of “sustainability”. With this sustainability reporting disclosure it became possible to cover the four main pillars of the behaviour of organisations (Carol, 1979): the economic responsibility to investors and consumers; the legal role to the State and according to law; the ethical responsibilities to society; and the discretionary responsibility that are assumed by the community.

If the financial report is the main vehicle for disseminating business performance information to the capital holders, then opening the range to the other stakeholders makes this type of disclosure insufficient. Companies started with the disclosure of sustainability reports which informed stakeholders about the social responsibility practices they had developed. Sustainability reporting always has two protagonists: the organisation that makes the disclosure (the writer) and the stakeholders who examine it (the readers) and this process only makes sense if the organisation, *a priori*, clearly identifies the intended audience and works to meet its needs and expectations. As the size and complexity of businesses grow, the trend to achieve sustainability reporting becomes more visible, more autonomous and more consistent (Branco, 2006; Kuasirikun & Sherer, 2004; Tagesson, Blank, Broberg & Collin, 2009).

Despite these trends in reporting, it appears, however, that the system currently in practice still maintains the original purpose for which it was created: a business reality which emphasises the primacy of the capital holders. While continuing to play an important role in communicating the performance of companies, the truth is that businesses have become more complex and there are some gaps in the method of reporting still used (IIRC, 2011). In an attempt to fill these gaps, there has been an increase in the information provided, including:

- More extensive and more complex financial reports;
- Management reports with more detailed information;
- Stand-alone sustainability reports, showing a rapid evolution and proliferation over the past decade.

These developments are meritorious in the process of providing information in a changing business world. They are, however, still seen by many as insufficient to overcome the existing communication gaps., for example, investors recognise the importance of non-financial factors in business performance, but they do not consider that the information they have access to in this matter is best suited for the decision-making process (Arnold, Bedard, Phillips & Sutton, 2009; Boston College Center for Corporate Citizenship, 2008).

Some behaviour should be changed in order to promote the filtering of information in annual reports. More detailed and extensive disclosure does not necessarily result in more efficient communication. Financial and sustainability reports which tend to reach a level where they each try to include as much relevant information as they can, may not result in the desired effect with the stakeholders who analyse them.

It should be noted that there are already some developments in certain parts of the globe that have the aim of restructuring corporate performance reports, encouraging the disclosure of clearer and more accurate reports (see, for example, the work developed by the Financial Reporting Council and Accounting Standards Board (2011, 2009)).

## **THEORETICAL REFLECTION AND FINDINGS**

### **Integrated Reporting: The Natural Evolution?**

The proliferation of forms of value-based management (where decisions made and actions taken are designed to create value for equity holders) helps to justify the need for reporting that goes beyond an explanation focused on the financial value of the company. It is necessary to go further and also include the value that is not detectable in the analysis of financial statements – the non-financial value.

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But the way in which financial and sustainability reports are currently structured does not fully satisfy the needs of stakeholders in their quest for obtaining information (Eccles & Krzuz, 2010). This was one of the conclusions which was drawn from the St. James Palace Meeting, held in London in September 2009, under the auspices of the United Nations, which brought together global investors, businesses, accounting professionals and representatives of civil society from all over the world to discuss the concept of integrated reporting, its challenges and its implementation. The need to produce a document that discloses, in an explicit and transparent way, the company's activity has broadly been gaining in size and pressure from stakeholders is increasing worldwide.

The practice of integrated reporting or organisations is assumed as the operating means of a holistic approach to the way companies communicate with their stakeholders by providing access to relevant information about the business developed. This kind of report combines financial and non-financial information, including information related to social practices present in the sustainability report. This does not, however, signal the extinction of these types of reporting. It makes sense that the company continues with the production and disclosure of both financial and sustainability information whose function is to respond to particular groups of consumers of data.

Integrated reporting serves as a more comprehensive and aggregated way of disclosing relevant information about the company's performance and, when necessary, can be complemented by the consultation of other documents that are more specific and more detailed, depending on the needs of each stakeholder. Even though companies disclose their performance information (Jeyaretnam & Niblock-Siddle, 2010), it cannot be assumed that stakeholders read the detail of both the financial and sustainability annual reports – because they either say they are too long, or find them difficult to read or lacking detail on issues that concern them.

By transmitting the way the company sees and reacts to the environment that surrounds it, enriched by description of the interaction that these actions have with the financial performance and the explanation of how strategic objectives will be achieved in the long term, it will be possible to demonstrate to stakeholders how the organisation has the ability to stay healthy over time (Wood, 2010).

The great advantage of integrated reporting compared with the separate disclosure of financial and sustainability reports is that it is possible to achieve a long desired objective in the field of social accounting: the interaction of financial and social dimensions (Faria, 2007; Pereda, 2002). Using this kind of disclosure of business information, companies can identify the impact that each of these dimensions has on the other. This level of interaction varies, of course, from organisation to organisation. Hence the integrated report, as more than just a way to disseminate

information, is also an explicit commitment to achieve a growing level of interaction between financial performance and sustainability behaviour and is also a stimulus for increased rigour in the internal control of non-financial data.

## **Diffusion and Adoption of Integrated Reporting Practices in Business**

The international commitment to the development of efforts to create a universally accepted integrated reporting system was made with the creation of the International Integrated Reporting Committee (IIRC) in August 2010. The IIRC brings together, across the board, leaders in areas such as business, investment, accounting and auditing, securities, regulatory, and academic and civil society. The key drivers of this initiative are organisations such as Accounting for Sustainability, the Global Reporting Initiative, the Fédération des Experts Comptables Européens and the International Federation of Accountants.

This international committee intends that integrated reporting will achieve the following goals<sup>1</sup>:

- Serve as information support to investors who wish to inject capital into the company, providing them with a broader view of the decisions taken and the expected consequences;
- Highlight the connections between financial, social and environmental factors that will influence the performance of the company in the medium to long term, establishing a clear relationship between sustainability and economic value;
- Provide the necessary framework for social and environmental factors which must necessarily be taken into account in decision-making processes;
- Recalibrate the performance measurement so that the emphasis on short-term financial indicators can be complemented with evaluations focused on non-financial issues.

Integrated reporting provides more comprehensive and useful information about the performance and positioning of the company and is more clear, concise and easier to interpret by those who read it. In order to work on the development of this kind of disclosure, the IIRC (2011) recently published a discussion paper that aims to compile a whole set of recommendations to support and promote the practice of the integrated communication of business information in order to create value.

Because it is a new area of research, in the academic world there is still a lack of consistent scientific studies on this subject, even though the IIRC recently had

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an opening discussion, with the intention of collecting contributions for the above document. The purpose of this committee is to establish an international framework – called the International Integrated Reporting Framework launched in 2011 – which will facilitate the development of integrated reporting over the next few years and allow, by 2020, all listed companies to put this kind of report into practice. Through this pilot programme the principles, substance and practical use of integrated reporting are being developed, experimented and verified by the participants on the project. It is happening for a period of two years and is expected to end in October 2013 after which the Framework will be published. Until then, the reality is that there does not yet exist a framework of reference that provides concrete guidelines about the format and logistical aspects of this type of report.

The starting point for planning the adoption of integrated reporting is to define the common contact points between financial and sustainability reports. If the integrated report presents the essential features that are similar in these two types of reporting, the process of introduction will be more easily initiated, as follows (White, 2010):

### **Complexity**

Financial reporting is constantly challenged to keep pace with the increasing complexity of economic transactions, sources of value, financial instruments and even financial obligations. Sustainability reporting also faces challenges that, even with a different type of complexity, are likewise central to their performance – the articulation of qualitative and quantitative measurements of social performance with financial performance, as well as the management strategies that sustain this performance.

### **Different Stakeholders**

Although financial reporting is primarily programmed to meet the information needs of investors, the truth is that other stakeholders access the information for purposes other than the act of investing (employees, suppliers, academics ...). The same applies to sustainability reporting, which also serves different audiences (some overlapping and others distinct from financial reporting).

### **Information Relevance**

Not all the information available is likely to be disclosed. In both financial and sustainability reporting, it is necessary to identify what is relevant and should be highlighted, bearing in mind the concern not to overload the report with unnecessary and/or superfluous data.

The assembly of integrated reporting is a process which is in a preliminary stage. Nevertheless, several companies have already implemented it, with templates tailored to each organisation (see, for example, BASF, United Technologies Corporation, Philips, American Electric Power, Renault, Axa, Pepsi Co., Alstom, Novo Nordisk and Novozymes, among others<sup>2</sup>). A specific example is Novozymes – a Danish enzyme company which is a spin off of Novo Nordisk, in 2000. This was the first company to produce an integrated report, in 2002. Novo Nordisk began integrated reporting shortly afterwards, in 2004 (see Table 1). After an initial period of six years, when the level of adoption were very low, in 2008 and the subsequent years it became common practice.

When it takes to integrated reporting adoption methodology, it must be seen as a continuous process of improvement. Year after year the company has to identify what works and what does not work. Stakeholders' expectations, needs and feedback are crucial to the (realignment of) business strategy. Likewise, the company needs to schedule meetings with investors in order to know what they want to read about. Finally, each time a report is released the company must get feedback from the disclosure and identify opportunities for improvement for future.

The Global Reporting Initiative (GRI) is a non-governmental organisation whose mission is to promote and guide the diffusion and adoption of sustainability reporting. It is this organisation that owns the framework of reference which is most commonly used worldwide for this type of report<sup>3</sup>. On its path to making sustainability reporting an activity of similar importance to financial reporting, the GRI has been promoting several guidelines regarding the disclosure of sustainability practices: first as an autonomous discipline to be portrayed in business reporting, then as a platform for providing information to specific groups of stakeholders, and now as an integrated element of reporting.

In this sense, it has been taking active steps. The IIRC, of which GRI is a co-founder, has exercised its own lobby to instil valid and reliable guidelines for sustainability reporting in the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB) and in the Generally Accepted Accounting Principles (GAAP) of each country. In this respect the GRI gives a validation to disclosure, giving it accuracy and precision.

Also in this context, the Global Reporting Initiative has already started, in 2011, to develop the next generation of guidelines. It is intended that the G4 guidelines will serve as a reference framework for business reporting and may become a sort of universally accepted protocol for corporate disclosure in May 2013. It is also intended to provide a business structure of support, in accordance with the work developed by the IIRC, the Organisation for Economic Co-operation and Development (OECD) guidelines for the international implementation of integrated reporting

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Table 1. Timeline for adoption of integrated reporting

Year	First integrated report	Business activity	Country
2002	Novozymes	Enzymes and other industrial biotechnology solutions	Denmark
2003	Natura	Cosmetics	Brazil
2004	Novo Nordisk	Pharmaceutical products and services	Denmark
2006	Aracruz (ctual Fibria)	Forest products	Brazil
2007	BASF	Chemical industry	German
2008	Alstom	Energy soutions and transport	France
	Aviva	Insurance	UK
	HSBC	Banking	UK
	Novartis	Healthcar solutions	Switzerland
	Philips	Electronics	Netherlands
	United Technologies	Building and aerospace industries	USA
	Van Gansewinkel Groep	Waste materials and energy	Benelux
2009	(...)	(...)	(...)

Source: Adapted from Eccles & Serafeim, 2011

and the United Nations Global Compact. With G4 guidelines, GRI in partnership with IIRC want to improve the diffusion and adoption of integrated reporting and their objectives are:

- To become user friendly for learners and skilled reporters;
- To increase the technical quality and clarity of definitions;
- To line up with other reporting frameworks;
- To provide support “materiality”;
- To provide support on how to link sustainability reporting and integrating reporting;
- To offer guidance to improve data search.

### Integrated Reporting: A Case Study<sup>4</sup>

In some companies, sustainability is already so embedded in strategy that there is no need for a separate report dealing with sustainability. However, in the absence of a mandatory *modus operandi*, there is not a standard plan about how to go about integrated disclosure. Some companies let the Global Reporting Initiative’s set of sustainability indicators drive the process of reporting and some do not, leaving the GRI checklist as the last resort.

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There is one company that is widely recognised as the global leader in integrated reporting: Novo Nordisk. Denmark was one of the first countries in the world to demand companies to report their non-financial performances within their financial reports and this Danish pharmaceutical company was one of the first corporations in the world to publish a sustainability report, in 1997. It was also one of the first to disclose an integrated report, in 2004 (see Table 2). After the launch of the Dow Jones Sustainability Indexes in 1999, Novo Nordisk has been rated at or near top of the list of healthcare sector.

Over all these years, since the publication of its first integrated report, Novo Nordisk implemented using this kind of statement not only as a communication tool with all external stakeholders but also as an internal way of focusing the company to best practice sustainability. This behaviour has put the organisation at a level that few other companies have yet achieved.

With the title *Novo Nordisk Annual Report: Financial, Social and Environmental Performance*, the company's integrated report includes both financial and non-financial statements. In addition, the company clearly declares on its website that their corporate governance is committed to triple-bottom-line results, making efforts to handle their activities in a financially, socially and environmentally responsible way.

Integrated reporting is a result of the improvement of all types of corporate reporting. Financial reporting standards and guidelines for non-financial reporting and accounting continue going forward. For many years, in some countries, companies have been asked to disclose information concerning their environmental and social practices along with their financial statements. That is what happened with Novo Nordisk, which in this case became an example of the logical extension of integrated reporting trends.

Although Novo Nordisk is one of the pioneers in this matter, it has not been alone in this. The company has worked with both the International Integrated Reporting Committee and the Global Reporting Initiative to share best practices, develop standards and identify where integrated reporting can and should evolve. In addition, the company is a signatory to the United Nations Global Compact, a platform that encourages and promotes good corporate principles and learning experiences in areas such as sustainable governance and management processes. The company has also been evolved in several research projects and has been available to assume the role of being used as a case study for academic papers and books.

## **Novo Nordisk: Integrated Reporting, Step by Step**

Its continuous desire to improve and be committed to the leadership of this type of reporting demonstrates the key role that Novo Nordisk wants to play. In its 2011 annual report, we can easily understand the areas in which the company is focused (Novo Nordisk A/S, 2012, Reporting section, paragraphs 6-10):

- Reporting sustainability information based on its importance to the company's strategy and the extent to which it impacts key business activities.
- Reporting information for each critical business activity, demonstrating the connection between sustainability and financial performance in a disaggregated format.
- Reporting all performance against targets and explaining the strategic intent of targets.
- Assessing and reporting on how the company is reducing its risk and will earn profits through sustainability-focused management.
- Using metrics that are standardised and comparable over time. Ideally, metrics should also be comparable with companies in and outside of our industry.

For the company, any decision that is taken, takes into account its financial, social and environmental responsibility – the triple bottom line. That is the first of all the steps (see Figure 1). After that, exercising social and environmental responsibility becomes an imperative business task and must be seen in the same way as all the other aspects of the organisation. This is a responsibility that lies not only with the Board of Directors but also with every single Novo Nordisk employee. Taking into account the implications for the company's long-term business, the next step is about creating a strategy in accordance with the triple bottom line business principle. Once this is completely integrated into the business procedures, the strategy will be revisited and amended as appropriate.

The practice of integrated reporting is not perceived to be considerably more difficult than writing standalone financial and sustainability reports. To this company, the difficulty lies with the development of non-financial accounting procedures as a robust and reliable financial accounting system. The key to overcome this handicap is to have more embedded sustainability goals as the core business strategy. Consequently, if this happens it will be more difficult to swap objectives. The more the sustainability goals are tied to company core business, the greater the impact.

Financial reporting is strongly regulated and all the company's statements are based on IFRS. On the other hand, sustainability reporting standards are not yet widely established, mainly because of its voluntary nature. For that reason, Novo

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Table 2. Novo Nordisk reporting history: 1997-2011

Report title	GRI adherence level	Assurance provider	Available
<b>Annual Report 2011</b> <i>Financial, social and environmental performance</i>	G3: A+ Self-declared	PricewaterhouseCoopers	online/PDF
<b>Annual Report 2010</b> <i>Financial, social and environmental performance</i>	G3: A+ Self-declared	PricewaterhouseCoopers	online/PDF
<b>Annual Report 2009</b> <i>Financial, social and environmental performance</i>	G3: A+ Self-declared	PricewaterhouseCoopers	online/PDF
<b>Annual Report 2008</b> <i>Financial, social and environmental performance</i>	G3: A+ Self-declared	PricewaterhouseCoopers	online/PDF
<b>Annual Report 2007</b> <i>Financial, social and environmental performance</i>	G3: A+ Self-declared	PricewaterhouseCoopers	online/PDF
<b>Annual Report 2006</b> <i>Financial, social and environmental performance</i>	G2: In Accordance (GRI-checked)	PricewaterhouseCoopers	online/PDF
<b>Annual Report 2005</b> <i>Financial, social and environmental performance</i>	G2: In Accordance (GRI-checked)	PricewaterhouseCoopers	online/PDF
<b>Annual Report 2004</b> <i>Financial, social and environmental performance</i>	G2: In Accordance (GRI-checked)	PricewaterhouseCoopers	online/PDF
<b>Sustainability Report 2003</b>	G2: In Accordance (GRI-checked)	Deloitte	online/PDF
<b>Sustainability Report 2002</b>	G2: In Accordance (GRI-checked)	Deloitte & Touche	online/PDF
<b>Reporting on the triple bottom line 2001</b>	1999 guidelines	Deloitte & Touche	online/PDF
<b>The Novo Group Environmental and Social Report 2000</b>	1999 guidelines	Deloitte & Touche	online
<b>Environmental &amp; Social Report 1999</b>		Deloitte & Touche	online
<b>Environment &amp; Bioethics Report 1998</b>		Deloitte & Touche	online
<b>Environment &amp; Bioethics Report 1997</b>		SustainAbility	online

Source: Novo Nordisk (2012, 2011, 2010, 2009).

Nordisk has been reporting its data using the GRI's G3 Sustainability Reporting Guidelines. The company reports on these guidelines because they are the only set of indicators that is internationally recognised. Using these guidelines, it allows the stakeholders to compare Novo Nordisk's performance to other organisations' performances. In addition, besides the annual report and the internal constraints

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*Figure 1. Initial steps to adopt integrated reporting (Source: Own elaboration, based on Novo Nordisk information)*



over financial reporting which are externally audited, the company voluntarily includes an auditor assurance report for the statement of social and environmental performance in its annual report (see Table 2).

One of the most important issues in determining what kind of information should be reported is “materiality” (Eccles & Krzuz, 2010). For financial information, it follows the conceptual frameworks developed by the Financial Accounting Standards Board, the International Accounting Standards Board and several regulatory agencies in each country. For non-financial information there are no specific definitions of what “material” information means. Besides using the GRI’s G3 guidelines, Novo Nordisk also bases its report in AccountAbility’s AA1000 Assurance Standard in order to assess, attest and strengthen the quality and credibility of sustainability reporting. AA1000 also provides guidance on how to design and conduct stakeholder engagement. This set of procedures, which is complemented by the external assurance providers, assure whether or not the non-financial data can be materially considered.

In its quest to carry out reliable, accurate and comparable reports, Novo Nordisk discloses the output of its performance following the corporate governance codes and in accordance with the existing international standards for mandatory and voluntary reporting:

- IFRS, International Financial Reporting Standards;
- GRI, Global Reporting Initiative - G3 Sustainability Reporting Guidelines;
- AccountAbility’s AA1000 Assurance Standard;
- UN Global Compact;
- US Sarbanes - Oxley Act, Corporate and Auditing Accountability and Responsibility Act.

The ongoing trends and the engagement with the stakeholders are the starting point to identify new subjects which are or could become reporting material. The company has a learning curve where it aligns the process of defining materiality

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with integration into business procedures. If new issues are classified as relevant and potentially material, they are incorporated at the base of the learning curve. After all the significant issues are categorised and implications for the company's long-term business are reviewed, it is time to set a strategy that includes the issues considered material and subsequent data as well as identifying relevant indicators and goals. Once the business management includes the management of those new issues, they become fully integrated into business processes and the strategy will be regarded as appropriate. Furthermore, issues that belong to the learning curve are taken as a piece of the integrated risk management practice.

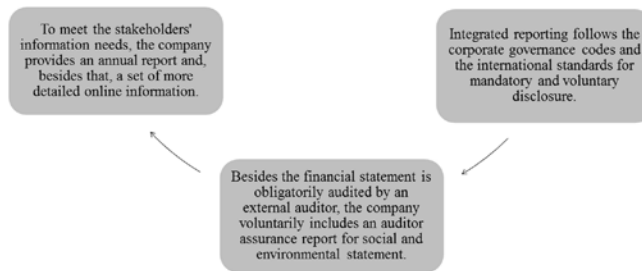
AccountAbility is a leading global organisation offering innovative solutions to critical challenges in corporate responsibility and sustainable development. It helps companies to improve their business performance and build sustainable, responsible and competitive advantages, contributes to the diffusion and enables the adoption of effective approaches to stakeholder engagement. Novo Nordisk has been using AccountAbility's materiality test to define what is and what is not material, what should be included in the annual report and which topics should be excluded. Using the materiality test, it is possible to prioritise sustainability-related subjects in order to define which information is going to be published in the annual report (most material; business critical), set online (material, often to specific stakeholders' needs) or not reported (not material). The same procedure is used when dealing with the assurance provider's recommendations.

The combined results from research, stakeholder engagement, formal reviews and internal materiality discussions are presented to Executive Management and the Board of Directors as a proposal for the annual reporting and subsequently approved. In addition, the company requests the external assurance provider to declare if the sustainability performance integrated in the annual report contains the material issues (the assurance provider states his conclusions in a document named Independent Assurance Report on Non-financial Reporting).

The company's annual reports are conceived to meet the information requirements of shareholders, stakeholders and financial analysts. Each report accounts for the financial, social and environmental performance during the economic year in one integrated report. Besides this, the company's website offers additional information of interest to stakeholders. Anyone who accesses the site can get more detailed material on financial (financial performance, socioeconomics and tax contribution), social (patients, employees and assurance), environmental (the company's approach, priorities and engagement and advocacy) and governance (Novo Nordisk way, corporate governance, risk management and boards and committees) information.

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*Figure 2. Setting-up integrated reporting (Source: Own elaboration, based on Novo Nordisk information)*



But this setting-up scheme (See Figure 2) is not the final step on reporting. The company understands integrated reporting as a continuous process of improvement. Year after year it has to be detected what works and what does not work. After each report has been released, Novo Nordisk starts getting the feedback from its stakeholders in order to identify opportunities for improvement in the future.

The complete reporting process is based on the engagement with stakeholders and their feedback on what is reported. It also incorporates independent expert reviews on the company's annual reporting. The process brings in benchmark analyses from a financial reporting perspective – with interviews with major shareholders and financial analysts – and from a sustainability reporting angle – using a series of focus groups with key stakeholders.

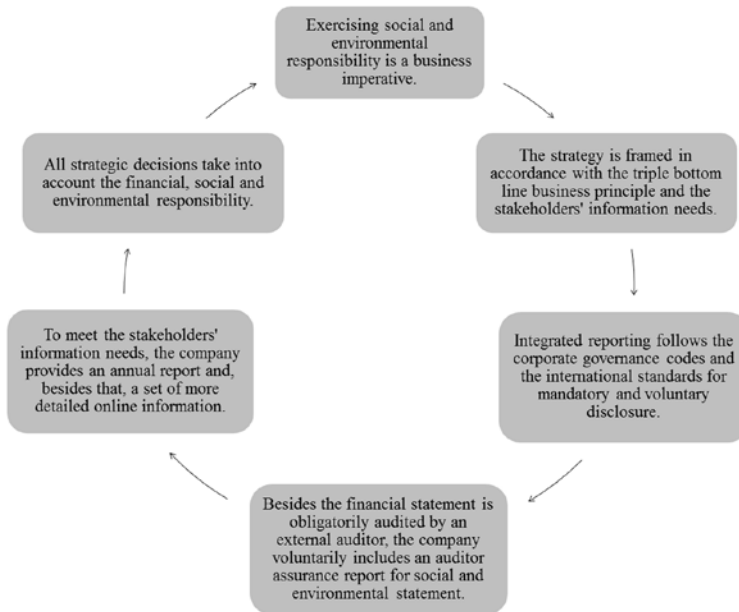
The set of information that is included in each annual report reflects the evolution of priorities in response to business and societal challenges. That is why integrated reporting is assumed as a continuous process (See Figure 3). Once the annual report and all the additional online information are available, a new cycle begins. In this phase the company evaluates what is done, collects opinions and contributions from stakeholders and takes them into account as soon as appropriate.

A considerable part of the success of Novo Nordisk's integrated reporting is due to stakeholder engagement. For decades, the company has continuously been connected with cross-sectional stakeholders. Trust and understanding are vital to the business and they are built with long-standing commitments. If all the players are and feel involved in the company's decision-making processes, decisions will be better founded and strategies more likely to succeed.

Who are Novo Nordisk's stakeholders? A stakeholder can be any individual or group that may affect or be affected by the company's activities (Prado-Lorenzo, Garcia-Sanchez & Gallego-Alvarez, 2012). It includes customers (public healthcare providers), patients (people with diabetes and other healthcare needs), employees, investors, suppliers and other business partners and society at large (see Figure 4).

## Sustainability Reporting and Financial Reporting

Figure 3. Novo Nordisk's integrated reporting continuous process<sup>5</sup> (Source: Own elaboration, based on Novo Nordisk information)



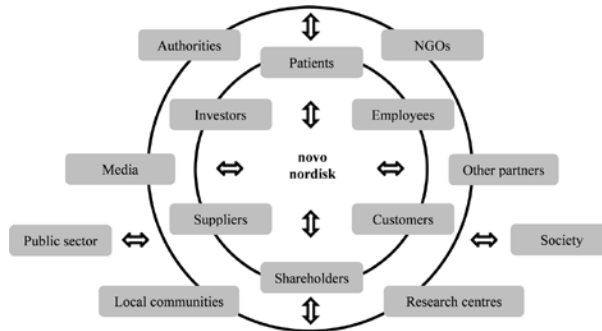
Within the company, there is a principle that rules among employees: Novo Nordisk builds and maintains good relationships with its stakeholders. This means that all employees (and not only from a corporate perspective) are responsible for engaging with the company's stakeholders.

Novo Nordisk puts in practice different forms of engagements, depending on how material the issue is (Novo Nordisk A/S, 2012):

- **Inform:** Stakeholders are informed on the company's position for transparency reasons through speeches, website information, press releases and reports;
- **Respond:** There is dialogue with stakeholders on each of their specific concerns through face-to-face meetings and written correspondence;
- **Dialogue:** The company interacts with stakeholders, based on shared interest on a certain topic, in order to build closer relationships and develop mutual acceptable solutions;
- **Long-Term Relationships:** When the company shares medium and long-term objectives with stakeholders, it will formalise their engagement by building joint platforms or trying to shape an agenda around a common goal;

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Figure 4. Novo Nordisk's net of stakeholders (Source: Own elaboration, based on Novo Nordisk information)



- **Involvement:** When stakeholders are involved in the decision-making processes, decisions are better founded and solutions more likely to succeed; that is specifically what happens when the company is developing new strategies on social and environmental issues.

## Does Integrated Reporting Influence Novo Nordisk Business Decisions?

Reporting is the end result of management processes and it should reflect the way the company is managed. If reporting cannot do this then it cannot serve as a way to better way for stakeholders to understand the company's performance.

Novo Nordisk's integrated reporting approach to business management does impact when it takes into account business decisions. The company is particularly concerned about the problem of access to health and it reflects on its understanding of managing chronic diseases.

The company acknowledges that donating medicines is not, *per se*, the way to create sustainable changes in healthcare systems. There are several more things that can be done and they have been working on that. Training and long-term healthcare system capacity building have been the focus for the last few years. The results that come from this sustainable management are slow to arrive but they are happening. Based on the philosophy of integrated reporting, Novo Nordisk has been offering the opportunity to provide improved results for patients with chronic diseases and investing in the long-term development of new markets.

In an earlier stage, some stakeholders resisted to the new integrated way of producing reports. They were essentially people who preferred to do standalone sustainability reporting and that thought that companies have nothing to gain with the inclusion of sustainable objectives in financial reporting.

Most of them changed their point of view when they realised the impact of integrated reporting on management results. The company receives feedback from all over the world, appreciating that Novo Nordisk's reporting is concise and straightforward. Besides the benefits of all the earnings, this reliable image that the firm has in the eyes of society is an immeasurable valuable asset.

The Board of Directors know that the company creates value that is not reflected on its balance sheet and income statements. It also acknowledges that key players in the financial market, such as Goldman Sachs, take sustainability indicators as proxies to management quality. Moreover, for the company, sustainable management involves taking a long-term perspective on business, looking at risks holistically and interacting financially with sustainability performance and *vice versa*. If there were no other reasons than these, it would be enough to understand the need and pertinence of an integrated way of disclosing information.

### **Novo Nordisk's Integrated Reporting: Details to Keep in Mind**

At this point, it is pertinent to point out the main ideas captured from this actual case:

- Novo Nordisk manages its business in accordance with the triple bottom line business principle and chases business solutions that maximise value for its stakeholders and shareholders;
- The company follows the current international standards in mandatory and voluntary reporting;
- Financial statements are complied with International Financial Reporting Standards;
- Annual Reporting is done in accordance with the G3 Guidelines at the GRI application level A+;
- The annual report is also done in accordance with the AA1000 framework and its principles of materiality, completeness and responsiveness;
- The accuracy and reliability of the company's reporting is certified through internal controls and external assurance by independent audits;
- The reporting process reflects the strong engagement with stakeholders. It also includes independent expert reviews of the company's annual reporting;
- The selection of the information that has to be included in annual reporting results from evolving priorities is in answer to business and societal challenges;
- Integrated reporting is a continuous process of communication where the company discloses information about its performance, showing to the shareholders the interaction between sustainability and financial performances and receiving from them all the inputs that are needed to realign the previous annual report and help in the preparation of future ones.

## ***Sustainability Reporting and Financial Reporting***

Finally, it has to be said that to Novo Nordisk the research regarding integrated reporting is not yet completed. The company is continuously trying to resolve many common criticisms in respect of sustainability and corporate reporting, namely the lack of comparability and the quality of the data. This improvement work is carried out, among others, not only by the company, but also in partnership with the Global Reporting Initiative and the International Integrated Reporting Committee. In addition, Novo Nordisk joined the IIRC pilot programme and since then it is reporting with reference to the International Integrated Reporting Framework, proposed by the IIRC in 2011 and explained earlier in this chapter.

## **CONCLUSION AND FUTURE RESEARCH DIRECTIONS**

If corporate reporting is the natural evolution of 150 years of the history of financial reporting and 15 years of sustainability reporting, it cannot claim to be infallible yet. However, it may definitely be concluded that a new approach is justified for the needs of a network of stakeholders that are continuously more demanding. As a corollary of the role played by stakeholders in these current times, companies will have to embark on new ways of communicating. In this connection, integrated reporting is, without doubt, a key tool to achieve this.

In conclusion, some lessons can be learnt from this study:

- Financial reporting continues to position itself as the main form of business communication but there has been gradually been an increase in sustainability reporting practices;
- The information disclosed by companies about the performance of their business is increasingly seen as inadequate for the growing demands for information from stakeholders;
- In business reporting there is an increasing requirement which is emerging for companies to produce information that meets the expectations of stakeholders, providing accurate, transparent and interconnected information on the totality of sustainable business performance;
- In corporate accounting a gap still remains. This results from the difficulty to include corporate social responsibility performance data in financial reporting outputs, to show the link between management and social behaviour and to demonstrate the existence of a sustainable corporate performance.

If companies want to publish integrated reports it is primarily necessary for the business to also be managed in an integrated manner. It is therefore necessary that sustainability is embedded in the highest levels of management and in the company

strategy. Only then can they have the conditions and the information needed to produce an integrated report. It is also desirable that some developments occur in the accounting model. Only with international standardisation it is possible to ensure that social and environmental assets and liabilities are accounted for and reflected in the companies' results.

Integrated reporting is not one single report. It is about the release of integrated information of financial and sustainability issues that can be retrieved through the analysis of an annual report and depending on the stakeholders' needs, enriched with additional online information.

Integrated reporting can carry further information where there are performance gaps. It can also improve the alignment between financial and non-financial practices and support the combination of strategy and performance management. It is a form of corporate reporting that brings together material information about the organisation's strategy, governance and performance. It reflects the commercial, political, social and environmental context within which it operates. It provides a clear and concise representation of how an organisation creates value.

It is obvious that integrated reporting is a trend and that the demand for sustainability performance data is growing. Although, integrated reporting metrics are not fully coherent and harmonised, within the process there prevails a lack of precision that leads to high reporting and verification costs and lack material focus (Arbex, 2012). Several alignments have to be achieved in integrated reporting processes. The Achilles' heel is materiality. Once material issues are identified, measurement becomes easier and consequently issues can be managed and, if necessary, can be changed.

Some missing links were detected on integrated reporting; for example, standardisation, comparability, materiality, complexity, stakeholder engagement, assurance and trust. If we look at the presented case, we note that Novo Nordisk already has exceeded the majority of these missing links and it is currently working on solving the others. Materiality, stakeholder engagement, assurance and trust are key subjects for this company and working on them is a top priority for the company. The same does not happen in all the other integrated reporting practices. If the aspiration is to speed up the adoption process, missing links need to be connected and companies must take responsibility to act. Universal standards are essential and legislation and regulation will ultimately be required. Further support from civil society will encourage others to act.

Talking about forthcoming research directions and knowing that more investigation in this field is currently being undertaken, as previously explain, it is expected that in the near future some work will be undertaken on the study of the diffusion and adoption of integrated reporting framework.

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## **ENDNOTES**

- <sup>1</sup> More information available at [www.theiirc.org](http://www.theiirc.org).
- <sup>2</sup> These integrated reports can be viewed on the companies' web pages.
- <sup>3</sup> To see G3 and G4 guidelines, go to <http://www.globalreporting.org>.
- <sup>4</sup> This case contains internal information from "Novo Nordisk A/S", which is available at the company's web site ([www.novonordisk.com](http://www.novonordisk.com)) and is used by the permission of the firm.
- <sup>5</sup> The diagram "Novo Nordisk's integrated reporting continuous process" (Figure 3) works as a concatenation of the two previous diagrams: "Initial steps to adopt integrated reporting" (Figure 1) and "Setting-up integrated reporting" (Figure 2).