Integrated Reporting in Germany
The DAX-30 Benchmark Study

Insight into the prevalence of integrated reporting in German annual reports – and why it’s good for business
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Preface/Executive summary

In September 2011, the International Integrated Reporting Council (IIRC) published a discussion paper with the objective of developing an internationally consistent but flexible framework for a global realignment of corporate reporting. The aim was to strengthen the explanatory power of reporting and the transparency of all business units, and thereby make resource allocation more efficient and enhance access to capital markets. Back in October 2011, a pilot programme was set up with the intention of publishing a final standard upon completion of the pilot phase in 2014. In order to enable businesses and investors to share experiences and to create the conditions for widespread adoption of integrated reporting in the years to come, the IIRC Pilot Programme was established: meanwhile over 80 companies from around the world and from a variety of sectors began to put the concepts and principles into practice. There is a constant exchange on emerging themes and practices, with a focus on the technical topics that are currently being examined, including business model, capitals, connectivity, materiality, users and their information needs, and value. In addition, the Pilot Programme Investor Network, with a membership of 25 institutional investors, helps to ensure that the information businesses communicate in their integrated reports is value-relevant and supports capital-market decision-making.

Integrated reporting is a new reporting trend that centres on the core of the company and its strategic direction. The aligned illustration of strategy, business model, performance, and business management sharpens the understanding of the relationships and makes it easier for external users to assess the company's ability to maintain and create value in the future.

The consistent implementation of integrated reporting requires a change in corporate divisions and leads to a strong need for action in terms of strategy, management, monitoring and reporting. The establishment of an implementation process with milestones is recommended and should be accompanied by the anchoring of an integrated thinking that affects all levels and hierarchies within the company.

Only such integrated thinking will reflect the megatrends driving the evolution of this new framework – globalisation, demographic change, resource scarcity, urbanisation, environmental concerns and technological advances.

In this study, PwC examined the degree of effectiveness of corporate reporting at DAX-30 companies based upon PwC's integrated reporting model and the IIRC framework. All information used for the assessment has been publically available in the 2011 annual reports, accessible on corporate websites.
Among the findings:

- In their current practices, 90% of companies have already adopted elements of integrated reporting.
- A good portion of reports showed a medium level of reporting effectiveness.
- Most of the DAX-30 companies give an account of their corporate strategy, but 70% remain vague in formulating their strategic targets, priorities and related time frames.
- German companies describe their performance fundamentals well, but a large potential still exists in linking external drivers, corporate strategy, and the explanation and measurement of actual and future performance.
- Non-financial information can be better integrated – only 33% of the reports show companies’ sustainability strategy and priorities to be clearly aligned with the material sustainability issues identified for their businesses.
- There are still challenges in translating sustainability into business perspectives – improvement opportunities exist for more than 50% of the reports in identifying risks and opportunities arising from key sustainability issues into core business perspectives.
# Contents

| Figures ..................................................................................................................... | 8 |
|-------------------------------------------------------------------------------------------------------------------------------|
| A Integrated reporting ..................................................................................... | 9 |
| B Why integrated reporting – the benefits ..................................................... | 11 |
| C The IIRC framework ................................................................................... | 12 |
| D PwC’s integrated model and reporting aspects ........................................... | 14 |
| E Study results ............................................................................................... | 17 |
| 1 How did our assessment work? ................................................................... | 17 |
| 2 Questions we posed – the 10 reporting aspects of our assessment .............. | 17 |
| 3 Key findings ................................................................................................ | 19 |
| 3.1 The overall DAX-30 result ....................................................................... | 19 |
| 3.2 Reporting effectiveness according to our 10 reporting aspects ................. | 19 |
| 3.3 A closer look at five reporting aspects .................................................... | 20 |
| 3.3.1 Strategy .................................................................................................. | 20 |
| 3.3.2 Business operations .............................................................................. | 22 |
| 3.3.3 Performance fundamentals .................................................................... | 23 |
| 3.3.4 Sustainability ....................................................................................... | 24 |
| 3.3.5 Level of integration ............................................................................. | 25 |
| 4 Industry comparison ................................................................................... | 26 |
| F Managerial implications ............................................................................. | 27 |
| G Conclusion – the way forward .................................................................... | 28 |

Contacts ................................................................................................................. 29
# Figures

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fig. 1</td>
<td>Key differences between integrated reporting and the current model</td>
<td>10</td>
</tr>
<tr>
<td>Fig. 2</td>
<td>The guiding principles and content elements underpinning the preparation of an integrated report</td>
<td>13</td>
</tr>
<tr>
<td>Fig. 3</td>
<td>Integrated model of main information areas and their interdependencies in the context of an organisation's environment</td>
<td>15</td>
</tr>
<tr>
<td>Fig. 4</td>
<td>How the PwC reporting aspects align with the IIRC content elements</td>
<td>16</td>
</tr>
<tr>
<td>Fig. 5</td>
<td>Average reporting effectiveness of DAX-30 companies in 2011 by reporting aspect</td>
<td>20</td>
</tr>
<tr>
<td>Fig. 6a</td>
<td>Key results for strategy</td>
<td>21</td>
</tr>
<tr>
<td>Fig. 6b</td>
<td>Selected question for strategy</td>
<td>21</td>
</tr>
<tr>
<td>Fig. 7a</td>
<td>Key results for business operations</td>
<td>22</td>
</tr>
<tr>
<td>Fig. 7b</td>
<td>Selected question for business operations</td>
<td>22</td>
</tr>
<tr>
<td>Fig. 8a</td>
<td>Key results for performance fundamentals</td>
<td>23</td>
</tr>
<tr>
<td>Fig. 8b</td>
<td>Selected question for performance fundamentals</td>
<td>23</td>
</tr>
<tr>
<td>Fig. 9a</td>
<td>Key results for sustainability</td>
<td>24</td>
</tr>
<tr>
<td>Fig. 9b</td>
<td>Selected question for sustainability</td>
<td>24</td>
</tr>
<tr>
<td>Fig. 10a</td>
<td>Key results for level of integration</td>
<td>25</td>
</tr>
<tr>
<td>Fig. 10b</td>
<td>Selected question for level of integration</td>
<td>25</td>
</tr>
<tr>
<td>Fig. 11</td>
<td>Average effectiveness of corporate reporting by industry</td>
<td>26</td>
</tr>
</tbody>
</table>
A Integrated reporting

Since the International Integrated Reporting Council (IIRC) proposed its reporting framework, integrated reporting has been the talk of the town in corporate Germany. Corporate representatives and external constituencies feel that existing reporting practices do not sufficiently meet the information requirements of investors and other stakeholders. The financial crisis has placed a premium on information disclosure, risk management and good corporate governance. It has led to calls for better reporting and more insight into a company’s process of value creation. Current criticism also focuses on the strong compliance-oriented character of reporting. There is a strong consensus that the aim should be that investors are able to form an integral opinion on the strategic value drivers of the company. Information on environmental, social and governance issues needs to be presented in conjunction with financial factors in order to give complete and balanced insight into the state of a company. At the moment, this tendency is globally referred as to “integrated reporting”.

Companies are increasingly asking us what it is all about and what they need to do in order to cope with this trend.

In our view, integrated reporting is more than just a collection of statements covering corporate strategy and business and financial results and then amended with environmental, social and governance issues.

An integrated report provides a strategic picture of a business that explains how the business creates and sustains value now and in the future. Often, one major concern is whether the current annual reports, at a length of 250 to 300 pages, should be expanded further. The answer is that nobody wants just more information, but rather, the information provided has to be concise, relevant, insightful and reliable. Reasonable integration and linking up lead to a reduction of complexity and number of pages. The principle of materiality cannot be stressed enough.
See below some key differences between integrated reporting and the current reporting model, as outlined in the IIRC discussion paper.

**Fig. 1  Key differences between integrated reporting and the current model**

<table>
<thead>
<tr>
<th></th>
<th>Current model</th>
<th>Future model</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Reporting scope</strong></td>
<td>Legal ownership and control</td>
<td>Value chain</td>
</tr>
<tr>
<td><strong>Dominant driver</strong></td>
<td>Financial, past</td>
<td>Strategic, holistic, future</td>
</tr>
<tr>
<td><strong>Timeframe</strong></td>
<td>Short term</td>
<td>Short, medium and long term</td>
</tr>
<tr>
<td><strong>Detail</strong></td>
<td>Long and complex</td>
<td>Concise and material</td>
</tr>
<tr>
<td><strong>Compliance</strong></td>
<td>Rule bound</td>
<td>Responsive to industry and company</td>
</tr>
<tr>
<td><strong>Presentation</strong></td>
<td>Paper based</td>
<td>Electronic</td>
</tr>
<tr>
<td><strong>Trust</strong></td>
<td>Narrow disclosure</td>
<td>Greater transparency</td>
</tr>
<tr>
<td><strong>Information construct</strong></td>
<td>Silos</td>
<td>Integrated</td>
</tr>
<tr>
<td><strong>Performance</strong></td>
<td>Financial capital</td>
<td>All capital-intellectual, human, social</td>
</tr>
</tbody>
</table>

B Why integrated reporting – the benefits

Internally, avoiding double work and cost reductions clearly speak for integrated reporting. It trims down reporting processes and allows synergies between divisions to be exploited. When non-financial data are put on the same level as financial data in accordance with the integrated reporting initiative, reporting becomes more synchronised and reliable. In addition, more internal attention can be focused on sustainability. From an external perspective, one major advantage of integrated reporting is that companies can obtain a competitive advantage by positioning themselves as “first movers giving proof of their cutting edge”.

The integral portrayal of all relevant corporate aspects leads to an improved grasp of the business model and a more accurate assessment of risks and opportunities.

A comprehensive, fair and even disclosure, with identical information provided to all stakeholders and meeting their diverse information requirements at once, leads to higher levels of trust as well as a lower cost of and better access to capital.
The new reporting framework sets out to guide companies to integrated reporting on the basis of certain principles while leaving room for innovation in reporting in a constantly changing business context, without aiming to establish a new set of rules. In its discussion paper, the IIRC introduces so-called “guiding principles” and “content elements”.

The following **guiding principles** are considered to be the starting point for integrated reporting:

- Strategic focus: does the information offer insight into the strategic objectives, and how do these objectives relate to the ability to create value?
- Connectivity of information: is there a correlation between (the building blocks of) the business model, the operating context, and the resources and relationships the organisation depends on?
- Future orientation: is there enough focus on the future, and is enough insight provided into management’s expectations and uncertainties?
- Information requirements: does the information meet the requirements of the stakeholders?
- Materiality: is the information concise, reliable and material to the process of value creation?

The principles should be applied in determining the content of an integrated report, based on the key **content elements** summarised below:

- Organisational overview and business model as a description of the process of value creation
- Operating context, including risks and opportunities
- Strategic objectives and how the company intends to achieve them
- Governance and remuneration, and how they relate to the strategic objectives
- Results that provide insight into performance with regard to all the resources the company disposes of, and thus the total output and social contribution with regard to the integral strategy
- Future opportunities and uncertainties and their implications for prospective performance
Fig. 2  The guiding principles and content elements underpinning the preparation of an integrated report

PwC’s integrated model and reporting aspects

With this notion of principles and key content elements, the IIRC discussion paper provides a foundation for preparing an integrated report, which we used to develop an integrated model of main reporting information areas based on the IIRC framework. It highlights the scope of the information that needs to be considered when assessing the information demands of an organisation, including the interdependencies among the various areas – external, strategic, business and performance. Regarding external drivers, companies might ask: What is the market and regulatory landscape like today, and how is it changing? What are the megatrends that are changing society now, and how will they impact markets in the future? With a view to the business model, relevant questions include: Are the business model and supply chain designed to withstand the impacts of climate change, technology failures and natural disasters? What assumptions have been made regarding the availability of resources?

Answering these questions within an integrated approach will give companies a much clearer picture of their industry, markets and broader environment, and of how to change products and services, business models and positioning to remain sustainable.
Based on both the IIRC framework and our integrated model, we derived 10 essential reporting aspects. These aspects provided a cluster for grouping our research questions. They are

- external drivers,
- strategy,
- risks,
- business operations,
- measures of success,
- performance fundamentals,
- sustainability,
- segmental reporting,
- corporate governance and
- level of integration.
The matrix below depicts how the six content elements from the IIRC framework relate to and overlap with our 10 reporting aspects. As shown in the matrix, PwC's reporting aspects are clearly linked to the IIRC model and oriented towards IIRC's guiding principles.

**Fig. 4  How the PwC reporting aspects align with the IIRC content elements**

<table>
<thead>
<tr>
<th>Operating context, incl. risks and opportunities</th>
<th>Strategic objectives</th>
<th>Governance and remuneration</th>
<th>Performance</th>
<th>Future outlook</th>
<th>Organisational overview and business model</th>
</tr>
</thead>
<tbody>
<tr>
<td>External drivers</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strategy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Risks</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Business operations</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Measures of success</td>
<td></td>
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<td></td>
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<tr>
<td>Performance fundamentals</td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>Sustainability</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Segmental reporting</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate governance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Level of integration</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

• = Link between elements from the IIRC framework and reporting aspects from PwC.
E  Study results

To understand how effective reporting is today, we assessed the degree of effectiveness of corporate reporting at the DAX-30 companies trading on the Frankfurt stock exchange with a special focus on integrated reporting aspects by examining their annual reports for the 2011 fiscal year.

In this section, we present our research findings on the current state of reporting at the DAX-30 companies.

1  How did our assessment work?

We reviewed each report based upon PwC’s integrated reporting model and the IIRC framework. We studied the degree to which companies produce annual reports both in line with the principles of integrated reporting and with clear alignment among reporting sections.

In addition to our focus on the content itself and the corresponding quality, we paid specific attention to the degree of integration – the linkage and interdependence among various statements, information sets and key performance indicators (KPIs).

2  Questions we posed – the 10 reporting aspects of our assessment

Our questionnaire was based on key questions companies should ask themselves in terms of their reporting and comprised more than 100 questions clustered around our 10 reporting aspects. The in-depth analysis was performed by our integrated reporting specialists in accordance with a dual control principle. The 10 reporting aspects are as follows:

- **External drivers**
  Key markets and territories, the competitive landscape, the customer base, and the linkage between external drivers and strategic choices
- **Strategy**
  Formulation of the corporate strategy, statement of the strategic objectives, corresponding time frames, strategic priorities and specific actions, as well as measurements of the corresponding achievements
• **Risks**
  How the company-specific risks were described, whether the company made reference to its risk appetite, and whether it transparently reported changes in the profile of single risks and provided insight into its risk management process. The core of this section is risk reporting, the quantification of the principal risks, and the integration and linkage of risk reporting and other aspects of the report, such as the description of the business environment or the influence of megatrends.

• **Business operations**
  The company’s business model and its core capabilities, resources and relationships. Furthermore, aspects like the corresponding measurements and explanations of how value is and will be created.

• **Measures of success**
  The description, reporting and consistency of financial and non-financial KPIs. The quantification of these KPIs and their alignment with segment reporting, strategic priorities and performance measures are key areas in this assessment.

• **Performance fundamentals**
  The presentation of the underlying performance. Fundamental questions that we posed were: Is there a consistent picture of performance measures in all sections of the report? Are the drivers behind revenues and earnings well explained? Are graphic illustrations used to provide users with a quicker and more comprehensive overview? Does the company use clear definitions and reconciliations for non-GAAP measures?

• **Sustainability**
  The reporting of sustainability issues, the concerning risks, how the company identified the material issues, and how these issues are aligned with strategy, strategic priorities and KPIs.

• **Segmental reporting**
  Disclosure of key figures on a segmental level, as well as the corresponding transparency and consistency. Further key aspects were the description of sustainability, strategy, risks and performance on a segmental level.

• **Corporate governance**
  Reporting on the board, its committees and its activities. We put emphasis on linkages to other reporting sections, board effectiveness and the use of graphics.

• **Level of integration**
  The linkage, alignment and consistency of all relevant aspects in the report, such as corporate strategy, KPI reporting, sustainability, remuneration and future outlook.
3 Key findings

3.1 The overall DAX-30 result

One of our key findings was that 90% of the companies show first signs of adopting elements of integrated reporting in their current reporting practices.

However, our study identified challenges to moving beyond a silo approach towards presenting a company's value more comprehensively. Difficulties can especially be seen in the integration of non-financial information such as sustainability, which was often reported on in a separate sustainability report.

Another peculiarity is the large gap between the best and the weakest reports. The most obvious observation is that half of the reports is clustered in the medium range of reporting effectiveness.

Two major explanations account for this. First, in Germany the group management report (Konzernlagebericht) is regulated by German Accounting Standard No 15 (Deutscher Rechnungslegungs Standard, or DRS 15). Since this standard reflects investors' information needs quite adequately, a large number of annual reports may have been prepared to a similar level of effective communication. In the international context, though, it has to be mentioned that very effective reporting was rarely seen. Second, the high level of public attention spent on rankings and awards with respect to annual reports may have led to a “me too” behaviour whereby pioneers are chased by followers.

3.2 Reporting effectiveness according to our 10 reporting aspects

The graph below depicts the average effectiveness of reporting per each of our 10 reporting aspects. In the area of performance fundamentals, ie, the description and quantification of earnings and other financials, German annual reports show high effectiveness, with no company having clear opportunities to develop.

The greatest potential for improvement lies in the measures of success, segmental reporting and corporate governance aspects.
3.3 A closer look at five reporting aspects

Let us take a closer look at five of the reporting aspects which companies usually put more weight on in their reporting because they carry the highest level of interrelation and informative value: strategy, business operations, performance fundamentals, sustainability and integrated reporting. If these aspects are well elaborated and aligned with each other, companies are a significant step closer towards integrated reporting.

3.3.1 Strategy

Most investors will ask for a written strategy for the simple reason that it is an indication that there is not just an implicit framework in the owner or CEO’s head, but rather a coherent strategy that represents a consensus within the management team and has been communicated broadly.

Most of the DAX-30 companies give an account of their corporate strategy – 30% even do so elaborately. However, 70% of the companies fail to provide a clear formulation of strategic targets, priorities and related time frames.
Of particular interest to investors are concise statements on strategic objectives and directly derived priorities, ie, actions through which the targets will be achieved. In order to facilitate measurability, KPIs should be defined with targets and actual values and time frames. In our study, only 20% of the reports clearly set out performance indicators to measure progress and the success of actions vis-à-vis the strategic priorities. In this regard, and in the integration of these KPIs, most of the companies show potential for development, especially in terms of aligning the KPIs with their strategic goals.

**Fig. 6a  Key results for strategy**

Average reporting effectiveness of the strategy aspect of DAX-30 companies

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>30%</td>
<td>Effective communication</td>
</tr>
<tr>
<td>17%</td>
<td>Clear opportunities to develop reporting</td>
</tr>
<tr>
<td>53%</td>
<td>Potential to develop reporting</td>
</tr>
</tbody>
</table>

**Fig. 6b  Selected question for strategy**

One of 10 questions we posed for the strategy aspect:
Does the report set out the performance measure(s) for management use?

![Performance Measure Rating](image)
3.3.2 Business operations

In this category, we looked for concise descriptions of the companies’ business models based on explanations of how value is and will be created. Business operations is one of the aspects with the biggest potential for improvement: 37% of the annual reports show clear opportunities to develop, while a mere 10% demonstrate effective communication. For example, only 13% of the reports effectively explained how companies manage their core capabilities, resources and relationships to create value.

**Fig. 7a  Key results for business operations**

Average reporting effectiveness of the business operation aspect of DAX-30 companies

- 10% Effective communication
- 37% Clear opportunities to develop reporting
- 53% Potential to develop reporting

**Fig. 7b  Selected question for business operations**

One of 12 questions we posed for the business operation aspect:

Does the report explain their management of core capabilities, resources and relationships?

- 40% Poor
- 47% To some extent
- 13% Good
3.3.3 Performance fundamentals

Good annual reports provide a concise presentation of the underlying performance. Consistency in all sections of the report, coherent explanations of the drivers behind revenues and earnings, as well as graphic illustrations are crucial for investors, especially in a volatile environment. We also set a high value on clear definitions and reconciliations for non-GAAP measures.

Our study found that German companies’ reports perform well in this aspect: 40% demonstrated effective communication. However, none could be characterised as having clear opportunities to develop reporting. An explanation for this gratifying fact could again be the investor-oriented regulatory standard for the group management report in Germany (DRS 15), which focuses on companies’ performance descriptions. But there is still a large potential to develop in terms of linking external drivers and corporate strategy, and explaining actual and future performance. For example, while more than 70% of the reports explain what has driven revenue performance, only about 56% explain the drivers of profits.

**Fig. 8a  Key results for performance fundamentals**

Average reporting effectiveness of the performance fundamentals aspect of DAX-30 companies

<table>
<thead>
<tr>
<th>Effective communication</th>
<th>Potential to develop reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>40%</td>
<td>60%</td>
</tr>
</tbody>
</table>

**Fig. 8b  Selected question for performance fundamentals**

One of 20 questions we posed for the performance fundamentals aspect:
Does the report explain drivers for revenue and profits?

<table>
<thead>
<tr>
<th>Revenue</th>
<th>Profit drivers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poor</td>
<td>To some extent</td>
</tr>
<tr>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>20%</td>
<td>37%</td>
</tr>
</tbody>
</table>
### 3.3.4 Sustainability

Sustainability is an increasingly important area for a company as management has to consider the implications of uncertainties like climate change, resource use and demographic shifts on the business model’s resilience, their impact on strategic success and, ultimately, on the bottom line. While more and more companies publish a sustainability report, leading companies have started to include sustainability information in their overall corporate reporting – some as part of integrated reporting and others as part of non-financial information.

Our study revealed, however, that only 7% of the reports demonstrated effective communication of sustainability. The challenges exist in integrating sustainability reporting firmly into the mainstream reporting strategy rather than letting it stand alone. For example, many reports did not communicate well about identifying risks (50% of the reports) and business opportunities (70% of the reports) arising from key sustainability issues and their transformation into core business perspectives.

**Fig. 9a  Key results for sustainability**

Average reporting effectiveness of the sustainability aspect of DAX-30 companies

- 7% Effective communication
- 37% Clear opportunities to develop reporting
- 56% Potential to develop reporting

**Fig. 9b  Selected question for sustainability**

One of 22 questions we posed for the sustainability aspect:
Are the risks and opportunities for the business arising from sustainability issues identified?

- Risks
  - Poor: 13%
  - To some extent: 37%
  - Good: 50%

- Opportunities
  - Poor: 20%
  - To some extent: 50%
  - Good: 30%
3.3.5 Level of integration

A quick test for good reporting is the linkage, alignment and consistency among all relevant aspects in the report, such as corporate strategy, KPI reporting, sustainability, remuneration and future outlook. A trademark of integrated reporting is a common thread throughout the report which relates to the company’s strategy execution and KPIs. Management’s capability to understand and explain how external drivers were considered in its strategy, and key risk indicators and related targets are expected to play an important role in the entire report, both in financial and non-financial terms.

The majority of the DAX-30 companies (83%) shows moderate effectiveness of integrated reporting, although with potential to develop. For example, only 24% of the reports link their sustainability strategy and priorities with the material sustainability issues identified for their businesses.

**Fig. 10a Key results for level of integration**

Average reporting effectiveness of the level of integration aspect of DAX-30 companies:

- 7% Effective communication
- 10% Clear opportunities to develop reporting
- 83% Potential to develop reporting

**Fig. 10b Selected question for level of integration**

One of 22 questions we posed for the integrated reporting aspect:
Do the sustainability strategy and priorities clearly align with the material sustainability issues for the business?

<table>
<thead>
<tr>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poor</td>
<td>33%</td>
</tr>
<tr>
<td>To some extent</td>
<td>34%</td>
</tr>
<tr>
<td>Good</td>
<td>33%</td>
</tr>
</tbody>
</table>
4 Industry comparison

When looked at by industry, the results again reveal a narrow range: six out of nine industries show a moderate effectiveness in their average reporting that lies between 53% and 58%. Only the transport and logistics, chemicals, and financial services sectors are outliers. With an average effectiveness of 66%, reports in transport and logistics show slightly better effectiveness and especially good results in performance and segment reporting. Chemicals, with an average of 66.7%, had good results in strategy reporting and in describing external drivers. On the other hand, the five annual reports in the financial services sector show lower effectiveness with an average of only 46.4%. Here we found potential to develop in the fields of sustainability, segment reporting and strategy alignment/integration.

Fig. 11 Average effectiveness of corporate reporting by industry
We learned that the vast majority of DAX-30 companies show first signs of integrated reporting. But we also detected a large gap between the best and the weakest reports and that a very large number of reports are clustered closely together in the moderate effectiveness range of reporting. We partly explained this by the standard that regulates management report as a huge part of the annual report in Germany.

Our conversations with institutional investors have highlighted that they still attach tremendous importance to the annual report as a key source for their investment decisions.

Therefore, communicating effectively and consistently, especially in the annual report, makes a difference to the way stakeholders perceive the organisation.

Hence, if companies yearly tie up substantial senior resources to prepare the annual report anyway, we endorse the notion of going the whole hog – preparing an integrated annual report that coherently informs investors and stakeholders about the company’s past and future development. And that is geared to the information needs of these constituencies.
Conclusion – the way forward

As the world wrestles with the challenges afflicting the economy and the environment, institutional investors will continue to put increasing weight on sustainability aspects and will increasingly need integrated reports that reveal how companies take account of the capitals in their business models and strategies. The IIRC continues to work with businesses and investors to develop the framework until 2014, with a standard „version 1.0“ to be released in December 2013.

In terms of integrated reporting, we discovered a large potential to develop. The biggest challenge to reporting in an integrated way stems from the fact that it requires integrated thinking.

What we hear from corporate representatives who are introducing the integrated reporting discipline is that it shines a light on its internal workings.

One of the benefits often mentioned is the fact that integrated reporting provides better information to support management decision-making, board review and employee awareness. The integration and alignment of internal processes will help the business from top to bottom to make better-informed decisions which again will foster a better understanding for stakeholders. Companies that run the path to integrated reporting will therefore benefit – externally and internally.
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