



MAKING SENSE OF INTEGRATED REPORTING

BRITISH AMERICAN TOBACCO STAKEHOLDER DIALOGUE REPORT



Illustration: Cured tobacco in Indonesia and cigarettes in production at our factory in South Africa.

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In December 2010, British American Tobacco's Chairman, Richard Burrows, hosted an independently facilitated stakeholder dialogue session that examined the challenges and opportunities posed by 'integrated reporting' and sought to gauge the extent to which British American Tobacco's current approach in this area might need to adapt in response.

The participants included investment analysts who focus on the tobacco sector and on environment, social and governance (ESG) issues; experts in both financial and non-financial assurance (with high level representation from all of the 'Big Four'* accounting firms); and senior managers from British American Tobacco involved in the preparation of the Company's Annual Report and Sustainability Report.

The session – facilitated by Acona Limited, a specialist sustainability consultancy – had three objectives:

- To examine the rationale for the adoption of integrated reporting by British American Tobacco (and other listed companies);
- To identify what changes (governance arrangements, language, content, assurance etc), if any, would need to be made to British American Tobacco's current approach to corporate reporting – both in relation to its Annual Report and its stand-alone Sustainability Report; and
- To understand what other potential implications the adoption of integrated reporting might have for corporate communications more generally.

The discussion focused on four interconnected themes:

- The role of corporations and identifying material issues;
- The selection of indicators and contextual information;
- Assurance and governance; and
- The future of sustainability reporting and communication.

While there were minor differences of opinion on some of the more detailed aspects of integrated reporting, there was a very high degree of agreement among the participants, specifically:

- The primary audience for an 'integrated' Annual Report should be shareholders. The needs of other stakeholders are best served through the continued production of a stand-alone Sustainability Report supplemented by additional information on the web.
- Integrated reporting should not simply be seen as the inclusion of more non-financial information in the Annual Report (for example, in an enhanced Corporate Responsibility section). Instead, integration should attempt to explain how a wide range of different issues – financial and non-financial – are managed by the business to deliver its strategy and stated objectives.
- Any indicators should relate to the Company's most significant impacts and should always be accompanied by contextual information. Institutional investors were keen that this should be subject to the same degree of scrutiny as financial data.

* Deloitte Touche Tohmatsu, Ernst & Young, KPMG and PricewaterhouseCoopers.



We are committed to managing, measuring and reporting on our sustainability impacts as well as being clear about the risks and opportunities these bring. We understand that reporting on this type of information is critical if our stakeholders, financial or otherwise, are to make informed decisions about our business.

**Richard Burrows, Chairman,
British American Tobacco**



i What is integrated reporting?

There is no universally agreed definition of what constitutes integrated reporting. Most definitions refer to the integration of financial and non-financial information into a single document. However, there are considerable differences of opinion over the underlying rationale; the type of non-financial information that should be included and how the latter should relate to financial data; and the audiences that such a report should address.

Acknowledging these challenges, the International Integrated Reporting Committee (IIRC) was established in August 2010 to develop a reporting framework that would command the support of interested parties. The IIRC includes representatives from the corporate, accounting, securities, regulatory and standards-setting sectors and builds upon work previously undertaken by the Global Reporting Initiative and the Prince of Wales' Accounting for Sustainability project. For more information on the IIRC visit www.integratedreporting.org.



Standards setter: Indicators and measures need to feature commonality but not common sets of data.



The role of corporations and identifying material issues

Participants agreed that companies' responsibilities extend to a range of stakeholders. At the same time, the overwhelming majority accepted the primacy of shareholders' interests on the grounds that they risk their capital to support the business. When assessing the significance – or materiality – of social and environmental issues a decisive consideration has to be the extent to which they affect financial performance.

Given that investors are not homogenous (particularly in terms of their investment objectives) this assessment of impact had to extend beyond the immediate future. Among longer term investors, both with an explicit 'ethical' or 'green' mandate and more mainstream investment criteria, there is increasing interest in the relationship between social and environmental risks/opportunities and the delivery of the business strategy. In the view of participants, many Annual Reports – with a few exceptions – are deficient in this area. In particular, a number of companies fail to provide convincing rationales for their selection of material social or environmental issues and to explain how they are managing and mitigating them.

The selection of indicators and contextual information

There has been much debate about the feasibility of developing a generic set of indicators that capture the social, environmental and economic impacts of every organisation. The major argument in favour is that this would allow stakeholders to compare and contrast the performance of different companies in different sectors. Participants were not convinced that the benefits of such an approach would outweigh the possibility of reporting becoming overly formulaic. However, they did acknowledge the valuable work undertaken by the Global Reporting Initiative (www.globalreporting.org) in this area, whose suite of indicators provide a resource upon which companies could draw. Likewise, participants also highlighted the positive contribution made by initiatives such as the Carbon Disclosure Project (www.cdproject.net) and felt that investors should make greater use of this information when engaging with the businesses they invest in.

Institutional investors articulated a clear hierarchy of information requirements. Firstly, they wanted to understand how a company was performing in relation to its stated strategy and objectives; secondly, how performance compared to its peers (although it was accepted that, even within the same sector, different companies have different business models); and thirdly the inclusion of metrics that reflect societal concerns. There was strong support for companies publishing details of the indicators used internally to manage non-financial performance, as this would be powerful evidence of what management regards as important.

Participants also stressed that while the inclusion of hard data played an important role in communicating non-financial performance, placing this information in context, by providing supporting narrative, was of equal value. Companies should be prepared to articulate how non-financial issues might impact (positively and negatively) on the businesses in both the short and longer term.

Another important point highlighted by participants was that, unlike reporting of financial data (whose scope is clearly defined by various national and international reporting standards), identifying where a company's social and environmental responsibilities start and finish – and the associated performance data – is far more fluid. Therefore, when reporting on these issues, companies should specify the scope (for example, which parts of its value chain are included) of the data and the rationale for selecting these parameters.

Finally, representatives of the investment community explained the psychology of institutional investors: put simply, there is an assumption that companies are managing financial and non-financial issues in a satisfactory manner. This view holds good unless – or until – something arises that fractures this trust. Such an 'event' does not necessarily have to take the form of a major disaster or performance data going in the 'wrong' direction; it could, for example, be that a company uses the same language year in, year out to describe its non-financial performance despite the fact that external factors and/or public expectations have changed.

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SRI investor: The notion that shareholder interests should rank alongside other stakeholders is not acceptable, as shareholders carry the financial risk of the business. ”

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Partner, 'Big Four' accounting firm: Very few companies go through the process of explaining what they are reporting and why. There is a big disconnect about informing the audience about strategy. Information needs to be far more future-oriented – making it more valuable to investors. ”

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SRI analyst: The Profit & Loss tells you where you've been, but not where you're going. Companies should explain the risks behind their figures, to tell investors where they're going – so they have to cover both metrics and narrative in the report. ”

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SRI analyst: Investors assume companies are managing most of these issues acceptably, until something goes wrong. ”

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Director, 'Big Four' accounting firm: It sounds like investors are saying it's not just about historical financial data, it's about the strategy and confidence in the selection of the issues that goes into that strategy. If there are material issues on which investors place a lot of value, why doesn't the auditor of the report also verify this information? ”

Assurance and governance

Institutional investors were in favour of non-financial information, if included in the Annual Report, being externally assured. This would embrace both the accuracy of data and validation of supporting statements that refer to past and, potentially, future performance. Representatives from the 'Big Four' accepted that the accountancy profession had to play a much greater role than before in defining the form and scope of assurance of this information.

There was some debate as to whether an 'integrated report' would require a different process for sign-off than is currently the case. Several participants believed that information on sustainability performance, whether contained within a stand-alone report or included within the Annual Report, is not currently subject to the same degree of internal and external validation as financial information. Consequently, if companies are serious about producing integrated reports that give due weight to environmental and social performance, and how that affects strategy, then this gap should be addressed.

Future of sustainability reporting and communication

Participants emphasised that the Annual Report should not be the sole vehicle for communicating environmental and social performance. In fact, the inclusion of such information should merely be seen as part of a wider debate. An important test for assessing how much importance a company attaches to non-financial aspects of performance is whether main board members and/or executive management could talk meaningfully about these matters when questioned. As one participant pointed out, the desire to produce 'One Report' (the term increasingly used to describe an integrated report)¹ should not be seen as a reason for reducing the quality or volume of non-financial information companies disseminate to their stakeholders. Regardless of how integrated reporting might develop, stakeholders will expect companies to provide as much information (data and narrative) in relation to their social, environmental and economic impacts as possible. This information would be web-based, searchable and, for international businesses, be capable of being disaggregated to a local level.

For more information



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Assurance

As part of our process for providing assurance on British American Tobacco's Sustainability Report, we have carried out a 'reasonable level' of assurance engagement on the information presented in the Report on the London based stakeholder dialogues, of which this was one.

To view our conclusions and observations, or for more details, see our online Assurance statement in the British American Tobacco Sustainability Report 2010 at www.bat.com/sustainability.

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The British American Tobacco Sustainability Report is assured by Ernst & Young LLP, the scope of which includes the assurance of all quantitative and qualitative information in the Report to a 'limited' level, the assurance of all stakeholder dialogue information to a 'reasonable' level and is conducted in accordance with the ISAE 3000 and AA1000 assurance standards. This scope includes the environmental and social data that is reported as part of the business measures performance review within the British American Tobacco Annual Report.



Partner, 'Big Four' accounting firm:

In 10 years' time stakeholders will be getting all sorts of real time information. XBRL [eXtensible Business Reporting Language] will tag this information and stakeholders will find it much easier to search for what they're looking for.



The dialogue reaffirmed our thinking that whilst it can only be a good thing to improve the quality of sustainability information within financial reports, there are different audiences who want different types of communication. It should never be a one size fits all approach.

Nicandro Durante, Chief Executive,
British American Tobacco