ESG reporting - are we keeping pace?

PwC's analysis of ESG reporting in Australia

Part of our Building Public Trust Series

“

Information is the lifeblood of good decision making. Capital markets are hungry for information linked to enterprise value creation, but they cannot easily digest what comes from a fragmented reporting landscape”

Robert K. Steel
Chair, SASB Foundation Board of Directors

Change has become part of our everyday. The way in which organisations communicate to stakeholders is not immune to this. What companies report on and measure themselves against has also undergone significant change and is becoming increasingly complex. Adding pressure to this, stakeholder demand for ESG (Environmental, Social and Governance) reporting is growing and international calls for social progress is gaining momentum. With ESG reporting no longer being optional, PwC has analysed Australia’s top 200 companies (ASX 200) to understand the maturity of the market, and have found a broad range in both quality and consistency. Key findings include:

1. ESG reporting falls short of the standard for financial reporting, and therefore below stakeholder expectations
2. Companies need to reshape how they think about and report on their corporate strategy
3. Lack of clear targets and accountability limits trust
4. Integrity of ESG reporting needs to be upheld

What is ESG?

Sustainability risks and opportunities. Purpose-led reporting. Corporate social responsibility. While known by many names, ESG covers various risks and opportunities that impact a company’s ability to create long term value. ESG includes social issues like labour practices, governance matters like diversity and inclusion, and environmental considerations like greenhouse gas emissions.

What is ESG reporting?

- ESG reporting is the disclosure of material ESG risks and opportunities, both qualitatively and quantitatively, to explain how they inform the company’s strategy and performance.
- The multiple ESG reporting frameworks that exist today create a challenge for investors and other stakeholders as they result in a lack of comparability and consistency in ESG reporting, both locally and globally. This has created a movement towards harmonisation, with the most recent being the World Economic Forum’s (WEF) white paper, which recommends the adoption of 21 core metrics and 34 expanded ESG metrics and disclosures[1].
- The adoption of, and consistency in, ESG reporting will continue to gain momentum in Australia with the Australian Stock Exchange’s (ASX) Fourth Edition of Corporate Governance Principles introducing key changes to disclosure of non-financial information.

1 World Economic Forum, Measuring Stakeholder Capitalism, Sept 2020, p6

Why is ESG reporting important?

Investor and stakeholder groups are calling on companies to become more focused on ESG – through embedding ESG into their core strategy and through transparent reporting. Little motivation should be needed to increase this focus, with growing evidence that companies which are transparent in addressing stakeholder interests, including ESG strategy and performance, may have their market value increase over time[2].

Australian investors are increasingly showing they care about ESG and demanding action:

- The Australian Sustainable Finance Initiative's recent roadmap recommended convergence of global frameworks and for listed entities to report on, and obtain assurance over ESG information.
- The Australian Council of Superannuation Investors (ACSI) report on the climate policies of major companies has highlighted that making a net zero commitment without detail of how it will be practically achieved is insufficient[3], and have been increasingly direct in their concerns over modern slavery[4] and lack of gender diversity at board levels[5].
- Climate Action 100+, representing the world's largest institutional investors (including PIMCO and BlackRock), has written to the CEOs of Australia's top 12 carbon emitters requesting they develop and publish plans to reduce their carbon emissions to net zero[6].
- Investor advocacy, through groups like the Australasian Centre for Corporate Responsibility, has gained traction with the promotion of various ESG resolutions including the establishment of science-based climate targets, labour, human rights and governance issues[7,8].
- Members of the Responsible Investment Association Australasia, representing a myriad of investors with more than $9 trillion in global assets[9], expects more than $100 billion in potential demand from Australian investors in impact investing products in the next five years (2020-2025).

2 PwC, 'Could a focus on stakeholders increase your company's value?', February 6, 2020

3 ACSI, 'ACSI toughens gender diversity policy', March 2019

4 ACSI, Shining a light on modern slavery in Australia, February 2019

5 James Fernyhough,'Net-zero pledges are empty without action: super funds', Australian Financial Review, 19 Oct 2020

6 James Fernyhough, 'Australia's top emitters told to draw net zero road map' Australian Financial Review, 14 Sept 2020

7 https://www.accr.org.au/

8 Maggie Coogan, 'Woodside shareholders send strong climate message', ProBono Australia, 5 May 2020

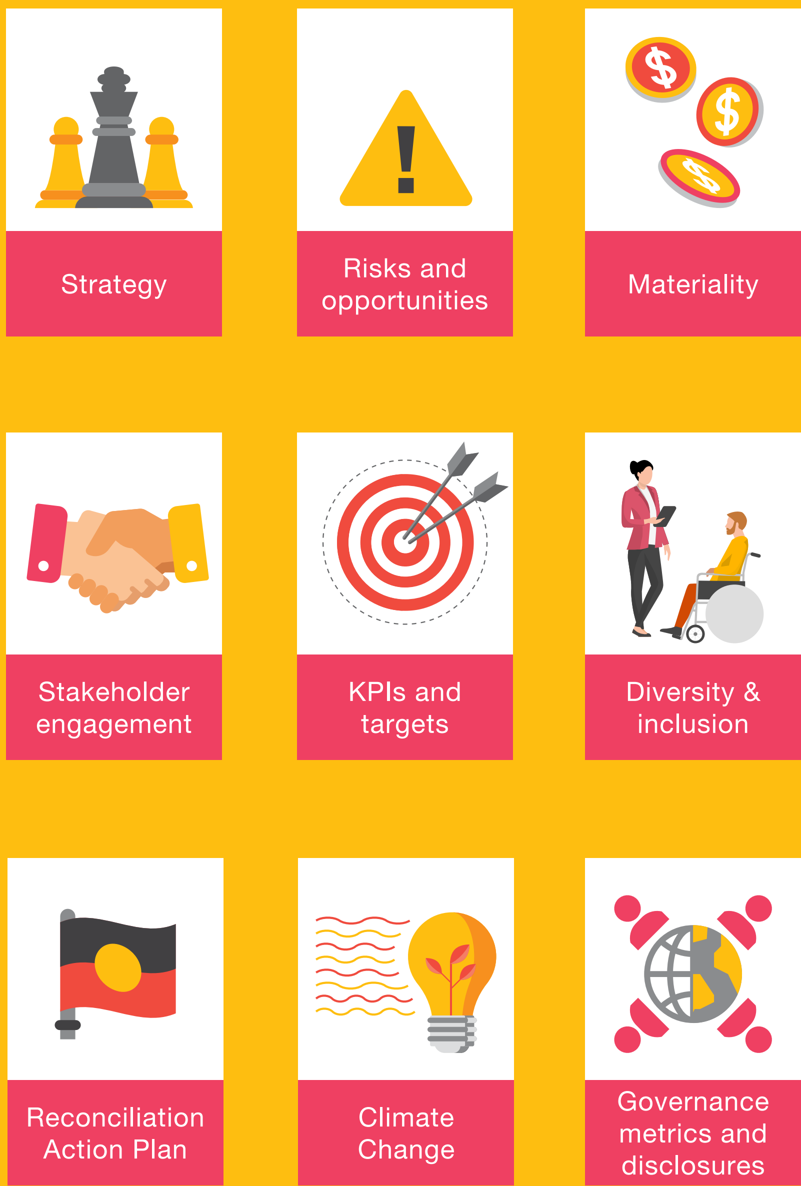
9 Responsible Investment Association Australasia, Australian Impact Investor Insights, 'Activity and Performance Report 2020', pg1 & 7

Our analysis

To understand the maturity of ESG reporting in Australia, PwC analysed the ASX 200[10]. Our analysis compared ESG reporting[11] of companies against PwC's Building Public Trust Insight's framework[12], which gives consideration to leading sustainability frameworks including the Global Reporting Initiative (GRI) Standards[13].

We found that while some organisations are increasing their focus on ESG, many have a long way to go to meet maturing stakeholder expectations for robust, consistent and comparable ESG reporting.[14]

Building Public Trust framework



10 This review included the most recent sustainability and annual reports available on 5 October 2020. For most reporters this included 31 December 2019 or 30 June 2020 reports, however 30 June 2019 reports were used if 2020 reports were not available at this date.

11 'Reporting' refers to information in the public domain, including sustainability reports and annual reports.

12 Building Public Trust Insight is a specific framework established by PwC, giving consideration to leading ESG frameworks including GRI, Task Force on Climate-related Financial Disclosures, and United Nations' Sustainable Development Goals

13 WEF, Measuring Stakeholder Capitalism, 2020

14 World Economic Forum, 'Measuring Stakeholder Capitalism - Towards Common Metrics and Consistent Reporting of Sustainable Value Creation' (September 2020) p6,

Key findings

Our findings are cause for concern for executives and investors alike. ESG shouldn't be considered an afterthought or purely a risk-mitigation strategy. Stakeholders across the board are expecting more, and those that meet those expectations are positioning themselves positively for the future. Highlights from our analysis include:

1. ESG reporting falls short of the standard for financial reporting, and therefore below stakeholder expectations

Investor demand is highlighting that the expectation for ESG reporting is that it be as important as financial reporting and of the same standard.

However:

- despite growing demand for ESG disclosure, 42% of the ASX 200 had insufficient reporting on ESG performance to warrant inclusion in our analysis
- companies excluded from the analysis had disclosed limited information about their approach to ESG, key areas of focus or material issues and included limited or no disclosure of their ESG performance metrics and targets
- this suggests that non-financial reporting is treated as less important than financial reporting in Australia
- this is a contrast to peer companies across Europe who have compulsory reporting requirements under the EU Non-financial Reporting Directive[15]
- the ASX's recommendations with respect to non-financial reporting will increase the extent and quality of reporting, with specific requirements for companies to disclose actions taken around diversity, ethical behaviour, and the environment.

2/5

companies within the ASX 200 have limited ESG reporting to the market

15 European Commission, Directive 2014/95/EU

2. Companies need to reshape how they think about and report on their corporate strategy

The needs of stakeholders extend beyond financial reporting into broader corporate reporting. To truly meet this need, clear reporting of integration of ESG into core strategy is needed to demonstrate to stakeholders the non-financial aspects that are also critical to the company's success.

We found:

- for the 115 ASX 200 listed companies that were reviewed, more than 80% disclosed their ESG strategy to stakeholders. However, evidence that ESG strategies are integrated with core corporate strategies, including by the use of both medium and long term targets, is limited. Without this integration, companies risk ESG being viewed as 'optional', undermining confidence in the veracity of ESG goals, targets and reporting.
- 85% of companies analysed reported their ESG risks, while just over half (54%) reported their ESG opportunities. As more companies integrate ESG into core strategy, ESG is expected to be seen as an area of opportunity with the potential for long-term value creation.

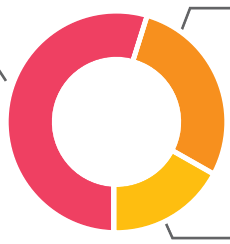
81% articulate a sustainability strategy

19% do not

48% have limited linkage to core strategy

33% state a linkage to core strategy

19% demonstrate a linkage to core strategy



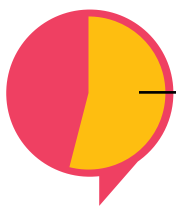
62% do not clearly state medium or long term goals/targets linked to their strategy

32% set medium term goals

6% state long term goals

98% of companies identified at least **5** material ESG issues

85% translated ESG issues into well articulated risks with at least basic commentary on mitigation strategies



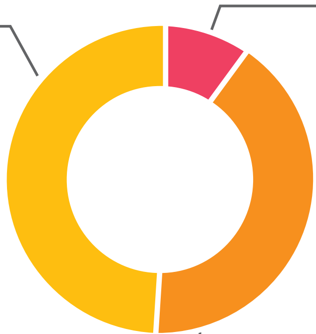
54% discussed opportunities arising from their ESG strategies, areas of focus or risks

3. Lack of clear targets and accountability limits trust

For companies to be trusted to meet their stated ESG commitments, it's becoming increasingly important to identify performance indicators for material ESG topics, set targets for performance, and allocate accountability for these targets, including linking executive remuneration to achievement.

- our analysis of the 115 companies reviewed, shows that ESG KPI identification is not widespread, with targets associated with these KPIs even more limited
- the most prevalent area where targets were set was with respect to climate change and greenhouse gas emissions, which was relatively widespread across the benchmarking group
- in contrast, setting targets across other ESG KPIs was inconsistent and should be an area of focus for the future, specifically in relation to social and governance aspects. Investors are increasingly vocal in their support for ESG to be linked to remuneration, suggesting this low rate of adoption may need to change[16].

Public reporting of ESG KPIs



49% have at least one KPI / metric for all of the material issues identified

10% have minimal KPIs / metrics

41% have KPIs / metrics for some of the material issues identified

Companies where at least 75% of reported **KPIs** have associated targets **33%**

Companies with climate change related targets **52%**

Companies with climate change targets linked to executive remuneration **21%**

16 https://www.willistowerswatson.com/en-US/Insights/2020/03/New-research-finds-progress-on-the-use-of-ESG-incentive-metrics

4. Integrity of ESG reporting needs to be upheld

For ESG reporting and non-financial reporting to be equivalent, the information reported therein must be drawn from comparable systems, processes and controls, with appropriate governance.

However, we found:

- Just over half of those companies examined having disclosure over how they verified the accuracy of reporting, only 43% obtaining some form of external assurance.
- With the ASX (Corporate Governance Principle 4.3) now recommending specific disclosure of the process to verify the integrity of any periodic corporate report, the current disclosure rate of 54% will need to increase. Without inclusion of such disclosure, boards are required to explain why a recommendation has not been adopted[17].

43%
of companies disclose integrity through external assurance

11%
of companies disclose integrity through other means

46%
are silent on how they verify integrity

"Reporting has to change, and change fast. It took decades of creative, inclusive discussion and experience to get to the clear and widely accepted standards we have today for financial reporting... We need an Apollo program to develop the new global reporting regime, focused on a clear goal: a globally aligned set of reliable, comparable non-financial reporting standards. Today, no business can succeed without conforming to financial reporting standards. The same should be true for non-financial reporting, with equivalent levels of governance, assurance, incentives and sanctions for non-compliance."

Bob Mortiz, Global Chairman, PwC

17 ASX Corporate Governance Council, 'Corporate Governance Principles and recommendations', Feb 2019, p2

Where to from here?

As demand for investor-grade reporting grows, companies need to understand current shareholder and broader stakeholder expectations, and take steps to close gaps in their ESG reporting. Recommendations on how companies can do this, along with initial questions for Boards to consider are explored below.

Focus reporting on ESG topics material to core strategy

Identify the ESG topics and metrics that are material to achieving the company's core strategy and to creating long-term value to help prioritise reporting efforts.

- Have established frameworks and standards been leveraged, and engaged with all stakeholders to get their input, in determining material ESG topics?

Integrate ESG into core strategy

Committing to ESG means moving away from an 'add-on' attitude towards ESG strategies, and moving towards an integrated approach where ESG is embedded in core strategy.

- Faced with a material decision today, are there conflicts between core strategy and ESG strategies?

Be accountable on material ESG aspects

Once a strategy is set, a company must be prepared for stakeholders to hold them to account. This means setting specific and measurable targets against KPIs for material ESG aspects, and driving desired behaviours by embedding performance against these targets in executive and management performance programs.

- Is the organisation prepared to set measurable ESG targets, tie these to executive performance and be assessed against these?

Substantiate the position

ESG reporting needs to include accurate, comparable and reliable information to facilitate decision-making by stakeholders.

How satisfied is the organisation that the integrity of the ESG report is sufficient and meets the ASX Corporate Governance Statement[18]?

- Are you comfortable with the integrity of your ESG report? Have you disclosed the process used to verify this integrity?
- Are there ESG policies, processes, controls, and governance in place, similar to those supporting financial reporting?
- Is external assurance required, or are additional processes implemented to confidently report ESG performance to stakeholders?

Closing the expectation gap in reporting will take time for the ASX 200, and will be assisted when globally aligned ESG standards exist, a journey that has taken a step forward with the WEF guidance. With clear strategic direction, and measurement and monitoring of established targets to address strategic ESG goals, effective ESG reporting will be essential in satisfying the needs of stakeholders to both understand how a company impacts the world, and how the world impacts that company.

18 https://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-fourth-edn.pdf (p3)

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