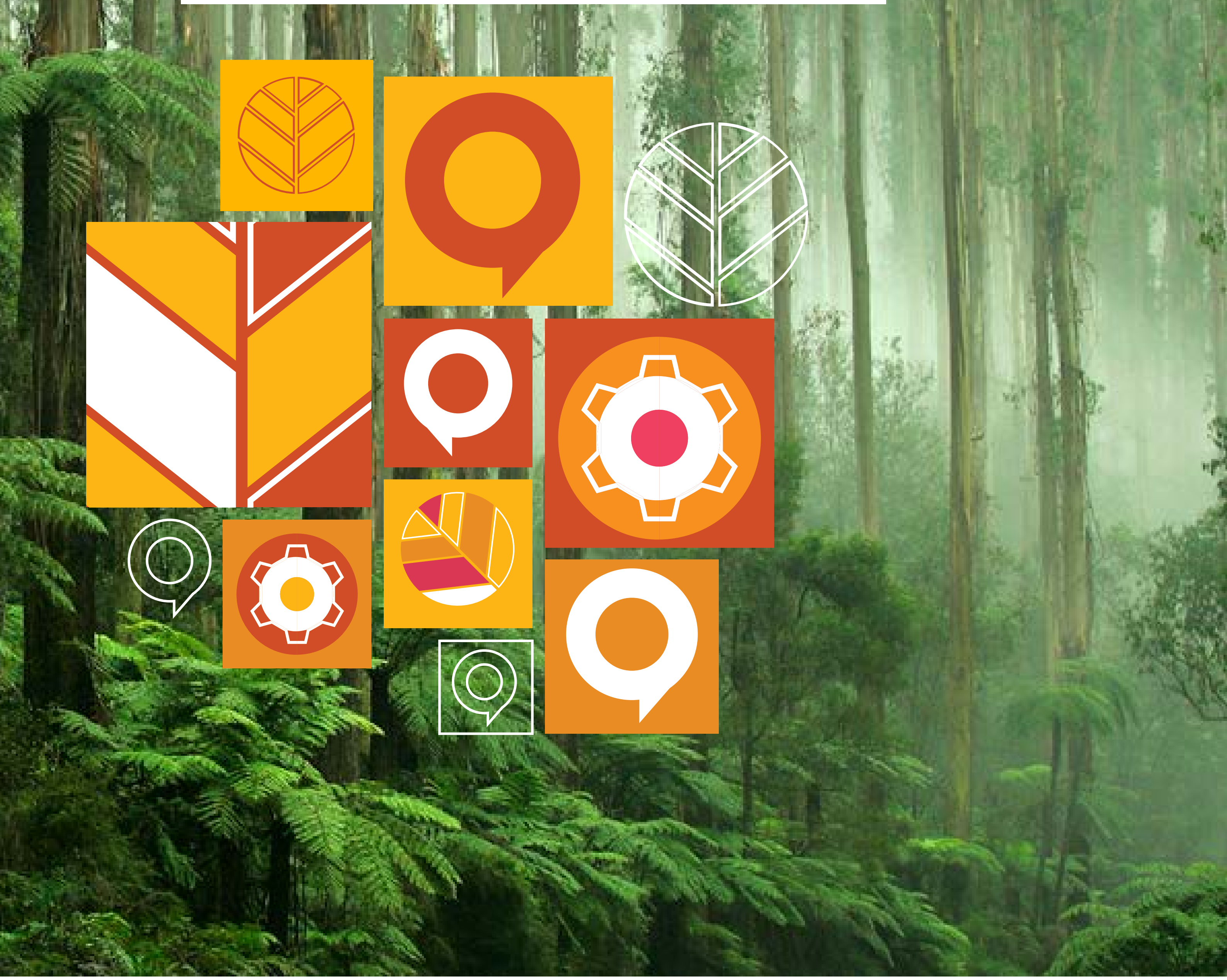
ESG reporting in Australia - the full story, or just the good story?

An in-depth analysis of the maturity of ESG reporting across Australia's top 200 companies



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Introduction

It's been a year of improvements in the maturity of ESG (Environmental, Social and Governance) reporting of Australia's top 200 companies (ASX 200). Stakeholders have raised the bar and companies have responded with 87% of companies now publishing a substantive level ESG information to warrant inclusion in our analysis, a significant step change from 2020[1] which identified only 58% of the ASX 200 meeting this mark[2]. The gap is closing between those at the bottom and those at the top regarding the quality of their ESG reporting.

Such progress is laudable, given the lack of universally adopted standards and regulatory guidance on ESG reporting. However, alongside notable pockets of excellence across select ESG matters, our analysis reveals a more nuanced picture where progress is still lacking in critical areas.

More importantly, in the 12 months since our last report, the broader context is a radically changed global landscape. This is in part due to the pandemic, unprecedented environmental disasters, the release of groundbreaking studies like the IPCC[3] and events like COP26; all lifting the education level of the global population.

Today, the increased sophistication of investors and other stakeholders is raising the bar on ESG reporting, with companies often playing catch up against these continually increasing expectations.

Interest in financial-grade ESG information continues to grow among a broadening group of stakeholders seeking the full story to be convinced that companies have a credible and sustainable economic model.

In this report:

Part one looks at the key findings of our analysis of ESG reporting among Australia's ASX 200.

Part two explores what's driving the bar higher on ESG reporting.

Part three how ASX 200 companies can improve their ESG performance and keep pace with stakeholder expectations.

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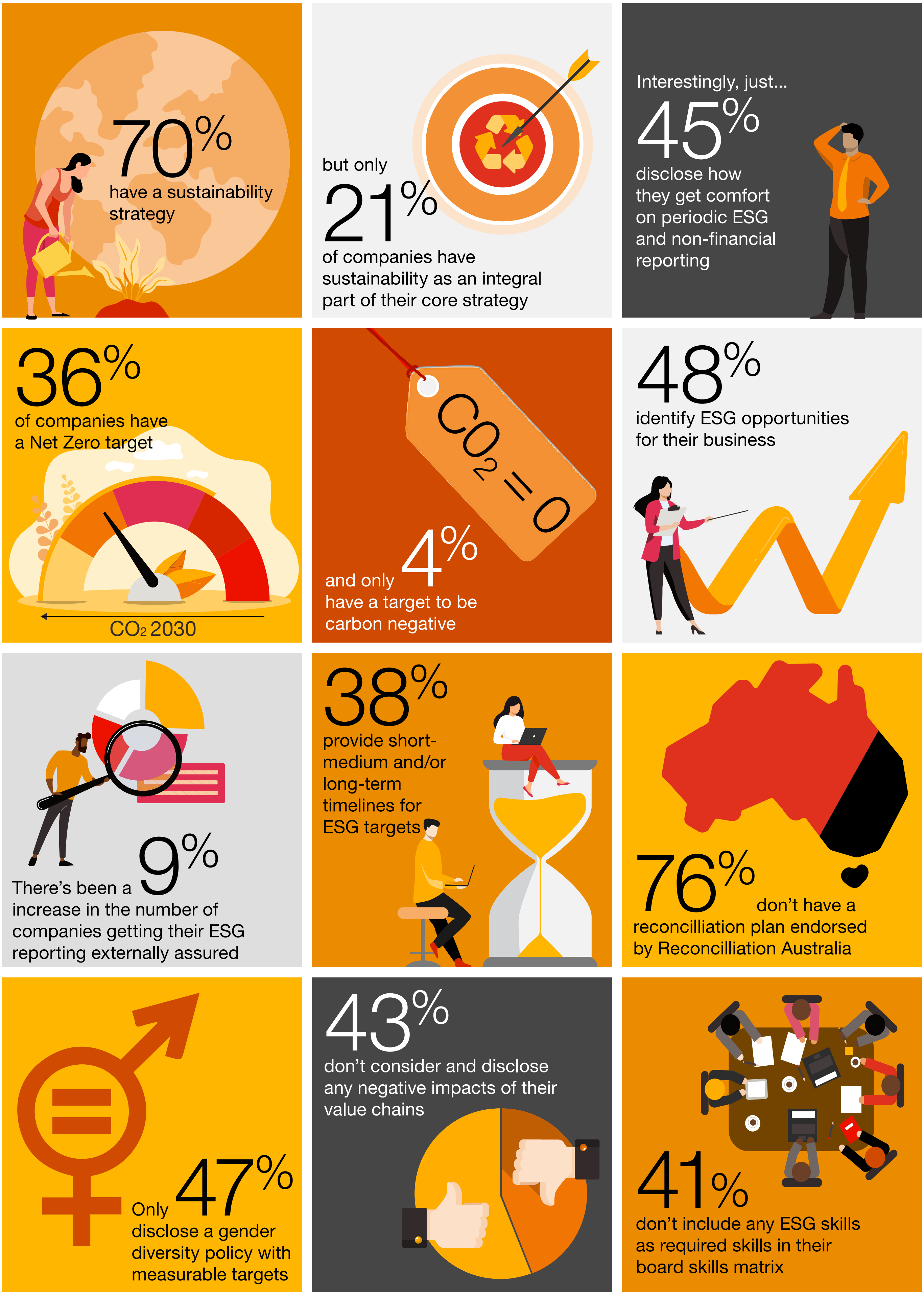
1. *Are we keeping pace? - https://www.pwc.com.au/assurance/PwC-ESG-Report.pdf*
2. *Current year data includes the entire ASX 200; comparative data is based on a subset of reporters that provided substantive ESG reporting.*
3. *Intergovernmental Panel on Climate Change Working Group I report Climate Change 2021: the Physical Science Basis*


70% have a sustainability strategy
but only 21% of companies have sustainability as an integral part of their core strategy
Interestingly, just... 45% disclose how they get comfort on periodic ESG and non-financial reporting
36% of companies have a Net Zero target
CO_2 2030
$CO_2 = 0$
and only 4% have a target to be carbon negative
48% identify ESG opportunities for their business
There's been a 9% increase in the number of companies getting their ESG reporting externally assured
38% provide short-medium and/or long-term timelines for ESG targets
76% don't have a reconcilliation plan endorsed by Reconcilliation Australia
Only 47% disclose a gender diversity policy with measurable targets
43% don't consider and disclose any negative impacts of their value chains
41% don't include any ESG skills as required skills in their board skills matrix

Part 1:

ESG Reporting moving in the right direction, but not fast or far enough

Our 2021 analysis reveals that more ASX 200 companies are reporting ESG information overall than in prior years, with the gap between the best and worst ESG reporting performers closing. However, digging further into the data, a more nuanced picture appears, where progress is either absent in essential areas or not meeting increased stakeholder expectations.

Key Findings

1. ESG strategy disclosures have improved but reporting against KPIs continues to lag

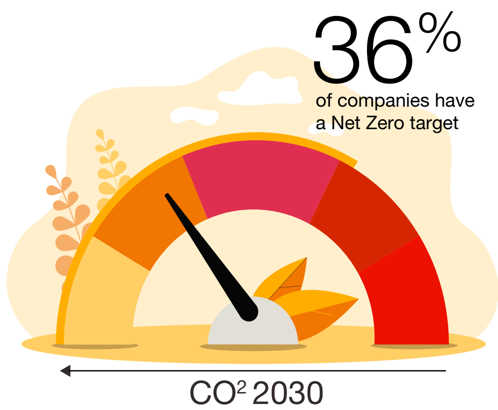
The inclusion and sophistication of ESG strategies has increased dramatically year on year. Over two thirds of the ASX 200 have a clearly defined sustainability strategy, with 44% of them articulating how it is integrated into their corporate strategy – which is critical to ensuring ESG and broader corporate goals are aligned.

Companies disclosing a time frame around achievement of sustainability strategies and goals have doubled, with 60 of the 200 (30%) providing KPIs and targets with clearly articulated deadlines – an essential step as the market is increasingly aware of the need for meaningful action on material issues such as climate change.

However, 62% of companies still don't publish an ESG strategy that goes into detail on short, medium, and long-term goals. An ESG strategy underpinned by goals and targets is vital for providing clarity, accuracy and trust in the sustainability objectives and performance.

Our analysis reveals setting targets and KPIs is one of the ASX 200's biggest opportunities for improvement (74% don't do this). In the absence of measurable KPIs, ESG statements and sentiment may be seen as 'green or ESG-washing'. The AICD has encouraged Boards to be alert to greenwashing, and to be sure that their company's disclosure on environmental risks and opportunities genuinely reflects their processes and practices in this area[4].

Further, amid the urgent global shift to decarbonise economies and reach Net Zero by 2050, only 36% of the ASX 200 have a net-zero target (with just a further 4% building on this and articulating carbon-negative plans and goals). Pledging to achieve carbon neutrality is regarded with scepticism without detail on how it will be achieved, however 69% of companies analysed don't provide any details around timing, with only 19% disclosing timeframes for targets related to their long-term vision.



4. https://aicd.companydirectors.com.au/membership/company-director-magazine/2021-back-editions/july/the-regulator

2. Better stakeholder engagement amid increased pressure from stakeholders

Stakeholder engagement is a key component of an effective ESG strategy, helping ensure the completeness of material ESG topics identified, and the effectiveness of strategies to respond to these. We've seen an improvement in the responses by companies to address stakeholder concerns.

There is growing evidence that stakeholders are taking matters increasingly into their own hands if companies don't act on their concerns.

In the past two years, there's been a dramatic increase in the number of shareholder resolutions put forward for ASX 200 companies, with 50[5] resolutions put forward by shareholders. ESG is also playing a part in strikes recorded on company remuneration reports.

ESG / Greenwashing

The process of conveying a false impression or providing misleading information about how a company's products and approach are more environmentally or socially sound or otherwise sustainable.

5. *https://www.accr.org.au/research/australian-esg-resolution-voting-history/*

3. Lack of external verification is notable

The lack of universally adopted standards and regulatory guidance on ESG reporting means companies may omit information that some stakeholders think is important, and it's often hard for these stakeholders to compare ESG performance from company to company. Looking abroad, we know that future regulations will change the status quo, and likely force the hands of organisations to provide like-for-like comprehensive information.

As a result stakeholders are increasingly looking to understand the process companies are putting in place to verify the integrity of their ESG reporting, including through third party assurance. Interestingly, our analysis revealed 66% of companies don't have their report externally assured, and only 45% of companies disclose how the directors obtain comfort over the veracity of periodic ESG and other non-financial reporting.

This reveals two crucial issues. First, a large section of the ASX 200 are not explicit in disclosing how they have met requirements introduced through the latest edition of the ASX Corporate Governance Principles and Recommendations regarding verification of periodic corporate non-financial reporting. Second, it appears that a significant number of Boards still don't regard ESG as critical data warranting third party assurance to provide investors and broader stakeholders with comfort over ESG disclosures.

4. ESG Risk and opportunity reporting improved, but linking material ESG uncertainties to financial performance and reporting still needs improvement

Reporting of risks and opportunities have both improved across a spectrum of sectors.

Interestingly, while a good majority (68%) of companies are adept at recognising ESG risks (for example, reputational risk), this year has seen a 20% increase in the identification of ESG opportunities which were reported upon by 48% of the ASX 200.

Companies now need to better link material ESG risks and opportunities to financial performance and reporting. Our analysis found that only 20% of companies in the ASX 200 are explicitly linking material risks and uncertainties identified in the ESG report to the financial statements.

In the climate risk space, this is where the revised Task Force on Climate-related Financial Disclosures (TCFD) highlights a way forward. Using the TCFD's disclosure recommendations, organisations can provide insights and greater transparency on their long-term climate-related risks and opportunities. The detailed climate scenario analysis being performed is helping companies to more confidently articulate the potential financial impacts, or conclude that they are not material.

5. Diversity and inclusion – greater gender focus, but what about other areas?

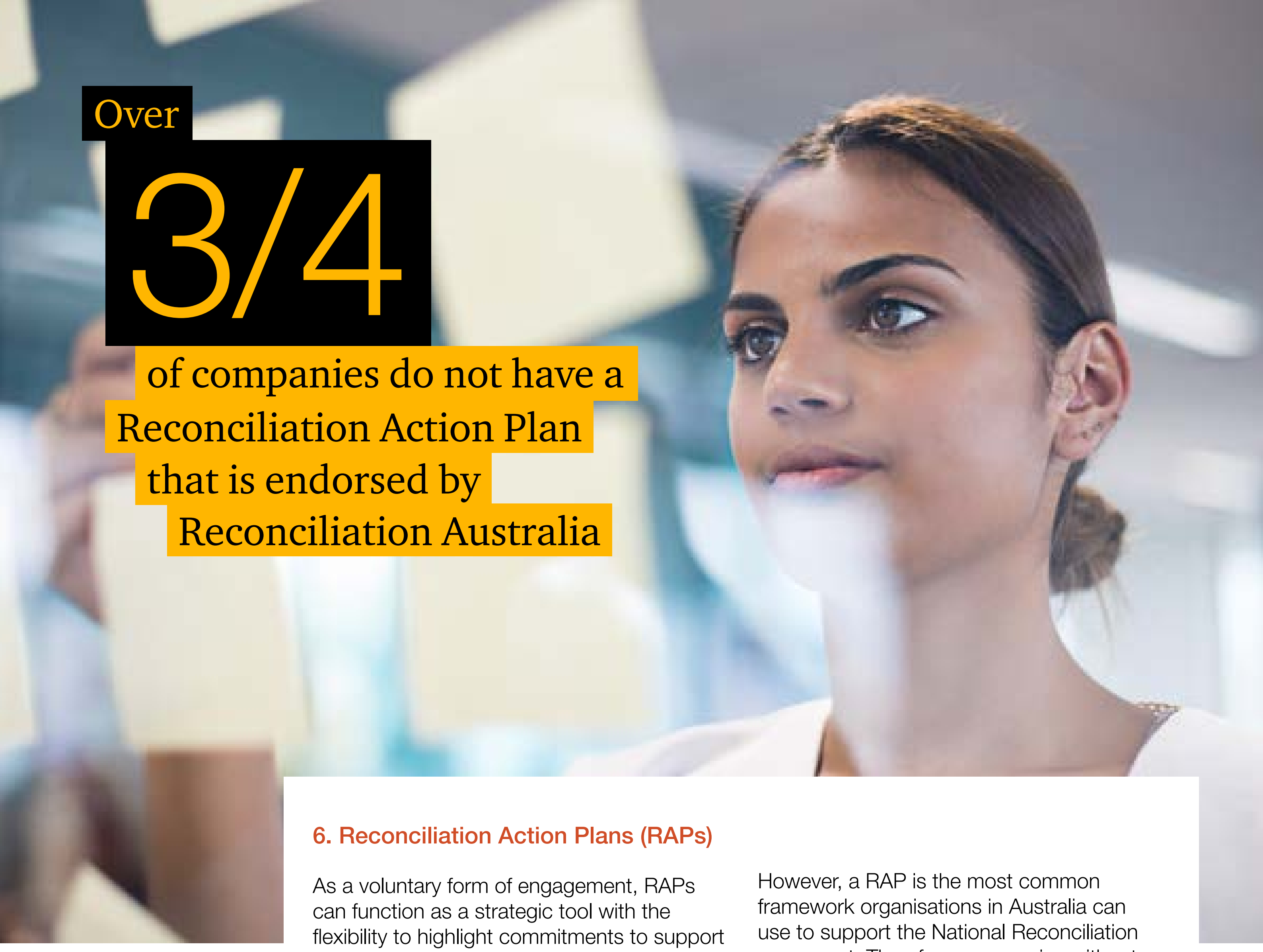
Diversity and inclusion (D&I) continues to feature prominently in the social metrics disclosed by the ASX200.

Disclosure across the range of D&I considerations has improved from FY20. Further analysis reveals that while gender diversity remains the most well reported area, with 95% of the ASX200 disclosing a gender diversity policy and an increasing number of organisations reporting on gender pay gap, the extent of reporting against other D&I lenses was not as mature. Top tier reporters cover a broad range of D&I areas. Disclosure of sexual harassment policies (72%), first nations representation (45%), accessibility and inclusion policies (63%) all fell short of the quality of reporting around gender diversity.

Notably, disclosure of sexual harassment policies has increased significantly from FY20. This increase may reflect the impact of the #MeToo movement, suggesting a crisis can trigger a response although perhaps not one strong enough to progress the broader D&I agenda.

While disclosure improved year on year, 29% of ASX 200 companies have not disclosed policies around sexual harassment which suggests there remains great opportunity for many companies to better disclose to their stakeholders, including most importantly current and prospective employees, how seriously they take this issue.

Less than half (47%) of the group have a gender diversity policy with measurable targets and progress against those targets



6. Reconciliation Action Plans (RAPs)

As a voluntary form of engagement, RAPs can function as a strategic tool with the flexibility to highlight commitments to support Aboriginal and Torres Strait Islander peoples' economic participation that align to a company's business plan and contribute to the reconciliation movement.

Focus on RAPs has grown, but unfortunately not significantly. Only 20% of the ASX 200 disclose two or more policies or commitments towards supporting Australian First nation peoples and their human rights. Regardless of sector, all companies across this group should be actively considering how they can contribute to the overall reconciliation movement in Australia. We acknowledge that it does not automatically follow that a company without a Reconciliation Action Plan is not doing its part to advance reconciliation.

However, a RAP is the most common framework organisations in Australia can use to support the National Reconciliation movement. Therefore, companies without a RAP can expect to have to explain why to stakeholders.

Reconciliation Action Plans (RAPs) are a voluntary form of engagement with Aboriginal and Torres Strait Islander peoples where commitments (determined by each organisation) follow a standardised framework endorsed and managed by an independent not-for-profit, Reconciliation Australia. They include specific actions that will drive an organisation's contribution to reconciliation by developing respectful relationships and creating meaningful opportunities for Aboriginal and Torres Strait Islander peoples.

Part 2:

A higher ESG standard driven by a radically changing landscape

Despite improvements in ESG reporting year-on-year, the broader context is a radically changed global landscape. The bar for satisfying stakeholder questions and expectations over ESG performance has risen much faster and higher than the market anticipated.

Three drivers are causing the bar to shift higher for ESG performance.

While making a commitment may seem like a challenge in itself, knowledgeable stakeholders will want more: meaningful plans, science-based targets, and authentic commentary from companies about their current practices

01 The expectations and education of stakeholders continues to expand significantly

The sophistication of stakeholder questions and expectations over ESG performance has grown markedly during another year filled with the continuing impact of the COVID-19 pandemic and natural disasters linked to climate change to name only two major drivers. This has been bolstered through the release of high-profile examinations of ESG matters. Notably, in the climate change space, the latest IPCC report[6] declares the link between human-caused warming and increasingly severe extreme weather is now 'an established fact'.

The education of stakeholders in this space has put pressure on companies to amp up their response, leading to a proliferation of net zero commitments. These statements, however, are not being taken at face-value. Increasing stakeholder activism has meant companies that make such disclosures have to be prepared to back them up with genuine plans to meet their stated targets, and use careful language around how 'green' or 'clean' their operations are.

Companies are also finding that the stakeholders most interested in progress in these areas are changing. Investors, customers and employees are in many cases joining or surpassing governments, communities and non-government organisations as highly interested consumers of this information. The pressure on companies to report and make commitments to reduce their Scope 3 emissions in particular, is driving changes in stakeholder expectations and behaviour all along a company's value chain.

[6] *IPCC Sixth Assessment Report - https://www.ipcc.ch/report/ar6/wg1/downloads/report/IPCC_AR6_WGI_Full_Report.pdf*

02 ESG reporting standards and frameworks are adapting and converging

While the Australian regulatory environment may be perceived as one with minimal ESG reporting obligations, this is changing. APRA's recent CPG 229 is a reflection of this, with the draft guidance based heavily from the well-accepted TCFD recommendations. More globally, a convergence of standards is occurring and a sophisticated regulatory system is emerging. Territories that Australian companies commonly operate in - including New Zealand, the United Kingdom, and the European Union - have increasingly active regulators that are mandating specific ESG disclosures. These range from TCFD reporting to detailed disclosures on the extent to which a company's revenue is sustainable based on jurisdictional definitions and thresholds.

Outside of the regulatory system, efforts to achieve reporting harmonisation have been bolstered through the IFRS Foundation's proposal for an International Sustainability Standards Board (ISSB)[7]. Given the IFRS global reach with respect to financial reporting standards, this development creates an opportunity for the creation of globally accepted sustainability standards - with climate risk the first area of focus and regulators taking a keen interest.

These developments mean the speed of change to Australia's own ESG reporting regulatory regime is becoming increasingly irrelevant. The result is that the global landscape sees robust ESG reporting as necessary (not preferred) to provide stakeholders with the information they need for decision making.

03 Finance providers require more ESG information

Financial services institutions are under increasing stakeholder and regulatory pressure to make investment and financing decisions which reflect the drive towards a more sustainable future. Again, climate change is the frontrunner to this trend, but by no means the only ESG topic where this approach is being adopted. In many jurisdictions these institutions are now required to report on the carbon footprint of their financed activities and align them to the net-zero ambition. In turn, capital providers are increasingly assessing a company's ESG performance and carbon footprint and looking beyond the metrics for evidence of tangible and measurable commitments.

ASIC is a member of the International Organisation of Securities Commissions (IOSCO), which recently released a statement on the urgent need for globally consistent, comparable, and reliable sustainability disclosure standards, and their priorities and vision for a Sustainability Standards Board under the IFRS Foundation[8].

[7] https://www.ifrs.org/projects/work-plan/sustainability-reporting/
[8] https://www.iosco.org/news/pdf/IOSCONEWS594.pdf

Part 3:

How companies can improve ESG performance and keep pace with stakeholder expectations

The bar for ESG reporting has risen. Gone are the days where mentioning ESG in separate sustainability reports would satisfy stakeholders. Companies are now being asked to integrate reports and provide sophisticated ESG metrics and targets that are linked to the most significant ESG risks and opportunities material to their organisation.

While this year's analysis shows a clear uplift in the quality of reporting, it's not improving fast enough. This section addresses how companies can keep pace with the direction of those expectations.

1. The quality of ESG strategy and execution - and then reporting on this

A) Integrate your ESG and corporate strategies to address stakeholder needs

- Engage with stakeholders to understand the topics that are important to them and reflect on how this translates into the company's overall purpose and strategy, beyond simply making profits for shareholders
- Ensure the needs of stakeholder groups help inform your ESG strategy
- Reflect on what can and should be achieved through the ESG strategy in the context of the business's core strategy and over various time horizons
- Link your ESG strategy with your organisation's values, purpose and corporate strategy (if discrete) to embed achievement of it into the day to day operations of the business as well as relationships, behaviours and interactions of and with stakeholders

24%
companies don't clearly describe their purpose beyond making profits for shareholders

Almost 70%
don't (or have limited) linkages of organisational values or purpose to strategic goals

74%
don't outline actions taken to address stakeholder concerns

B) Understand and articulate the plan to achieve your strategic imperatives

A strategy without a plan, a timeframe or measurable targets against which the company will be held to account is not a strategy but rather a statement of ambition. Short, medium and long-term plans are needed to ensure progress is made against a company's ESG strategy supported by relevant targets and KPIs.

Our analysis found 61% of companies have insufficient or no disclosure, 20% short, medium and long term strategic imperatives, and just 19% disclose inadequate articulation of intended timelines for delivery of their strategies. Development of medium and long term strategic goals, articulating these to stakeholders and developing the short term targets needed to ensure organisations remain on-track to achieve these goals should be a key focus area for the ASX 200 laggards in the next reporting period.

2. The quality of reported data

Stakeholders are increasingly demanding a more balanced mix of financial and non-financial reporting (including future-focused information) to assess risks and opportunities associated with ESG topics including climate change. As a result of this focus, Boards and executives need to consider whether they are providing sufficient governance over the quality of this reported data.

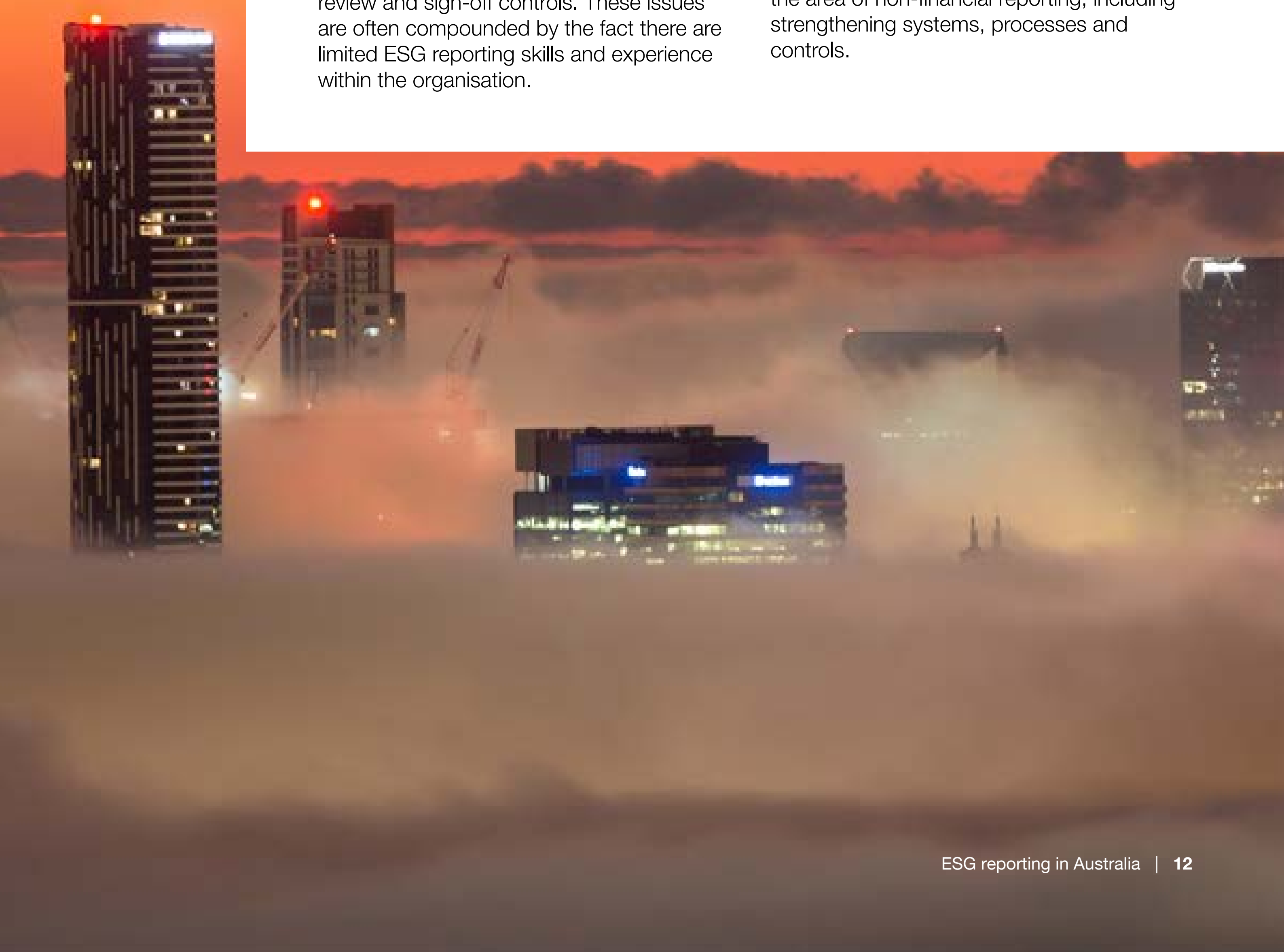
A) Invest in people, systems, processes and controls

Currently, in most instances, the systems, processes and controls supporting ESG data at both a management and governance level are not as robust or mature as those supporting financial reporting. In many instances the data is captured in spreadsheets, with issues of consistency of data capture across operations, lack of data entry controls, access management and system documentation, not to mention an absence of back-up processes and a higher propensity for transposition errors as a result of human error and a lack of formalised review and sign-off controls. These issues are often compounded by the fact there are limited ESG reporting skills and experience within the organisation.

Reporting against non-financial data is valuable to investors as it provides the company's forward looking view that is wider than profits alone. Reporting against these targets on a consistent and transparent basis is integral to providing all stakeholders with the full picture of the company's performance. Increasingly, stakeholders will also expect that executive remuneration is tied to the achievements of these ESG targets, to demonstrate real commitment.

This lack of systems, controls and expertise to capture and report on ESG performance, coupled with a lack of assurance and a perceived lack of governance processes over the reporting, are building as a perfect storm on the horizon at a time when stakeholders are increasingly demanding investment grade ESG information.

Many companies are beginning to acknowledge the need to invest resources in the area of non-financial reporting, including strengthening systems, processes and controls.



In the ASX guidance, a Board skills matrix identifies "the competencies and skills desired by the Board as a whole to fulfil its role and in light of the organisation's strategic direction[9].

B) Link material issues to financial statements

Companies provide a lot of detail outside of their financial statements about the material ESG risks and opportunities to their business, however there often isn't a correlation in the financial statements of the potential impact of those risks and opportunities.

Emerging reporting frameworks (i.e the European Union through the Corporate Sustainability Reporting Directive and the TCFD's July 2021 recommendations), are increasingly requiring companies to financially quantify the impact of ESG risks, including climate risks on their balance sheets and income statements. For example, companies must become comfortable with the notion that an ESG risk can have a financial impact to both asset and liability carrying amounts and an organisation's future income and expenses under different climate-related scenarios.

C) Tell the **full** story not just the good story

Balance is an important concept in ESG reporting. As an example, as part of its reporting principles the new GRI Foundation Standard[10] requires organisations to report information in an unbiased way and provide a fair representation of the organisation's negative and positive impacts. This includes not omitting relevant information concerning its negative impacts. However, our analysis shows that over half (55%) of companies don't include any narrative on the actual or potential negative impacts of activities within their value chain.

Many companies also exclude any information with respect to ESG topics which they do not consider material. Such a conclusion should be firmly based upon stakeholder engagement, ensuring topics that stakeholders consider material are addressed and, should a company feel that a certain topic of stakeholder concern is immaterial, provide an explanation of why such a conclusion has been formed.

3. The quality of ESG governance

Proper governance by a Board requires a solid understanding of ESG to ensure that (i) a robust ESG strategy is in place (ii) ESG opportunities are capitalised on, and (iii) ESG risk management and regulatory compliance is ensured. This is only possible when the right ESG skills are in place at a Board level which can be achieved through both candidate assessments and/or training.

More than a third (41%) of ASX 200 companies did not include specific ESG skills within their respective board skills matrices, which are publicly disclosed and set out the mix of skills that the board currently has or is looking to achieve in its membership. For a further 25% of the ASX 200, only one ESG related skill was included these matrices (usually governance or people experience).

Many Boards are asking questions around ESG, but they're not turning the magnifying glass on themselves to ensure they have the right knowledge and expertise to be able to appropriately manage or provide governance over ESG.

Incentivising those responsible for implementing ESG governance frameworks is increasingly common and required, ensuring remuneration and long term incentives at the C-suite level are linked to the achievement of the organisation's ESG targets.

Linking executive remuneration and sustainability incentivises management to make ESG a strategic priority.

ESG governance should be built with consideration to the mature structures used for managing financial risk and performance, using the typical risk management processes such as internal and external audit to add rigour to the governance.

More than 80%

don't identify and disclose material ESG risks for the organisation but do not link these risks to the financial statements.

9. *https://www.asx.com.au/documents/asx-compliance/creating-disclosing-board-skills-matrix.pdf*

10. *GRI 1: Foundation 2021 Universal Standard, issued by the Global Sustainability Standards Board (GSSB)*

As we move into 2022, and undoubtedly face a year of unwanted climate records and corporate crises, companies should consider the following:

Emissions: What is our long-term emissions ambition? If we have committed or want to commit to net zero, how will this be achieved practically considering reasonable timeframes and annual reduction targets between today and net zero?

Product offering: What types of products and services do we plan to sell given shifting consumer / business demands and changing regulatory enivronments? How will these be developed and over what timeframe?

Skill set: How do we upskill our current workforce and Board to have the requisite knowledge to achieve our strategic sustainability goals? Where a skills gap exists, what hiring is needed to close this?

Capital: Where will our capital come from in the future, and what expectations do our debt and equity investors have regarding ESG risks and how we report on them?

Data quality: What is the gap in quality between financial and ESG data? How can we close that gap and be comfortable as a company that our ESG data is reliable?

Regulation: How might future ESG-related policy changes in our key markets impact on our value chain and strategy?

For a more in-depth discussion on our analysis and findings, please reach out to one of our ESG experts below.

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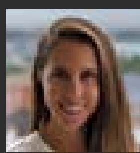

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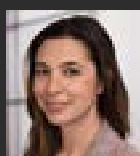

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