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Perspectives on ESG Reporting

The future of ESG (Environmental, Social, and Governance) reporting explored

Global Public Policy Committee – April 2022

Preface

We are pleased to share 'Perspectives on ESG Reporting – The future of ESG Reporting explored' which has been issued by the Global Public Policy Committee (GPPC).

The GPPC comprises representatives of the six largest accounting networks being BDO, Deloitte, EY, Grant Thornton, KPMG and PwC.

The Environmental, Social, and Governance (ESG) reporting landscape is evolving rapidly and will change even more so in the coming months and years, and as a result has become a focus of the GPPC.

Consequently, the GGPC has brought together representatives from the reporting and assurance, corporate governance, investor and policy making communities from across the world to participate in four[1] regional roundtable discussions to consider the current ESG reporting landscape so they could contribute their knowledge and experience on this complex topic.

These discussions, held under the Chatham House Rule[2], focussed on answering three broad questions on ESG reporting and assurance which were:

- where are we now?
- where do we want to go?
- how do we get there?

with a view to helping standard setters and public policy decision makers identify potential approaches to better align corporate reporting and auditing solutions with stakeholder and societal objectives.

This paper draws out key points made by the roundtable participants and highlights areas where there is both convergence and divergence of opinion. They are summarised under the following headings:

- There is clear agreement that there are gaps between what is desired and what is delivered, with a focus on climate
- There is a divergence of opinion on the root causes of the current gap
- Data is a challenging issue
- Materiality is critically important
- Integrated reporting – or separate sources for different users?
- Consistent global standards are needed, and policymakers must step up; the ISSB broadly welcomed
- Robust assurance is essential
- New skillsets needed – and a whole of ecosystem effort.

If you would like to discuss any areas of this paper in more detail, we encourage you to contact either Sarah Carroll, Grant Thornton International, Director – Sustainability Reporting at **sarah.carroll@gti.gt.com** or your local Grant Thornton representative.

[1] The regional areas were the Americas, EMEA (Europe, Middle East and Africa), Asia Pacific and Oceania

[2] When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.

Perspectives on ESG Reporting
The future of ESG reporting explored

Towards the end of 2021, the GPPC[1] brought together stakeholders representing various groups in the corporate reporting ecosystem[2] in four regional discussions to explore Environmental, Social, and Governance (ESG) corporate reporting and assurance of the future. Representatives from the reporting and assurance, corporate governance, investor, and policymaking communities across the Americas (United States, Mexico, Canada and the Latin American region), Asia-Pacific (Japan, Singapore, Hong Kong, Malaysia), EMEA (Europe, Middle East and Africa), and Oceania (Australia and South Pacific island groups) were invited to take part in the roundtables based on their knowledge and experience with relevant topics.

The discussions explored the current ESG reporting landscape in terms of 1) Where we are now, 2) Where we want to go, and 3) How to get there. Grounded in the understanding that there may be a disconnect between what current accounting and auditing reporting standards require and permit, and what some investors and stakeholders are expecting, the discussions were held under the Chatham House Rule[3]and were designed to explore potential approaches to better align corporate reporting and auditing with stakeholder and societal objectives.

The report below draws out key points that were made by the roundtable participants, in particular examining areas of convergence and divergence of opinion. Certain participants' remarks are quoted (in italics) throughout the report with attribution by category of participant rather than name and organisation. This attribution is designed to help understand the perspective from which comments were made, rather than to suggest that any position is typical or otherwise of a particular stakeholder group. For a full list of participant categories, please see Appendix A.

1. There is clear agreement that there are gaps between what is desired and what is delivered, with a focus on climate

There was general agreement amongst participants that reporting needs to change to better account for climate-related risks, and indeed wider ESG risks. Investors, for example, are demanding more information to make better informed decisions about where to allocate capital.

> *There are gaps between investor expectations for reporting on climate risk and what companies deliver.*
>
> *TCWG, Oceania*

[1] The Global Public Policy Committee (GPPC) is the global forum of representatives from the six largest accounting networks: BDO, Deloitte, EY, Grant Thornton, KPMG, and PwC, which has as its public interest objective, the enhancement of quality in auditing and financial reporting.
2 Participants represented stakeholder groups including investors and asset managers, investor associations, corporate preparers and ESG leaders, business organizations, those charged with governance (TCWG) including audit committees and corporate boards, auditors/assurers, and professional bodies.
[3] When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.

One assurer/professional body participant in the Americas observed that current reporting is designed to present a historical perspective of what you have achieved, and not necessarily to capture forward-looking information or assess what your impact will be. There is a need for standards both for reporting on ESG performance metrics in terms of what a company has accomplished to-date and for capturing a more forward-looking view on impact.

> *"Everyone is in violent agreement that we need better reporting, and that is the journey we are on. There are differences of views between folks -- investors and often companies and professional accountants – on what is required by current standards."*
>
> *Assurers and professional bodies, EMEA*

2. There is a divergence of opinion on the root causes of the current gap

In three of the four roundtables, when asked what is driving the gap between what investors and others expect companies to present in their financial statements and what is currently provided, a plurality identified: "Financial reporting, accounting, and auditing requirements today are outdated and need to evolve…" (A plurality of participants in the Asia-Pacific roundtable identified: "Companies need more time to finalize the climate assessments and their impact on financial statements.")

There was nevertheless a divergence between those who attributed the information gap to inadequate standards and those who faulted inadequate application of existing standards.

For some, the key issue is that standards have not kept pace with changing demand.

> *"There's a disconnect between what current accounting and auditing standards require and what a growing number of stakeholders are expecting."*
>
> *Academics and policy makers, Oceania*

One participant in EMEA argued that (despite the guidance issued by IASB and IAASB) current reporting and auditing standards lack the specificity, or in some cases even the permission, to enable companies and auditors to meet investor expectations. An example was the IAS 36 impairment test. Where the recoverable amount of assets is based on their value in use, future cash flows are required to be estimated on the basis of the assets in their current condition and future restructurings are not permitted to be taken into account. Forecasted cash flows are also required to represent management's best estimate of future cash flows, which would not necessarily represent a net zero scenario, and instead be a projection based on a number of possible future outcomes.

However, others felt that current IFRS standards are broadly adequate, and the issue rests in how the standards are applied.

> *"I think it's more the application of the standards rather than the standards… There may be a need to change some standards down the road, but as a starting point it's about incorporating the risk into the current standards and the current framework."*
>
> *Academics and policy makers, EMEA*

For some, there was a view that climate is often a material financial risk and, therefore, should be factored into financial statements under current standards:

> *"We are dealing with perceptions, including a lack of evidence that companies are incorporating material climate-related matters in their financial statements, that climate-related assumptions are not visible in financial statements, and that companies don't have a consistent story in their ESG reporting."*
>
> *Academics and policy makers, Oceania*

Some put forward the argument that, given the pace of change, companies need more time to adequately perform climate risk assessments and provide climate-related disclosures. In the Asia-Pacific discussion, participants cited a number of contributing factors, including a lack of talent and knowledge within the corporate and audit communities necessary to understand complex and often highly scientific-based data and prepare and assure reports in accordance with a number of different reporting frameworks.

On the other hand, one investor/investor association participant rejected the argument outright that more time is needed for companies to prepare, firmly believing that the IASB has made it clear that climate risk is a material economic risk like any other and thus, is subject to the same disclosure requirements.

> *"We've been talking about this for a long time – we're six years out from the Paris agreement. It's hard to see … What more signal is required, from government, from society, from the financial system that this is a material issue?"*
>
> *Investor and investor associations, Asia-Pacific*

3. Data is a challenging issue

Another area in which there was widespread agreement across the discussions is that obtaining the right data is difficult. The quality of models, results, usability and reliability varies from an action-oriented perspective, but generally do not yet meet the standards of quality that companies need to meet investor demand.

> *"Garbage in, garbage out. Poor data quality can result in poorly informed investment decisions, which impacts capital markets."*
>
> *Companies and business organizations, Americas*

In particular, obtaining data for Scope 3 emissions is challenging, relying heavily on calculations and estimations. A company/business organization participant in the Americas noted that certain companies believe these types of disclosures are akin to nothing with which they have previously dealt, and the technologies for capturing the data to support these disclosures have not evolved quickly enough to meet regulatory and investor demand.

But one investor association participant took a different perspective on the data issue, suggesting that there is almost too much data out there. Companies are reporting a wealth of information but are not assigning "weight" to each data point against what is actually material to investors.

"But what they're finding difficult to ascertain is which data points are actually material. And if they give equal weighting to each data point, then they're going to come up with the wrong investment analysis. They're struggling with which are the material data points."

Investors and investor associations, Americas

4. Materiality is critically important

Another key concept that was widely debated – with differing views – is materiality. How do you define what is material in ESG terms and how do you reconcile the different perspectives of different stakeholders? Additionally, how can quantitative materiality be applied to narrative-based reporting on Key Performance Indicators (KPIs), for example, or sensitivity analyses?
In the Asia-Pacific discussion, a fundamental disagreement over what is material was seen as a primary driver of the gap between what companies are reporting and what investors are seeking.

"I cannot believe that companies and auditors would be signing off on accounts that did not include this as a risk unless they had this view already, that climate was not a material risk to their business. And that, I guess, is where the frustration is being felt. Investors are saying this is material to our investment decision-making, but companies are saying, 'Well, our best judgment and the judgment of our accountants and our auditors, is that this is not material to our financial statements.'"

Investor and investor associations, Asia-Pacific

In EMEA, some expressed support for SASB's approach to standards[4], and a desire for companies to form a materiality assessment that stakeholders can then challenge.

"Looking at the materiality and saying that what is most important for individual companies, the danger is to say we have climate change and a social risk, or other environmental risks. Part of this is about the board doing the analysis to understand what are the most important ESG risks and telling their investors about it. Which is why a lot of investors support SASB because it has the materiality lens."

Academics and policy makers, EMEA

There was a view also that a greater focus on materiality would widen the focus to topics related to the "S" (e.g., social/human capital, diversity) and "G" (e.g., governance/board oversight).

"What about G? We know about biodiversity; we know about environment. G, deserves a full place. Long term risks for companies to highly correlate how many risks are in the governance of a company."

Assurers and professional bodies, EMEA

5. Integrated reporting – or separate sources for different users?

4 SASB describe their work as 'identifying the subset of ESG issues most relevant to financial performance in each of 77 industries… based on extensive feedback from companies, investors, and other market participants as part of a transparent, publicly-documented process.'

Turning more to solutions, one aspect that was widely discussed was the manner of reporting of key ESG related information. There was some divergence here.

In the Americas, for example, many commenters across participant categories expressed the notion that ESG reporting can serve different purposes depending on the user. Generally, commenters believed there should be differentiation between what is reported in or *with* a company's financial statements and what should be transmitted through other sources such as Corporate Sustainability Reports (CSR).

This was mirrored in Asia-Pacific, where there was wide agreement among participants that there exists a multitude of diverse stakeholders with varying interests in ESG-related information. Thus, disclosures should be packaged in different ways and may differ in terms of content and detail based on the audience. However, the majority of participants agreed that material information should be reflected in reports that contain audited financial statements, whereas certain, forward-looking information such as that currently reported under the GRI framework could remain in a company's sustainability reports or other non-financial reports.

> *"You must have material ESG information in the annual report because it is actually a part of a well- functioning company. A company that is functioning well <u>will</u> be managing and <u>will</u> be monitoring both its key risks and opportunities.*"
>
> *Investors and investor associations, Asia-Pacific*

In EMEA, there was a view that the link between financial reporting and the management narrative needs to be clearer and more consistent. Some participants argued that a key step forward would be more intrinsic connection between the assumptions and views set out in the management report with the assumptions that sit behind financial reporting.

> *"The point about cash flows is that the front-end assumptions link to resulting numbers. For example, impairment testing is about cash flows and does need to factor in climate."*
>
> *Academics and policy makers, EMEA*

This led towards the view that financial and ESG reporting need to become more converged:

> *"I don't like to distinguish between financial information and non-financial information anymore. This is the information investors need. We need to treat it all in the same way."*
>
> *Companies and business organizations, EMEA*

6. Consistent global standards are needed, and policymakers must step up; ISSB broadly welcomed

However reporting is treated, there was agreement across the four regional discussions that clear and consistent global standards are critical. For some, policymaking has not been keeping pace. From the perspective of one business organization participant in the Americas, for example, the domestic regulatory and policy environment in the U.S. is lagging behind, although important Securities and Exchange Commission (SEC) rulemakings on ESG-related disclosures are expected in 2022[5]. Absent these regulations, companies continue to struggle with *what* they are measuring and what different jurisdictions are or will be requiring in the future. Having policies in place will help take out uncertainty in the marketplace, one company participant asserted, and help companies with decisions on what and how to measure and report. One Americas participant observed:

> *"We want our regulators to provide us with guidance that isn't necessarily there."*
>
> *TCWG, Americas*

In a related vein, participants in EMEA expressed frustration over the proliferation and fragmentation of frameworks.

> *"In the next two years we are expecting CSRD, EU sustainability standards, IFRS, social taxonomy and these are just a few things we are looking ahead at. I have to tell you methods, processes, IT systems -- they have to be prepared to bring the data together which is needed by the financial community. We are absolutely willing to deliver that, but it will take some time for us. As long as we have five, six, seven frameworks to fulfil, this is really a struggling process."*
>
> *Companies and business organizations, EMEA*

In the Americas, there was widespread support among participants for a global baseline of ESG reporting standards which could be supplemented by additional standards for matters of local importance.

Many participants across categories and regions specifically applauded the creation and direction of the International Sustainability Standards Board (ISSB), seeing it as the best path forward toward a single set of globally accepted standards. In Asia-Pacific, one participant said:

> *"I welcome the direction that the ISSB seems to be going… the ISSB and IASB seem to be very much investor-focused with integrated reporting at its core."*
>
> *Companies and business organizations, Asia-Pacific*

The positive perception was generally shared in Oceania, where many participants felt the ISSB framework is largely cause for optimism, especially if it serves as a baseline that allows for supplemental reporting based on local markets and industry needs. Some believed that the ISSB framework would address the current challenges and clarify reporting requirements that meet investor and societal expectations and improve consistency of reporting.

5 Since the date of the Americas Roundtable (December 14, 2021), the SEC has issued a proposal for public comment entitled The Enhancement and Standardization of Climate-Related Disclosures for Investors. The full proposal is available here.

"Consistency is the key. You never like to see certain countries reporting a certain way. We've become such a global environment … I would dare to think that we would have different systems, we need to try and prevent as much as possible separate systems coming around – even if it isn't initially so. I think governments need to show leadership in this area."

Assurers and professional bodies, Oceania

In EMEA, there was also support for the ISSB and for a 'building blocks' approach where a global baseline could be built upon in different jurisdictions:

"*Building block 1 is the global base line of information which is needed by investors in capital markets. Building block 2 issues will be jurisdiction specific public policy issues. The system has to accommodate the local jurisdiction initiatives that will be public policy-driven by the government in those jurisdictions to get the reporting that they think they need in their jurisdiction. It is naïve to think that these public policy issues in Europe would be the same in North America, South America and Asia. But as long as we get the global baseline of investors in the capital markets it will be a huge win."*

Companies and business organizations, EMEA

7. Robust assurance is essential

There was general agreement amongst participants from across categories that some level of assurance over ESG reporting is important so that investors have confidence in the reliability of the reporting that drives their investment decisions.

"The credibility that's provided by assurance is really important."

Investors and Investor Associations, Oceania

"I'm definitely a fan of having some level of assurance because otherwise it really is the wild, wild West."

TCWG, Americas

In Asia-Pacific, several participants across a broad spectrum of the reporting ecosystem agreed that assurance over the most material ESG information is essential to provide confidence and promote reliability and fairness of the data.

One investor association participant in the Americas expanded on the concept of assurance, pointing out that by its very nature of being grounded in probing, assurance also can improve the rigor of the disclosures. However, currently, there are some inconsistencies in assurance over ESG information, including who provides it, to what level (i.e., limited or reasonable), and what information is actually assured. Another investor association participant added that where assurance is taking place, it is in areas that are easily measurable and not over qualitative information which is a real issue for investors. These inconsistencies in sum are creating confusion in the marketplace.

"There is a lot of limited assurance over certain metrics; it's not accounting firms providing that assurance for the most part. I think people are taking comfort in the idea that there's assurance without really understanding what that assurance does. In the long run, it has to be moving back toward the profession that is so much better prepared."

Investors and investor associations, Americas

One investor/investor association participant in Asia-Pacific remarked that policymakers could actively work toward an accreditation system for certifying or qualifying auditors to provide the necessary assurance services, beginning with the creation of a core skillset. Such a measure, the participant concluded, would give assurers confidence in conducting assurance services and delivering the reports and give investors the confidence that the reports are reliable.

8. New skillsets needed – and a whole of ecosystem effort

The previous point about a new core skillset for assurance was part of a wider theme running through the discussions that new skills are needed across the piece to create a system in tune with the demands of the rapidly evolving ESG agenda.

For example, it was noted in the EMEA roundtable that an understanding of Scope 3 emissions, and the relative lack of such experts, is a challenge in the ability of reporting to deliver what is needed.

"The boundary is a big problem. So is finding people who are fully conversant with what scope 3 gasses are. That's an enormous challenge for companies. One of the real issues is systems and controls to gather the data in the first place."

Academics and policy makers, EMEA

At the same time, participants in EMEA expressed the view that getting to a change at scale and at the necessary pace is a team game and everyone in the ecosystem has a role to play to drive positive change – including preparers, assurers, standard setters, policy makers, investors, and others.

To that end, the words of one participant in Asia-Pacific felt significant: while imperfections may always exist, we must *"not let perfection be the enemy of the good."* This participant encouraged companies to "*start disclosing something and incorporating with your management systems*" believing that the quality of reporting can be improved over time.

In short, the task of creating ESG reporting that is fit for purpose confronts everyone collectively – every party in the ecosystem needs to play an active role, wherever they sit at present, and work together to create the solutions that are needed.

GPPC

Perspectives on ESG Reporting

The future of ESG reporting explored

Appendix A: Participant Categories

Participant Category	Description
Companies and business organisations	Publicly-traded companies or organisations that represent them
Investors and investor associations	Investment funds or associations representing investors
Academics and policy makers	Professors of accounting or civil servants with a role in corporate governance
Assurers and professional bodies	Auditors at GPPC member firms or leaders at professional bodies