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Investor Agenda For Corporate Esg Reporting

A Discussion Paper By Global Investor Organisations On Corporate Esg Reporting

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Executive Summary

Despite growing consensus that the integration of relevant environmental, social and governance (ESG) factors into company value creation models and corporate reporting is important, listed companies and organisations providing reporting standards have yet to coalesce on an approach to the treatment and inclusion of ESG factors in company disclosure and reporting. Progress in this area may be frustrated by measurement challenges and the endogenous nature of many ESG risks within companies. However another factor inhibiting further progress may be the mixed signals that many investors are sending about their ESG preferences.

List of investor organisations: Ceres, CFA Institute, Global Impact Investing Network (GIIN), Global Sustainable Investment Alliance (GSIA), International Corporate Governance Network (ICGN), Principles for Responsible Investment (PRI), United Nations Environment Programme Finance Initiative (UNEP-FI).

A group of leading global investor organisations has convened to address open questions relating to corporate ESG reporting to provide guidance and an investor perspective to the global Corporate Reporting Dialogue and its members.[1] This Discussion Paper presents the preliminary outputs from the group (referred to herein as “the Group” or “GIOC” (the Global Investor Organisations Committee) on a range of ESG reporting issues, calling attention both to points of broad consensus, and where opinion may still be divided.

The aim of the initiative is to provide a more unified view of investor perspectives on corporate ESG-reporting. We hope that our work may provide guidance for the future development of corporate reporting on a structural level.

Of the many points raised in the discussion paper, some of the key takeaways are as follows:

- **There is a clear business case for ESG reporting for investors and companies** (management and boards). Reporting can help investors and companies better understand material ESG related risks and opportunities. We cite in Appendix 2 five studies which support the claim that there is a clear linkage between ESG factors, company performance and investor preferences.
- **There is no single solution – one set of metrics or a single framework – that will satisfy all users of ESG data**. The heterogeneity of ESG data users – investors, stakeholders and companies - will remain and is not inherently negative. However, the Group believes it should be possible to serve different needs and still come to a more unified agenda. From companies’ perspective, ESG issues are endogenous and difficult to standardise. In spite of these challenges we believe that companies should seek to identify and publish material ESG issues and relevant KPIs as part of their annual reports. Integrated reporting may provide a good framework for this.
- **At the same time, it would be beneficial for companies to disclose standardised ESG information at a basic level** to complement more customised ESG reporting, just as financial accounting has required its own disclosure standards.

[1] List of GIOC investor organisations: Ceres, CFA Institute, Global Impact Investing Network (GIIN), Global Sustainable Investment Alliance (GSIA), International Corporate Governance Network (ICGN), Principles for Responsible Investment (PRI), United Nations Environment Programme Finance Initiative (UNEP-FI).

- **Both investors and companies need to think more about systemic issues**, including the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, the UN Sustainable Development Goals (SDGs) and their links to individual companies. For companies this is a matter of strategy and sustainable value creation. For investors, particularly those with longer term time horizons, systemic risks need to be reflected in valuation models and incorporated into engagement with company executives and board members.
- **Investors would benefit from members of the Corporate Reporting Dialogue[2] proactively articulating how its different bodies fit together.** Where are the complementarities? Where are the disconnects or conflicts? The GIOC has found ongoing discussion useful in building mutual understanding, and we remain open to ongoing dialogue with the CRD.

It is important to state clearly that the Group believes a workable "solution" can be achieved with the existing data providers and standard setters: the current members of the CRD. We support improving coordination of existing frameworks rather than creating new ones. However, it is incumbent on the standard-setting organizations to present a coherent vision of how these standards can and should fit together.

How the Global Investor Organisations Committee was formed

Corporate reporting on ESG was on the agenda of the April 2016 meeting of the IIRC Council in Frankfurt. During the meeting, a report from the chair of the CRD raised a major issue for the CRD partners' further collaboration: a more unified view from investors on corporate ESG-reporting was needed. This was supported during discussions, with feedback from a range of participants of the IIRC Council (including regulators, investors, companies, standard setters, accounting professionals, audit firms and NGOs). Many said that investors send very mixed signals.

Overall it was agreed that market participants would benefit from a collective expression of broad principles for ESG corporate reporting (including financial and other forms of reporting) to make better sense of the landscape and to encourage greater alignment throughout the system.

This request was the basis for the Group's formation, and we have worked together to explore if this can be meaningfully addressed. Part of the work was to adapt information from existing initiatives (TFCD, for example), with the aim of preventing duplication of efforts, and adding value in the areas where corporations and global reporting organisations may seek investor guidance.

Our research and discussions identified several consensus areas, some of which have been developed over the course of several discussions. We provide a brief overview of these in the paper. For those issues where differences of opinion remain, we will propose some avenues for solutions.

[2] The Corporate Reporting Dialogue (CRD) is a set of 8 providers of standards for corporate reporting. Members are: The Carbon Disclosure Project (CDP), Climate Disclosure Standards Board (CDSB), Financial Accounting Standards Board (FASB), The Global Reporting Initiative (GRI), International Organization for Standardization (ISO), International Financial Reporting Standards (IFRS), International Integrated Reporting Council (IIRC) and The Sustainability Accounting Standards Board.

The Business Case for Corporate Reporting on ESG: an investor perspective

We believe in the first instance that the business case for ESG data and reporting is an internal one within the company itself: to inform the company's management and board of the broad range of ESG factors that are material to a company's sustainable success—or which pose potentially material business risks. Without reliable data and metrics it can be difficult, if not impossible, to link ESG factors meaningfully to corporate strategy, risk management, executive remuneration, and overall board expertise. Boards increasingly seek to "futureproof" companies from sometimes qualitative environmental and social risks. To do this effectively requires the integrated reporting of qualitative business drivers, including ESG factors, together with traditional elements of corporate and financial reporting.

This link between corporate reporting and the need to understand ESG issues as sources of risk or opportunity is where investors come in. Companies require risk capital -- either through an IPO, direct loans, issuing additional shares or public corporate debt -- both to survive and successfully create sustainable value. As a matter of financial flexibility it is fundamentally important for companies as issuers to be attractive to providers of risk capital and to develop strong relationships with long term investors (both debt and equity). Maintaining a supportive investor base that is open to maintaining or increasing investment is a matter of good investor relations. We believe strong ESG reporting can contribute to this end, can also help companies attract new investors and can help to reduce its cost of capital. In sum investors' interest in ESG factors as part of the investment process continues to grow worldwide, and executive management and board directors need to understand what investors want and expect of companies, and how these expectations may be evolving.

"R3": bringing the investor perspective together

Investor approaches to ESG and the use of ESG information differs from those mainly interested in the financial implications material ESG issues to values-driven and impact investors, whose objectives are both financial and non-financial. Applications are expanding from management of ESG risks and opportunities to factor into investment analysis and appraisal of individual companies, as well as the contribution of companies and investors to address systemic issues and wider objectives of society. This includes global sustainability challenges - particularly relevant areas which are likely to have an impact on performance over time. This suggests three types of information that an investor may consider in an investment decision: return, risk and real-world impact. We label this "R3".

Investors and R3

Return: Investors are responsible for generating a positive and sustainable risk-adjusted financial return for their beneficiaries, with the expectation that investee companies make an economic profit to cover their cost of capital. How then, do ESG issues present promising business opportunities? How are companies responding to such opportunities to provide sustainable solutions? Commercial opportunities lie for many companies in addressing new sustainable solutions for companies, sectors or the systemic level, potentially through the Sustainable Development Goals (SDGs).

Risk: Entrepreneurial business activities involve risk. Both boards and executive management must understand a company's enterprise-wide risks, which can include ESG factors. Expected (or hoped for) returns on capital may fail to materialise due to adverse events or developments relating to ESG factors-- some anticipated and others entirely unforeseen. As one listed company CEO once stated: "Unidentified risks are a threat; identified risks are a managerial issue." (AkzoNobel Annual Report 2005). Increasingly, ESG issues and sustainability challenges represent material risk factors, either in the short- or long-term. This raises the management question of how companies seek to understand and adequately manage general and ESG-related risk.

Real-World Impact: Companies have an impact on society and the environment through the products and services they provide, their production processes and treatment of workers, willingness to pay taxes, selection of business partners and more. This impact can be either positive or negative across diverse ESG or sustainability issues, and a company's social impacts are often monitored and given widespread visibility through social media. Increasingly, many investors want to ensure their investments have a positive (or at least neutral) real-world impact and are aligned with broader objectives of society, and will allocate their capital accordingly. Impact investors in particular will expect current and potential investee companies to provide information on their real-world impact.

Because of this R3-focus, investors want to see reporting (including ESG reporting) presented in the context of strategy, governance, performance and future prospects in a way that provides them with information on value creation over time (or value protection for fixed income investors). Several leading investors have publicly called for boards to provide an annual report on long-term strategy and performance.[3]

How investors use ESG information reported in the investment process

Incorporating ESG issues in investment strategy, policy decisions and active ownership is increasingly regarded by investors as part of their fiduciary duty. For example, both PRI and ICGN

[3] For example, BlackRock CEO Larry Fink's 12 January 2018 letter to US company chairmen stated: "to prosper over time every company must not only deliver financial performance but also show how it makes a positive contribution to society".

explicitly call on their respective members to integrate ESG factors into their stewardship activity. [4] Therefore, transparency around how a company manages ESG risks and opportunities is part of its value proposition. This summary of how investors use the ESG information reported in the investment process shows the many uses it has:

- Fundamental ESG integration in 'stock picking'
- Positive screening (producing ESG 'best in class' approaches, ESG ratings)
- Thematic investment
- Integrating ESG data in alternative beta, quant, factor investing etc.
- Negative screening (identifying companies to screen out, for regulatory or other reasons)
- Exclusion (norms based)
- Creating and monitoring funds with specific E and/or S characteristics
- Measuring the impact of companies and/or funds (portfolio monitoring, carbon foot printing)
- Risk management (climate-related financial risk disclosure)
- Active ownership, stewardship, engagement
- Communicating with clients and beneficiaries

It would be a mistake to limit the scope of ESG-reporting to such an extent that any of these legitimate information demands are neglected. Corporate ESG reporting should facilitate investor decision making irrespective of the preferred investment strategy. There may also be other reporting needs from non-investor stakeholder groups that companies should also strive to meet.

Preliminary thoughts on reporting

Reporting on ESG is not a goal unto itself. Rather, it is a means to adequately inform the management of the company, its shareholders and its stakeholders to make informed decisions and facilitate behavioural change, both by companies and their investors. A company should always communicate its 'mission' and statement of purpose, explaining how this fits into a clear corporate strategy. These items should clearly be developed and based on an assessment of the company's 'environment' or operating context. This should explain the role the company wants to play in society. The mission, purpose statement and strategy should also provide clear guidance to investors and stakeholders on the main objectives of the company and how it seeks to achieve them in the context of its ESG risks, opportunities and the company's own social impact.

> The GIOC investor organizations share this broad sentiment: "Incorporating ESG issues in investment strategy, policy, decisions and active ownership is increasingly regarded by investors as part of their fiduciary duty."[1]
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> Therefore, transparency around how a company manages ESG risks and opportunities is part of its value proposition.

[4] See PRI, UNEP FI: Fiduciary Duty in the 21st Century: www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf ,ICGN's Global Stewardship Principles (2017): http://icgn.flpbks.com/icgn-global-stewardship-principles/#p=1 and ICGN Guidance on Investor Fiduciary Duties (2018): https://www.icgn.org/policy/guidance. Another prominent example relating specifically to climate change is the Financial Stability Board (FSB) Task Force on Climate-Related Financial Disclosures, Phase 1 report, page 4: seven fundamental principles for effective disclosure: https://www.fsb-tcfd.org/wp-content/uploads/2016/03/Phase_I_Report_v15.pdf

Investors are primarily interested in material ESG issues, but at the same time investors usually want companies to have a thorough process of stakeholder dialogue, not just with investors, but also with NGO's, local communities, their employees, business partners and governments. Investors understand that such stakeholder dialogue may encompass a relatively wide set of sustainability issues, including some that may be regarded as "salient", if not financially material.

With these factors in mind, the Group considered current practices in financial reporting, as a 'system' of reporting developed over a period of more than 100 years with many lessons learned along the way. One interesting element in financial reporting is the distinction between 'annual accounts' and the 'annual report', a distinction that is not regularly made in ESG reporting. On the one hand companies publish (more or less) standardised and comparable data in their Annual Accounts and their customized story about their strategic issues in the Annual Report. Analogous to that 'dual' financial reporting system a similar approach to ESG-data could make a distinction between the annual ESG accounts (a broad set of data) and annual reports (the customized storyline of the company about the ESG issues they consider key to their company). In the remainder of this report it is useful to keep that analogy in mind.

Key Elements for Corporate ESG-reporting

While there is no one-size-fits-all method or framework that can produce reporting that meets the needs of all investors for all purposes, there are emerging international and local best practices, guidelines and frameworks. Similarly, despite having different needs, there is a growing level of consistency in incorporating material ESG factors into investment decision making. Building on existing resources and practices, this section summarises existing views on corporate reporting of ESG information to investors.

We have aimed to identify areas of broad consensus that can provide a clearer message to the corporate community, stock exchanges and regulators, to enable these actors to providing markets with more consistent and comparable ESG information. What follows below is our discussion of key elements of corporate ESG reporting where our investor working group identified a generally common position on a range of issues.

Key elements

Terminology

While we recognize that some companies use the terminology Corporate Social Responsibility (CSR), we prefer the broader terms 'sustainability' or 'ESG'. Although the term 'non-financial' is widely used, it can imply misleadingly that ESG factors are financially immaterial. Although companies can also report information for a broader stakeholder audience, investors are primarily concerned with ESG information that is material for their investment decisions. The concept of materiality always includes financial materiality, but both companies and investors may have broader interpretations that reflect a values-driven or impact investing orientation.

For this reason, we propose that the terminology aligned to the concept of stocks of value (or capitals) be used when talking about reporting, or 'sustainability factors'.

Purpose of reporting

Reporting should adequately inform the management of the company, its shareholders and its stakeholders. It should help these users to make informed decisions. This includes confirmation of a company's internal commitments to achieve its ESG goals.

Company mission, statement of purpose, strategy

A company should communicate its mission (or 'statement of purpose'), which explains the company's main objectives and articulates a clear corporate strategy. Mission, statement of purpose and strategy should be based with full consideration given to the company's environmental or social performance. It can include articulating the role that the company wants to play in society.

Board responsibility

Management of strategic ESG risks and opportunities is the responsibility of executive management under the oversight of corporate boards. While different corporate departments (such as finance, investor relations, communications, legal, sustainability and individual business units) can all make valuable contributions to the outcome of a report, ultimate oversight sits with the Board. By embedding knowledge of sustainability factors into their core duties, directors can position themselves to facilitate the mainstreaming of ESG factors into business strategy, organisation culture and operational practices in a way that supports the long-term profitability and viability of the company.[5] Evidence also suggests that companies with strong systems for board sustainability oversight are more likely to perform better on sustainability challenges such as climate change, water scarcity, pollution, and human rights abuses.[6]

Boards may find it beneficial to issue a statement[7] that clarifies how the board determines:

- The importance of different stakeholders and ESG factors;
- Which stakeholders/ESG factors were selected as material and why; and
- What time frame they had in mind making these judgments as they change over time.

Developing such a statement is also an opportunity for the board to reflect on the company's role in society and contribution to sustainable development. It can provide transparency regarding the board's position on and oversight of the company's ESG risks and opportunities, and strengthen the company's credibility when communicating on ESG factors. A statement of this nature will depend on the materiality for the intended readers of reports. Board commitment to reporting on ESG factors provides credibility for company reporting on sustainability commitments and performance. It indicates that risks and opportunities are dealt with at the highest level. Many investors examine not only ESG performance and the quality of disclosures, but also the governance or management of these issues by the board and executive teams.

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[5] See UN Global Compact (2015) Board Programme: Unlocking the Value of Corporate Sustainability and

[6] See Systems Rule: How board governance can drive sustainability performance (Ceres, 2018) at https://www.ceres.org/systemsrule.

[7] Eccles and Krzus (2014) *The Integrated Reporting Movement: Meaning, Momentum, Motives, and Materiality*.

Non-Executive Directors and oversight

ESG policies, activities and reporting are key board responsibilities, though specific requirements may differ between jurisdictions. In some jurisdictions, this is also reflected in national corporate governance codes. For example, the Dutch Governance code explicitly mentions the ESG responsibilities of the non-executive board, who address these issues in their own annual report. Investors agree that non-executive directors have a role to play in ESG oversight the board's activities in this area should be included in company reporting.

Stakeholder dialogue and engagement

Engaging stakeholders on ESG factors is best conducted as a preventative rather than reactive activity, as stakeholders can help a company identify, mitigate, and manage ESG risks and opportunities before problems emerge. Disclosing a company's stakeholder engagement process should shed light on how well a company is integrating ESG risks and opportunities into planning and operations, as well as lend credibility to company claims about leadership in ESG performance.

Executed properly, stakeholder engagement is likely to result in improved understanding by the company of its strategic partners and resources, strengthen relationships with stakeholders and foster higher levels of trust among external parties regarding the company's actions and reporting.[8] Stakeholder engagement can also be a source of innovation and new partnerships for strategic growth.

Audience of the report

The target audience of the ESG-report should be the company's investors though it also it may serve the information needs and other legitimate purposes of a wider audience including stakeholders and civil society.

In financial reporting the question sometimes is to whom the company reports? Although in most jurisdictions corporate law requires boards to act in the interest of the company (including all its relevant stakeholders), the annual accounts and reports are normally and formally targeted at the company's investors in general, and the shareholders at the AGM in particular. However, company reporting is also important for all relevant stakeholders, including the general public. An auditor's role is largely to confirm that the accounts present a true and fair view of the financial position and results of the company, as reflected in generally accepted accounting principles.

Similarly, the company's ESG-report has a wider audience than investors, including its wider stakeholders and the public. Long term investors in particular are also focused on the concerns of broader stakeholders, due to the possibility they may represent potential financial opportunities or risks in the long term. However, as investors with stewardship obligations our GIOC working group emphasises the particular importance and rights of shareholders.

[8] The International Integrated Reporting Committee (2013). The International <IR> Framework.

Integrated reporting

While integrated reporting by all companies will not be achieved in the short term, the GIOC working group considers it to be a desirable end goal. It is also recognized that integrated reporting should result from integrated thinking, strategy formulation and policy making. However, the road towards integrated thinking/reporting may take different courses in different geographies, based on the needs of specific markets. Above all, getting the content of ESG-reporting right should have priority (substance over form), and this may include supplemental information outside of an integrated report.

Materiality (for companies)

A company should clearly articulate how the concept of materiality has been applied at the start of any report. Companies should also report the results of their materiality processes, the stakeholders involved in the decision making, issues prioritized and how they are integrated in the corporate strategy. We note that different jurisdictions may have differing formal approaches to the definition of materiality.

Whether a company decides to apply a strict interpretation of materiality (such as the one provided by their regulator) when considering which ESG information to report, or whether it takes a wider view, understanding the process by which companies apply the concept of materiality can be as important as the data provided. For example, it is possible for salient issues regarding company ESG performance (for example an environmental accident or a labour relations problem) to be regarded by companies as financially immaterial.

The GIOC group will not propose a new definition of materiality, but we also believe that the approach companies take to materiality need not strictly be defined by financial thresholds; there should be scope for some degree of qualitative judgement.

For their own purposes of investment decision making or dialogue, investors may make their own assessment of what they consider material and whether they agree with the company's definition. This can be done by identifying relevant issues as a starting point for identifying material factors.[9] For determining relevant matters, it can be useful to gauge how much an issue might potentially affect the company's ability to create (or lose) value over time.

Impact, outcomes and SDGs

Companies should focus on the impacts, outcomes and SDGs that are most material or relevant to their business, and subsequently also report on how these issues are addressed. For investors to allocate capital, make investment decisions and be transparent about systemic risks and SDGs in particular, it is important that companies provide information (including data) on their contribution to society and the SDGs. GIOC welcomes the fact that existing corporate reporting standards organizations are in the process of integrating the SDGs in their reporting standards.

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[9] Materiality. Background Paper for <IR>. 2013.

Timeliness

Material ESG information should be communicated to investors at the same time as financial data. For information to be used in investment decision making, it should be communicated to investors at the same time as financial results and should be included in company reporting. We recognise that this might involve some increased effort and cost relative to current ESG reporting practices. However for ESG factors that are being actively managed as a core part of business strategy it should not be difficult to prepare data together with financial data and results.

Consistency and comparability

Disclosures should be consistent over time, be provided in the appropriate context and, when possible, quantify ESG factors. Investors appreciate information that is:

- Linked to the company's business strategy and financial performance.
- Quantitative, as it can be more easily compared across time within the same company or with similar data from other companies. Such data is also useful for enhancing investment valuation and credit rating models.
- Easy to find, for example by producing an online content index with hyperlinks to boost digital accessibility indicating where all existing ESG information can be found. It is useful to make use of existing taxonomies, for example XBRL, where available
- Put in the appropriate context, including comparisons to historical company and industry trends, related corporate goals, benchmarks and targets, relevant ratios, industry averages, and financial results/performance.

Companies should also explain why key indicators may have changed (positively or negatively) year-to-year, and provide an indication how these might change in the future. They should explain their choice of data collection methodologies where it is essential to understand the data.

Standardized comparable full disclosure versus limited customized material information?

Competing investor requests for full disclosure of standardised comparable data and limited and/or customized information, focused on financial materiality could be addressed with a mix of customization and standardisation. Part of that solution is accepting the current distinction, widely accepted in financial accounting and reporting, between annual accounts (which emphasize data) and annual reports (which focus on story line). This would follow the same distinction as already exists in financial reporting, where the annual accounts provide the data and the annual report provide narrative and context. It is a three-step approach.

- Step 1: All companies shall be expected to report on some general core indicators (including but not necessarily limited to sustainability governance and the role of the board, approach to materiality and risk, and stakeholder management);
- Step 2: The company decides which ESG issues they consider *relevant and material for their specific company*. Companies should make a clear statement and explanation of why they consider ESG issues to be material, either for investors or other stakeholders, but ultimately for the company itself.
- Step 3: The company will report on the identified relevant or material ESG issues using a *widely accepted standardized and comparable* set of data requirements.

In this solution, the annual report would provide the customized (and limited) report on the ESG issues that the company regards as relevant and material, including meeting regulator or listing requirements. The annual report should communicate how an organisation's "strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term".[10] Material ESG factors should be included for this requirement to be met. We believe that this information should be presented together with financial data wherever possible, so that the relevant customized ESG information is fully integrated in the annual report.

Key Performance Indicators (KPIs)

Linked to the above point about standardisation, corporate reporting would benefit from a globally agreed set of common performance metrics as it would allow for comparability by industry, portfolio and across time-series.

Securities regulators should come together to codify industry and sector specific KPIs for ESG factors, making use of the work done by GRI, SASB and other standard setters. There are significant efficiency gains from developing a refined set of industry specific KPIs for the reporting of ESG information. This may improve the quality of the information produced and create efficiencies in both production and analysis. A core of industry-specific KPIs can then be supplemented by additional disclosures that management considers material and relevant to the individual company. We recognise that there is scope to further explore the feasibility of such a set of metrics, taking into account the pros and cons of standardised baseline metrics. This may produce several efficiencies in both the production and evaluation of information set out in registrant filings. The participants in the GIOC are interested and prepared to assist in the exercise of identifying standardised KPIs.

Levels of forward-looking information

To make informed decisions regarding asset allocation, portfolio weighting, valuation, engagement and voting, investors require forward looking information. A company should publish KPIs and targets for material or otherwise relevant ESG issues, and report annually on the progress the company is making on those ESG targets.

The discussion on forward-looking information might benefit by distinguishing different categories of forward looking information:

1. Regular information about 'going concern' business continuity over a one-year term;
2. Information or data that allows investors to make an assessment if the company is equipped and adapted to manage future risks and opportunities, including ESG risks and opportunities;
3. Strategic targets for material or otherwise relevant ESG issues and information or data on the progress (or lack thereof) the company is making to meet those ESG targets (KPIs).

We encourage companies to disclose how their sustainability targets relate to methodologies or frameworks focused on reducing overall environmental and social impacts, such as life cycle assessment and science-based targets for climate emissions.

[10] IIRC definition of an Integrated Report.

An additional element to consider is the extent to which forward-looking information can be meaningfully audited and assured. We elaborate further on those different categories:

- *Regular information about 'going concern' business continuity on a one-year term.* At present, the annual accounts and report provide information and data that will allow an auditor to make a statement that there is no threat to business continuity on a one-year term. The audit process that allows for such a statement includes at least two relevant issues. One is an analysis of the consistency between annual accounts and annual reports. A lack of consistency may qualify as a 'material issue' from an auditing perspective. The second consideration is whether material ESG issues are adequately addressed in the annual report and accounts. If they are not and the auditor is aware of the omission(s), it may also qualify as a 'material issue' from an auditing perspective, at which point the auditor must address the omissions with the company. If the company does not adequately redress the omission, the auditor must reference this inaction in its opinion.

- *Forward-looking information (or data) that allows investors to make an assessment if the company is equipped, adapted to manage future risks and opportunities, including ESG-risks and opportunities.* Here the work of TCFD may provide a model. Analogous to the proposed approach to climate-related risks, the GIOC organisations encourage companies to assess broad ESG risks and how they may affect the company on a medium to long-term basis. The issues that should be addressed in the annual report include the material ESG risks over the medium to long-term; the process that has been followed to identify these issues; the strategy revisions, policies and measures put in place to address those risks; and the KPI's that will be used to monitor the progress of managing these risks. Auditors are generally not asked to provide an assurance statement on the correctness of this information or data, but can give a statement about the robustness of the processes and, based on their knowledge of the company, highlight potential ESG risks that are missing or not adequately addressed.

- KPIs and targets provide forward looking information on the company's ambitions. It is important to track how KPIs develop even if there are challenges for auditors relating to conducting audits or providing assurance on ESG data.

This distinction between categories of forward-looking information may be helpful to companies, standard-setting and reporting organisations, and serve to manage expectations among investors about the possibilities of providing forward-looking information and assurance. It may also be useful to refer to the example of the UK Companies Act, which was the model for the EU Non-Financial Reporting Directive. The requirement is to create a narrative "strategic report" which provides shareholders with a clear presentation of a company's business model, strategy, development, performance, position and future prospects.

If a company provides a clear strategy statement, with ESG information fully integrated, combined with clear targets and KPIs in the annual report, the annual report and accounts can then provide information about the progress the company is making. The annual report gives management the opportunity to reflect on that progress and present their plans for the future. The report should therefore provide a clear, fully integrated strategy statement and targets and KPIs, with a thorough risk analysis inclusive of ESG risks. Investors should note that this part of the report will by definition have a different character than the actual financial statements and often may lack verification or assurance.

Legal status of corporate reporting on ESG

Disclosure of material ESG risks should be mandatory. Some investors may argue that ESG reporting should be mandatory in a much broader sense and there are already several countries that have mandatory reporting referencing the GRI framework. A prominent example of obligatory ESG reporting is Article 173 of France's law on "energy transition for green growth", with an implementing decree setting out the reporting requirements in greater detail.

Assurance and accuracy

It must be acknowledged that it is not (at least not yet) possible for all ESG information to be held to the same audit standards as financial data, but there is increasing demand for the various different applications of third party assurance. The CFA Institute's ESG survey from 2017[11] found that 69% of analysts want ESG data to be assured by third parties. Auditors distinguish between different levels of assurance, and the extent to which auditors can and will provide assurance is currently an issue of debate. Auditors must address (potential) inconsistencies between the annual accounts and the report(s) which come to light during their audit of the annual accounts. But investors want a higher level of assurance based on actual audit of the ESG data. Again, there are different approaches to the assurance process:

- Assurance that procedures have been adequately followed versus assurance of the data about the outcome of the procedures;
- If the assurance is applied to the data, it can apply to the robustness of the data collection or for the accuracy of the data itself; and
- The statement of the auditor can attest that the processes, procedures and data are trustworthy, or the statement can declare that no inconsistencies or material deviations have been found.

Assurance can be even more complicated when some ESG indicators in a given sustainability report are process-oriented (e.g., responsible procurement procedures) and others are quantitatively expressed (e.g., carbon emissions). Similar questions may present themselves with respect to the depth of auditing comply-or-explain statements on corporate governance. Should the auditing firm only check that the statement is present in the annual report? Should it assure that it is reflected in all the articles of association? Should the auditor verify, for example, whether an independent non-executive board member does indeed meet the criteria for independence? In other words, if investors want third party assurance on ESG information and data, what is it they are asking for?

GRI has provided some guidance on what 'assurance' of ESG-information can be. It focuses on the 'Assurance Statement' provided by the auditor. Information provided in an assurance statement may include:

[11] See 2017 CFA Institute investor survey: https://www.cfainstitute.org/en/research/survey-reports/esg-survey-2017

- *Addressee.* The intended audience for the assurance report or statement (e.g. stakeholders or the board of directors, executive or committee responsible for report signoff, etc.);
- *Introduction.* A statement of the overall objectives or mandate, and the responsibilities of reporter and assurer;
- *Scope.* A statement identifying which disclosures are covered by the assurance verification process;
- *Level of assurance*. Assurance providers often offer two levels: 'reasonable assurance' (i.e. high but not absolute) or 'limited assurance' (i.e. moderate). The higher the level of assurance, the more rigorous the assurance process is, as defined in the standards and procedures used for the specific assurance engagement;
- *Criteria for report preparation and assurance standards.* A statement identifying the criteria and methodologies used by the reporter when preparing the sustainability reporting and final report (reporting protocols, and descriptions of or reference to internal management and control procedures) and the standard(s) used to by the assurance provider to guide the assurer's approach (e.g. ISAE 3000, AA1000AS, or national and sector standards);
- *Limitations.* A comment on any noteworthy limitations on either the scope of the information assured or on the assurance activities, such as the unavailability of some data, or changes in the data gathering systems;
- *Activities*. A summary of the actions taken to check the accuracy, plausibility or relevance of the sustainability disclosures covered by the assurance;
- *Conclusion(s).* A statement indicating whether the assured information is fairly presented, free of material misstatements and reported in accordance with reporting criteria. The wording of the conclusion will differ according to the standard used; the level of assurance, and the assurance provider;
- *Recommendations*. Some assurance reports include a summary of recommendations for further action or attention;
- Signature and date. A formal sign-off by the assurance provider's most senior executive responsible for the assurance[12].

This may provide a useful reference for investors to communicate their expectations of ESG assurance.

Legal obligations for ESG assurance or market driven development

We conclude with fundamental questions on the legal obligations around assurance, and an invitation to debate towards solutions. Mandatory reporting on material ESG issues implies that the 'normal' assurance requirements should apply. But should external independent assurance of corporate reporting on ESG be legally obligatory or should development towards assurance of ESG-reporting be driven by market forces? Should governments encourage third-party verification of ESG factors, to a 'reasonable' level (considering that companies need time to adapt so requirements should be phased in)? While some questions remain to be resolved, we hope this paper has helped to build awareness of the key issues and drive conversations towards consensus on progress.

[12] https://www.globalreporting.org/resourcelibrary/GRI-Assurance.pdf

Closing Remarks

With this paper the organisations represented the GIOC hopes to make a contribution to the further integration of ESG reporting standards and to the work of both companies and the Corporate Reporting Dialogue members in this area. We hope that our investor perspective is useful and we recognise that the pace of change is sometimes slow. It is our hope that this paper provides some foundations for moving forward and also helps to build the dialogue between the institutional investors and standard setting communities.

Contributing Organisations

Ceres
Chartered Financial Analyst (CFA) Institute
Global Impact Investing Network (GIIN)
Global Sustainable Investment Alliance (GSIA)
International Corporate Governance Network (ICGN)
Principles for Responsible Investment (PRI)
United Nations Environment Programme Finance Initiative (UNEP-FI).

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Appendix 1: Publications Reviewed

AccountAbility (2011) *A1000 Stakeholder Engagement Standard 2011: Final Exposure Draft.*

Australian Council of Superannuation Investors and the Financial Services Council (2011) *ESG Reporting Guide for Australian Companies: Building the Foundation for Meaningful Reporting.*

Accenture and UN Global Compact (2013) *CEO Study on Sustainability.*

Bursa Malaysia (2010) *Powering Business Sustainability: A Guide for Directors.*

Ceres (2014) *Investor Listing Standards Proposal: Recommendations for Stock Exchange Requirements on Corporate Sustainability Reporting.*

CDSB (2015) *"XBRL Project Governance."*

CDP (2015) *"XBRL."*

Chartered Professional Accountants (2013) *A Starter's Guide to Sustainability Reporting.*

The Climate Group (2015) *"Green Bond Market's Growth is Boosting Low Carbon Projects".*

Deloitte (2014) *Navigating the Evolving Sustainability Disclosure Landscape.*

Deutsche Bank Climate Change Advisors (2012) *Sustainable Investing: Establishing Long-term Value and Performance.*

Deutsche Börse Group (2013) *Communicating Sustainability: Seven Recommendations for Issuers.*

Eccles and Krzus (2014) *The Integrated Reporting Movement: Meaning, Momentum, Motives, and Materiality.*

Eccles, Robert G., Michael P. Krzus, and George Serafeim (2011) *"Market Interest in Nonfinancial Information" Journal of Applied Corporate Finance, Vol. 23, No. 4, pp. 113-127.*

EFFAS and DVFA (2010) *KPIs for ESG*

Ernst & Young and Boston College Carroll School of Management's Center for Corporate Citizenship (2013) *Executive Summary: The Value of Sustainability Reporting.*

Ernst & Young (2014) *Tomorrow's Investment Rules.*

EU Directive *2014/95/EU of the European Parliament and of The Council as regards disclosure of non-financial and diversity information by certain large undertakings and groups.*

FSB Task Force on Climate-related Financial Disclosure (2017)

Ghoul, S. et al. (2014) *Corporate Environmental Responsibility and the Cost of Capital: International Evidence.*

GSIA (2014) *Global Sustainable Investment Review.*

GRI (2013) *The External Assurance of Sustainability Reporting.*

GRI (2015) *G4 Sustainability Reporting Guidelines. GRI (2015) "XBRL Reports Program."*

International Accounting Standards Board (2005) *IASB Framework.*

International Corporate Governance Network (2015) *Guidance on Integrated Business Reporting.*

Integrated Reporting Committee (South Africa) (2014) *Preparing an Integrated Report: A Starter's Guide.*

Khan, Mozaffar, Serafeim, George, Yoon, Aaron (2015) *Corporate Sustainability: First Evidence on Materiality, Working Paper 15-073, Harvard Business School.*

KPMG (2008) *Sustainability Reporting: A Guide.*

KPMG (2014) *Sustainable Insight: The Essentials of Materiality Assessment.*

Ministry of Corporate Affairs (2011) *Government of India. National Voluntary Guidelines on Social, Environmental, and Economic Responsibilities of Business.*

Porter and Kramer (2011) *Creating Shared Value.*

SEC Consultation *PRI's response to* ***SEC*** *Consultation (which looked at other organization's consultation responses and direct investor feedback). We also reviewed and had input from those who worked on the relevant consultations listed* here.

Syntao (2011) *Sustainability Reporting Guidelines Mapping & Gap Analyses for Shanghai Stock Exchange.*

Sustainable Stock Exchanges Initiative (2014 and 2016) *Report on Progress.*

Sustainable Stock Exchanges Initiative (2015) Model Reporting Guidance

The International Integrated Reporting Committee (2013) *The International <IR> Framework.*

The Prince's Charities Accounting for Sustainability (2009) *Connected Reporting: A Practical Guide with Worked Examples.*

Toronto Stock Exchange (2014) *A Primer for Environment & Social Disclosure. TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976).*

UNCTAD (2008) *Guidance on Corporate Responsibility Indicators in Annual Reports.*

UNCTAD (2014) *Best Practice Guidance for Policymakers & Stock Exchanges on Sustainability Reporting Initiatives.*

UNCTAD (2014) *World Investment Report: Investing the SDGs an Action Plan.*

UNEP, GRI, KPMG, and The Centre for Corporate Governance in Africa (2016) *Carrots and Sticks: Global Trends in Sustainability Reporting Regulation and Policy*

United Nations Global Compact (2013) *The Value Driver Model: A Tool for Communicating the Business Value of Sustainability.*

United Nations Global Compact (2015) *Board Programme: Unlocking the Value of Corporate Sustainability.*

US SIF (2013) *Comments to IIRC Draft Framework*

US SIF (2016) *Sustainable Economy Report*

World Federation of Exchanges (Oct 2015) *Exchange Guidance and Metrics*

Additional resources

Investor letters, including a Ceres and PRI led letter from October 2014 to IOSCO SG David Wright outlining the need for IOSCO to play a role in establishing globally cohesive approach to ESG reporting. $9.3 Trillion AUM supporting; and a October 2015 Investor and Company letter to Stock Exchange, request they create an ESG Guidance for Issuers. $10 Trillion AUM +400 billion in market cap supporting led by PRI-UN Global Compact and Allianz Global Investors.

Appendix 2: Research on ESG that supports the business case.

We cite below five studies which support the claim that there is a clear linkage between ESG factors, company performance and investor preferences.

1) A 2014 meta study from the Smith School of Enterprise and Management at the University of Oxford. This paper examines the research literature, and concludes that of 49 papers reviewed 43 (86%) demonstrate positive correlations between company operational performance and environmental , social and governance factors: http://www.smithschool.ox.ac.uk/publications/reports/SSEE_Arabesque_Paper_16Sept14.pdf
2) A 2015 meta study reviewed around 2200 empirical studies relating to ESG and corporate financial performance and concludes that roughly 90% of studies find a non-negative relation between ESG and corporate financial performance. More importantly, the large majority of studies reports positive finding. It also concludes that the positive ESG impact on corporate financial performance appears stable over time: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2699610
3) A 2017 study published by State Street Global Advisors draws from a survey of close to 600 institutional investors, both asset managers and asset owners from a wide range of countries globally. It demonstrates that ESG factors are regarded as financially material by most investors and that 92% of the investors surveyed want companies to identify and report on the material ESG issues they believe affect financial performance. It also observed that of 80% respondents agree or strongly agree there is a lack of standards around ESG integration: https://arabesque.com/research/Final_The_Investing_Enlightenment.pdf
4) Another 2017 study by EY which drew from 320 responses from buy-side senior decision makers. This study's findings are consistent with the State Street study, and concludes that investors see long-term benefits in companies with high ESG performance, and also noted that investors are demanding more from company ESG reports: http://www.ey.com/Publication/vwLUAssets/EY_-_Nonfinancial_performance_may_influence_investors/$FILE/ey-nonfinancial-performance-may-influence-investors.pdf
5) A 2018 "toolkit" for guiding ESG disclosure and transparency published by the International Financial Corporation, part of the World Bank Group. It provides detailed guidance on ESG disclosure for companies, and articulates the business case for these disclosures – including taxonomy of the main providers of ESG related frameworks and standards (including many of the CRD members). While intended primarily for emerging markets companies much of this toolkit has relevance for companies in developed markets as well.