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Strategy and Sustainability

What is ESG Reporting and Why Does Business Need It?

ESG & Sustainability Transformation

Hung NINH 12/2023 ESG Transformation

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ESG reporting is the disclosure of data covering business activities related to environmental, social, and governance aspects of a business.

By disclosing this information in a report, a company's progress related to these three areas can be checked against benchmarks and objectives. Again, ESG reporting is designed to provide full transparency about an organisation's environmental, social, and governance impact on a multitude of stakeholders, including investors, employees, and customers.

The ESG reporting process requires organisations to collect and manage data from a variety of financial and non-financial data sources. The data must then be organised and mapped against a variety of reporting standards from bodies such as the Sustainable Accounting Standards Board (SASB), the Global Reporting Initiative (GRI), and the Task Force on Climate-Related Financial Disclosures (TCFD) and disclosed to rating agencies and shareholders.

What Is ESG Risk?

Think of ESG reporting as a form of risk management that addresses business, sustainability, and social issues. Some of ESG-related risks include:

- Environment: Climate change, greenhouse gas (GHG) emissions, deforestation, biodiversity, waste, and pollution.
- Social: Customer relations, employee relations, labour, employee welfare, community relations, health and safety, supply chain, human rights, and work-life balance.
- Governance: Board management practices, succession planning, equity and inclusion, diversity, compensation, regulatory compliance, fraud, data, privacy, and corruption.

These ESG risks are claimed to cause physical, financial, and reputational damage to a business. Failure to report and manage ESG-related issues is risky business activity that can lead to ESG-related incidents or controversies.

Why is ESG reporting important?

ESG reporting is the documentary aspect of ESG. In this next section, we list the benefits of this document to understand why ESG reporting is important for organisations.

ESG reporting creates transparency

Understanding the importance of ESG reporting requires a mindset shift, one that does not see ESG regulation as a burden but sees reporting as a means of transparency. Transparency is a tool for unlocking capital and creating solutions to major global challenges organisations face today (e.g., climate change, equity, and data security).

Transparency also encourages accountability, which is essential for collaboration and the development of actionable solutions. Additionally, organisations can track progress, set benchmarks, and communicate when their ESG goals have been met.

ESG reports attract financiers and investors

Increasingly, investors and lenders will use the transparency offered by ESG reporting to assess a company's level of risk and determine its possible future financial performance.

To demonstrate this investor change, we turn to reports published by the Principles of Responsible Investing (PRI). PRI is a group of contracting investors started in 2006, and supported by the United Nations. The aim is to help investors integrate ESG factors into the investment process. Thus, PRI has established a specific, voluntary, and aspirational set of principles for investors to follow.

As investor interests in ESG grow, so does the number of signatories in PRIs. That is, in 2006, the PRI had 63 signatories commanding $6.5 trillion in assets under management. In 2021, this number increased to 3826 signatures, controlling $121.3 trillion.

In addition, the Deloitte Center for Financial Services expects ESG-authorised assets in the United States to account for 50% of all professionally managed investments by 2025.

In short, investors avoid companies that lack ESG reporting, with reduced transparency being a major concern.

ESG reporting meets stakeholder needs

However, it's not just investors demanding more transparency when it comes to environmental and social concerns in business. Consumers are also demanding responsible brands. For instance, a survey from First Insight found that consumers, especially Gen Z, are willing to support brands with an effective ESG strategy.

62% of Gen Z prefer to buy from a sustainable brand, and 73% of them are willing to spend up to 10% more on a more sustainable product/service.

And we have a similar scenario when it comes to employees. Cone Communications found that 76% of millennials consider an employer's sustainability agenda before making their career choice. As such, ESG reporting will boost an organisation's chances of attracting new talent.

ESG reporting reacts to regulatory change

Regulatory forces are also putting pressure on companies to produce ESG reports. Proactive and future-focused brands will understand the importance of meeting ESG criteria in response to the changing business landscape.

Therefore, it should come as no surprise to learn that 92% of companies in the S&P 500 and 70% of Russell 1000 companies have released their annual ESG reports.

Current regulations and policies are leaning towards mandatory reporting on ESG. And the European Green Deal appears to be the most ambitious of these new regulations.

Between 2000 and 2017, research by the European Organisation for Corporate Governance (ECGI) identified 25 countries that gave companies a mandate to disclose ESG information.

Countries include Australia, China, South Africa, and the United Kingdom. However, until now, these mandatory regulations have only applied to state-owned companies, large corporations, and listed companies.

In addition, the obligation for companies to report sustainable information is also increasing. For instance, in March 2022, the Securities and Exchange Commission unveiled a new climate disclosure proposal. This currently represents the most widely authorized disclosure of federally mandated corporate ESG data ever required in the United States. The aim is to address climate-related risks and improve reporting consistency, quality, and comparability.

How is ESG reporting different from sustainability reporting?

First, to create an effective ESG report, you need to understand how this differs from a sustainability report. You need to make sure the two are separate within your business. You can then use ESG frameworks and standards to guide your business in creating a comprehensive ESG report.

The main difference between ESG and sustainability reporting is the stakeholders addressed each. ESG is a concept used by investors, providing them with a framework for assessing a company's performance and risk. As an investment framework, standards have been set by legislators, investors, and ESG reporting organisations.

Sustainability, on the other hand, has a broader stakeholder focus, accounting for employees, customers, and shareholders. In contrast to ESG, sustainability standards incorporate scientific input.

The difference between ESG and sustainability reporting is subtle but important.

ESG criteria act as a shopping list that companies need to have on hand to attract responsible and ethical investments. These criteria are more specific and data-driven than those used to assess organisational sustainability. This specificity may be why ESG is becoming the preferred phrase choice when thinking about purpose-driven businesses.

To invest effectively and responsibly, investors need ESG reports because these reports allow them to review reliable, accurate, comparable, and timely data.

Management reports are usually provided in an organisation's annual report. It is standard for companies to provide a copy of their governance procedures and code of ethics.

Environmental data is harder to report because the metrics are much more complex. New regulations are being developed in this area and with that, reporting standards can be improved.

Social issues include employee welfare, labour relations, workplace health and safety. Companies have been slow to provide reliable and comparable data on social issues.

ESG reporting requirements, standards, and frameworks

Before deciding which ESG framework and standards to use, it's important that you understand the difference between these two terms, which we explain below:

ESG framework: A framework is broad in its scope, giving a set of principles to guide and shape understanding of a certain topic. In this case, we're referring to ESG. An ESG framework will guide the direction of ESG reporting but will not provide a methodology for the collection of information, data, or the reporting itself. Frameworks are useful to use alongside ESG standards, or when a well-defined standard does not exist.

ESG standards: Specific standards in their focus. They contain detailed criteria explaining what should be reported. In the context of ESG, this means standards that dictate how information and data are collected and how reports are generated (including what topics and areas of business). Standards make frameworks easier to act on by ensuring comparable, consistent, and reliable disclosure.

ESG FRAMEWORKS

Voluntary disclosure frameworks

Under these frameworks, a company proactively discloses its sustainability-related policies, practices, performance data, and information related to ESG criteria. Usually, these frameworks take the form of questionnaires. Below we have identified the most common voluntary disclosure frameworks.

- Carbon Disclosure Project (CDP);
- Global Real Estate Industry Benchmark (GRESB);
- Dow Jones Sustainability Indices (DJSI).

Guidance frameworks

The guidance framework provides recommended methodologies and guidelines to help companies identify, manage, and report on their ESG performance. Below, we've identified the most common guiding frameworks.

- Sustainability Accounting Standards Board (SASB);
- Global Reporting Initiative (GRI);
- Task Force on Climate-Related Financial Disclosures (TCFD);
- Carbon Disclosure Standards Board (CDSB);
- International Integrated Reporting Council (IIRC).

Third-party aggregators

Third-party aggregators refer to frameworks that evaluate an organization's performance based on aggregated and publicly available data. Data is collected from records sourced from the company, publications, company websites, annual reports and/or sustainability or CSR reports. Here are the main third-party aggregator players.

- Bloomberg Terminal ESG Analysis;
- Institutional Shareholder Services (ISS E&S) Quality Score (ISS);
- MSCI;
- Sustainalytics.

ESG REPORTING STANDARDS

- European Financial Reporting Advisory Group (EFRAG);
- International Sustainability Standards Board (ISSB).

ESG REPORTING FRAMEWORKS, STANDARDS AND CHALLENGES

There are more than 600 ESG (Environmental, Social, Governance) reporting terms globally. This is creating a soup of ESG interpretations, obfuscating what constitutes a sustainable investment versus what doesn't.

As such, The International Business Council (IBC) and the World Economic Forum published their report: Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation.

This 2020 report attempts to standardize ESG metrics and disclosures for interoperable ESG reporting. Interim figures and disclosures were established and made at the IBC Winter Conference 2020 in Davos. The consultation saw more than 200 companies, investors and other stakeholders provide feedback. This feedback has been used to refine ESG metrics.

The selected ESG indicators were chosen because of their universality across industries and business models. However, it should be noted that the selected metrics do not replace the relevant industry and company-specific ESG reporting standards.

Given below is a snapshot of some of the core metrics and disclosures chosen:

Principles of Governance

Purpose of establishment: This is the stated purpose of the company, as an expression of how a business proposes solutions to economic, environmental and social problems. The purpose of the company is to create value for all stakeholders.

Anti-corruption: The total percentage of governance body members, employees, and business partners who have been trained on anti-corruption policies and procedures, broken down by region.

The principle of the Planet

Greenhouse gas (GHG) emissions: Greenhouse gases are reported in tonnes of Scope 1 and Scope 2 GHG emissions of the Equivalent GHG Protocol (tCO2e). Scope 3 emissions estimates are also given where appropriate.

Land use and ecological sensitivity: This is reported by the number and acreage (in hectares) of owned, leased, or managed sites in or adjacent to protected areas and/or key biodiversity areas (KBAs).

Principles of People

Diversity and inclusion (%): The percentage of employees by employee type determined by age group, gender, and other indicators of diversity (e.g., ethnicity).

Salary (%): The ratio of the standard entry wage by gender to the local minimum wage.

The list above gives you an idea of what figures and disclosures have been agreed upon.

Adding to this, in 2020, reporting organisations CDP, CDSB, BRI, IIRC, and SASB presented their "Statement of Intent to Work Together Towards Comprehensive Corporate Reporting". This paper is an agreement between the contributing parties, to communicate and collaborate together to produce globally recognised ESG reporting standards.

These efforts are resolving contradictions and aim to create a common, global language for ESG. Currently, there are many tutorials available. This will and is changing.

ESG reporting is mandatory for the purpose-driven business

Creating ESG reports is imperative for purpose-driven business. Doing so will promote transparency in business, investor demand, and sales and will attract top talents. You can use your ESG reporting as a springboard to come up with an effective ESG strategy that will realise the full benefits of ESG compliance.

To learn more about ESG and sustainability-related models, don't hesitate to contact **YTT Consulting**!