

Environmental, social, and governance reporting Supporting informed decisions



Today, as organizations flood the market with sustainability information to meet various reporting requirements and demands from stakeholders, the validity and usefulness of this type of information both internally and externally is a front-burner topic in executive suites and boardrooms.

While sustainability reporting remains largely voluntary in most areas, there is increasing pressure for more depth and accuracy in sustainability reporting. Sustainability data has increasingly broad implications for key internal initiatives, such as risk management and cost-saving initiatives. Accurate sustainability data is also needed to fulfill external reporting and disclosure needs, such as preparing reports for the Carbon Disclosure Project (CDP) and for answering institutional investors' questions about a company's sustainability performance. The bottom line is that sustainability information, particularly reports on a company's environmental, social, and governance (ESG) activities, is achieving a higher profile, drawing

attention from regulatory bodies in the US, South Africa and Europe. Therefore, it is important that companies' reporting on their ESG efforts become more uniform and reliable.

Reporting accuracy at issue

Consumers, investors, and employees are increasingly making economic decisions about companies based in part on sustainability alignment and performance. Third parties are now involved in assessing ESG performance and reporting metrics (see sidebar, "The drumbeat for change grows louder"). Therefore, business leaders are increasingly concerned about the accuracy and trustworthiness of the ESG information they release to the public. Moreover, senior executives and board members are recognizing the strategic and operational implications of more closely linking the company's position on sustainability issues to their own decision making about where and how the company operates.

The drumbeat for change grows louder

Demands for more and better ESG reporting are growing — as are the ways stakeholders and media outlets use the data. Heightened attention to detail and accuracy has led to three basic categories of influence on what and how companies report:

Standard setters: These are groups that guide or shape the content and frequency of ESG reporting. These guidelines are generally used to measure ESG progress or to link sustainability efforts to performance metrics:

- The Global Reporting Initiative (GRI) released the third version of its reporting framework (known as the G3) in 2006. Reports prepared according to the framework, according to the GRI's Web site, can be used to "benchmark organizational performance with respect to laws, norms, codes, performance standards and voluntary initiatives; demonstrate organizational commitment to sustainable development; and compare organizational performance over time."
- For 10 years, the Carbon Disclosure Project, on behalf of hundreds of institutional investors with assets of \$55 trillion,¹ has annually challenged thousands of large global companies to measure and report carbon emissions.

Aggregators: Some groups, such as Bloomberg, gather publicly available ESG data from companies and offer it to financial analysts and others:

Bloomberg's 250,000 data terminals now make ESG data available on more than 2,000 companies for investor use. Bloomberg executives have estimated that 11 percent of assets under management were "socially responsible," noting that with the advent of its new data the other 89 percent will now get a chance to see what that 11 percent are doing.²

Evaluators: These groups analyze data and draw conclusions about leading practices in a particular industry, sector, or dimension of sustainability:

- The Dow Jones Sustainability Index tracks the financial performance of the leading sustainability-driven companies worldwide, and the FTSE4Good Index measures the performance of companies that meet globally recognized corporate responsibility standards. Both indices are designed to provide asset managers with reliable and objective benchmarks with which to manage sustainability portfolios.
- Supply-chain partners and customers are becoming more interested in the sustainability performance of companies with which they do business — and are increasingly taking this performance into account when making purchasing and partnering decisions.

Effective reporting yields benefits

Sustainability reporting provides a credible way for organizations to publicly disclose their corporate responsibility activities and to relate that progress to stated goals. Done effectively, sustainability reporting can offer investors, customers, employees, and other interested external parties the insights into sustainability activities that will help them make informed decisions about their dealings with a particular company. In addition, the process of developing a sustainability report can yield information that might help a company's leaders better align the organization's sustainability efforts with its business strategy.

However, our conversations with business leaders suggest that growing numbers of CFOs, sustainability officers, and risk officers wonder if too much emphasis is being placed on data gathered with little or no formal process and controls. They have expressed concerns regarding existing metrics and monitoring systems—and data reliability, even among companies with mature sustainability programs. At a minimum, it is possible that what accurate information does exist is not being used to its full value.

¹ Carbon Disclosure Project, <https://www.cdproject.net/en-US/WhatWeDo/CDPNewsArticlePages/Become-2010-CDP-Signatory.aspx>. Accessed October 21, 2010.

² www.greenbiz.com, "Live from the Ceres Conference: Corporate Sustainability Reporting and Beyond," April 15, 2009. Available online at <http://www.greenbiz.com/blog/2009/04/15/live-ceres-conference-corporate-sustainability-reporting-and-beyond>.

The goal is better decision making

Though sustainability reporting is voluntary today, many believe a tipping point for change is coming. The better the condition of an organization's reporting process on a voluntary basis, the more likely it will be to shine as a leader under new regulations and mandates. The time has come for organizations that aim to conduct their sustainability efforts in a serious, businesslike fashion to put in place proper collection, control, reporting, and monitoring processes. Above all, the essential point to remember is that better sustainability reporting is about providing the information needed for improved decision making.

We think the keys to effective sustainability reporting include picking the relevant metrics, deciding how much to report about each one, and choosing a framework and methodology for reporting that aligns with the company's strategy. It's important to focus on what matters—the information that is important to one's own constituents. Draw on a finely tuned understanding of external and internal stakeholders' needs to determine what is appropriate to report; go into the process with a conviction that the effort will take time to get right; and be prepared to juggle multiple steps and tasks along the way.

Getting started

Leaders' decisions on whether and how to change their sustainability reporting efforts should be based, at least in part, on how to meet the objectives of keeping better records and producing sustainability reports that meet both internal and external stakeholder needs. Past questions from stakeholders about a company's sustainability activities, for instance, would indicate that there may be a need for reporting improvements. An expectation of future regulatory compliance needs could drive changes as well. In addition, the need for better reporting could stem from increased competitor transparency or from demands for greater accountability from analysts, customers, or investors.

The goal of sustainability reporting is analogous to that of a company's financial reporting activities: to gather data and produce reports that tell stakeholders what they want and need to know about the company's objectives and progress. Working through what constitutes the right details with respect to sustainability reporting will likely take time. The stakeholder groups concerned

with sustainability are probably broader than those focused on financial reporting, extending to the general community, wider NGO groups, and perhaps more deeply penetrating consumer and employee populations. This further complicates the choice of metrics and key performance indicators (KPIs), as they will likely need to address the informational needs of a wide range of constituencies.

It will help jump-start the process to raise several essential questions about why and how the company is undertaking sustainability reporting:

- What is the company required to report?
- Where is the company in its sustainability journey — in other words, what is its level of sustainability maturity? Have the appropriate drivers and relevant KPIs been identified? Has the materiality of the KPIs been fully assessed?
- Have key stakeholders been identified? Have their views been fully considered in the development of the sustainability KPIs to be reported?
- Does the initiative align well with business priorities? Have risks and opportunities associated with sustainability efforts been identified and prioritized? How satisfied is the board, management, and other key stakeholders with what is being reported?
- Has a formal framework and appropriate processes been put in place to gather, review, and report on data, as well as to track and monitor KPIs, risk, etc.?
- Who owns the data? What is the quality of the source data?
- What will be the main challenges to launching or improving a reporting initiative?
- What is happening in the marketplace, particularly among competitors?
- What does the company want to be known for with respect to sustainability?
- What will be the impact on the enterprise—e.g., how might the sustainability reports affect taxes, the balance sheet and P&L, and cross-silo cooperation?

Sustainability reporting reviews and assurance

As sustainability grows in importance for companies and their internal and external stakeholders, sustainability reporting may become core to business processes. As such, the data should be subjected to internal controls and processes associated with an internal audit and potentially also a third-party, external review of the information.

Sustainability assurance is an objective, systematic way for an organization to evaluate its environmental, social, and governance initiatives, including assessing how well its sustainability reporting processes are working and exploring how they can be improved. There may be a number of opportunities to improve an organization's sustainability performance (and, through improved decisions, potentially also its profitability) in areas such as facility efficiency, supply chain management, and risk management. Leaders can improve their chances of identifying and taking advantage of such opportunities by putting a defined internal assurance program in place. Internal assurance can also help demonstrate that an organization is producing high-quality, dependable data for decision making.

Although most companies have internal audit departments, many are not set up to assess economic, environmental, and social initiatives—or, for that matter, to meet the challenges of reporting on a topic as broad as sustainability. As companies work to bring non-financial measures to the forefront of their decision-making processes, internal assurance professionals must prepare to broaden their view on performance concepts, shifting from a traditional financial perspective toward a view that integrates financial measures of performance with other, non-financial metrics that relate to the organization's well-being.

Once an organization's sustainability information satisfies the requirements of internal assurance, a company may choose to subject the report to an external assurance process. Organizations will need to seek third-party professional support for the external assurance process.

Benefits of improved sustainability assurance

As with reliable financial reporting, there are many possible benefits for a company that implements assurance processes and reporting on sustainability activities. These benefits may include:

- Greater understanding of current sustainability performance
- Identification of areas for improvement around reporting processes and controls
- Improved ability to meet investors' and other stakeholders' expectations of accurate disclosures
- Greater credibility among current and potential employees, business partners, and government regulators
- Greater conformity to the standards of reporting under relevant frameworks (e.g., the GRI G3 framework)
- Enhanced corporate reputation with employees, investors, business relationships, and government regulators due to an improved ability to provide more reliable information and greater transparency stemming from internal assurance
- Improved monitoring of controls and processes related to environmental, social, and governance metrics
- Improved ability to maintain or achieve a sustainable business model
- Increased awareness of and visibility into the contribution of sustainability activities to enterprise value
- Improved decision making with integrated sustainability considerations

Leaders should take care that specialized service providers are delivering skills and counsel appropriate to their area of specialty and that their recommendations connect effectively with the general objectives and direction of the business strategy, rather than taking it off course.

Demonstrating company commitment

With a formal approach to sustainability reporting and assurance in place, areas for improvement around reporting processes and controls can be addressed, and executives charged with responsibility for sustainability programs will be in a better position to make informed, data-supported business decisions. Organizations may benefit from a greater understanding of their current sustainability performance, enhanced transparency into sustainability efforts, and an improved ability to meet investors' and other stakeholders' expectations of accurate disclosures. In turn, an organization's commitment to providing stakeholders with accurate ESG information may lead to greater credibility among current and potential employees, customers, investors, business partners, and regulators. In short, by establishing a reliable sustainability reporting process and seeking assurance on the same, management demonstrates its desire to deliver accurate and useful information to its various stakeholders.



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