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Non-financial numbers that add up for ESG reporting

Consistent and comparable data will unlock further progress in ESG reporting. An initiative from the WEF could be a catalyst.

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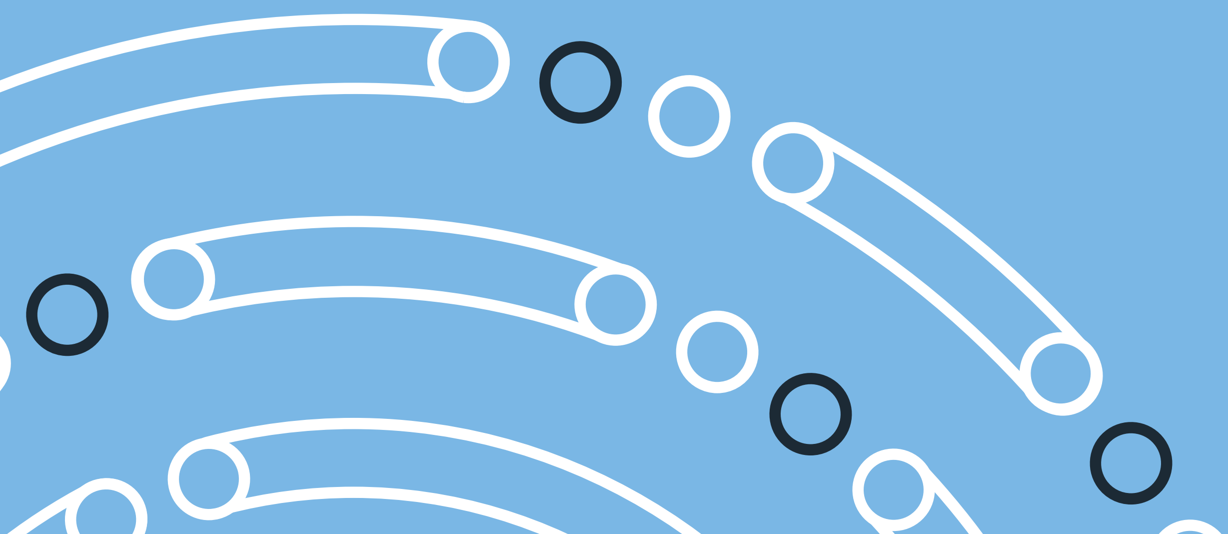
September 2020

The E, S and G of investment has been moving up the reporting agenda rapidly in recent years as environmental, social and governance factors moved from the periphery to become a key part of decision making by businesses and investors.



When they use ESG data to make decisions, they need data that is complete, consistent, reliable and comparable. On all counts, there is still some way to go and calls for better data are growing louder. In a recent survey, McKinsey and Co asked executives and investors for reasons why ESG considerations are not fully included in assessments of competitors, suppliers and/or capital projects. The number one reason, cited by 62% of executives and 58% of investment professionals, was insufficient data.

Toward Common Metrics and Consistent Reporting of Sustainable Value Creation, a paper by the Word Economic Forum (WEF), published earlier this year and backed by the Bank of America and the Big Four professional services firms, represents a serious attempt by the auditors to address the shortcomings. While this article's primary concern is data, the initiative by the WEF brings into focus some wider issues around ESG reporting and we will cover some of the practicalities and explore how the annual reporting suite could evolve.

Investment grade data in the context of ESG numbers has the following characteristics:

- Accuracy: does the company deploy rigorous data collection systems?
- Boundaries: does the data align to the fiscal year and business ownership model (adjustments for partial ownership/acquisitions/divestments)
- Comparability and consistency: are companies using consistent global standards?
- Data provision: does the company provide raw as well as normalised data?
- Timeliness: does the data coincide with the annual reporting cycle?
- External assurance: has the data been assured to strengthen its credibility?
- Balance: has the company provided an objective view including favourable and unfavourable commentary?

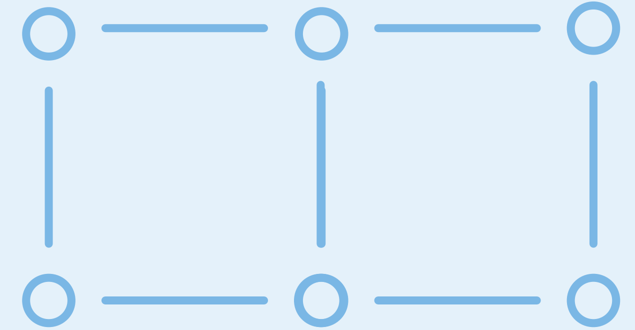
Accuracy is clearly important, and most companies employ an independent party to collect the data. These provide data against a number of reporting standards such as the GRI (Global Reporting Initiative). The challenge is achieving consistency on the reporting standards.

On **boundaries and timeliness**, the recommendation to publish the data within the annual report means that the non-financial data will be consistent with the financial data. A current EU directive only requires reporters to publish their non-financial statement “within a reasonable period of time, not exceeding six months after the balance sheet”.

This has been a challenge for reporters, particularly those pushing for a fast close or those that publish their annual report on the day they announce their year-end results. To date, a less than satisfactory solution for some of these companies was to publish a combined report with sustainability disclosures, and unaudited data sitting outside the strategic or management report. This will address an important issue for sustainability reporting. Until non-financial data is published alongside financial data, it won’t be considered in equal measure.

The issue of **comparability and consistency** has been a bugbear for investors and analysts seeking to quantify business risks and opportunities arising from ESG. A plethora of sustainability reporting frameworks hasn't helped. The solution in the WEF paper is to establish a minimum requirement by making a distinction between 22 core metrics and expanded metrics. Importantly, these metrics are also drawn from existing frameworks such as GRI, so the initiative hasn't compounded the current problem by introducing a new methodology. There have been initiatives to streamline the number of frameworks, such as the Better Alignment Project, but this initiative could be an agent for change because it's being driven by independent parties.

These are sensible measures, but a long way from the SASB framework, currently endorsed by Blackrock, a leading asset manager, which provides sustainability accounting standards for each of 77 industries. There is a tricky balance to be achieved between comparability and sector specificity and it is unclear how the principle of materiality fits into the picture. On one hand, there is a risk that other material disclosures will be missed as companies focus on a smaller number of metrics. On the other hand, some companies may find themselves reporting on issues that a materiality assessment would have disregarded.

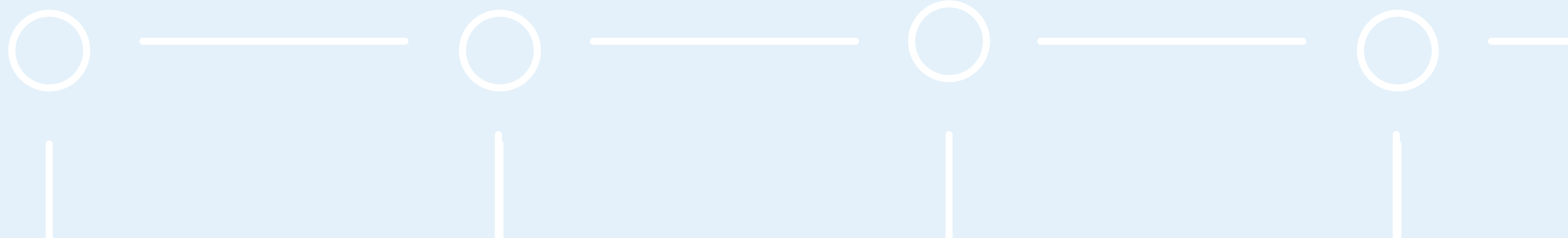


82% of sustainability reports reviewed sought external assurance.

The WEF paper states that metrics and recommended disclosures should be capable of verification and assurance. Assurance for sustainability metrics is not new, the world's first sustainability assurance standard was published in 2003. According to Reporting Matters, which is produced by the World Business Council for Sustainable Development (WBCSD) in partnership with Radley Yeldar, 82% of sustainability reports reviewed sought external assurance. Of those obtaining external assurance, a limited level of assurance on a large range of indicators or the reporting process continues to be the norm (76%). These results represent the views of WBCSD members which tend to be larger entities with the means to seek assurance even if not mandatory. While its importance is understood and ability to provide assurance is well established, we can expect it to become the norm for a broader range of companies including smaller companies.

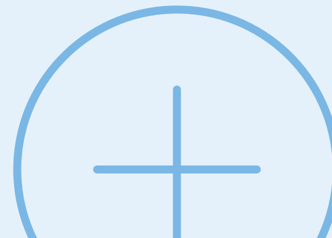
When it comes to compliance, the WEF paper advocates a comply or explain approach, which works well in other areas of reporting such as governance.

It can actually be more insightful when companies that don't comply explain why. State Street Global Advisors, one of the largest asset managers, has announced that, in 2022, it plans to start voting against the boards of big companies that have underperformed relative to their peers on ESG standards, particularly financially material sustainability issues, and cannot explain how they plan to improve.



The paper advocates discussing the metrics in the annual report rather than in a separate sustainability report. The mantra for annual reports is that they are fair, **balanced** and understandable, which would address the issue of balance. In recent years, the European Securities and Markets Authority (ESMA) has been tightening up the requirements for comparable **raw and normalised data** to ensure that companies aren't trying to present an unrealistically favourable picture. Yoking financial and non-financial information within the annual report should help bring consistent reporting standards.

There is also an assumption having these metrics in the annual report will get board members to focus on non-financial reporting. The involvement of the Board or top management in sustainability reporting processes is a best practice and unfortunately not mainstream, so placing these metrics within the annual report would also help raise Board-level awareness on sustainability challenges.



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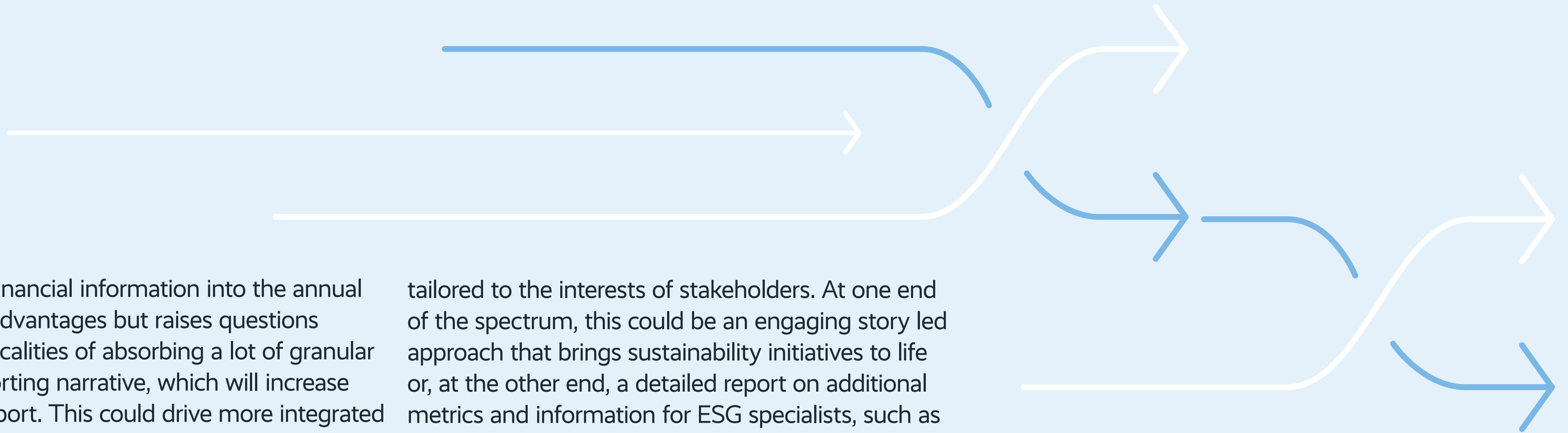

Integrating non-financial information into the annual report has clear advantages but raises questions around the practicalities of absorbing a lot of granular data and a supporting narrative, which will increase the size of the report. This could drive more integrated reporting and we are supporters of this as means of providing a holistic view of a business, while focusing on the most essential information. However, companies shouldn't underestimate the size of the task. It doesn't necessarily mean the end of a separate sustainability report either. For some companies, this will provide additional and more detailed information tailored to the interests of stakeholders. At one end of the spectrum, this could be an engaging story led approach that brings sustainability initiatives to life or, at the other end, a detailed report on additional metrics and information for ESG specialists, such as MSCI and Sustainalytics.

The WEF report is out for consultation, with the results of this expected soon and a planned introduction in 2021.

We'd love to chat. Get in touch via hello@ry.com or visit ry.com

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