GLOBAL DEVELOPMENTS IN CORPORATE REPORTING

On climate, broader ESG & other intangibles

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KPMG

Transformation of the Global Corporate Reporting System

Last year's publication provided an overview of developments to standardise sustainability reporting and transform the global corporate reporting system.

Over the last twelve months, the pace of change has accelerated with significant accounting, management, and reporting implications for Australian businesses with respect to climate, broader ESG and other intangibles such as innovative and technology capability.

It is important to note the contemporary concept of 'sustainability' being embraced within that system under the leadership of the International Organization of Securities Commissions (IOSCO) and the IFRS Foundation, as explained in IOSCO's final report, 'Report on Sustainability-Related Issuer Disclosures', in June 2021.

That concept equates sustainability in relation to investor reporting to enterprise value, or the net present value of future cash flows. Accordingly, the concept clearly embraces ESG matters and other intangibles such as brand, customer satisfaction, innovation, intellectual property, technology, and governance and strategic management, notwithstanding the current prioritisation of climate reporting. It is important that this broad concept is not lost in broader reporting, such as in integrated reports.

The 2021 KPMG report shows that many ASX200 companies are reporting more fully on their climate, COVID-19, broader ESG value drivers. Even so many will not be ready to deal with the change that is coming through standardisation of sustainability reporting standards, a new globally 'connected' reporting system and other local and global regulations requiring increased data segmentation and disclosure (e.g., driven by the EC Directives) unless they prepare well now ('think global, act local').

The global timeline

IN DECEMBER 2020, the 'Group of 5' (IIRC, SASB, GRI, CDSB, CDP) issued a report, *'Reporting on Enterprise Value – Illustrated with a prototype climate-related financial disclosure standard'.*

The prototype standard is consistent with the TCFD Recommendations and uses two of the principal resources of the Value Reporting Foundation – the International Integrated Reporting Framework and the SASB Standards. This work is being used by the Technical Readiness Working Group of the IFRS Foundation as it prepares for the creation of the ISSB (refer below). It is worth noting that many global corporations are now reporting in accordance with the TCFD Recommendations, and it is now required for listed companies in the UK and Japan, and soon New Zealand.

IN MARCH 2021, the IFRS Foundation, with support from IOSCO, confirmed its plan to launch an International Sustainability Standards Board (ISSB) at the COP26 Conference in **November 2021.** That plan seems well on track to be realised in the weeks to come, with the formation of the ISSB likely to be announced in or around the COP 26 Conference, with a draft climate reporting standard to follow that. Next year's edition of this publication is likely to focus on first-time reporting in accordance with that standard. We also expect that a discussion about assurance under that standard will also be active at that time.

IN APRIL 2021 the International Auditing and Assurance Standards Board issued guidance on assurance on all forms of 'extended external reporting', including integrated reports and ESG reports. Integrated reports prepared in accordance with the <IR> Framework, which can include material SASB metrics, as set out in a rigorous Basis of Preparation and Presentation, are likely to meet the requirement in assurance standards for 'suitable criteria' to be in place before assurance can be provided.

Almost all existing instances of integrated reporting assurance have been provided by an audit firm and always under the relevant IAASB assurance standard according to the **April 2021** IIRC / IFAC paper, *'Accelerating Integrated Reporting Assurance in the Public Interest - IFAC and the IIRC Support Pathway to Integrated Reporting Assurance'.*

Investors are increasingly understanding the value of assurance and demanding it by an external auditor over corporate reports.

Recent IFAC research (*'The State of Play in Sustainability Assurance'*, **June 2021**) found that 100% of the 50 Australian companies reviewed provided ESG disclosures, 56% of these 50 companies obtained assurance on those disclosures, always by an audit firm and almost always under the relevant IAASB assurance standard.

The value of assurance has been recognised in the new ASX Corporate Governance Recommendation 4.3, where Directors are accountable for reporting on the integrity of disclosures in their periodic corporate reports, and for explaining how they have achieved integrity if not through audit or review. The 30 June 2021 reporting season saw the vast majority of first-time reporting under Recommendation 4.3.

IN MAY 2021, the IASB published the Exposure Draft *Management Commentary.* The Exposure Draft sets out the Board's proposals for a comprehensive new guide for preparing a management commentary that would be available for adoption by companies, or adoption by national regulations. Feedback on these proposals which are essentially consistent with the <IR> Framework closes on 23 November 2021. Their finalization is likely to form an early point of interaction between the ISSB and IASB as the basis for developing a new 'connected' corporate reporting system.

Likewise, in Australia, the AASB has issued ED311 on *Management Commentary* asking questions with respect to adoption of the IASB exposure draft in the Australian context. Submissions closed on 1 October 2021.

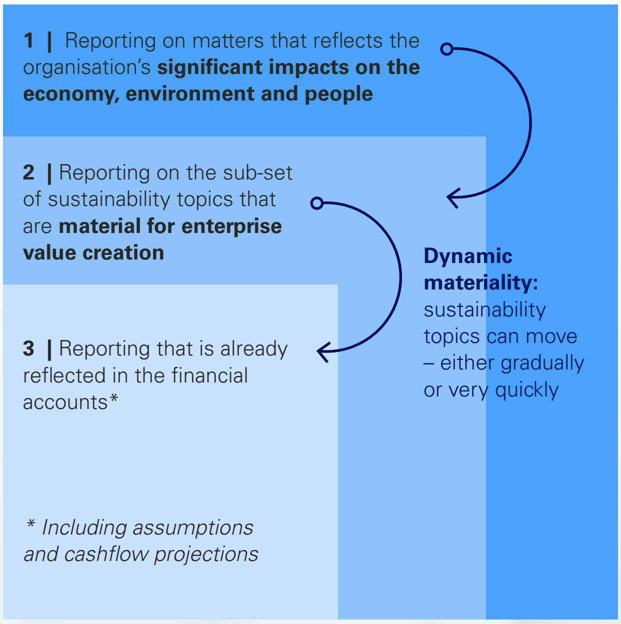
In the submissions to the IFRS Foundation's earlier Exposure Draft on changes to its constitution, many organisations responded that the <IR> Framework, which has now been adopted by many countries and leading organisations, should form the basis of the required 'connected reporting framework.'

IN JUNE 2021, the IIRC and SASB merged to establish the Value Reporting Foundation (VRF), supporting the information needs of the capital markets through the International Integrated Reporting Framework, SASB Standards, and Integrated Thinking principles. The merger of the IIRC and SASB represents significant progress towards simplifying the corporate reporting landscape.

Over the past decade, SASB has developed 77 sector-specific Standards identifying ESG topics reasonably likely to affect an entity's financial condition or operating performance. The Standards, which include key ESG metrics for relevant sector topics, were prepared with support from SASB's Investor Advisory Group, which manages US$40 trillion in assets and includes eight of the world's 10 largest asset managers. The SASB Standards are one of the VRF's three principal resources.

SASB standards are compatible with the most widely adopted sustainability reporting standards (GRI Standards) but are designed for a different purpose. SASB Standards are also aligned with the TCFD Recommendations. Importantly, the <IR> Framework enables material ESG topics and metrics under SASB Standards to be put in the strategic context of the description of The Business - its strategy and resource allocation, governance, and business model - in an integrated report.

The 'nested materiality diagram' (above right) developed by the 'Group of 5' explains how the primary financial and sustainability reporting frameworks (inner box – IFRS, middle box -SASB Standards, TCFD Recommendations, CDSB) are aligned through the International Integrated Reporting Framework to provide material information on enterprise value creation to the capital markets, as well as supplementary information which is not currently material to enterprise value (including additional ESG information, such as in a GRI-based ESG or CDP report – outer box).



1 | Represents reporting to various users with various objectives who want to understand the enterprise's positive and negative contributions to sustainable development

2 | Represents reporting specifically to the sub-set of those users whose primary objective is to improve economic decisions

Source: Impact Management Project, World Economics Forum and Deloitte (2020)

IN SEPTEMBER 2021, the IFRS Foundation issued a paper providing an *"Update on the work of the Technical Readiness Working Group (TRWG)".* The TRWG started work in response to IOSCO's call for the coordination of work to drive international consistency of companies' sustainability-related disclosures that focus on 'enterprise value creation'. The TRWG deliverables, many of which we understand are well advanced will include:

TECHNICAL PREPARATORY WORK

1 | Enhanced prototype climate standard.
Further develop the content of the prototype climate-related disclosure standard to provide a basis for consideration as an exposure draft under an ISSB.

2 | Enhanced prototype presentation standard.
Further develop the content of the prototype presentation standard to provide a basis for consideration as an exposure draft under an ISSB.

3 | Conceptual guidelines for standard setting.
Principles and concepts to support the early standard setting activities of an ISSB (e.g. materiality).

4 | Architecture of standards*.
Key concepts and architecture of what standards look like (e.g., reporting areas, cross-industry metrics and industry-specific metrics).

5 | Other items to inform a standards agenda.
Other items to inform standards agenda. The items that demonstrate the features of pressing topics' for potential standard-setting.

6 | Due process characteristics.
Considerations for transitory and steady-state due process of an ISSB.

7 | Digitisation strategy.
Digitisation strategy fro onset of ISSB's work.

8 | Connectivity.
Evolution of management commentary to provide connecting framework and connectivity between ISSB and IASB.

**(IFRS Foundation: Update on the work of the Technical Readiness Working Group (TRWG), IFRS Advisory Council, September 2021.)*

IN NOVEMBER 2021, the formation of the ISSB is likely to be announced at or around the COP 26 Conference in Glasgow. It was announced that work on its inaugural standard, on climate impact reporting, is likely to be released in the first half of 2022. **In September 2021**, IFAC published a guide for countries to consider in creating their own responses to the ISSB and its standards. The International Integrated Reporting Framework and SASB Standards as a basis for industry-specific interpretations of ISSB Standards are among the contributions of the Value Reporting Foundation.

FRAGMENTATION RISK

Meanwhile the European Commission is moving fast to drive new ESG standards and enhanced reporting for Europe, as part of their Sustainable Finance Action Plan and EU Green Deal.

For EU asset managers and other financial market participants, the Sustainable Finance Disclosure Regulation (SFDR) from 2022 onwards imposes mandatory disclosure requirements. These are aimed at improving transparency in relation to the sustainability of financial products, the consideration of adverse sustainability impacts in investment processes and the provision of sustainability-related information with respect to financial products.

The SFDR was issued by the European Commission alongside the Taxonomy Regulation and Low Carbon Benchmark Regulation. The Taxonomy Regulation establishes an EU Framework for classification of sustainable economic activities. It lays down criteria under which an economic activity can be described as "environmentally sustainable".

Large listed EU corporates that are currently under the scope of the Non-Financial Reporting Directive (NFRD) will be required to disclose the turnover, capex and opex from their 'eligible' operating activities across EU Taxonomies.

Initial taxonomy reporting on climate change mitigation and adaption activities undertaken in 2021 are required to be reported in 2022. The other four taxonomies, on water and marine resources, circular economy, pollution prevention and healthy ecosystems, will come into force for 2023 reporting.

IN APRIL 2021, the EC proposed that the NFRD will transition into the Corporate Sustainability Reporting Directive (CSRD) as of 2023, increasing the number of corporates captured by the extended reporting from 11,000 to over 49,000 companies as it will cover all large non-listed companies, including large foreign subsidiaries. The CSRD proposals would require independent limited assurance over these additional disclosures from 2023 onwards (with a stated ambition to move towards reasonable assurance over time as reporting matures).

In addition, the CSRD also mandates the European Financial Reporting Advisory Group (EFRAG) to set EU sustainability reporting standards through a European Sustainability Reporting Board (SRB).

These developments are at an early stage, but there is a clearly expressed market hope that EU sustainability standards will be developed in alignment with the building block of ISSB standards, whilst recognizing that additional reporting for EU specific public policy objectives may be necessary.

Australian companies with material EU subsidiaries (that meet the definition of large), investments or equity/debt from EU financial institutions should monitor EU developments and determine what if any additional reporting obligations they have under the EU Taxonomies or the CSRD.

2021/22: In the USA, the SEC is expected to propose rules prescribing disclosures over three specific ESG issues: climate, human capital, and cybersecurity risk. The human capital disclosure guidance will build upon the principles-based guidance that came into effect in 2020 and is expected to focus on diversity of the workforce and boards. Climate-related disclosures will build upon the guidance issued in 2010 regarding disclosure related to climate change.

The SEC Staff has been instructed to contemplate whether the disclosures should be included in the Form 10-K, which quantitative and qualitative climate-related disclosures to require, and what level of assurance is appropriate, amongst other considerations. Based on preliminary feedback from industry associations, preparers, auditing firms, and others, the TCFD requirements are favored in the USA, which should drive global convergence in reporting on that specific ESG topic.

IN SEPTEMBER 2021, the SEC began issuing 'please explain' letters to listed companies that have identified and reported on climate matters, and their likely impact on business value, in their CSR and other reports but not in their regulatory filings.

IMPLICATIONS FOR AUSTRALIAN COMPANIES

Globally, duplication, lack of consistency and comparability of sustainability reporting frameworks and standards is finally being addressed. These developments are substantial and are occurring at unprecedented speed in the corporate reporting world and promise a clear path forward for directors and executives to oversee and manage their businesses, and communicate effectively with investors and other stakeholders on climate, ESG and broader intangible enterprise value creation.

Australian business leaders will need to be fully informed on what is happening globally and ready to embrace and respond to the changes in accounting, management and reporting driven by the new international sustainability standards and reporting requirements. In the past Australia has been an early adopter of international financial reporting standards that drive consistency and quality in reporting to the capital markets. On that basis, we may see similarly rapid local developments with sustainability standards.

Business leaders will also need to be across the impacts from changing rules in the USA and EC, especially where they have material businesses, investment, or debt/equity exposure in those jurisdictions.

In the short term, Australian business leaders should have confidence in using the International Integrated Reporting Framework, SASB Standards and TCFD Recommendations, together with company specific intangible value drivers in an integrated fashion when preparing the front part of their annual report (typically in the OFR). Links can be used to direct report users to other reports and on-line repositories, including more detailed ESG and TCFD information, not considered material to enterprise value and so for disclosure in the primary report to shareholders.

In their Recommendation 4.3 adoption statements, boards should be considering audit or review of those corporate reports and disclosures judged to be most significant to investors. The OFR is likely to be among the most significant. Australian directors should feel confident that their auditors are equipped to assist them in responding to investor calls for assurance. beyond 30 June 2021.

Of note, in September 2021, Dexus became the world's eighth instance of integrated reporting assurance, and the first instance for an Australian listed company.

Directors should also be confident in using integrated reporting, SASB Standards and integrated thinking principles as tools of governance and oversight of risk and opportunity management, as well as for encouraging their management teams to use integrated thinking principles as a basis for strengthening their businesses, in other words their creation of enterprise value and delivery on Purpose.

Also in September 2021, the AASB and AUASB established a joint Extended External Reporting Advisory Panel. It is thinking about whether and to what extent the Australian corporate reporting system should replicate or otherwise align with the global corporate reporting system; and whether and to what extent Australia should be a taker of ISSB Standards, including its climate reporting standard.

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