Insights from leaders across the corporate reporting supply chain

Developments in ESG and integrated reporting, including some of the associated benefits and challenges

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Introduction

In September and October 2022, KPMG Australia interviewed leaders from across the 'corporate reporting supply chain[1]' on what ESG means for them, the importance of ESG information to their various decisions as well as its importance to managing and reporting on the organisation's creation and preservation of sustainable enterprise value.

THE CORPORATE REPORTING SUPPLY CHAIN

Interviews have been undertaken with the following senior leaders from across the corporate reporting supply chain:

Reporting Supply Chain	Name	Entity	Perspective
Report preparer	**Anastasia Clarke,** CFO	GPT	Provide preparers view on the presentation of quality ESG data through an integrated report to meet investor information needs, as well as the needs of other stakeholders.
Report approver	**David Thodey,** Chair and NED	Xero, Tyro and Ramsay Health	Provide governance view on engagement with stakeholders, and oversight and direction to management on what information is material to report on ESG, potentially through an integrated report to investors and other stakeholders.

[1] The corporate reporting supply chain refers to the people and processes involved in the preparation, approval, audit, analysis and use of corporate reports. The cycle both starts and ends with the investors and other stakeholders, who want to make informed economic decisions about a company and therefore require information about enterprise value creation to do so.

Auditor	**Michael Bray,** Connectivity and Integrated Reporting, IFRS Foundation; Professor of Practice (Integrated Reporting), Deakin University	IFRS Foundation	Providing an auditor's view on integrated reporting and its assurance from perspective of being a retired KPMG Australia audit partner who advised on the integrated reporting assurance for CBUS (first such engagement in Australia) and CPA Australia. Now at the IFRS Foundation and Deakin University focused on Intangibles and Assurance.
Regulator	**Sean Hughes,** Commissioner	ASIC	Provide the regulator's perspective on developments and challenges with sustainability and integrated reporting to the capital markets.
Report user – Analyst	**Alison Ewings,** Head of Engagement on Corporate reporting developments	Regnan	Provide the analyst's perspective on what they are looking for in corporate reporting and how ESG information (or lack of it) shapes/ changes their research and recommendations.
Report user – Investor	**Lou Capparelli,** Head of ESG	Unisuper	Provide the investors/ asset owner view on what they are looking for in corporate reporting and how ESG information (or lack of it) shapes/changes their investment decisions.
Report user – Proxy advisor	**Martin Lawrence,** Co-founder, and Director	Ownership Matters	Provide the proxy advisor perspective on what they are looking for in corporate reporting and how ESG information (or lack of it) shapes/changes their investor advice.

Detailed insights are included in the KPMG report 'Corporate Reporting Trends 2022 – A review of ASX200 corporate reporting trends in the year to 30 June 2022'. This can be found online at: kpmg.com/au/betterbusinessreporting.

This document includes the full transcripts of each interview.

Report preparer

Interview with Anastasia Clarke, CFO, The GPT Group

Do you believe ESG is critical to enterprise value? Why?

Yes, I do, and I think the Environmental is critical because some organisations are negatively impactful to the environment, and they have an absolute obligation and responsibility to society to eliminate and offset their environmental impact. Substantial sized corporates in the Australian ASX50 should go above and beyond to deliver a positive effect even beyond neutral.

On the Social side, we have a real role to play within communities. We operate in communities; we sell to people in communities and therefore we must give back.

On the Governance side, we have our own shareholders, other key stakeholders such as community, customers and we also have investors in our funds. Getting governance right to ensure we are acting in the best interest of stakeholders in every decision we make and being conscious of the impact on different parties, I think elevates governance and is something very keenly focused on by GPT. A failure of governance will kill your business and I think we have seen that in the industry.

What does ESG mean to you (in your role) and your organisation?

As CFO, it's really to advocate for capital investment and help teams present the returns on that capital that are not strictly known financial outcomes only. This then assists in getting CEO, leadership, and board commitment to that investment to make a difference, i.e. continuing investment in ESG. CFOs can be very damaging to the business by strictly focusing on known financial measurements without being more conceptual and bullish on future unknown financial outcomes.

Part of my responsibility is Technology, which includes automation, enablement of data collection, source of truth, quality control of data, assurance of data. This is important so that we can say what we say authentically and with confidence. The ISSB activities will be a future responsibility and we are planning to voluntarily early adopt.

How do you determine who your primary stakeholders are?

Anyone who we have an impact on, where we change their life in any shape or form, whether that be their financial returns, shopping experience, whether they could have an accident in one of our assets for example, or whether they can prosper their businesses in our places of work. To me that has impact, and they are our stakeholders.

Our stakeholders include investors, employees, customers, communities, suppliers, and cities. It's also our assets, do we enhance our assets to be the best they can be or do we destroy value in them by sweating them and letting them become irrelevant, for example.

I also look at GPT's proud history as something that needs to be nurtured and fostered as if it were a stakeholder. GPT was the first Australian REIT in 1971. GPT suffered during the GFC that destroyed value, but the DNA of the GPT people remained very much intact, built on that founding purpose of creating an opportunity for investment into commercial real estate for mums and dads. It has gone on from that, but that ethos of doing the right thing remains at its centre.

What have you done differently to address stakeholder ESG information requirements?

We have kept ESG central to how GPT thinks and cares, so we have chartered our own journey. For stakeholders, I think what we have done differently is our transparency, which is good governance because stakeholders need and want it.

We provide information differently now; we are sharing spreadsheets and more consumable data than just a website with printed material. I think we have done assurance a lot more than what we did before to provide trust in what we are reporting. We do case studies and storytelling, so our disclosures are more consumable and understandable. Our Modern Slavery Statement is about to come out and you will see specific assurance we got done, where there were some issues identified at one of our assets and the case study really goes into detail on what the concerns were and what are we doing about them, in plain English. I love the commitment by the Board and management to be transparent, good or bad news.

What benefits have you received from your investors and their proxies through your enhanced ESG reporting/ integrated reporting, (or what potential adverse responses have you avoided)?

Benefits – Investors reach out to us in every single meeting we have to now ask about ESG, and 9 times out of 10 they request a second meeting on ESG. They are humble, they are saying we are learning, we are learning from GPT, can we hear from your experts to help us think about this, we love what you are doing. Even in the recent interim presentation, there was a slide for both the Group and the sectors on what are we doing in ESG. One of the investors said to me you know ESG wasn't just reported on for the Group, it was included in each of the sectors and that is so impressive and so real. Investors are looking for ESG detail, and it's more than just ticking a box, they want to be real about it as well.

Adverse – ESG discussions with proxies. I don't think we are getting any heat from the activists or proxies on ESG about us not stepping up or not reporting adequately. I suspect if we were potentially seen as greenwashing, and not providing evidence for our ESG claims, then we would hear from them loud and clear.

Have you changed your capital raising strategies and/or processes to incorporate the impacts of ESG on GPT? If so, can you describe why and how?

Relating to equity first. Wholesale funds are a very important source of capital. Wholesale investors predominantly come from Europe, and Europeans are very focused on ESG credentials. So everything we do in raising wholesale capital has this in mind.

Whereas the main register of GPT is nearly 50% owned by offshore investors and a large amount, approximately half is from the USA. The USA have been ESG laggards generally, but they are catching onto a lot more quickly now. But when we are raising equity or attracting people to the GPT stock, we are talking about ESG front and centre. We used to wait for an investor to ask a question about ESG and we would have it at the end of the data pack but now the discussion, led by the investor, is right up front.

In terms of debt, we launched our Sustainable Debt Framework at the end of 2021 and the Office fund is operating carbon neutral across its assets since 2020. We have $250 million of green finance bonds and another $450 million of green bank loans. They are all certified independently by CBI, the Climate Bond Initiative. We actually held off on green financing for a long time because we were doing our sustainability initiatives regardless, however, we decided that 'we are green anyway, so let's do green funding too because our debt investors want to invest in green funding'.

If not, have you seen changes to the demands from your existing capital providers with respect to ESG? If so, can you describe what they are and how you've incorporated?

Debt investors really want green; as well as certainty of cashflows. Despite questions on utilisation of CBD Office buildings due to COVID, and market volatility (resulting in debt investors preference for shorter 5–7-year tenors), we were able to tighten pricing on the 10-year bond because of the GWOF Fund's green credentials. It's hard to tell whether we saved 8 basis points, we can't pinpoint it, but we had more demand for that bond due to the green nature despite the uncertainty around the Office sector's future performance. Debt investors don't care so much about valuations, they care about cashflows (the rent income paying part). They were able to couple the market weakness at that time with the strength of green assets, which made a real impact on the amount of demand for the issuance and on driving in the price.

What other benefits have you received from staff and other stakeholders through your enhanced ESG reporting/ integrated reporting? What examples? And were they worth it?

As an example, we have just invested in 1100 ha at Noosa for a full reforestation project of what was a pine timber plantation. We are reforesting it to re-establish the bio diversified natural habitat. It will have a diverse mix of plant species that were original to that area and provide valuable habitat for the now endangered Koalas as well as many other animal species. The land is currently QLD government's crown land, but it is hoped that it will soon be passed back through native title to the Traditional Owners.

Our people at GPT are so proud of this project. It's big and meaningful, and we estimate it will provide us carbon credits equivalent to our residual emissions for the next 5 years to offset against our operational emissions and the upfront embodied carbon in our new developments. It's really substantial and we are very proud of that because we will move beyond creating positive legacies with our spaces in the built environment and we will also now leave a legacy in the natural environment.

Why are you adopting integrated reporting? Do you believe the Integrated Reporting Framework is 'locked in' as the base for global business reporting? Why?

I like the concept of integrated reporting. I really like the fact it is multi-faceted; it's thinking about the organisation as why you exist, what do you produce, and what is the impact and outcome of what you do. This is then reported in a thorough story. I am particularly drawn to integrated thinking being at the heart of integrated reporting and how we think determining then how we tell our story through reporting. Integrated reporting captures the wider network of stakeholders and discusses the whole business far more than the traditional financial report.

How have you embedded integrated thinking within GPT (systems, scorecards, incentives)? What differences have you noticed/ achieved?

I would say through systems – we capture a lot of ESG information. To give you an example, Anaplan is our core financial model. It was introduced 6 years ago as a budgeting and forecasting module and at the time became three models – the asset, treasury, and group modules.

There are now around 20 models – remuneration, equity schemes, waste etc. It's far deeper and more sophisticated. So, systems-wise we are much more enabled to be thorough and extensive beyond financial through our core systems whether it be SAP, Anaplan or Health and Safety etc.

What are your biggest challenges with transition to ESG/integrated reporting? Why and what are you doing to address them?

Our transition to adopt ESG, I think, has been a well-practiced evolution. I think our biggest challenge is where does the ESG bar now lift to?

GPT's strategy and competitive advantage is to be the leader in ESG. We are happy for people to fast follow of course, but we want to use the skills and learnings we have to keep going as fast as we can in a very authentic way.

We are Australia's first to have achieved Green Star design validation for an upfront embodied carbon neutral development for our office development at 51 Flinders Lane, Melbourne through the Green Building Council of Australia (GBCA). The development will be certified as upfront embodied carbon neutral by Climate Active upon completion. We are also Australia's first in our logistics asset at 143 Foundation Road Truganina, to deliver an upfront embodied carbon neutral Climate Active certified development verified by GBCA.

There are many potential ESG metrics, how do you determine the right ones that are or will be material over the short-, medium- and longer-term time horizon?

Every aspect of ESG matters.

On the longer term, I think we have a way to go with valuers to see and evaluate the environmental (E) difference. We've got specific instructions to the independent valuers to consider ESG, the impact of climate change, the cost and future savings from achieving climate resilience. We know valuers go through each of the line items in the cashflow and factor in ESG, for example lower insurance costs due to climate resilience investments. They take into account that we've managed our buildings for 2100 predicted climate conditions as opposed to only for 2050.

Their focus is around the operating cost of the asset and not the differential around the buyers/tenants giving premiums for those properties with better climate outcomes. I think valuers will evolve in time with the growing expectation on ESG. From a metrics perspective, we have a strong science-based sustainability team that pick metrics that matter (impact long term value) instead of what is considered popular today.

I think engagement scores for employees are the right measurement. It's not just a happiness measure, it's about true engagement. We don't have a productivity measure – it would be great to define this.

On the community aspect, we are measuring dollars to determine our contribution. We are doing a lot with our Reconciliation Action Plan (RAP), but even for the broader community I think we need more metrics that are not just dollars, but valued outcomes.

How has the business model of the organisation changed since adopting integrated reporting? How is decision making different as a result of thinking about financial and non-financial inputs and outcomes? Do you have an example of where integrated thinking has led to a better stakeholder outcome?

There is a very high expectation and judgement on corporates that ESG is considered in every decision – climate, marriage equality, diversity and inclusion, modern slavery – just doing things right. I think this has amplified and that is fantastic because I think corporates play a big role in all parts of society.

There is an expectation on corporates that wasn't there previously to be progressive and have a voice on social matters, and that is an opportunity to be leaders in shifting that dial. Years ago I felt uncomfortable in expressing my views on, let's say, marriage equality and the vote, whereas now I'm like 'no, it matters to our employees that we have a position'. I think integrated reporting and integrated thinking is helping corporates embrace what is coming – for GPT, adoption has helped us be much more holistic in our decision making and reporting.

Report approver

Interview with David Thodey AO, Chair of Xero and Tyro and Non-executive Director of Ramsay Health Care

Do you believe ESG is critical to enterprise value? Why?

Yes, ESG really is critical to enterprise value because it's the way the business manages its environment and social impacts along with good governance. It really reflects the ability of that business to deliver value to shareholders over the longer term. Good ESG management is about doing business responsibly, and representing all your stakeholders, and that includes the environment and society. But I think every board is aware that you still need to deliver financial outcomes and it's that context of how you do it, and how you do it for a business that is going to be around for the long term. I have always wondered how people can view shareholders' outcomes separately to your environmental, social and good governance commitments. I see these as absolutely integrally linked and I think good companies have always done that.

Companies that haven't been built around a strong Purpose have probably had a more volatile history because whilst things don't always go as you planned, if you have a long-term Purpose and you have a good set of indicators to illustrate how you are progressing then the sustainability of your business and consistency of results is probably going to be stronger.

What does ESG mean to you (in your NED role) and your organisation(s)?

It is about how we do business rather than what we deliver. However, there is an element of delivery in ESG. If you are running a business, you must be conscious of a number of factors, including your environmental impact and the diversity of the workforce, and you need to measure these outcomes.

But I think at the end of the day it is about what you stand for as a business and that relates very strongly to Purpose. If you are really investing into the community and the environment, it is circular [and it impacts back on the business], and we see that all the time. I think that is what good boards think about. Yes, you want to deliver financial outcomes but how you do that is very important. So, that is what it means to me.

ESG has become a popular term, but I think it goes deeper into the fabric of what an organisation really is. I am on the Climate Leaders Coalition in Australia, and that climate question is just a manifestation of one element of ESG. You can see that the really strong companies, despite pressure from investors and regulatory pressure, are saying 'Look, this is what we stand for as a company and that is why we are taking these steps. Yes, there is a degree of external pressure, but this is going to the fabric of who we are and why we are taking these steps.'

How do you determine who your primary stakeholders are?

This goes to the very heart of what a board is responsible for. It is responsible to act in the best interests of the company. So, when the Board is sitting around the table, we are looking at what is going to make this company incredibly successful and create value for all stakeholders. We have done quite a bit of work at Xero, and all the companies I am involved with, in trying to determine how we identify and engage with all our stakeholders. Of course this includes shareholders, but it is equally as much about employees – especially when you have got such a challenging resourcing market, where talented people have got discretion about who they work with. Also the younger generations coming through want to work for a company that they share values with. So employees are critically important stakeholders.

We are seeing [the importance of alignment of values] with customers as well. We held Xerocon in Sydney during September, which is one of the world's premier events for cloud accounting leaders. At the event I met with many of our accounting partners, including a Tasmanian accounting firm that provides consulting on ESG in addition to accounting services for their small business clients. They said the reason they partner with Xero is because of our shared values. And that is tangible real stuff, not just theoretical. And for us at Xero, because we run an open platform, our application partners are also important to us. These are the companies that build applications to solve a range of small business needs, linking through APIs to our core platform and the Xero App Store.

Another example of how Xero thinks about the breadth of stakeholders is how we consider the Tax Offices across the regions we operate in. We provide integrity in terms of the accounts that are digitally filed. If they lose confidence in what we are doing, it could have detrimental impacts to our reputation and our business. So, we have a wide set of stakeholders that we are conscious of, and we keep reviewing.

What have you done differently to address stakeholder ESG information requirements on your Board(s)?

Every company is different but quite often ESG matters are identified through risk management. [At Xero] we look at our risk assessment, be that climate, or diversity on the board/management, as a potential risk to doing business and this is governed via our Board's Audit & Risk Management Committee. But it is more than that because we have put ESG risks on the agenda and we are on that journey of really putting firm metrics around measuring those key ESG indicators that we need to manage. We have broken down [responsibility for action] within the management team. We have discrete management groups that are looking at a range of areas, for example Xero's CFO is the lead for climate. We are looking at what our actual carbon footprint is, [determining what actions we should take, and how we should] get the metrics right [in terms of how we can measure our progress]. We then have got a set of metrics that are coming through the Audit & Risk Committee to the Board. We are trying to take it from just the generic discussion on ESG risks and bringing it into the Board room for more detailed discussion and action. Then of course there is the reporting on progress at the end of the process in our Annual Reports.

I think probably 3 or 4 years ago, in some companies I was involved in, we started with the ESG report and that was moving towards integrated reporting, but [reporting is] now the end of the process. [There is a lot of work to do to address the ESG matter]. For example, we take modern slavery very seriously at Xero, but we know that following the value/supply chain all the way down is complicated and difficult, but we are on the journey to do that.

What benefits have you received from your investors and their proxies through your enhanced ESG reporting and integrated reporting?

The big funds have declared their position, and so it was nice (at Xero) to get a tick of approval this year. Looking at Fidelity, they have made a statement that they will not invest in companies that are not really leaning into ESG. I think the proxies have also been active in this area.

At one of the company's Boards I am on, for one element of ESG around Climate, we got a 20-basis point reduction in a debt deal because of our decarbonisation strategy, there was a green element to the debt. But we still need to deliver the bottom line and keep this in perspective when making decisions.

I do think over time, that we will see the translation of your responsible commitment to the environment and society in accounting standards, but this still has a long way to go. We are still working through TCFD, ISSB, SASB with respect to climate and decarbonisation, [but this is making positive progress].

What other benefits have you received from staff and other stakeholders through your enhanced ESG reporting and integrated reporting? What examples can you share? And was the investment worth it?

Yes, we have enhanced our ESG disclosures and are moving to adopt integrated reporting at Xero. The investment has been worth it, and we have had positive results from our people and partners about our reporting. They appreciate we are holding ourselves accountable and that is the type of company we are. We have had really good feedback from stakeholders in terms of the FY22 Annual report. At Xero, in our 2022 financial year (12 months ended 31 March 2022) our employees increased to nearly 5000, up 31% year on year, and this was in a global market where there was an enormous shortage of digital skills.

So, I do think our work is attracting wonderful people. People with great talent who are really then contributing back to our business because Xero's values are aligned with their own. They want to be involved in a company that takes itself seriously and leans into its ESG responsibilities. Even when we went into the market for new board members, we got great candidates, especially in the US, because we are the type of company they want to work for. It really has some tangible outcomes.

As a Board member, what are you and your fellow directors doing differently/more transparently, especially in light of ASX Corporate Governance Council's 4th Edition changes (post Hayne) and increased market and regulator focus on Governance (in ESG)?

When the Board visits Xero's different locations, for example recently in the UK, we made a point of discussing what the local teams are doing around ESG, for example work to decarbonise our offices in London and in Manchester.

At Ramsay Health Care, we would visit hospitals [to talk to staff, clinicians and patients to gather insights into the operations]. We discussed energy reduction, as hospitals are a big consumer of power, resulting in putting solar power on many roofs to try and offset the power consumption.

Also at Ramsay, we are trying to make ESG tangible in the way we behave, in terms of engagement with the community, we always try to reach out to local communities. Keeping it real I think is who we are. At Ramsay one of our core values is 'People caring for people' [in our interactions with staff, customers and broader community] – we are Purpose driven.

At Xero it's about improving the lives of people in small business. Life is not about working 18-hour days. It is about freeing up time, so people have a more balanced lifestyle. We get great insights from customers at our Xerocon events on how our cloud technology can change customer lives for the better. In addition, the Board has regular dinners with customers to understand their experiences with Xero. We (the Board) also have town halls with employees, which we call 'Ask me Anything' sessions. Xero has a value '#challenge' and our employees do speak their minds, so the Board constantly gets feedback in line with the 4th Edition of the ASX Corporate Governance Principles and Recommendations.

What are you doing different where information in your primary reports is not independently assured/reviewed beyond management sign-off? To what extent do you/your boards believe there is value in assurance over these additional material ESG/non-financial disclosures & why? What are the benefits?

To give yourself comfort that any of the policies are being effectively implemented, it needs to be managed at the frontline. The resources companies have done this well. In resources companies, the ownership of ESG is in the front-line manager or the second line manager and there are very clear targets. Front line managers take accountability, rather than there being a top-down push.

I think we are on the journey at Xero. We haven't got there just yet, and that will unravel itself more when you get into Scope 3 considerations. For example, in terms of travel, the key is getting all employees to be conscious about whether the trip is really necessary and always consider what the resultant impact on their carbon footprint is. We are working on these things, and I am very committed to it because I think that's when you see change happen.

You need to validate and get independent eyes on things, but to really drive significant change it's not driven by compliance or assurance, you have to get buy in across the organisation because it is the right thing to do. Line managers and employees have permission to do what is right.

How are you embedding improved ESG – thinking/ integrated-thinking throughout your companies? (i.e. through training, more direct Board engagement (with staff), systems & processes, enhanced templates, scorecards, incentives)?

I think primarily to embed ESG it's all about communicating and educating. For example, at Xero's 2023 kick off meeting I came in and was interviewed by the ESG team for a firm-wide podcast. We made what we are trying to do in ESG real. We talked about what we stood for as a company and what we are doing with and for our customers and partners, and how we are helping them along their ESG journey. This podcast created a sense of wholeness around what we are doing – we are not just saying we are carbon neutral, but that we are taking this seriously. The very fact I was on that podcast helped the team to understand this is an area we are taking very seriously as a business. It's like anything in change, you need leadership, you need culture, and you need to fund it and then you need to measure it.

What are your Boards' biggest challenges with transition to ESG/ integrated reporting? Why and what are you doing to address them?

It's time, resourcing, and funding. It's a bit like Australia's commitment to the 43% reduction by 2030. I am really committed but you have to understand how much it is going to cost you and really unpick it, that's when people really sit up and can see you are really serious. If you take the issue around diversity or racial diversity, it's when people do something about it or when they invest in the community or how we do business to drive change, that's when it really starts to take real shape.

There are many potential ESG metrics, how do you determine the right ones that are or will be material over the short-, medium- and longer-term time horizon for your businesses?

With difficulty because there is a lot of work going on to fully understand the standards. At Xero we completed a materiality assessment and that helped us elevate what are the most critical ESG matters at Xero which should come through in our reporting. The sooner the World can land on some sort of standardisation, the better for all of us. Europe appears to be more advanced than other regions in terms of their willingness to put their ESG metrics out there, and again we are on the journey.

It will be important how these standards are used. They cannot be 'tick a box' if you want to focus on and drive what is important in action through to reporting on ESG matters. We must keep it real. Organisations have to think about their ESG priorities in relation to their Purpose; 'this is who I am, and this is what I stand for.'

How has the business model of the organisation changed since adopting integrated reporting? How is decision making different as a result of thinking in a more integrated way about financial and non-financial inputs and outcomes? Do you have an example of where integrated- thinking has led to a better stakeholder outcome?

At Xero it changed the engagement enormously because we were feeling our way through a new process. The move towards integrated reporting resulted in more interaction between the Board and management. It wasn't just the team writing the report, but this also involved line management coming in from right across the business.

There were quite a few questions around why we should report certain metrics and what they really meant. As an example, for the first time when we surveyed our workforce on their individual ethnicity.

The integrated reporting process really did change the way we approach our reporting. At times we said maybe we don't feel comfortable saying that at this time since we're not ready yet and we'll revisit next year. I think that journey towards integrated reporting brings a reality and an edge to ESG that we have not had before.

Auditor

Interview with Michael Bray, Special Adviser – Connectivity and Integrated Reporting, IFRS Foundation; Professor of Practice (Integrated Reporting), Deakin University

Background

Michael was a KPMG Australia audit partner for 27 years and former Registered Company Auditor. He is currently, special advisor to the Connectivity and Integrated Reporting team at the IFRS Foundation and Professor of Practice (Integrated Reporting) at Deakin University. Within that team he is focused on are Intangibles and Assurance Integration workstreams.

Do you believe ESG is critical to enterprise value? Why?

ESG means different things to different people. For this reason, I prefer to not use the term ESG. I prefer to talk about 'sustainability' as it is broader. Using the lens of the 6 capitals in the Integrated Reporting framework, E and S are mostly aligned with the Natural and Social and Relationship capitals, and the G attaches to Governance in relation to E and S matters. So, I prefer to a '6 capitals view', which captures all the drivers of enterprise value.

The middle box in the dynamic materiality diagram relates to *sustainability-related financial disclosures*, including disclosures in relation to intellectual capital, strategic aspects of human capital, and performance of the board in terms of governance and the executive in terms of strategic management, and the whole area of innovation, intellectual property, technology, customer relationship management and so on. It extends to how an organisation ensures the integrity of its corporate reporting. Broader sustainability is a critical component of enterprise value and the best way to report on sustainability so defined is through an integrated report.

What does ESG mean to you (in your role) and your organisation?

Sustainability and integrated reporting are central to my role at both the IFRS Foundation and Deakin University, with me focused on what intangibles mean to integrated reporting and what integrated reporting means to communicating intangibles to investors.

As we move to adopt integrated reporting, what challenges do you experience in providing assurance over statements relating to unrecognised but material intangibles? How is this overcome?

Through the 1 August 2022 consolidation of the Value Reporting Foundation into the IFRS Foundation, the IFRS Foundation assumed responsibility for the Integrated Reporting Framework, the Integrated Thinking Principles and the SASB standards. So on 1 August 2022, integrated reporting became part of the corporate reporting mainstream. A coming IFRS Foundation communications campaign will feature integrated reporting and its connectivity to ISSB standards.

Do you believe assurance is required over increased ESG and integrated reporting? Why? What benefit would a company get if its expanded external reporting was assured?

I believe in the importance of integrated reporting assurance as a component of broader sustainability assurance. Integrated reporting has become part of the mainstream, and there are a number of instances of integrated reporting assurance around the world. As people get to understand the importance of integrated reporting, the practice of integrated reporting and its assurance is only going to become more important and more prevalent. This ties in with the IAASB kicking off a sustainability assurance project. Given the broad framing of its sustainability assurance project, I think we are going to see integrated reporting assurance as part of the mainstream of audit and assurance through the IAASB as we move through a journey towards a more integrated approach to assurance. So that ties in very much with the 'unrecognised but material intangibles' point. Those critical pieces of intangible value will be assured through the integrated report audit.

If I could give the one liner of what the integrated reporting audit is going to communicate it goes something like, "Dear investor, you have my assurance that the description of The Business in the integrated report reflects its design and operation, and the associated metrics reflect the performance and prospects of The Business." So, I am not only assuring the metrics, but I am also assuring the description of The Business and basis of selection of the metrics as well as the metrics themselves. I think the benefit the company will get from that is the value of that assurance to investors – knowing that there is a good basis for investors to evaluate the credibility in what the company is saying about its approach to governance, strategic management and risk management etc. In my experience, 'getting assured' also means that companies need to get their processes, systems and controls straightened out internally.

What are the biggest challenges for organisations seeking to have their ESG/ integrated reporting data assured?

There are challenges to all assurance, not just integrated reporting/sustainability assurance, but the challenges can be overcome with the right methodologies and knowledge, skills and experience. Assurance is assurance. A company makes a statement or claim, and the assurer obtains evidence to support the basis of claim and whether it has been fairly stated.

And I would prefer to look at the opportunities of independent integrated reporting assurance proving to be a well-accepted approach to enhancing the credibility of integrated reports and so a basis for investors and other stakeholders to trust the reliability of the report.

A key claim in the integrated report is that The Business operates in the way it is described in the report. This is akin to auditing a financial report or assuring ESG metrics or other disclosure where the claim is that the contents of the financial report or the metric reflect reality. People often talk about the need for special skill sets when it comes to 'ESG metrics' assurance. Again, I would prefer to concentrate on integrated reporting assurance. I believe that the financial report audit auditor is ideally placed to lead integrated reporting assurance engagements because The Business is at the heart of what is contained in the financial report. To do the financial report audit, auditors must develop a strategic understanding of The Business (and there is an auditing standard telling them that they must). The difference in integrated reporting assurance is that the strategic understanding of *The Business* that is the basis for planning a financial report audit, is a key component of the evidence in an integrated reporting assurance engagement because of the foundational description of *The Business* in the integrated report. Financial report auditors will need to supplement their skills with those of specialists in governance, strategy, business models and risk management to the extent needed, and also with industry skills and ESG-type skills, where required.

There is no difference to the financial statement audit in reality. It is just that the outcome is different in terms of the integrated report. So, yes there are challenges to the firms undertaking integrated report assurance. However, firms will have been thinking about accreditation for people to deliver this type of assurance and there will be a need for upskilling of people providing integrated report assurance. The broad skill sets at a large audit firm are ideally placed to this very valuable form of assurance, which I believe is critical to the future of the accounting profession and a big part of the audit of the future.

You have provided assurance over integrated reports, what are the challenges for the practitioner? Do you need more guidance?

A key challenge for practitioners has been convincing their clients of the distinctive contribution of integrated reporting itself as this is the foundation of the value that assurance on the 'description of The Business' can deliver. And then bringing the organisation along on understanding this 'distinctive contribution, so that the client's choice of obtaining assurance is an important one based on the potential benefit for their stakeholders. And then just bringing them along in the audit process, just as financial statement auditors and ESG data auditors do. So, I think taking the reporting organisation through the different things they are going to have to be doing and into providing a robust description of The Business that can withstand audit scrutiny is critical, just as is done when auditing financial statements.

Do we need more guidance? Yes, the IAASB has a big job here and so do the big accounting firms that have got the skill sets to undertake these engagements. When integrated reporting assurance moves outside the few people who have undertaken integrated report assurance to date towards a mass market requirement, then the IAASB, IFAC, the professional accounting bodies, the big accounting firms, will all need to produce the additional guidance that will be needed in the mainstream of assurance.

You are working for the IFRS Foundation now with a focus on ESG/ integrated reporting assurance, where are we today and what is the path forward and timing for making this mainstream?

Yes, I am working for the IFRS Foundation, I am in the Connectivity and Integrated Reporting Team and within that team I am focused on intangibles, but also on assurance integration – that includes integrated reporting assurance.

I also work with the Deakin Integrated Reporting Centre where we focus on integrated reporting assurance. I am speaking on integrated reporting assurance at the ANCAAR Conference at ANU in October 2022. It's a conference put on by ANU to help the AUASB think about what is coming down the track on assurance. So, I am talking about integrated reporting assurance and its importance to the future of audit and the accounting profession.

Regulator

Interview with Sean Hughes, ASIC Commissioner

Role

As a Commission member we have responsibilities across the entirety of ASIC's portfolio of jurisdictions and areas of responsibility, but we do have some specifics, particularly in my case to financial reporting, oversight of audit profession and corporate governance. In addition, ASIC decided at the beginning of this year to set out 8 core projects that were going to be significant initiatives, and one of those core projects/initiatives is sustainable finance and not only from the point of view of periodic reporting and potentially the development of mandatory standards but also from the point of view of prevention of greenwashing and undesirable 'pump and promotion' type schemes. That work is currently being led by me and Deputy Chair, Karen Chester.

What are your expectations for reporting by listed Australian entities under current reporting requirements? In particular, reporting of risks, strategies, and future prospects in the OFR, as well as adoption of the TCFD recommendations?

The first thing to acknowledge is the significant increasing investor demand for entities to provide climate and sustainability information in their annual reports. There have also been rapid recent developments towards establishing a comprehensive international baseline of climate and sustainability disclosures for periodic reports. On 3 November 2021, at COP 26, the IFRS Foundation announced the formation of the International Sustainability Standards Board (ISSB). On 31 March 2022, ISSB exposure drafts of standards on general sustainability disclosures and climate disclosures were released with the aim to issue final standards in early 2023 and there is widespread in-principle support in Australia for adopting the ISSB framework.

While many companies, assurance providers, investors and financiers have commenced upskilling for any new reporting requirements, many will need more time to fully prepare if the reporting becomes mandatory. In the meantime, the current requirement in the Corporations Act 2001 for listed entities to prepare an Operating and Financial Review (OFR) that accompanies and complements the financial report remains unchanged. ASIC Regulatory Guide 247 Effective disclosure in an operating and financial review (RG 247) continues to apply. What we are seeing is that listed entities are already required to present important information for investors in the OFR on the underlying drivers of financial performance, as well as strategies and financial prospects for future financial years. This includes covering material environmental, social and governance risks and climate-related risks that could have a material impact on the future financial position, performance or prospects. Quoting from RG247 we say that "Directors may also consider whether it would be worthwhile to disclose additional information that would be relevant under integrated reporting, sustainability reporting or the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), where that information is not already required for the OFR." Listed entities that voluntarily report climate-related information under the TCFD recommendations will be better placed to transition to any future ISSB standard. The ISSB proposals are based on the same four pillars of disclosures as the TCFD recommendations – governance, strategy, risk management, and targets and metrics. We are encouraging listed companies to also consider the recent TCFD Guidance on Metrics, Targets, and Transition Plans. We think financial reports may need to factor in climate-related impacts affecting asset values and provisions, and disclose key assumptions made as well as any sources of estimation uncertainty.

We think this is more likely to apply to large emitters, particularly given the Government commitment to 'net zero' by 2050, so we continue to encourage directors of listed entities to:

- Consider climate and sustainability risks and opportunities;
- Develop and maintain strong and effective corporate governance to identify and manage material risks; and
- Disclose useful information to investors where risks are material.

Has Government indicated its position on Climate reporting? Has there been any indication as to which entities might be subject to new standards?

The mandating of any new requirements for corporate reporting of climate-related information is a matter for Government policy. At an Investor Group on Climate Change Summit on 24 June 2022, the Minister for Climate Change and Energy, the Hon. Chris Bowen, referred to the Government's high-level in-principle commitment to corporate reporting on climate information and the importance of consulting with key stakeholders. Minister Bowen indicated that reporting would need to be mandatory for 'large, listed companies and financial institutions'. He indicated that the Government would 'look at international best practice' in this regard, we certainly know that the government is considering developments overseas and how they might be adopted in Australia.

Do ASIC and other securities regulators support the development of standards by the ISSB?

We are a member of The International Organisation of Securities Commissions (IOSCO). IOSCO has members from more than 130 jurisdictions who collectively regulate more than 95% of the world's securities markets. On 3 November 2021, IOSCO issued a press release welcoming the formation of the ISSB (see IFRS Foundation's International Sustainability Standards Board on the Right Track, Says IOSCO). The IOSCO Press Release indicated that the IOSCO will consider endorsing the final standards to encourage their adoption in member jurisdictions. The endorsement of the International Financial Reporting Standards by IOSCO in 2000 was seen as key to the widespread international adoption of those standards so one may assume the same will apply to the ISSB standards.

But as I indicated before whether they are adopted and mandated for any part of the population in terms of reporting standards will be a Sovereign decision of the Australian government. On 14 December 2021, ASIC issued a media release welcoming the establishment of the ISSB.

What do you see as the challenges for adopting the proposed ISSB General Requirements and Climate Disclosure standards in Australia?

There is clearly a strong and growing investor demand for climate and sustainability information. But that needs to be balanced against allowing time for corporates to upskill, develop systems and processes, source data, and develop or recruit expertise and resources. While many in the reporting chain have commenced work in this area, companies, assurance providers, investors and financiers will need time to upskill and prepare for any new reporting requirements. Entities may need to establish new systems and processes to support new reporting requirements and may need to source new data from third parties in their value chains. Climate disclosures may also require region-specific scientific analysis and scenario information. One of the matters being considered by Treasury is the need to establish a legislative framework for the making of sustainability standards in Australia and requiring Australian entities to apply them. We would be surprised if this is not the case that larger listed companies and financial institutions should have implementation plans underway now. Even if there is a transitional period before requirements apply, there may be investor demand for companies to report earlier, especially if companies are required to be report cross-border in jurisdictions that are ahead of Australia's timeline. Along with Treasury, RBA and APRA, ASIC is a member of the Council of Financial Regulators and on 27 July 2022, the Council of Financial Regulators (CFR) sent its submission on the ISSB exposure drafts. We expressed support for the establishment of the ISSB to deliver a comprehensive global baseline for sustainability-related disclosure standards. The submission by the Council of Financial Regulators (which includes ASIC) to the ISSB expressed in-principal support for adopting the proposed ISSB general sustainability and climate disclosure standards (subject to their final form) in Australia.

The commencement date, applicability and mandatory nature of any new reporting regime are ultimately matters for the Australian Government to determine. Without detracting from this broad support, we also drew attention through the CFR to the finalisation of the proposed standards:

- transitional and phasing arrangements on adoption of any new standards that balance demands for information from investors and other users with giving adequate time for reporting entities to prepare for new disclosure requirements (including upskilling, developing appropriate systems and processes, and having access to necessary data).
- whether some flexibility may be required in terms of the proportionality and/or scalability of the standards if they are applied to smaller entities. This is particularly relevant for Australia given the large number of small to medium sized listed entities in Australia relative to some other international jurisdictions.
- the need for clear and consistent definitions, guidance and support for entities adopting the proposed standards, in order to promote consistent and comparable disclosure. For example, ISSB guidance on applying the 'significance' and 'materiality' criteria in the proposed general sustainability disclosure standard, as well as a clearer definition of the value chain and its operational boundaries.
- whether the proposed industry-based climate metrics should be field tested by some issuers in different industries and jurisdictions. Experience from the field tests may assist to improve those metrics and ensure their relevance and applicability across different jurisdictions.

Do you believe sustainability reporting should focus on enterprise value? Why?

The financial report is an important document for corporate accountability and is also used by many investors and analysts as a base for assessing the future financial prospects of an entity. The financial report of listed entities is currently complemented by the OFR, covering risks, strategies and future financial prospects. We think that the ISSB proposals are intended to provide sustainability information to complement the financial report and to similarly enable investors to better understand and assess the value of an entity and its businesses. The ISSB focus on enterprise value is important in ensuring investors and markets are properly informed and well-educated.

Social impacts of climate and other sustainability-related matters (e.g. human capital, modern slavery and biodiversity) will also be relevant under an enterprise value model. For example, governments may introduce incentives or penalties to influence corporate behaviour, and these may affect enterprise value. The ISSB will be coordinating its work with the Global Reporting Initiative (GRI) (see IFRS – ISSB and GRI provide update on ongoing collaboration). The GRI has a focus on disclosures about social impacts of an entity's activities that may go beyond and enterprise value model.

Although the ISSB workplan is not yet available, are there any areas of sustainability reporting that you believe should be considered to improve consistency of reporting to the capital market on sustainability matters for investors?

While the ISSB is focusing its efforts on finalising the general sustainability and climate disclosure standards, it intends to consult on its future work plan to develop further sustainability standards on specific topics. Although a background paper was presented to the July 2022 ISSB meeting, the ISSB has not yet considered which topics might be covered in the work plan. We think some of the possible topics could include biodiversity, nature, soil, human capital, and modern slavery.

What is ASIC's position on integrated reporting in the context of current Australian corporate reporting, especially through the OFR?

The OFR already covers much of the information that would be required under integrated reporting. Disclosure using the six integrating reporting "capitals" (financial capital, manufactured capital, intellectual capital, human capital, social and relationship capital and natural capital) is not specified for the OFR. However, the OFR must cover underlying drivers of results, strategy, material risks and future financial prospects. Paragraph 66 of ASIC Regulatory Guide RG 247 says "… Directors may also consider whether it would be worthwhile to disclose additional information that would be relevant under integrated reporting, sustainability reporting or the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), where that information is not already required for the OFR." We certainly through RG247 envisage there will be instances where Directors decide to include that information.

Could you tell us more about your focus on greenwashing and director responsibilities on climate reporting?

Greenwashing is an ASIC core priority. Australian investors are demanding environmentally friendly, sustainable or ethical investment options, particularly younger investors. A 2022 research report by the Responsible Investment Association Australasia (RIAA) revealed that four out of five Australians expect their superannuation or other investments to be invested responsibly and ethically. These investors are motivated by personal values and, increasingly, by financial returns – 71% of those surveyed believed expectations of improved long-term performance was a driver of market growth in responsible investments. Managed funds and superannuation funds are responding to increasing investor demand by offering investment products focused on sustainability-related considerations. Greenwashing is the practice of misrepresenting the extent to which any entity's financial products or activities are environmentally friendly, sustainable, or ethical. The potential to mislead can result from unclear disclosure on how an entity integrates sustainability-related considerations into investment decisions; or overstating green credentials. There is growing global unease about the risks of greenwashing of financial products – partly driven by a lack of clarity about product labelling and a single generally accepted taxonomy for sustainable finance. This issue has been recognised by the International Organization of Securities Commissions, of which ASIC is a member. ASIC recently reviewed funds that offer sustainability-related financial products to establish whether the product or investment strategy is as "green" or sustainability-focused as claimed when promoting these products.

In particular, ASIC reminds entities to ensure their disclosures and promotions:

- use clear labels
- define the sustainability terminology used
- clearly explain how sustainability considerations are factored into the investment strategy.

Following an ASIC review, we issued Information Sheet 271 to help entities avoid "greenwashing" and provide investors with the information they need to make informed decisions to avoid greenwashing. ASIC's Information Sheet 271 is designed to assist responsible entities of managed funds and tustees of superannuation funds to avoid greenwashing. ASIC is also alert to claims by listed companies that may not be supportable, such as 'net-zero' targets without a reasonable basis. ASIC will consider appropriate enforcement actions. Greenwashing distorts information that a current or prospective investor might require in order to make investment decisions driven by sustainability-related considerations. The Corporations Act 2001 prohibits misleading and deceptive conduct and false or misleading statements in relation to financial products such as securities or interests in funds. Boards should avoid and look out for any greenwashing – and ask whether the entity's disclosure accurately reflects their practices in this area. Directors should ensure that entities have appropriate governance arrangements in place to drive better disclosure. ASIC has also published information to help investors assess if their values and goals align with a sustainability-related or ESG product. In weighing up investment options that suit their values, we encourage consumers to look out for vague or ambiguous language or exaggerated marketing claims that lack a reasonable basis to support them.

Analyst

Interview with Alison Ewings, Head of Engagement on Corporate reporting developments, Regnan

Do you believe ESG is critical to enterprise value? Why?

Yes, and I would say that there are three different ways in which ESG can be critical.

1. Firstly, where there is an ESG risk that is ill-managed, that can compromise the company's ability to create value.

2. Secondly, the flipside of this is that organisations can miss opportunities to create value if they are failing to comprehend ESG trends – essentially the opportunity cost story.

3. Thirdly, are systemic risks that can create portfolio risks for investors and compromise the ability of companies to create value. These are often more about the general operating environment and influences on economic conditions. Climate change and the pandemic are both examples of these.

I believe that these three aspects are the most consistent ways that value is realised or lost through ESG. But these certainly manifest in many different forms across the individual dimensions of Environmental, Social and Governance.

What does ESG mean to you (in your role) and your organisation?

A lot of ESG is related to trying to identify blinds spots. For us as an investor, these can be growth opportunities that the rest of the market isn't yet seeing, because they haven't fully comprehended some of the ESG trends (this is especially true for the impact investing arm of our business). But this is also true for the blind spots that companies themselves are not attentive to, which can cause significant challenges to individual companies. ESG is really a lens for us to uncover these blind spots, and ideally see that they are being addressed.

Does ESG reporting or integrated reporting (including material off balance sheet intangibles) provide you with better information for your analysis, modelling and valuations? If yes, how? If no, why not and what is required?

It really depends on the quality of the disclosures that are being provided. There is certainly information that can be very useful in our analysis, but others are completely useless.

However, considering a framework such as the Integrated Reporting Framework, it can be very telling to look at what the board themselves have nominated as the most relevant drivers of business value, as well as to assess the integrity and sincerity of the information that is being provided.

There are certainly areas where data is underdeveloped. I believe there's a long way to go in terms of climate data – particularly in the physical risk space which requires the use of data at sufficient granularity as an input in order to enable sensible decision making. Often issues can be dismissed when looking at high-level trends rather than looking at a specific location, and this also occurs when looking at the impact of averages rather than extremes.

Human Capital is an area that I'd nominate as being particularly underdeveloped in terms of data. Metrics like high-performer retention are still rarely communicated, and there are many contextual factors that make it difficult to form a view on the appropriateness of the numbers reported. More generally, oversight of Human Capital matters is not readily communicated to the market, so it is difficult to determine how the board and senior executives are exercising oversight.

What benefits accrue to the company in providing this increased ESG/ integrated (6 capitals) reporting? How do these benefits accrue?

In general terms, the biggest benefit is really to the organisation itself – it actually creates a platform for which integrated decision making can be made, and so these sorts of issues and trends can be more easily embedded in organisational decision making. The core benefit of this is a better decision-making process and a path to value, and where these benefits are clearly stated to the market, you would hope that they are recognised.

Can you put these company benefits in order of importance?

It depends on how the data is used. For some investors the scores in mechanisms from data providers (e.g. MSCI) are used to help define the investable universe – so a company may require a certain threshold score to be included in a portfolio and this would certainly impact the potential available capital. For other investors, it's more of an integration model, and asking what price are you expecting for the risk. It speaks to all the different permutations of responsible investing, whether that be exclusion based on a score, inclusion based on best in sector or integrated into investment analysis or else looking through to underlying potential areas of concern with a more integrated view of how you expect that to be priced. We are aware that even if we like a stock, if it has a poor rating then we understand that that would potentially influence sections of the market's view on that company.

What is the benefit for the company in having their ESG/ integrated reporting extended external reporting assured by a quality auditor?

A lot of ESG data is not yet subject to any audit. But I think the benefits of getting this data assured are multidimensional, because it conveys the importance that the company places on the information and how it is used in decision making. There can be a halo, suggesting that this information is considered with equivalence to the more traditional financial information that is provided to the market.

The other benefit of course is the additional scrutiny that an audit provides, allowing the data to be used with more confidence by investors. It does depend on the specific issue or datapoint though, and it may not be necessary to have absolute confidence in order to take appropriate actions. For example, do you need to know the precise value of Scope 3 emissions in order to identify that it is a risk? Probably not, but you may to get confidence that there has been progress.

Most importantly, a company should not be over-diagnosing such matters as a precursor to taking actions – we shouldn't use imperfect information as a barrier for action.

Would you prefer that companies provide a number of long reports each half year and year end, or a more succinct report focused on what the Board believe is material to the company's ability to create sustainable enterprise value over time supported by a detailed spreadsheet with key financial and non-financial (sustainability/ other) performance measures say with a 5 or 10 year trend line and an index to frameworks used and where information can be found if relevant (i.e. GRI, TCFD etc.)?

If your objective is to have those efforts recognised by the market, then actually having an integrated discussion in your investor discussion packs is the single most useful thing – because it puts the information firmly in the context of the strategy, highlights the most relevant metrics, and communicates that in an effective forum for the audience. Of course this is not the only audience, and there are other vehicles that are useful such as clearly articulated additional data packs, so it is important to consider the combination of information being reported. Also, there is a degree of market education that needs to happen, and so that is a forum where you can have that upfront conversation and then provide the supplementary materials to allow people to go into further detail.

This also provides the company with more control over the narrative, rather than merely adhering to the gazillion frameworks that are out there.

But I do think that for certain material issues, particularly with climate votes at AGMs, it is still important and can be easier to have your arms around all of that content and detail when you are reviewing the company. These complex topics don't lend themselves to just living as a couple of pages in the Annual Report, particularly as people are exercising greater scrutiny over the scenarios being used and the assumptions that underpin those. There can be a lot of detail required.

Increasingly you will be stuck with doing both or be stuck with disconnected narratives. Pull everything together and then jump off into the detail. Overall, we need a clear strategic direction in the IDP and the annual report – both to tie everything together but also to educate market. But we also need to dive off into technical details for those subjects that require it, including potentially separate updates or deep dives in the briefing update style that we are increasingly seeing.

Do you believe integrated reporting will be the basis of the future global reporting system per IFRS Foundation? Why?

As an investor, what you're trying to determine is what are the value drivers for the company and how are they managing the risks to those – that can be risks from the external environment and they can be risks from within the business (particularly governance components and matters such as human capital). It has always been problematic that these things are talked about in isolation, as if ESG and the accounts aren't related, but in many instances they are. Looking at some of the things that have blown up organisations, these have often come from the ESG space. Integrating these matters in a way that gives proper scrutiny within the business is important.

What advice would you give a company thinking of moving to adopt integrated reporting?

Moving to integrated reporting shouldn't just be thought of as moving towards disclosure – it should be thought of as ensuring that you are running your business appropriately and demonstrating integrated thinking.

Going back to Bob Eccles' One Report, what was interesting about that was it was a range of different companies in terms of sectors, but also geographies and regulatory environments that were all getting to the point where it became difficult to talk about their sustainability practices as distinct from their businesses.

There is a degree of sophistication in a company's sustainability activities that is required before you can do integrated reporting well, so integrated reporting can be a good vehicle to drive that thinking and consideration. But it is important that the activities themselves are the company's focus, not the reporting. The reporting is an outcome, and although it can be a driver it should not be the purpose or starting point.

For a purpose-led business, disclosure is a logical step, and impossible to avoid if you are running a business in that way. It's also harder to fake, unlike some of the frameworks that can be retrofitted. And that's why the investor discussion pack is really useful, being somewhat less scripted and enabling them to offer a compelling narrative – this really requires detail and substance underneath.

How should ESG or integrated reporting performance be incorporated into executive (and staff) incentive arrangements and reported?

There is a tendency to look for whatever metrics have been nominated as material and designing incentive arrangements specifically around those metrics. However, I think an effective pay plan or incentive structure should be less about the individual components of the plan, and more about what the entire structure is driving. For example, you can include an emissions reduction incentive plan, but there may be other aspects of the plan that would incentivise increased emissions – so the overall plan provides a signal and is an indicator of what is rewarded in that organisation.

It would be strange to discuss integrated reporting without integrated incentive structures. Balanced scorecards attempted to do that – but it needs to be done in an integrated way. Assessing the plan shouldn't just be a checklist of the metrics but should instead consider whether the whole plan is leading to a desired outcome or better management of the underlying risks. For example, transitioning the GHG emissions to a different part of the value chain would not adequately address the underlying risk. In the context of investment management and discussion of net zero in portfolios, you cannot truly have a long-term net zero portfolio in a world that is not net zero.

Additional thoughts

Another factor in addition to the need for data quality would be data timeliness, as this speaks again to the credibility and sincerity of management's commitment to addressing ESG risks. Although there may be legitimate reasons why certain data may be delayed, if management is truly using this information to manage the business, then they should be obtaining this data in a timely fashion and communicating it to the market.

It has become less common that the sustainability report is being significantly delayed until after the financial report, and integrated reporting has improved the timeliness of reporting to the market, it is a clear warning sign if the data being reported is delayed or reported from a prior period.

For example, reputation measures are highly volatile and dependent on what's going on in the news cycle. We don't want to create situations where companies hold back on news that they may find controversial until after the survey period is completed, but nor do you want them penalised because a competitor has destroyed an industry's reputation as a whole – so there needs to be additional points for remuneration committees when these metrics are being used in incentives, truly understanding the complexities of the measure and appropriately overseeing it.

Report user – Investor

Interview with Lou Capparelli, Head of ESG, UniSuper

Do you believe ESG is critical to enterprise value? Why?

ESG has become an anacronym or buzzword in recent years, but the reality is most investors have always focused on some version of investing in quality. ESG tries to look at issues of quality along the three pillars of E, S and G but it really is nothing more than the application of investing in a quality sort of thematic that most people are familiar with. It is all around sustainability, investors are focused on sustainability of earnings, but sustainable business practices will lead to sustainable earnings.

What does ESG mean to you (in your role) and for your organisation?

Essentially, when we talk about each of the three pillars, each of them in turn is quite broad. A lot of people when they think about E focus on climate and decarbonisation, but it is broader than that, there is now more and more work being done and consideration being given to biodiversity and the TNFD. We think about E also in terms of circular economy, erosion prevention, waste management.

In S, that's a range of issues, the most topical one that people are thinking about is modern slavery, but it extends to cultural heritage management, relationship with traditional owners, standard workplace relations, occupational health and safety, extending these days to mental health.

On Governance, my role of getting this ESG role is really on governance, and that is engaging with management and particularly boards to ensure management is held accountable to the board and the board is held accountable to the investors and that chain of accountability is critical. That is a broad range of activities ranging from regular engagements with board and management all the way to exercising our proxy voting rights at AGMs.

When we talk about ESG in the context of asset owners like us that is a focus purely on investment side of our business. We have also recently introduced a role in CSR (Corporate Social Responsibility), but that role relates more to UniSuper as a business itself. It is around what are we doing as a business, for example what are we doing for decarbonization etc. what are our practices, how do we engage with communities.

Does ESG reporting or integrated reporting (including material off balance sheet intangibles) provide you with better information for your investment decisions? If yes, how? If no, why not?

We do think it provides us with better information, the reason is that we have moved on from looking at one year's performance in isolation and we are a long-term investor, so we are not going to be that interested in a company going for a short-term gain if it compromises their long-term sustainability. There are a lot of clues you can get from reading sustainability reports to get a sense of the attitude and culture of the organisation. Sadly, these areas are found lacking sometimes and we ended up having a Royal Commission into the banks and casinos because of issues that had been uncovered. It would be great to say that all that integrated reporting and ESG reporting is good at proactively identifying these issues, but inevitably a lot of it ends up being reactive. But issues do get highlighted, and the idea is that we are focused more on identifying whether the processes are lacking so we can then help identify issues ahead of them arising, that's the ultimate aim of ESG reporting. So, for example, one of things we look at is Health and Safety – it's great that companies report on their TRIFR and those other similar metrics, but more and more companies are reporting on the 'near misses' and the 'root causes' of safety incidents before they lead to workplace injuries. If there are workplace issues, is there a whistle-blower hotline? Is there a dispute resolution mechanism? These are the sort of things that are helpful in identifying where there could be potential risks.

What benefits accrue to the company in providing this increased ESG/ integrated (6 capitals) reporting? How do these benefits accrue?

This does go back to the first point on ESG and the focus on quality – it is an indicator, obviously not determinative in and of itself, of management being prepared to hold itself to account for various matters by publishing its sustainability issues and ESG metrics. It just reveals some sense of how the company is managing these things. We have often had discussions with companies that don't necessarily rate that well with the agencies on their ESG, and a lot of the time it isn't that the company is poor at it, it's often because they are poor at disclosing it. In the past, we have helped companies make their disclosures more prominent and more frequent as a way of improving their rating. It's not about getting an elephant stamp from the rating agency; it is about ensuring the company has a good approach to ESG and the management of risks.

When I think about ESG, I always struggle with descriptions of ESG being non-financial issues because that dichotomy is very difficult to prove, and I just talk about it as material issues for a company that stretch beyond current financials. Good ESG practice is a necessary condition for a good investment, but I don't think it is a sufficient condition. There are a lot of companies that have good ESG practices that are poor investments but there are no situations of bad ESG practice that leads to good investment performance over the longer term.

In terms of the benefits, if you invest in a quality business with quality management it just gives you better long-term performance. It is important as a tool in identifying whether you are dealing with a quality business. We have incorporated a shadow carbon price in what we do. We use it to identify the companies that are most vulnerable to the imposition of a carbon price. The results intuitively back what we think. Obviously, if you are a utility company with a lot of coal in your mix then life may well get difficult over time.

Other things, I would suspect the analysts and the portfolio managers get a greater degree of comfort investing in a company that looks expensive in terms of being on a higher multiple if they are satisfied that they have a good ESG approach. I would say that it is more intuitive that scientific, that is more the art of investing rather than the science. I talk about fundamental and quantitative investing as different religions. Fundamental investors look at the financials and may consider MCSI ratings as an input, but we don't invest in companies based on a view that a AA stock is going to perform better than an A rated stock.

Are these benefits accrued across all your investments (i.e., what about indexed investments if used?)

We do have some indexed or passive holdings but that will be for specific strategies. We could have an ASX200 component of a particular strategy where we would invest in all the companies in the ASX200. The vast majority of how we invest is done in an active way. The resultant benefits get measured by the alpha in the returns we are making.

Can you put these company benefits in order of importance?

We don't seek to quantify the benefit of ESG. The general principle still holds which is buying large companies with good ESG practice (thought to be better rated by the market), if like for like, then the company that has better ESG practices than the other will trade at a premium to the other. Then whether you can disentangle that premium into different sorts of factors is beyond the scope of what we will try to do.

CBA trades at a premium to the other three banks and now can you attribute that all to ESG? I am not sure, I think that would be bold, there would be a bunch of reasons why CBA has performed better than the other banks. The simple one is it achieves higher returns on equity than the others, but the next question becomes what drives the higher return? Is it ESG or a business mix in terms of better processes in what they do? But even CBA is not without fault on ESG.

What is the benefit for the company in having their ESG/ integrated reporting extended external reporting assured by a quality auditor?

There is clearly benefit for the users of external reporting from third party verification but that is a motherhood statement. The reality is that a lot of this information is internal to the company and very much aligned with management accounts. A good management team will have its reasons for reporting its performance stats the way it does. All we can do is hope the metrics they use, for example when they do their safety metrics, there is some sort of external verification that the numbers are what they are saying, otherwise we are just relying on the company's word. Some level of assurance is always going to be welcome, as it provides validation by an external party.

Would you prefer that companies provide a number of long reports each half year and year end, or a more succinct report focused on what the Board believe is material to the company's ability to create sustainable enterprise value over time supported by a detailed spreadsheet with key financial and non-financial (sustainability/ other) performance measures say with a 5- or 10-year trend line and an index to frameworks used (i.e., GRI, TCFD etc.)?

We are big believers in using appendices or having a detailed spreadsheet or a link to the website for all the sustainability data. However, it is important the Annual Report has a few key highlights from the Sustainability reporting, or to have a separate Sustainability Report if the company is big enough to do that. It doesn't need to be a cluttered 50 pages of data.

Many large companies do a separate large Sustainability report. That is a choice for them, but sometimes when you cover the full gamut of sustainability issues for a company it may become too big for inclusion in the Annual Report. Then you have a detailed separate Sustainability Report. You would have the highlights of E, S and G in the Annual Report and then a more comprehensive document. That document may include the key sustainability stats or even just a link to the key stats, but it is very common practice to put a report out like that. An Annual Report is okay for the highlights, but then have the details in the Sustainability Report.

Do you believe integrated reporting (incl. ESG and off-balance sheet intangibles) will be the basis of the future global reporting system per IFRS Foundation? Why?

Yes, obviously that will be the basis of the future global reporting system. It just makes sense, a lot of companies, especially the smaller, less resourced ones are freaking out about the new requirements released by the ISSB. No one is going to get pinged early on it, but the idea is this evolves over time. This year's Sustainability Report has to be better than last year and so on. What companies are doing currently in their sustainability reporting will likely be sufficient at least initially. One of the issues of course is what are the material issues and companies usually have a pretty good handle on what they think are the material issues. We often get approached by companies as part of their own materiality assessment as we are one of their key stakeholders, and they ask us what don't we currently cover and what do we cover? And typically, companies have a pretty good handle on what are their key issues for materiality and I personally am okay when it comes to sustainability reporting with letting the companies decide but I will never say that about financial reporting. In fairness, financial reporting has been going on for hundreds of years and sustainability reporting is pretty nascent and over time standards will develop. But it is a great first step what the ISSB is doing, and we encourage it strongly. These days with everything being accessible online, whether it's integrated into one single bound document is not as significant as it used to be.

What advice would you give a company thinking of moving to adopt integrated reporting (if you have an opinion)?

What I have said above really, my advice would be for companies to do it. You can quantify how much profit you can make, there is a mathematical answer, but attributing it to ESG practice and trying to quantify that is an intellectual flight of fancy. Companies should provide the information, but these are judgement calls for investors and stakeholders to determine how well each company is doing.

How should ESG or integrated reporting performance be incorporated into executive (and staff) incentive arrangements and reported?

It should be and increasingly companies are including ESG as a component of STI and LTI measures into their performance plans. There should just be accountabilities around actions on decarbonisation, contribution to work health & safety. These are always difficult and end up being quite subjective assessments, even though they are taken by a Board using some sort of framework and checklist. It does end up being subjective. There are certain things which are objective, e.g. around safety. If there is a fatality- it always becomes like a gateway issue – there should be a zero tolerance for fatalities. What is the right quantum attributable to ESG in the incentive arrangement? Practice has been 10-20%, it has got to be meaningful.

Report user – Proxy advisor

Interview with Martin Lawrence, Co-founder and Director, Ownership Matters

Do you believe ESG is critical to enterprise value? Why?

I think ESG is absolutely critical to enterprise value. ESG provides an insight into company culture and provides indicators of other risks. Environment and climate change are impacting the financial accounts, and ESG is also showing up in litigation. I look at sustainability not in the narrow sense but more broadly, a business that makes itself objectionable to its employees, communities, regulators are unlikely to please its shareholders for very long. As an example, five years ago, coal companies were just normal listed companies, with just a few green activists challenging them and largely dismissed by investors, now most institutions don't really want to invest them. These coal companies find it hard to find new board members, and they have to pay a premium to retain executives and staff. It is a real issue, which happened very quickly because what they do has become objectionable. Coal mining has probably been objectionable for quite some time, but it is now manifestly objectionable to a very large group of the people with whom they interact and Australian society in general. Suddenly, they are in a very weird place. If you have a look at the multiples on certain listed coal miners now, they are low at a time when coal prices are as high as they are ever likely to be.

Banking is an interesting sector. Many banks, post the Royal Commission, got caught up in the question of financial vs non-financial risk, and for me it's all about the non-financial risks. To be fair to the banks, what the Royal Commission exposed is that wealth management was the main problem. Going back to the ESG point, you are seeing a lot of discission about, "We need to be less stringent about the regulation over financial advice because it is making it too expensive."

Well, financial planning is an industry based on customers not knowing what they were paying for. If all the defence for that model is that customers don't know what they are paying for, then when they find out, they are not going to continue to pay for it.

One of the interesting groups I talked about ESG with were resources analysts. Most resources analysts have very sophisticated ESG assessments, which they probably don't call ESG because their business is so intrusive because of the nature of what it does. I remember asking a Veteran resources analyst once, "Would it be possible to be a really successful mining company but have a very dreadful safety record?" and he said not for very long. So, that S component goes to your ability to retain staff.

What does ESG mean to you (in your role) and your organisation?

We compete for talent with the Financial Services sector, we are a small business. One of the ways we try and compete is that it is a place where you can bring your 'whole self' to work. So, we would see that social and cultural piece as absolutely critical to our value as a business as it allows us to keep people that would probably get paid more elsewhere.

Organisations work best when they have a sense of mission, and it's a rare organisation that can actually succeed long term with a sense of mission that is solely around making money. I know of one listed company in that category, and it is a miracle in its space, and it is a testament to its governance structures.

That sense of mission is critical to its enterprise value, and why people want to work there other than the fact that they have to work. And so, that's critical to what makes Ownership Matters work – we have a sense of mission, and I think that goes to that social piece – how you maintain culture and retain it as a good place to work.

ESG for us – in the work we do – tends to be an indicator of risk. There will be times where you have reservations about a particular company, but you can't just work it out. You then go and talk to the Chair/ Senior directors, and you realise that they are aware of these risks and there are people in charge who know what is going on and ultimately are going to try make the right decision. They might be wrong but at least they are going to try make the right decision. By contrast, there are a couple of organisations, one in particular that I am looking at right now and you just look at them and honestly you think they are rotten from top to bottom and that can often be bizarrely in places pitched as part of their ESG story. I mean the most notorious entity I can think of was Babcock and Brown Wind. They were hitched with sustainability and renewable energy in 2006. It was a catastrophe; it was a vehicle designed by Babcock and Brown to 'pillage' as much as possible. Babcock and Brown was building itself to be the mini-Macquarie, but it's been in the dustbin for more than a decade and Macquarie is still going.

Governance has always been a major part of what we do, we are tending to get more information volunteered by companies, but it's always been part of what we are interested in. Companies are more willing to talk about. An example of a question I have been asking after the Harvey Weinstein story, I just ask chairs of large companies, "You employ x employees, there is unquestionably in your organisation a man in a leadership or senior role who is behaving badly. So how do you find about that quickly to change it and stop it?' And the responses to that question are always fascinating. For example, I was with an older male chair, who had a female director with him, and she was cringing as he went on about how he always makes sure he has another woman in the room, just in case he gets accused of sexual harassment. A good answer acknowledges that the problem exists. The standard answer is that we have cultural surveys and a whistle-blower hotline to identify such matters. A lot of what we do is work out what is the stuff that people say because they have to say it, and who means it.

Does ESG reporting or integrated reporting integrated reporting (including material off balance sheet intangibles) provide you with better information for your investment advice? If yes, how? If no, why not?

Generally, not, someone made a point it has taken about 600 years to get the accounting standards to where they are today and many still talk about how imperfect they are. The ESG reporting landscape is 20-30 years old, so it's in infant stages compared to accounting standards. When someone says this is the value of the goodwill on our balance sheet, you know what that means. From an ESG/ Sustainability reporting perspective, a lot depends on who the person in charge of sustainability actually reports to? If they report to someone with Corporate Affairs in their title, then the quality of the ESG reporting is considered a bit questionable but if they report to the CFO/CEO – then okay, this is likely to be actual reality. I'll tell you a story of climate action transition reports from two large miners. One report is very dense. It was very clear that the 40 pages mattered to the organisation, it told an integrated story and was very detailed and correct. It took 2 hours to read. The other miner's climate change action plan report takes about 20 mins to read and has more of a marketing feel, rather than hard facts and discussion.

Even though there are a lot of Sustainability/ ESG frameworks out there, they are immature when compared to financial reporting. Even for something more mature, like safety, some companies include contractors in their reporting, and some don't.

Amcor, the packaging company, seems to have a culture that for 15 years has driven success by doing all the things that are very hard very well, like buying businesses and integrating them, dealing with inflationary inputs and keeping its customers. To me that suggests there is a strong cultural impact there. I have asked them about it, and they've said they've got the 'Amcor Way' and our Values etc. but I have worked in a company that was a private equity caricature with an appalling management culture and it had a nice glossy statement of the 'X way' and its Values. I guess, it's just really hard to work out the value of some of the intangibles, and the truth of what is reported, other than through the company's prolonged success.

What benefits accrue to the company in providing this increased ESG/ integrated (6 capitals) reporting? How do these benefits accrue from an investor/ proxy advisor perspective?

The benefit to the company of ESG reporting, outside of what I call market benefits, we saw when the ASX Corporate Governance framework was released. It forced companies to think about why they do certain things. The human tendency is either why do we need to that, or we do that because we have always done it that way. I think the process of preparing these Sustainability/ ESG and Corporate Governance reports and working out what is important to an organisation can be really valuable, if they do it from a good faith perspective.

A good example is to consider how retail organisations dealt with the payroll underpayments issue recently, one major retailer disclosed the issue but have not copped much public heat for it. This is partly because in all their discussions about the matter publicly, they stood up and said: "Yes the awards are complicated, but we do a lot of complicated stuff as a core part of our business, and that's not an excuse and we messed up." And then they took it that step further and ended up doing an end-to-end review of their entire system. This is opposed to what others did who blamed the award complexity and/or just mentioned the problem and that they were fixing it.

What is the benefit for the company in having their ESG/ integrated reporting extended external reporting assured by a quality auditor?

If you don't do it, then no-one will take the report seriously so there is absolutely a benefit. It gives you comfort that someone else has verified the reported non-financial data. Just about every listed company that has fraud in history has had unqualified audited accounts. But at least in financial audit there is audit standards, audit disciplines, which means if the organisation did something badly, there will be consequences. The framework just doesn't exist in the ESG space yet, which makes it harder. From an investor's perspective, one of the problems is the fact you just don't know if the data is correct or reasonable, and you fall back on a reputational protection, that a quality audit firm and partner have put their names to this data/ report so they must be satisfied to a point, otherwise they wouldn't have.

Would you prefer that companies provide a number of long reports each half year and year end, or a more succinct report focused on what the Board believe is material to the company's ability to create sustainable enterprise value over time supported by a detailed spreadsheet with key financial and non-financial (sustainability/ other) performance measures say with a 5- or 10-year trend line and an index to frameworks used (i.e., GRI, TCFD etc.)?

I would prefer the second option, a broad outline of what the company believes is material and then more detailed statistical reporting over time. Very few companies have the resources to do what BHP do, in the near term; but it is absolutely the right way of doing things. It is putting ESG/Sustainability reporting in the same discipline as financial reporting through a well-structured reporting framework.

Do you believe integrated reporting (incl. ESG and off-balance sheet intangibles) will be the basis of the future global reporting system per IFRS Foundation? Why?

I honestly don't know, I am a pessimist by nature, I have a horrible feeling in 30 years' time I will be sitting on an user advisor committee board debating the principles for the ISSB standards still. The fundamental issue we have is that in accounting standards we fundamentally agree on what we are trying to do; on the sustainability reporting framework I don't even think we are at that spot. I don't even think there is agreement amongst investors on what kind of information they want, and what they want it for. The area you are most likely to unify reporting standards for investors will be on climate – unified, regulated, verified, as good as financial data. You kind of see it anyway from those entries that report their greenhouse gas emission data under the NGERS regulations. A lot of work is going into this topic because it is absolutely critical and important.

How should ESG or integrated reporting performance be incorporated into executive (and staff) incentive arrangements and reported?

There are philosophical differences about the best way of rewarding good ESG performance. To my mind, you should never incorporate something you cannot measure, because then it gets awarded as a result of a lot of activity, but you don't know whether it worked or not. My personal view is that leading indicators always get met. If you are doing the lead indicators well then surely it shows up in the lag ones. I like hard fact-based indicators. For a company like Telstra or Qantas for example, it's really hard to unpick – they use brand NPS and episode NPS. I mean to me the true test is whether they do not vest sometimes? Because if they always vest, no one is that good. There must be times when the executives don't get their incentives because something went wrong?

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