



The ESG journey begins

**2017 ESG reporting survey
of Hong Kong listed issuers**

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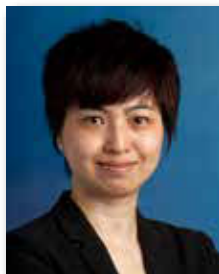
01

Welcome to the 2017 ESG *reporting survey*

Globally, there is increasing pressure on companies to disclose environmental, social and governance (ESG) information due to the increasing concern about the effects of ESG factors on business risk, financial performance and prospects. A recent example is the recommendations of the Task Force on Climate-related Financial Disclosures set up by the G20 Financial Stability Board and supported by institutional investors to promote consistent disclosures on how a company copes with climate risks and approaches climate-related opportunities.

Hong Kong Exchanges and Clearing Limited (HKEX) has strengthened its *ESG Reporting Guide* (ESG Guide) to help listed companies meet greater demands and expectations from investors and other stakeholders, and in 2016, HKEX upgraded the ESG Guide to 'comply or explain' for all listed companies. To understand how the listed companies are doing in disclosing useful information for investors and other stakeholders in the first year of implementation, we reviewed the ESG reports of around one-quarter of HKEX listed companies with a December year end and set out the key findings in this report. We also provide recommendations to help companies assess and further develop their own approaches.

We hope you find it an enlightening read, and would be delighted to hear your thoughts.



Maria Cheng

Partner,
Head of Business Reporting and Sustainability,
KPMG China

"2016 was the first year that HKEX elevated the requirement of disclosure of ESG information to 'comply or explain', and this survey shows good progress for listed companies to identify and disclose their ESG risks and opportunities.

The survey reveals that this new reporting space is off to a good start. We hope that companies will benefit from KPMG's suggested improvement points, and that Hong Kong can be a leading light in ESG reporting quality."



David Graham
Chief Regulatory Officer
and Head of Listing,
HKEX

02

Executive summary

Key findings:

The survey revealed that most companies are at an early stage of the ESG journey. Many have yet to demonstrate awareness of the significant ESG risks they are exposed to and the effective management of their impacts.

ESG risks often not considered principal risks



Eighty-four percent of the surveyed companies have not identified any ESG risks as principal risks in the business review section of the directors' report.

HKEX's *Corporate Governance Code*¹ calls for comprehensive risk assessment that covers existing and emerging ESG risks. To avoid missing material ESG risks, companies may need to review and adjust the existing risk management system.

Unclear board engagement in ESG governance



Only a minority of the surveyed companies disclosed ESG governance. This includes 13 percent which reported that the highest level of responsibility for ESG is at the board level, and 4 percent which said responsibility lies at levels below the board.

According to the ESG Guide, the board is charged with the responsibility of overseeing ESG risks, and it is vital to have a governance structure in place to keep the board informed of the company's ESG risks and opportunities.

Disclosure of methodology in identifying material issues is not common practice



Seventy-seven percent of the surveyed companies disclosed all environmental and social topics ("ESG Aspects") listed in the ESG Guide, and only one-third of the surveyed companies disclosed how they identified material issues.

This potentially indicates the adoption of a box-ticking approach by some companies, and that many have not assessed and identified the ESG issues that can pose the greatest risk to the business.

1. 'Appendix 14 Corporate Governance Code and Corporate Governance Report', HKEX, accessed on 28 September 2017, http://en-rules.HKEX.com.hk/en/display/display_main.html?rbid=4476&element_id=3828

Different approaches to explaining the management of ESG issues

Only 29 percent of disclosures mentioned the management system and/or targets set for the relevant ESG topic to demonstrate how the company is managing, monitoring and improving performance.

Management systems should be in place to address material issues. A lack of relevant disclosures could imply that applicable ESG risks and opportunities are not adequately managed.



Limited discussion around challenges and setbacks

Less than one in five (18 percent) companies in the survey disclosed negative incidents, challenges or failures, as well as achievements in the report. This, coupled with the finding that up to 29 percent of companies have not disclosed certain compliance information in the report, potentially indicates a tendency for businesses to be less transparent about less favourable issues.



Other findings:

The survey also found that while the majority (81 percent) of the surveyed companies have followed the 'comply or explain' rule, 19 percent did not provide explanations for not reporting on one or more ESG Aspects listed in the ESG Guide (the 'explain' criterion).

While some surveyed companies voluntarily disclosed key performance indicators (KPIs) this year,² the top KPIs selected – 'employee profiles', 'community investment', 'energy consumption & reductions', and 'occupational health & safety' – are those that are relevant across sectors and generally managed by an organisation, suggesting KPI disclosure tends to be based on data readiness.

Furthermore, larger companies tend to provide more comprehensive reports, probably reflecting that a larger number of them embarked on the ESG reporting journey earlier and are experienced at following the more demanding international sustainability reporting guideline, the Global Reporting Initiative (GRI). No prominent difference in reporting practice across sectors was observed, with many companies being new to ESG reporting.

Setting the road map for improvement

For many companies, ESG reporting practice is at an early stage and there is much to learn. Realising its value to the company and stakeholders requires attention to the reporting process and quality. It is not possible to achieve everything from the start – so it is important to set a road map for incremental improvement. Our research suggests the following potential areas for improvement:

▶▶ ESG governance

- Formalise the board's involvement in ESG
- Develop informed oversight
- Enhance transparency regarding ESG governance structure and operating mechanisms

▶▶ Materiality assessment

- Understand the ESG risks and opportunities
- Focus on the most significant issues
- Engage stakeholders as well as high-level management

▶▶ Management policies and approach

- Ensure that robust systems are in place to manage the material ESG issues
- Disclose further information for material issues including:
 - Systems and controls in place
 - Responsibilities for monitoring
 - KPIs

▶▶ KPIs

- Consider the relevance and usefulness
- Maintain effective internal reporting systems and control
- Ensure data integrity
- Set goals and targets

2. Disclosure of KPIs is recommended in the first year of implementation of the ESG Guide, and Environmental KPIs will be upgraded to 'comply or explain' in the second year.

03

About the survey

Background

Following the release of the revised ESG Guide by HKEX in December 2015, HKEX listed companies are required to publish their ESG information annually. For financial years commencing on or after 1 January 2016, issuers must report on the 'comply or explain' provisions in the ESG Guide related to a number of Aspects, or provide considered reasons if they do not report on these provisions.

This survey was carried out in response to the first year of implementation of the ESG Guide, and focuses on the overall state and quality of ESG reporting among the listed companies.

Objectives

Provide a baseline for measuring progress in enhancing quality disclosures

One of the intended purposes of ESG reporting is to provide a company's relevant non-financial information in addition to its financial information to gain a more comprehensive view of its risks and outlook.

Reporting therefore has to be effective so that investors and other stakeholders are able to get information that is useful to decision-making. As this is a journey of continuous improvement, this survey reviews the current reporting status and aims to serve as a baseline to evaluate future improvement.

Provide valuable information for future planning and actions

Companies

Survey findings and our accompanying guidance and recommendations may be used by companies to:

- Benchmark themselves against their peer group and the wider market
- Understand how the reporting process may be improved to increase value gained, e.g. through enhanced knowledge and monitoring of ESG impacts, and better communication with important stakeholders.

Policymakers

Findings about companies' initial responses to the ESG Guide may:

- Help reveal opportunities to promote better reporting, e.g. by providing specific support and guidance to issuers
- Serve as a reference for planning for future enhancement of the reporting environment.

Methodology

Sampling criteria:

Size

Approximately 25 percent of the total number of issuers in both the Main Board and Growth Enterprise Market (GEM) Board as at 31 December 2016 which have a December financial year end.

Market capitalisation

Companies are selected based on their market capitalisation as at 31 December 2016, and the number of samples from each market capitalisation class is proportional to the number of companies in the corresponding capitalisation class.

Sector

The distribution of samples by sector, type of companies and stock nature is examined to ensure the sample reflects the landscape of HKEX listed companies. To improve the representativeness of the sample, it was slightly adjusted so that there are at least 10 companies from each sector.

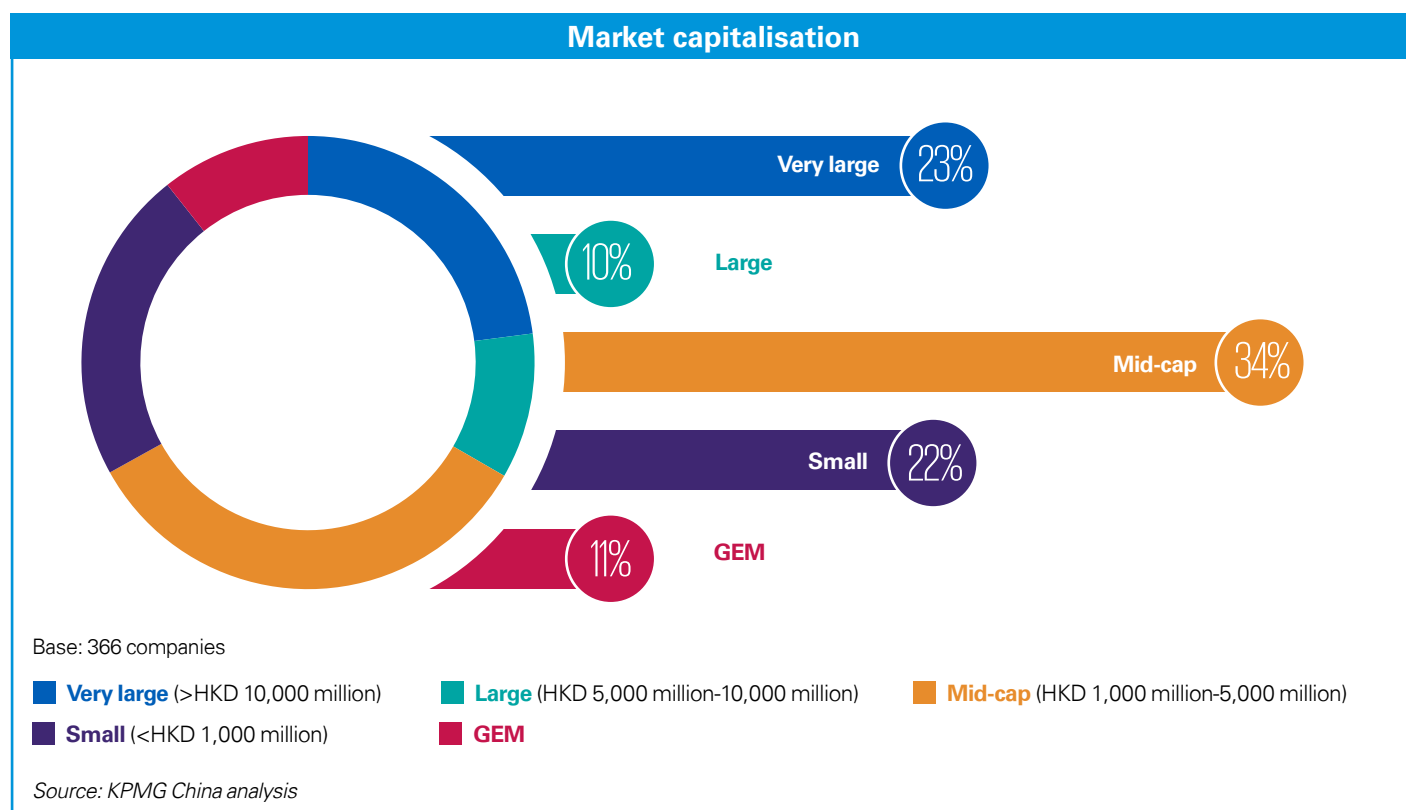
Sample size

366 companies (327 companies on the Main Board and 39 companies on the GEM Board).

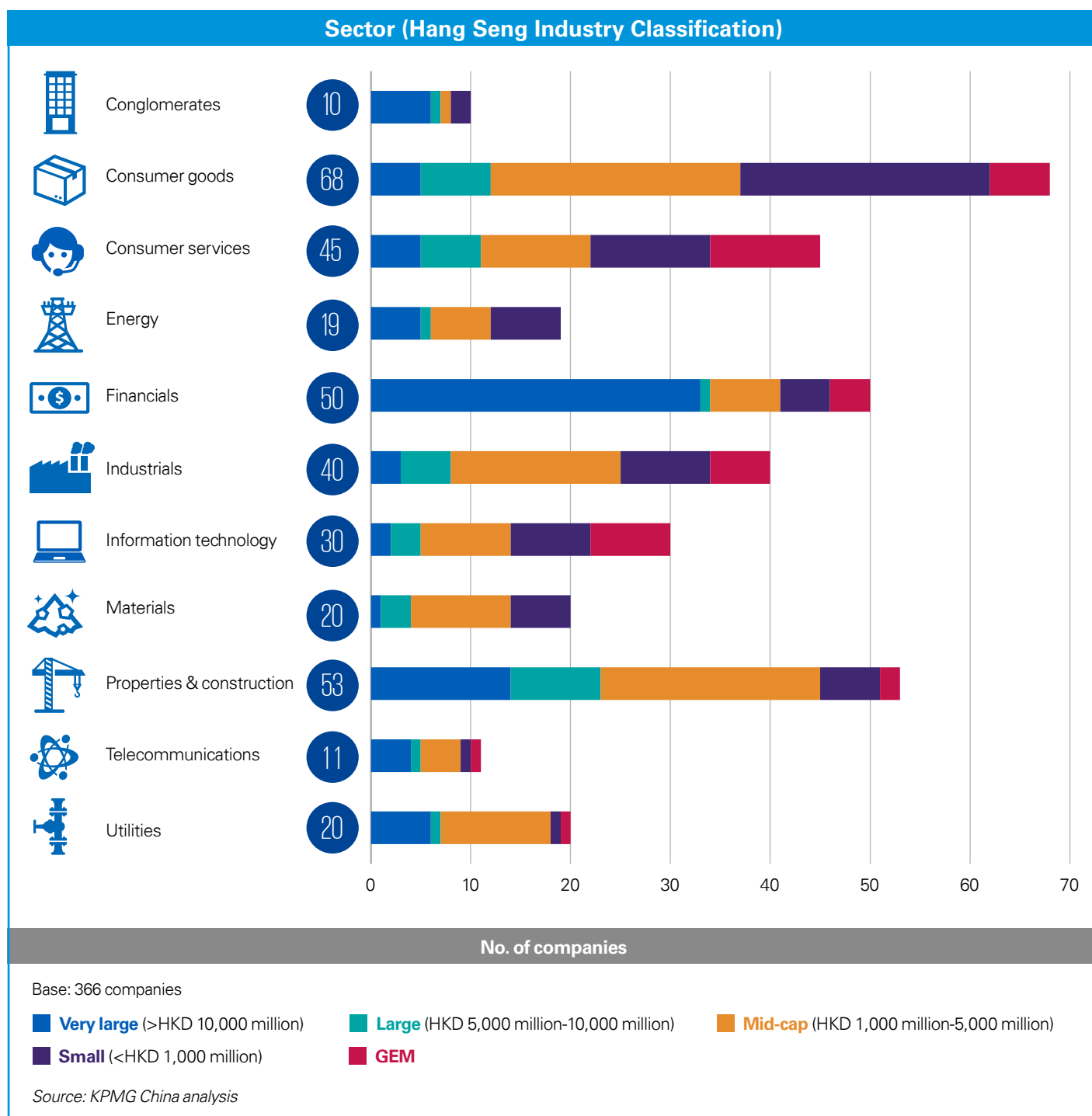
Source

Annual reports and separate ESG reports for the year ended 31 December 2016.

Sample companies' characteristics



“This survey was carried out in response to the first year of implementation of the ESG Guide, and focuses on the overall state and quality of ESG reporting among the listed companies.”



“One of the key business risks is ignorance of the environmental and social risks that the entity is exposed to.”



Maria Cheng
Head of Business Reporting
and Sustainability,
KPMG China

04

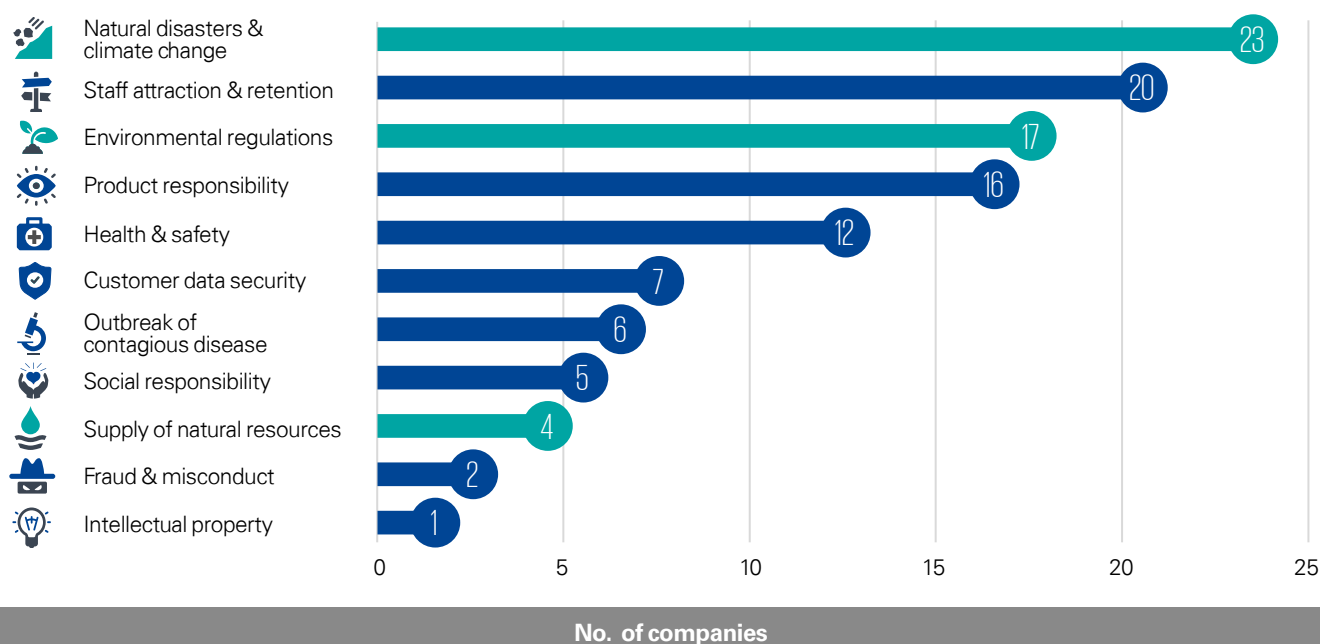
ESG risks often not considered principal risks

In accordance with the Main Board Listing Rule Appendix 16.28 and GEM Listing Rule 18.07A, all listed issuers have to include a business review in their directors' report, which must contain a description of the principal risks and uncertainties facing the company.

Our research found that only 16 percent of the surveyed companies have identified one or more ESG risks as principal risks in the business review.

'Natural disasters' was the most quoted risk facing companies due to potential disruptions to operations, and financial loss. While severe weather conditions can affect the business operations of a wide range of industries, more companies from the energy sector, such as coal mining and petroleum exploration, recognise this risk to their operations.

ESG risks identified in business review



Base: 366 companies

■ Environmental ■ Social

Source: KPMG China analysis

“There is an important link between ESG risk and reputational risk. Boards and CEOs that can make this connection can create trustworthy brands and improve customer loyalty.”



Pat Woo
Partner, Business Reporting
and Sustainability,
KPMG China

More companies from the consumer services sector referred to 'staff attraction & retention' as one of their principal risks, reflecting the industry's reliance on human resources to deliver quality services.

The financial sector had the lowest rate of ESG risk disclosure. Only one surveyed company referred to the risk of 'staff attraction & retention'. This is surprising given the growing environmental and social risks facing the clients/investees of financial institutions and the increasing demand for the financial sector to integrate climate risks into decision-making.

It was also observed that larger companies were more likely to identify ESG risks, perhaps due to their earlier start in the ESG journey and that they have evaluated the ESG impacts and risks.

ESG risks identified in business review

(Market capitalisation view)



% of companies in the respective market capitalisation class

Base: 366 companies

■ **Very large** (>HKD 10,000 million)

■ **Large** (HKD 5,000 million-10,000 million)

■ **Mid-cap** (HKD 1,000 million-5,000 million)

■ **Small** (<HKD 1,000 million)

■ **GEM**

Source: KPMG China analysis



KPMG view

Understand the different nature of ESG risks and define the responses required

ESG risks to businesses emerge from changing conditions in the socio-economic environment. For example, the rise of social media and the public's expectations regarding what companies should do has made companies more vulnerable to reputational damage from their own or their business partners' undesirable business practices (e.g. unfair treatment of workers). More and more complex supply chains and partnership arrangements also expose companies to a wider range of environmental and social risks in the extended value chain.

Many businesses do not recognise ESG risks as principal risks. This could be because they struggle to develop a holistic view of risk which incorporates both core internal operational risks and emerging risks from the external environment.³ ESG risks may be more easily overlooked for various reasons, including limited knowledge of their impact and the perception that they have longer time frames.

In fact, according to KPMG's *2017 China CEO Outlook*, China CEOs ranked 'reputational/brand risk' the no. 1 risk they expect will impact their companies' growth over the next three years. Externally, this may reflect a heightened awareness that having a good reputation and a 'social licence' to operate is important for companies to be successful, particularly when they are investing and operating in markets outside China. Domestically, China CEOs are aware that in an increasingly crowded market with a consumer that is growing in sophistication, it is imperative to create a brand that consumers can trust in order to stay ahead of the competition.⁴ Yet, many CEOs and boards may not see the connection between ESG risk and reputational risk, and this will need to be a greater focus going forward.

ESG risks are increasingly seen to have a more significant financial impact. For instance, natural disasters incurred global losses of USD 166 billion in 2016, more than double the level in 2015.⁵ Climate-related risks such as extreme weather and regulatory risks are indeed recognised to pose serious risks to the global economy, and have an impact across sectors. Thus the G20's Financial Stability Board set up the Task Force on Climate-related Financial Disclosures (TCFD) to promote consistent disclosures so that investors, lenders and other financial stakeholders can better understand an organisation's climate-related risks and opportunities, and how they are likely to impact its future financial position.⁶ Even before the release of the final recommendations from the TCFD, 48 percent of the world's 250 largest companies had already acknowledged the financial risk of climate change in their annual reports.⁷ In scaling up green finance, China will also be promoting such disclosures. As ESG reporting continues to develop, pressure will grow for companies to better communicate ESG risk information in ESG reports and mainstream financial reports.

HKEX's *Corporate Governance Code* calls for comprehensive risk assessments that cover ESG risks, whether existing or emerging. To avoid missing material ESG risks, companies may find themselves needing to adjust the existing risk management system. It is important that companies define the risks and responses required in the short to long term to enhance resilience in a more dynamic business environment.

3. 'Risk Management: navigating change in Hong Kong', KPMG & The Hong Kong Institute of Chartered Secretaries, July 2017, <https://home.kpmg.com/cn/en/home/insights/2017/07/risk-management-navigating-change-in-hong-kong.html>

4. 'Disrupt and grow: 2017 China CEO Outlook', KPMG China, August 2017, <https://home.kpmg.com/cn/en/home/insights/2017/06/china-ceo-outlook.html#landing>

5. 'Natural catastrophes and man-made disasters in 2016: A year of widespread damages', Swiss Re, 28 March 2017, http://institute.swissre.com/research/library/NatCat_and_manmade_disasters_2016.html

6. For more on the TCFD, see <https://www.fsb-tcfid.org/>

7. 'The road ahead: The KPMG Survey of Corporate Responsibility Reporting 2017', KPMG International, October 2017, <https://home.kpmg.com/xx/en/home/insights/2017/10/the-kpmg-survey-of-corporate-responsibility-reporting-2017.html>

05

Unclear board engagement in ESG governance

Of the surveyed companies, only 13 percent disclosed that their board is responsible for ESG, while the vast majority have not disclosed relevant information on ESG governance structure.

The highest level of accountability for ESG



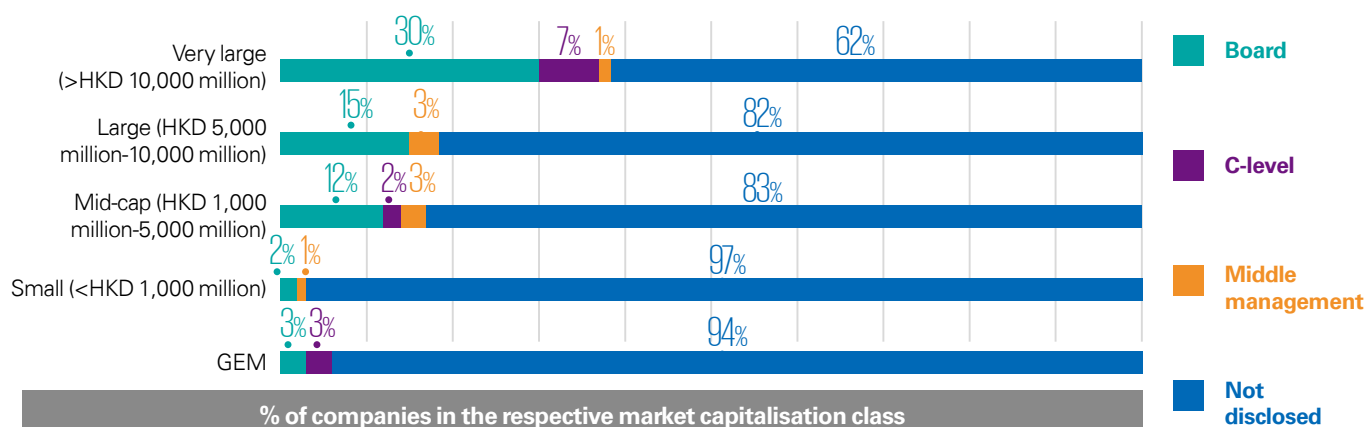
Base: 366 companies

Source: KPMG China analysis

However, those with relevant disclosures included gave different levels of detail. Some only indicated the general responsibility of the board and other relevant departments regarding ESG; others provided more details including the ESG governance structure that consists of an ESG committee and working groups, composition of the ESG committee, and work performed in the year.

Generally, larger companies tended to report having ESG governance that also involves the board. These companies may have more experience in ESG and are likely to have established ESG governance for more effective ESG management.

The highest level of accountability for ESG (Market capitalisation view)



Base: 366 companies

Source: KPMG China analysis



KPMG view

More robust disclosure is needed to demonstrate the board's awareness and oversight of ESG trends and risks

Board awareness

Currently, it is unclear how aware the boards are of ESG risks and opportunities. Most companies do not provide detailed information on the ESG governance structure and board's involvement in ESG. Of the companies that provided information related to ESG governance, some disclosed that responsibility for ESG rests at levels below the board.

With the amended *Corporate Governance Code*, HKEX is emphasising the roles and responsibilities of the board and management in relation to risk management and internal control to address the risks. The ESG Guide also states the following:

"In line with the Corporate Governance Code, the board is responsible for evaluating and determining the issuer's ESG-related risks, and ensuring that appropriate and effective ESG risk management and internal control systems are in place. Management should provide a confirmation to the board on the effectiveness of these systems." (ESG Guide para. 9)⁸

ESG impacts can be both risks and opportunities that can significantly affect business value. It then follows naturally that the board should be overseeing ESG trends and making important decisions on addressing them based on management information. These decisions, therefore, are not limited to ESG reporting alone, but to wider strategic issues including capital expenditure and the integration of ESG considerations into existing operations.

For instance, in approving major capital expenditure, such as power generation facilities, the board of a power company will have to consider the assets' future value in a world with a higher cost of carbon emissions and other environmental and social impacts. Also, in reviewing the existing business strategy, the board of a food and beverage company will need to consider if it can address the rising challenges of water scarcity and public health concerns.

We appreciate that ESG may be a new topic for a lot of companies, and that they may not have set up ESG governance with a clear structure and responsibilities. As it takes time to build a well-structured governance model and management systems, we suggest that companies should begin to develop an effective approach for the company to ensure that the board understands the financial implications of ESG risks and is able to make more informed decisions to preserve future competitiveness.

Robust disclosures

Although the ESG Guide does not require the disclosure of ESG governance structure, stakeholders such as investors and analysts place considerable weight on the topic due to its probable connection to ESG performance. For instance, a governance structure with board-level interest in ESG issues can help ensure that ESG considerations are factored into decisions, related initiatives are adequately resourced, and the appropriate systems and processes for managing issues are implemented. Given that awareness, leadership and accountability at board level are critical for the successful management of ESG issues, we encourage more transparency and disclosure with regard to ESG governance. This would allow report users to assess the company's commitment to ESG and the quality of governance.

Better disclosure on ESG governance may include descriptions of how the board is informed about ESG issues and monitors progress against goals; and how management assesses and manages ESG risks and opportunities. Companies may further reference TCFD's recommendations on climate-related financial disclosures for developing their reporting in the area of governance for ESG.

8. 'Main Board Listing Rules Appendix 27/GEM Listing Rules Appendix 20: Environmental, Social and Governance Reporting Guide', HKEX, extracted on 18 September 2017, http://en-rules.hkex.com.hk/en/display/display_main.html?rbid=4476&element_id=3841

06

Disclosure of methodology in identifying material issues is not common practice

“It is crucial to have the involvement of high-level management to ensure they are informed of the material ESG issues and can form a holistic view of all the significant risks affecting the company.”

It is fundamental to assess relevant topics and identify any material issues (conduct a materiality assessment); yet, the disclosure of how companies have performed this is not common practice. Material issues are expected to form the focus for management and reporting, and therefore how these material issues are identified would be important to readers.

All companies face a range of ESG issues, but not all are equally important in terms of impact on the business and its stakeholders. That is why the principle of ‘materiality’⁹ is essential in ESG so that the most significant issues are given priority. Put simply, materiality means that instead of tracking and reporting on all possible issues related to ESG, companies should focus only on those that matter.

There are 11 Environmental and Social Aspects listed in the ESG Guide. Most of the surveyed companies (77 percent) have reported on all of the Aspects, and only one in three companies (33 percent) disclosed a materiality assessment process to highlight the method upon which they identified material issues.

77% of companies reported on all ESG Aspects listed in the ESG Guide

77%

33%

Only 33% of companies disclosed their materiality assessment process

Base: 366 companies

Source: KPMG China analysis

9. “Materiality is the threshold at which ESG issues become sufficiently important to investors and other stakeholders that they should be reported.” (ESG Guide para.11(1))

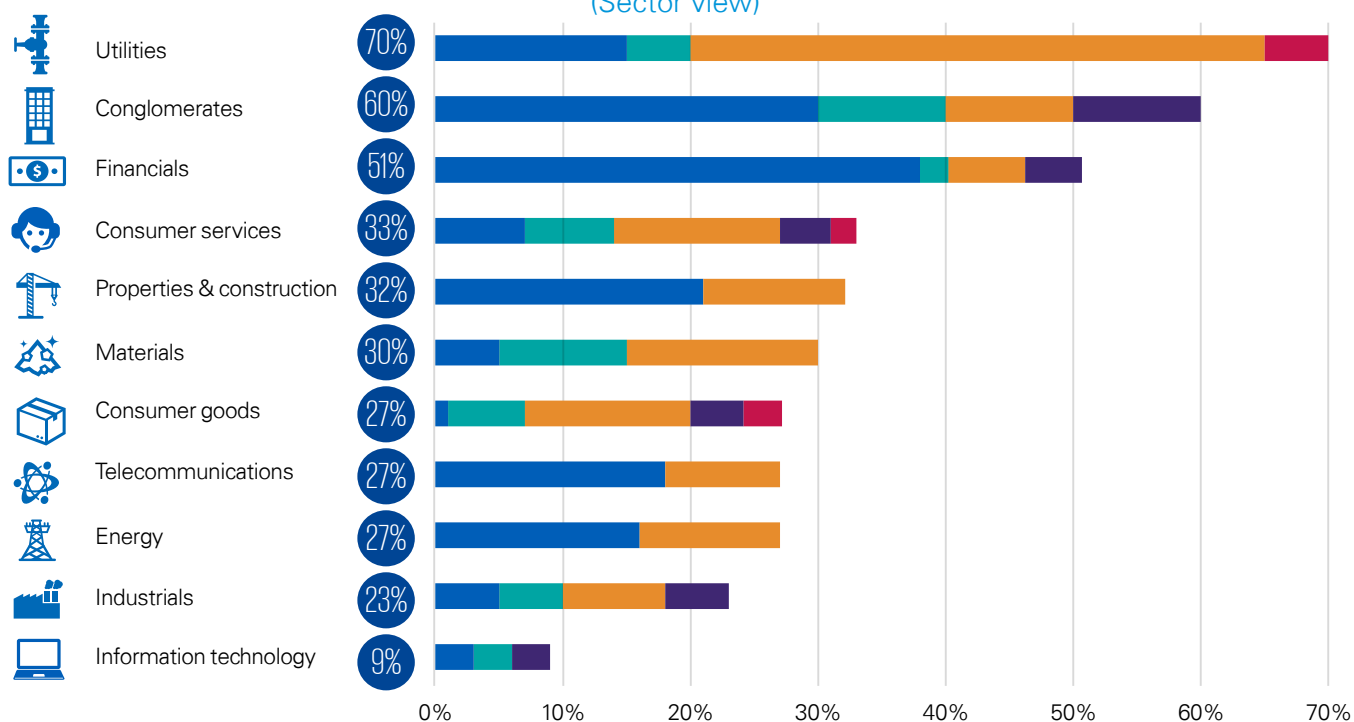
“Traditional corporate responsibility reporting has focused on reporting statistics such as how many cubic metres of water a company has saved, how many tons of carbon it has reduced or how many employees it has sent on training programmes. Such statistics increasingly lack real meaning without information on context and impact. The future of corporate responsibility reporting is all about communicating impact, not statistics. Investors need to know what impact corporate responsibility activity has on business performance. How has it helped to reduce risks, unlock opportunities or build capacity for future value creation?”



José Luis Blasco Vazquez
Global Head,
KPMG Sustainability Services

Materiality assessment process disclosed

(Sector view)



% of companies in the respective sector

Base: 366 companies

Very large (>HKD 10,000 million)

Large (HKD 5,000 million-10,000 million)

Mid-cap (HKD 1,000 million-5,000 million)

Small (<HKD 1,000 million)

GEM

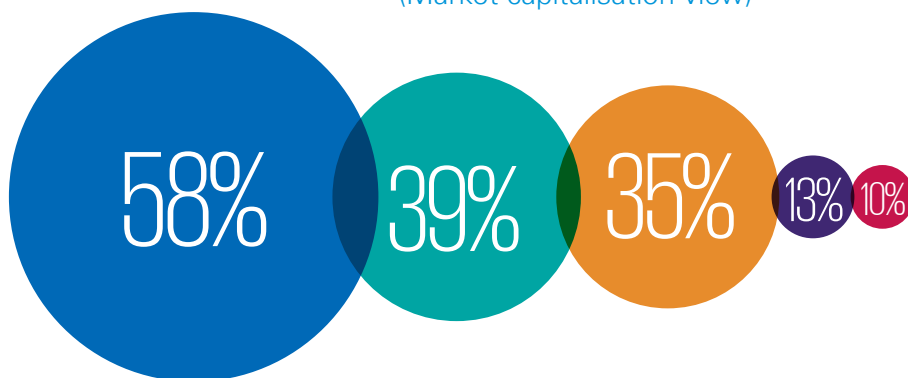
Source: KPMG China analysis

It was identified that the majority of the companies that disclosed their materiality assessment process were also reporting under the GRI guidelines. This may have helped create peer pressure for others in the sector to follow suit.

The reason that larger companies were more likely to disclose the materiality assessment process in the report may partly be due to a higher tendency to use the GRI.

Materiality assessment process disclosed

(Market capitalisation view)



% of companies in the respective market capitalisation class

Base: 366 companies

Very large (>HKD 10,000 million)

Large (HKD 5,000 million-10,000 million)

Mid-cap (HKD 1,000 million-5,000 million)

Small (<HKD 1,000 million)

GEM

Source: KPMG China analysis



KPMG view

The fact that a large proportion of reports have covered all ESG topics in the ESG Guide could reflect the adoption of a box-ticking approach by some companies

As many companies are just starting out with ESG, the use of a 'tick-box' approach to comply with the ESG Guide can be expected in the beginning. However, companies using this approach and trying to include everything in the report may lose focus on the really critical issues. Therefore, from the second year, companies should start to consider applying the materiality principle by disclosing their materiality assessment methodology, and engage stakeholders to assess what issues are really material and only disclose those issues.

A proper process to define the material Aspects/issues:

- Informs prioritisation of the company's resources on managing and reporting the most important issues to increase efficiency **(comply)**
- Adds credibility to the explanation for not reporting due to the Aspects being of low significance given the results of the materiality assessment **(explain)**.

Although the ESG Guide has not upgraded the disclosure of the determination of materiality and stakeholder engagement to 'comply or explain', disclosing the materiality assessment process, including the groups of stakeholders engaged and the engagement methods, will enable readers to assess the process and the company's situation more comprehensively and objectively. It may also give credit to the 'explaining' of non-disclosures.

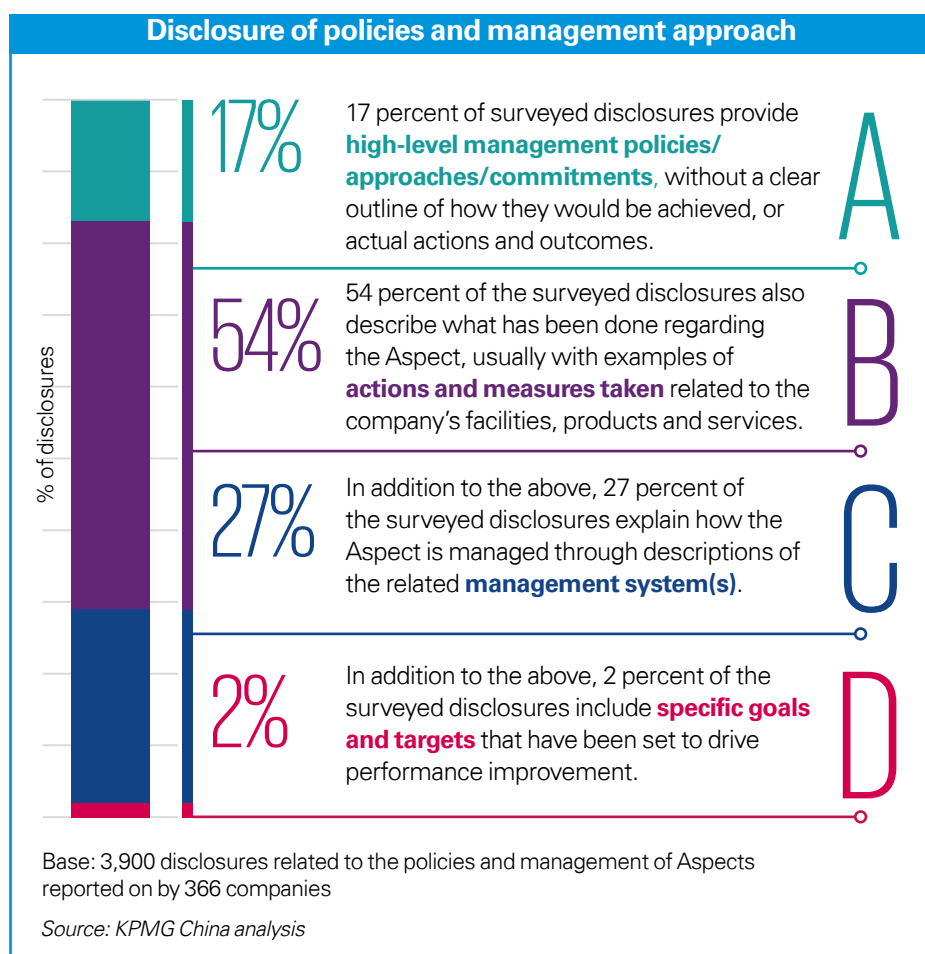
More importantly, the materiality process can serve as part of a risk assessment through which companies can gain a fresh and fuller understanding of what ESG factors would have the greatest impact on the company's business prospects, risks, asset value, reputation and investor confidence, and incorporate them into the company's business strategy. Thus as companies develop their process, we recommend that an assessment/review be conducted regularly to ensure new issues or changing topics are captured. Moreover, it is crucial to have the involvement of high-level management to ensure they are informed of the material ESG issues and can form a holistic view of all the significant risks affecting the company.

07

Different approaches to explaining the management of ESG issues

“Where limited information is provided in addition to high-level commitment and policy statements, readers have a limited base to assess the company. They may perceive this as an indication that the company has an inadequate management system to address the related ESG risks and opportunities.”

The ESG Guide sets out 11 ESG Aspects for which policies should be disclosed, but it has no specific requirements and guidance on what information is expected in the disclosures. A wide variation in the reporting approach is found among the surveyed companies:



Based on the above, category D descriptions are more likely to provide greater insights into how well an ESG Aspect is managed, while category A descriptions provide the least.

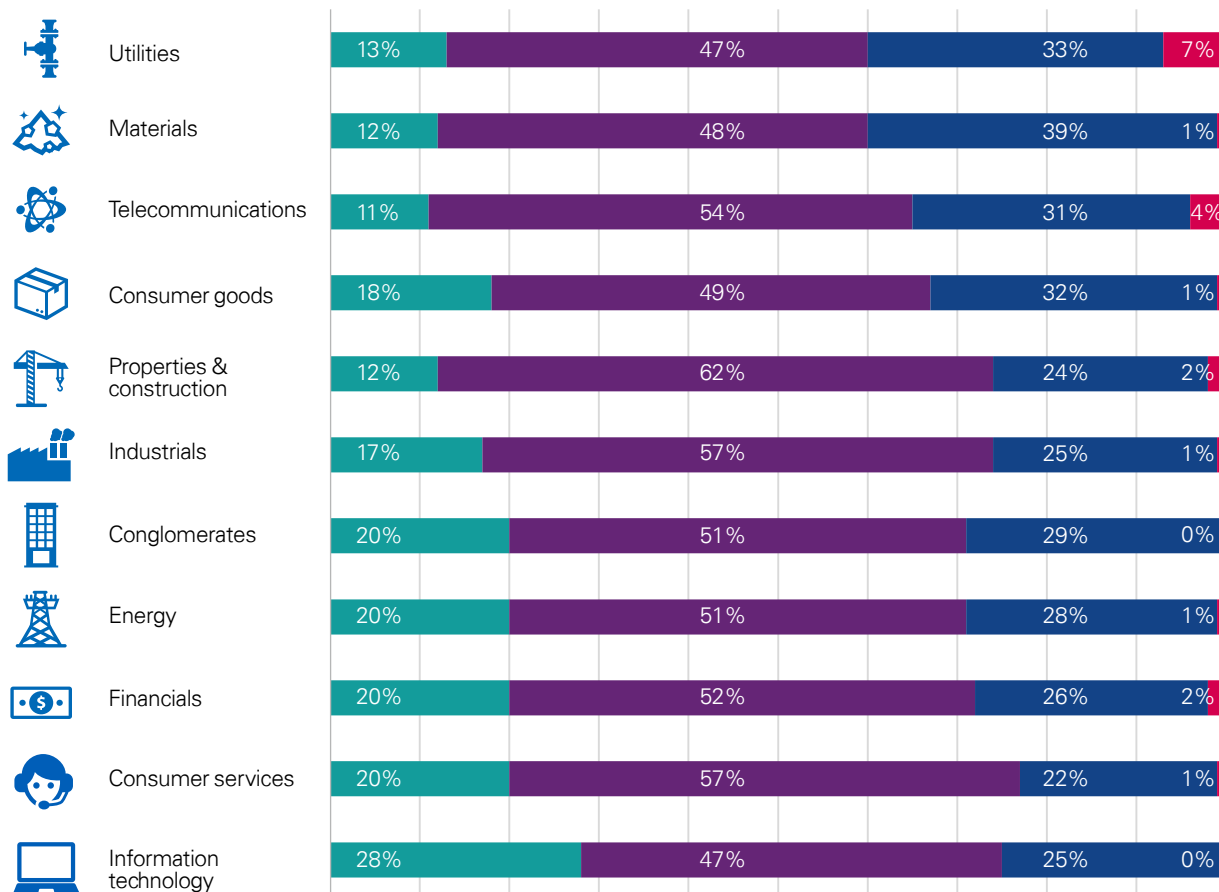
Disclosures of the policies and management approach in the utilities and materials sectors are more likely to include descriptions of the relevant management systems and processes.

The utilities sector, which holds public interest and has high exposure to environmental and social risks, tends to explain the systems and goals implemented relating to areas such as emissions control and resource conservation.

The materials sector, which has considerable environmental, health and safety regulatory compliance obligations, also tends to provide information regarding the systems for managing ESG impacts, such as the procedures in place for controlling negative environmental impacts at the mining sites to meet local laws and regulations, and regular local inspections.

Bigger companies tended to provide more insight into the management of ESG issues. This could partly be attributed to the higher proportion of companies referencing the GRI, which has more requirements for the reporting of management approach.

Disclosure of policies and management approach by sector

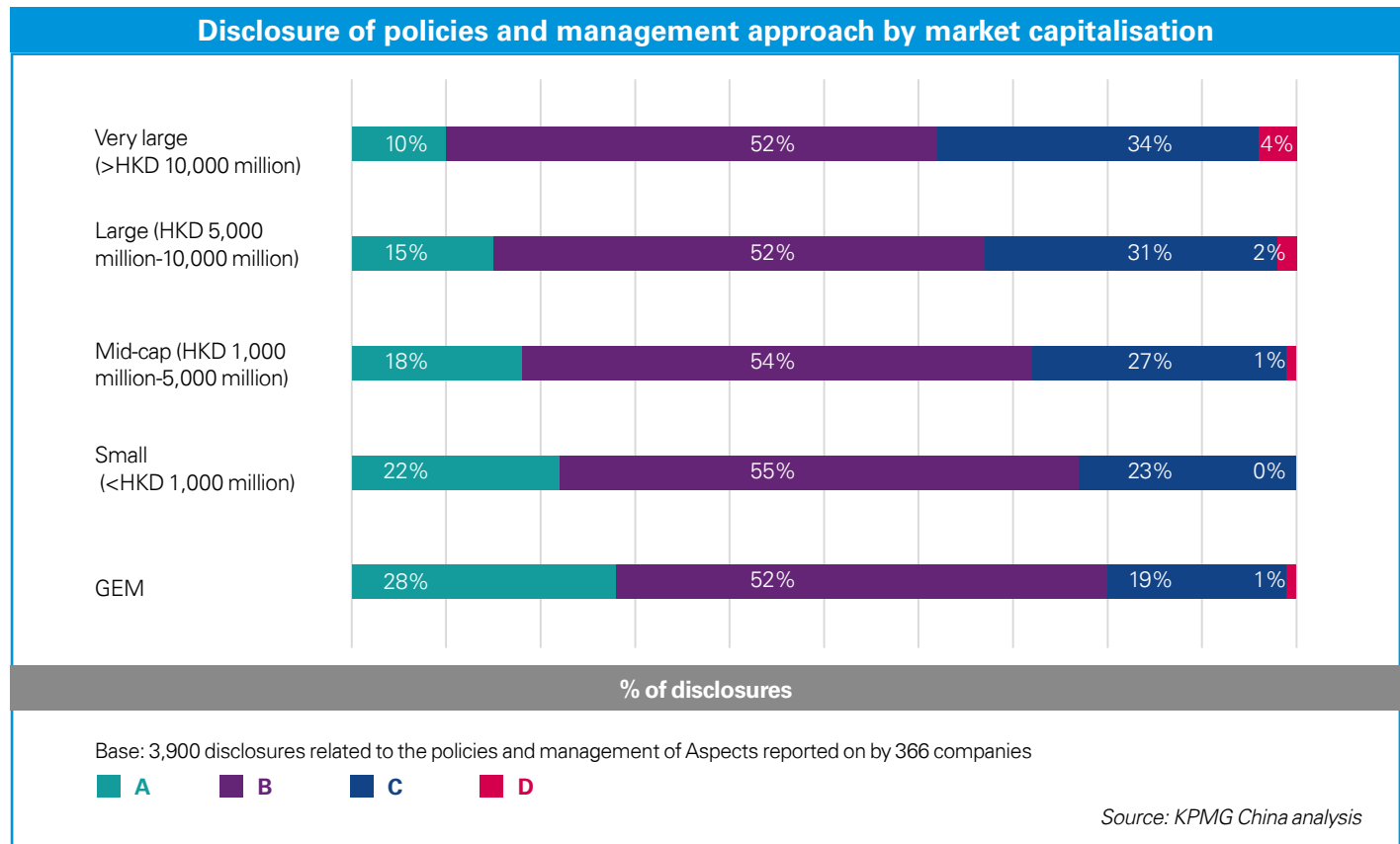


% of disclosures

Base: 3,900 disclosures related to the policies and management of Aspects reported on by 366 companies

A B C D

Source: KPMG China analysis





KPMG view

Review the adequacy and effectiveness of the existing management systems

It is important to know how exposed the company is to risks (i.e. how material the risks might be to the company). The higher the exposure, the stronger the management of these issues should be. Where material issues that can create significant risks and opportunities for the company are identified, the next question is how the company has addressed or will address them.

For material issues, effective management systems and processes should be in place, which involves assigned roles and responsibilities for the ESG performance, a monitoring mechanism, an approach for continual improvement, and

sometimes an external certification on the management system. However, only 29 percent of the surveyed disclosures provided descriptions of management systems and targets to demonstrate how the company is managing, monitoring and improving performance. While a lack of disclosure does not necessarily indicate the lack of such systems, there is a concern about the companies' understanding of their exposure to ESG risks and the responses that may be required. A thorough review of the adequacy and effectiveness of the management processes is considered necessary.

Consider how disclosures express the management quality

Readers use the information disclosed to help them understand how, and if, ESG issues are properly managed. Where limited information is provided in addition to high-level commitment and policy statements, readers have a limited base to assess the company. They may perceive this as an indication that the company has an inadequate management system to address the related ESG risks and opportunities.

Companies should therefore consider whether their reporting approach is sufficient to meet their stakeholders' information needs and achieve the company's objectives. When a report does not focus on the material issues and only aims to meet the minimum disclosure requirements for the Aspects, this can result in generic information.

Many companies have disclosed certain actions and measures taken to manage the ESG Aspects (category B). Yet, without mention of the management systems in place and goals, these can sometimes become an extensive list of unconnected and ad hoc environmental and social activities that are not particularly useful for understanding how performance is going to be continuously monitored and improved.

For material ESG issues, companies are encouraged to disclose further information, including:

- How they relate to daily business operations
- The respective policies on these issues
- The systems, controls and processes that are in place to manage and monitor them
- Targets and follow-up actions.

08

Limited discussion around challenges and setbacks



The balance reporting principle requires that an ESG report “provide an unbiased picture of the issuer’s performance” and avoid selective presentations that may “inappropriately influence a decision or judgement by the report reader” (ESG Guide para. 11(3)).

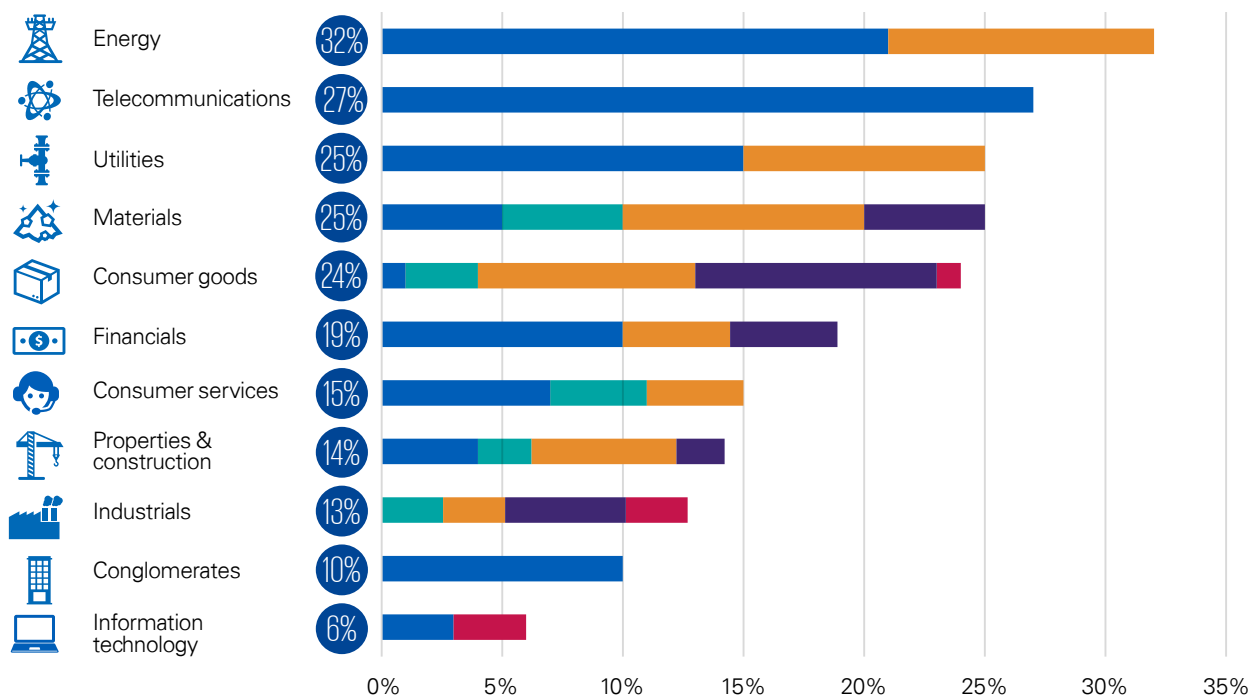
In practice, this can mean revealing negative and positive aspects of ESG performance to enable unbiased assessment by readers. Our research found that only 18 percent of the surveyed companies have done so.

Base: 366 companies

Source: KPMG China analysis

Negative incidents/challenges/failures and achievements discussed

(Sector view)



% of companies in the respective sector

Base: 366 companies

Very large (>HKD 10,000 million)

Large (HKD 5,000 million-10,000 million)

Mid-cap (HKD 1,000 million-5,000 million)

Small (<HKD 1,000 million)

GEM

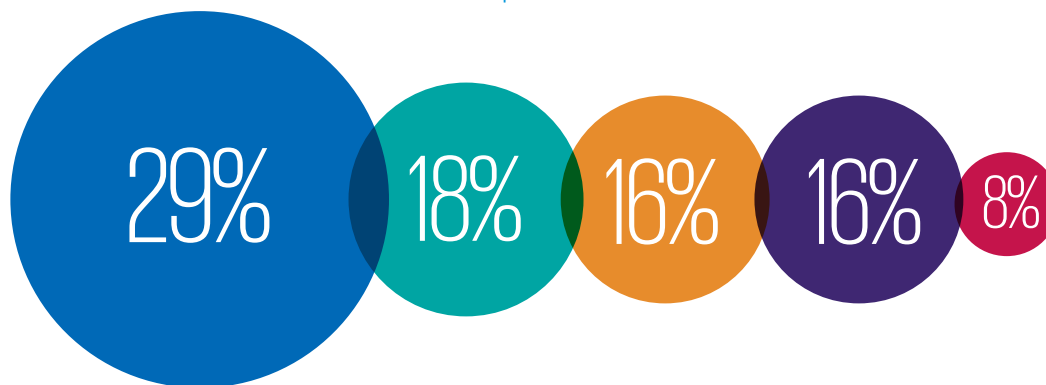
Source: KPMG China analysis

The energy sector is more likely to disclose challenges and performance related to safety and the global shift to low-carbon and clean energy, while the telecommunications sector may focus on complaints and improper advertising.

Larger companies were more likely to disclose negative aspects of performance. This can partly be explained by the greater use of the GRI which requires specific disclosure of environmental and social impacts and incidents.

Negative incidents/challenges/failures and achievements discussed

(Market capitalisation view)



% of companies in the respective market capitalisation class

Base: 366 companies

■ **Very large** (>HKD 10,000 million)

■ **Large** (HKD 5,000 million-10,000 million)

■ **Mid-cap** (HKD 1,000 million-5,000 million)

■ **Small** (<HKD 1,000 million)

■ **GEM**

Source: KPMG China analysis



KPMG view

Embrace transparency to build trust

Our research shows that most of the surveyed companies have not mentioned negative aspects of ESG performance in their report. Coupled with the finding that up to 29 percent of companies have not disclosed certain compliance information in the report (refer to 'Compliance with relevant laws and regulations' on p. 38), this could indicate a tendency to be less transparent on less favourable issues.

Considering that the scope of ESG is very broad and covers a wide range of topics, it is simply impossible for a company to maintain a flawless record on everything and be free from challenges. Negative aspects do not only refer to serious incidents such as fatalities and significant oil spills; companies could be disclosing anything from

the challenges of increasing staff turnover, to customer complaints and missing internal goals.

Nevertheless, companies need to first understand what the potential ESG impacts may be, so they can implement internal systems to capture the relevant information for management and drive continual improvement.

If companies focus exclusively on achievements and positive stories in an ESG report, they run the risk of reducing their credibility and losing readers' trust. By disclosing negative aspects, and reporting how the company has actively taken steps to mitigate the impact and improve in the future by addressing these issues, the company could present a more positive image and show they are committed to actively solving problems.

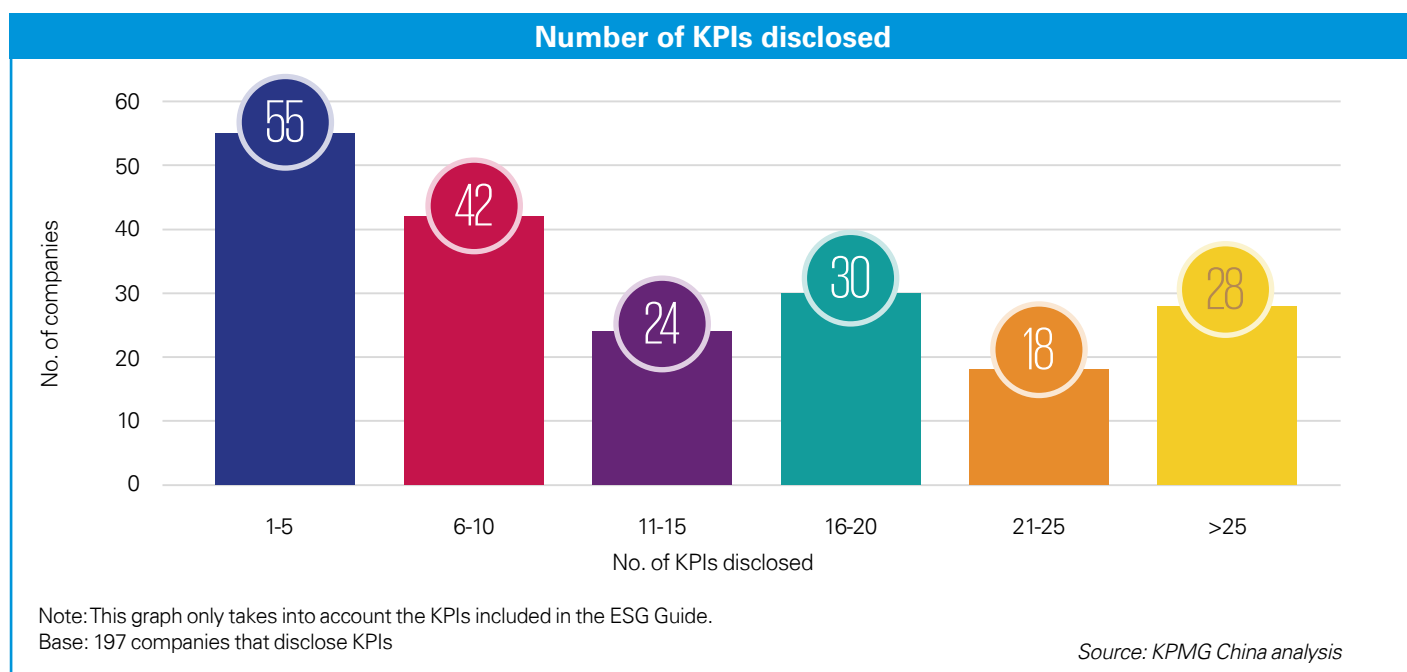
09

KPI disclosures tend to be based on data readiness

Companies are voluntarily disclosing KPIs

Disclosure of KPIs was recommended in this first year of implementation of the ESG Guide, and Environmental KPIs will be upgraded to 'comply or explain' in the second year.

54 percent of companies included KPIs in the ESG report. Of those disclosing KPIs, 28 percent disclosed one to five KPIs, including 8 percent that disclosed only one KPI.

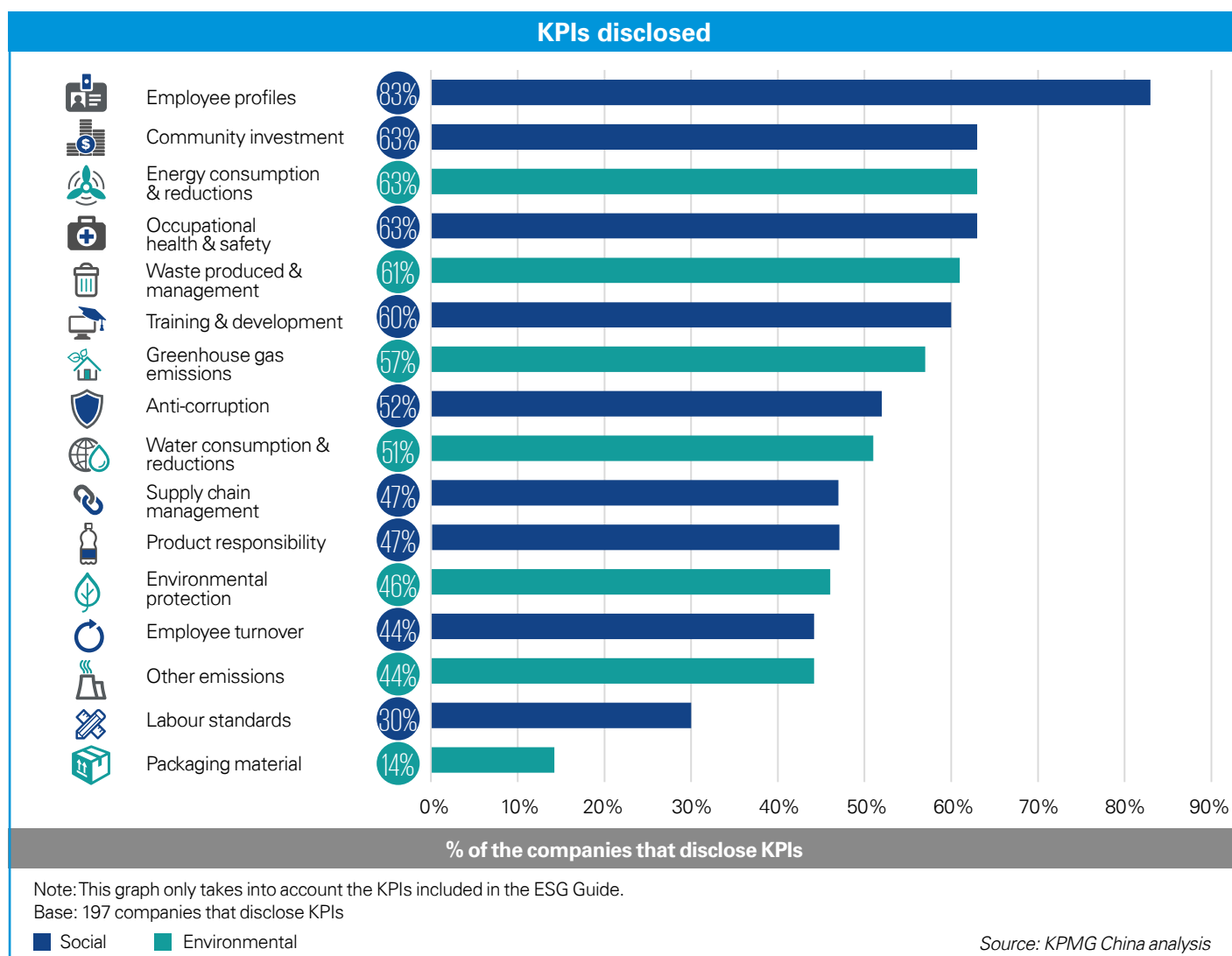


“A lot of companies may find that they need to collect new information to report on these KPIs. Companies should note, however, that KPIs are only meaningful when they are truly key and relevant for the company.”

Companies tend to select KPIs based on data readiness

KPIs related to 'employee profiles' are most popular in reports that include KPIs, followed by 'community investment', 'energy consumption & reductions', and 'occupational health & safety'. This could indicate that the associated issues are relevant across sectors and are generally managed in some way by a typical business organisation, hence there is a higher level of data readiness.

The Environmental KPIs listed in the ESG Guide are shown in green in the chart below. The disclosure rates of Environmental KPIs are not particularly high, despite the fact that they will move to 'comply or explain' status in the next year.





KPMG view

Keep KPIs key and meaningful

Twelve Environmental KPIs will be upgraded to ‘comply or explain’ for the next financial year. Considering that quite a number of surveyed companies have not disclosed KPIs, and that almost half of the companies that disclose KPIs disclose no more than 10 KPIs, it is unclear how prepared companies are for KPI disclosure in the coming year.

Our findings seem to indicate that KPIs are selected based on data readiness. A lot of companies may find that they need to collect new information to report on these KPIs. Companies should note, however, that KPIs are only meaningful when they are truly key and relevant for the company. So instead of jumping into gathering information for disclosure purposes only, they should first identify what issues are material, and focus on tracking and reporting the related KPIs.

Even though Social KPIs are not under ‘comply or explain’, if any Social Aspect is found to be material (e.g. supply chain management), companies should also report on the related KPIs that can effectively measure performance. For example, if staff retention is important, will there be KPIs on the retention rate for certain groups of key staff? For community investment, are there any measures on the impact and efficiency of the investment made (e.g. social return on investment)? For energy efficiency KPIs, are they consistent with accepted industry standards?

Systems may have to be established and adjusted to capture the relevant data. Since KPIs will be used for analysis and decision-making by the company and report users, it is necessary that the systems are sufficiently robust to ensure data integrity.

This survey found that only 10 percent of the companies that disclosed KPIs included related targets. As KPIs are being tracked, setting targets and action plans is a crucial next step to ensure the company works towards achieving its objectives. Progress against targets can then become a valuable measure of the success of the company’s management strategies.

“ESG data disclosure in Asia Pacific markets is rising rapidly as the region’s regulators introduce new ESG reporting guidelines and stewardship requirements. This trend is especially driven by stock exchanges since ESG reporting is seen as a proxy for good governance, which is critical for attracting foreign investment, and investors and governments are increasingly concerned with how companies are building long-term value. In tandem, there should be a mutual interest because companies want to attract the kind of long-term capital that cares about these issues amid a climate of geopolitical uncertainty.”



Sung-Woo Kim
Regional Leader,
KPMG Sustainability Services,
Asia Pacific

10

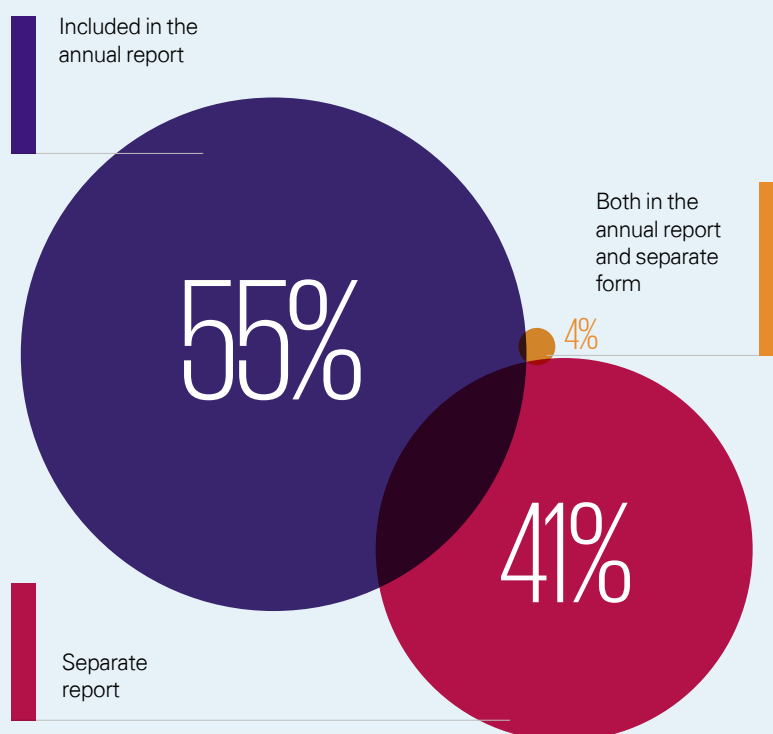
How companies are implementing the ESG Guide requirements

10.1 The reporting landscape

Are disclosures in annual reports or stand-alone reports?

According to the ESG Guide, an ESG report may be presented as information in the annual report, in a separate report, or on the company's website.

Regardless of the report format, it is vital to ensure the consistency of information disclosed in the company's different reports and filings.



Base: 366 companies

Source: KPMG China analysis

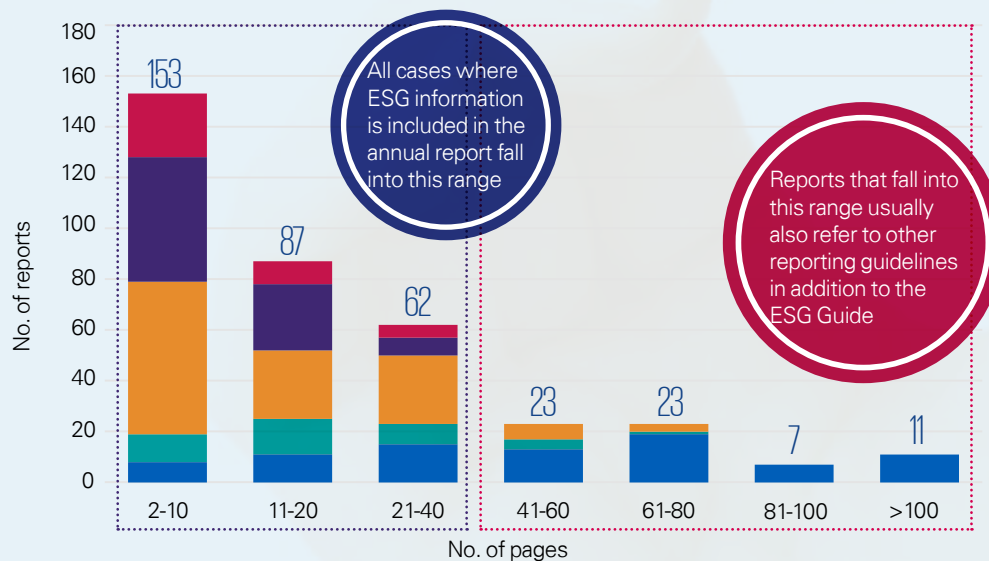
How long are the companies' reports?

The length of the surveyed reports varies significantly from 2 pages to 233 pages. The majority (66 percent) do not have more than 20 pages, and 42 percent of the sample reports are 10 pages or less.

The amount of information disclosed in a report is associated with the reporting guidelines adopted. Almost all of the surveyed reports with more than 40 pages refer to other reporting guidelines in addition to the ESG Guide, predominantly the GRI.

Reports also tend to be shorter when they form part of the annual report, compared with a separate report. The longest ESG report presented in an annual report is 33 pages.

How long are the reports?

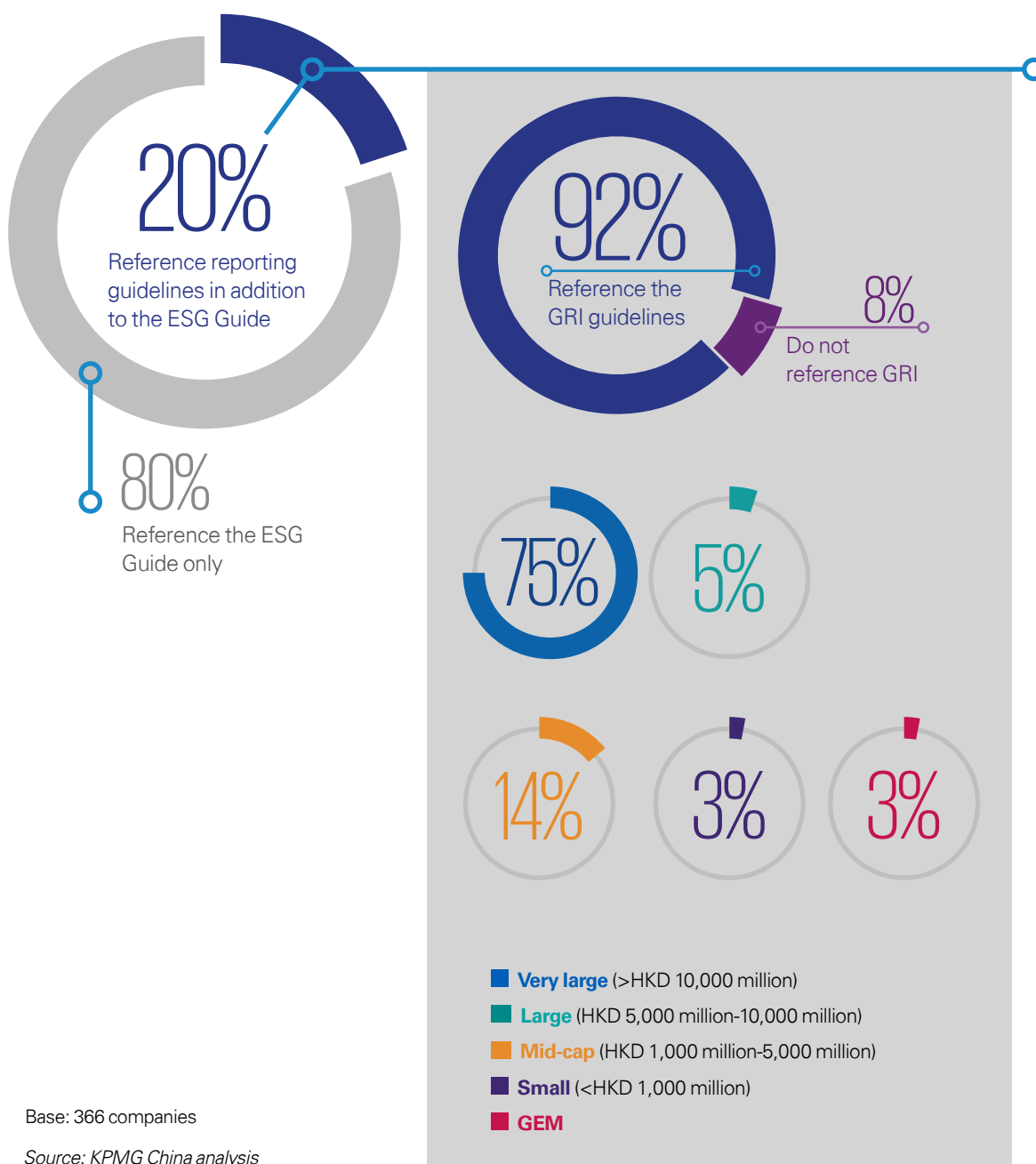


Source: KPMG China analysis

10.1 The reporting landscape

Do companies use other reporting guidelines?

The GRI is the most widely used sustainability reporting standard globally. While it is compatible with the ESG Guide, its disclosure requirements are more demanding in areas such as the identification of material issues, and the disclosure of KPIs and other information in relation to the material issues. Companies may find it a useful reference to improve the quality and credibility of their disclosure.

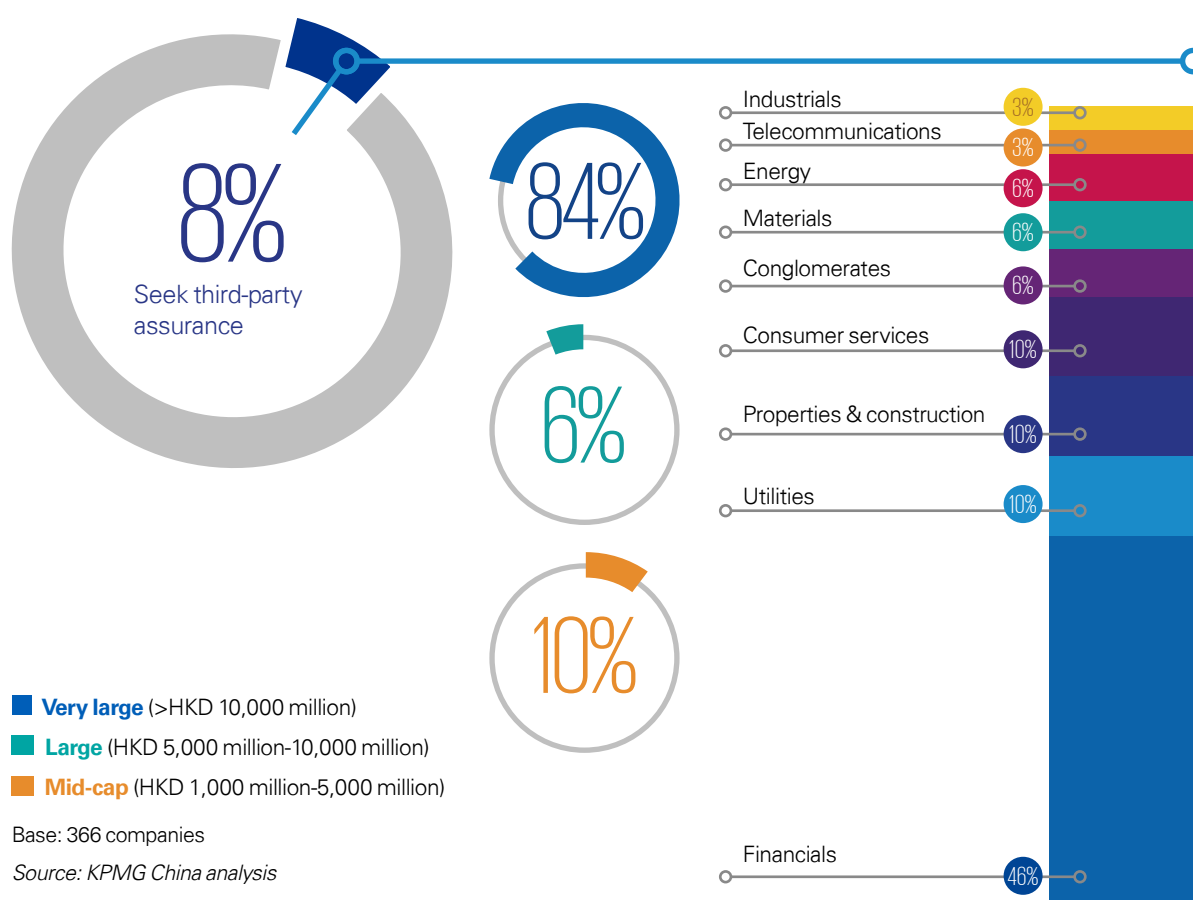


Which surveyed companies have sought external assurance?

Given that many of the companies are first-time reporters and that external assurance is voluntary, there is a low uptake of assurance on ESG disclosures.

However, companies should note that all information reported pursuant to the listing rules must be accurate.¹⁰ As ESG information is now increasingly being used in conjunction with financial information by management, investors, rating agencies and other analysts to make decisions, it is vital that the information disclosed is reliable. As with financial audits, external assurance on the ESG report can help improve the usefulness, robustness and credibility of information, as well as strengthen the company's internal reporting systems and control.

Third-party assurance on ESG information is now accepted standard practice. More than two-thirds (67 percent) of the world's top 250 companies by revenue are seeking assurance.¹¹ As HKEX listed companies gain more ESG reporting experience, we expect more of them to be motivated by the need to demonstrate their commitment to credibility and sustainability to external stakeholders, and understand the value assurance can create internally through more reliable data and a clearer understanding of ESG issues. This may encourage them to seek assurance on their reports.



10. Main Board Listing Rules 2.13 states that: "...any announcement or corporate communication required pursuant to the Exchange Listing Rules must be prepared having regard to the following general principles: (1) the information contained in the document must be clearly presented and in the plain language format specified or recommended by the Exchange and/or the Commission from time to time; and (2) the information contained in the document must be accurate and complete in all material respects and not be misleading or deceptive ..."; http://en-rules.HKEX.com.hk/en/display/display.html?rbid=4476&element_id=1970

11. 'The road ahead: The KPMG Survey of Corporate Responsibility Reporting 2017', KPMG International, October 2017, <https://home.kpmg.com/xx/en/home/insights/2017/10/the-kpmg-survey-of-corporate-responsibility-reporting-2017.html>

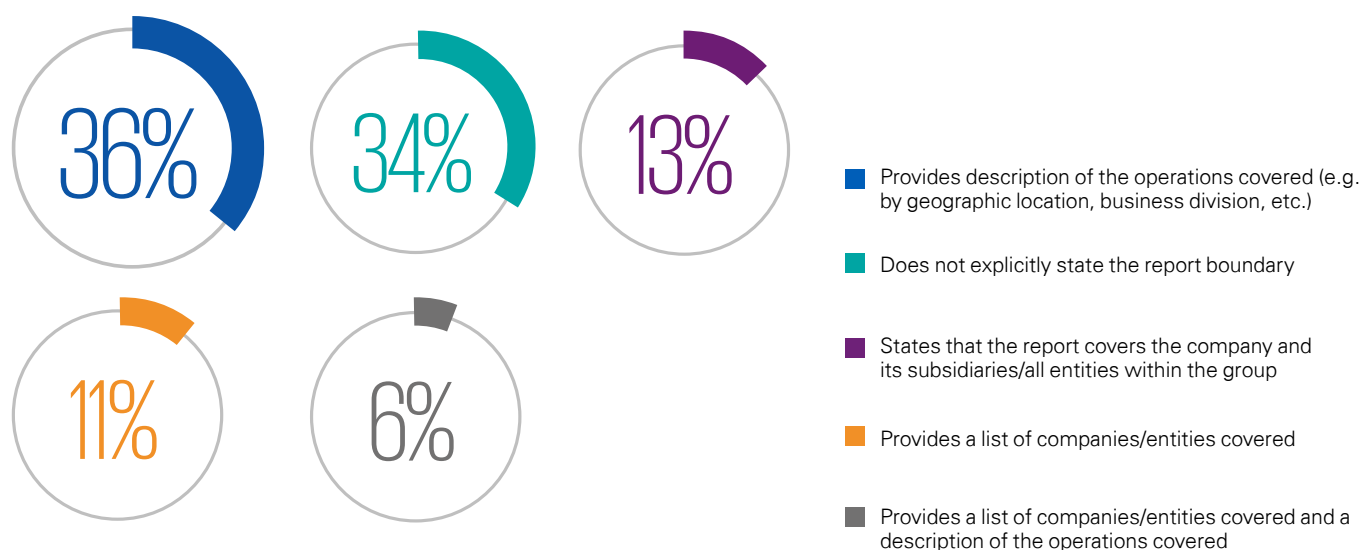
10.2 Disclosure of the report boundary

The report boundary defines which entities and operations, within or outside the company's group, are covered in the report. The ESG Guide has corresponding guidance on stating this information:

"An ESG report should also state which entities in the issuer's group and/or which operations have been included in the report. If there is a change in the scope, the issuer should explain the difference and reason for the change." (ESG Guide para. 10)

Even though it is not covered under the 'comply or explain' provisions, this information is important to provide a context for readers to understand the ESG disclosures.

Disclosure of the report boundary



Base: 366 companies

Source: KPMG China analysis

"Companies should be clear about the ESG report boundary and ensure the ESG information reported is in line with this boundary."

34 percent do not explicitly state which entities and operations are covered in the report

Most of these companies (70 percent) include ESG information in the annual report, but there is no separate confirmation that the boundary is the same as that applied to the rest of the annual report in accordance with financial reporting standards and other applicable rules. Companies should be clear about the ESG report boundary and ensure the ESG information reported is in line with this boundary. If any information, especially the environmental data to be disclosed in the next financial year, does not represent all the entities covered within the report boundary, companies should state this clearly to avoid misleading readers.

Companies express their report boundary in various ways












Boundary setting is essential for companies to determine and readers to understand the extent of disclosures. Our research observes that companies have different reporting approaches and in many cases do not disclose the basis for defining their boundary. Not only does this make comparisons between companies difficult, but it also complicates the comparison within the same company over different periods. It can also make it more difficult to see the connections to financial information. We look forward to further discussion and guidance in this area.



10.3 General Disclosures

General Disclosures of each Aspect are 'comply or explain' provisions in the ESG Guide, and require information on the (1) policies, and (2) compliance with relevant laws and regulations that have a significant impact on the company.

Comply or explain?

(1) Policies				
By Aspect				
Subject Areas	Aspects		% of companies Comply	% of companies Explain
			Base = 366 companies	Base = Total number of companies that have not disclosed the corresponding Aspect
Social		Health & Safety	100	N/A
Social		Training & Development	100	N/A
Environmental		Use of Resources	99	0
Social		Employment	99	0
Social		Community Investment	99	0
Social		Anti-corruption	98	0
Social		Supply Chain Management	97	17
Social		Product Responsibility	96	20
Environmental		Emissions	96	57
Social		Labour Standards	95	16
Environmental		The Environment & Natural Resources	88	19

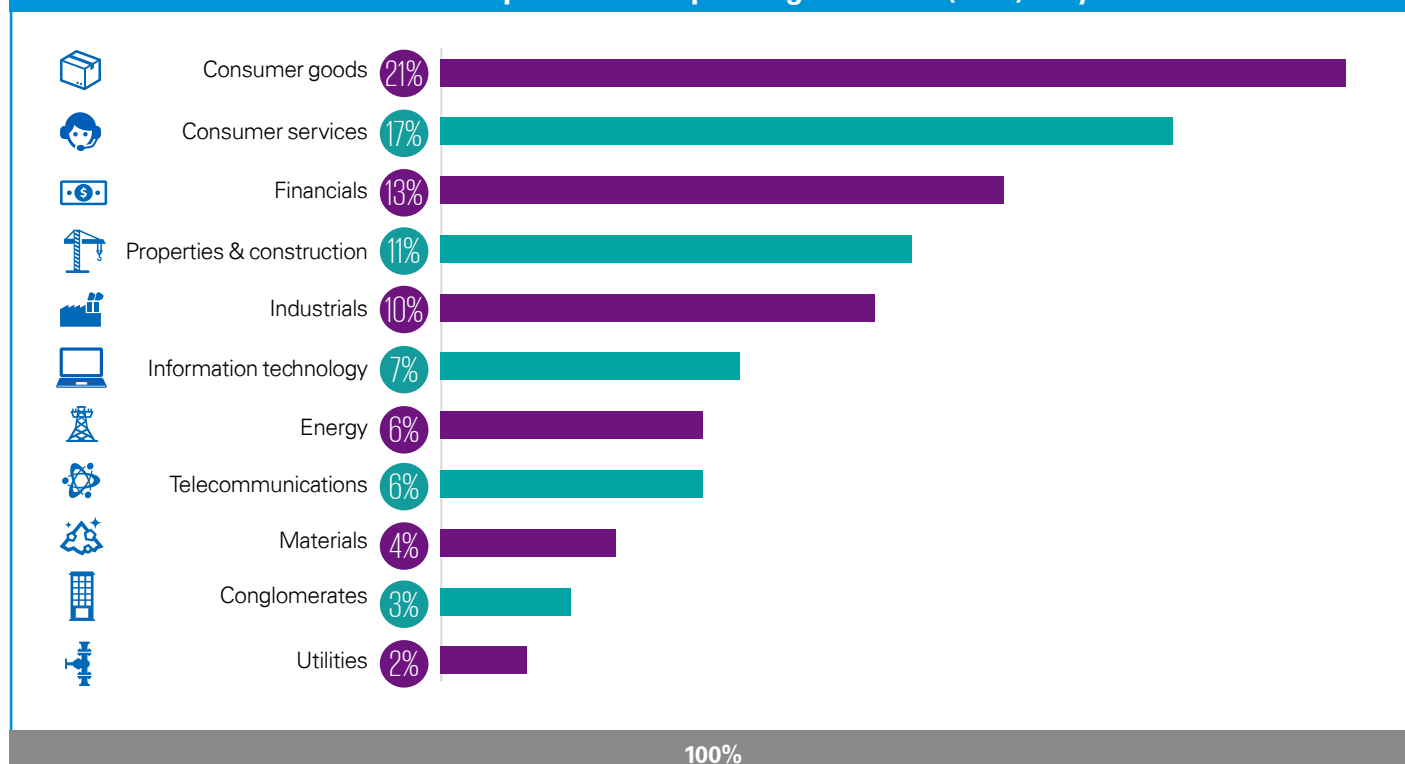
Source: KPMG China analysis

(1) Policies**By company view**

Comply	<ul style="list-style-type: none"> 77% of companies include policy disclosures for all 11 Aspects.
Explain	<ul style="list-style-type: none"> 4% provide explanations for each Aspect omitted. Low significance of the Aspect is cited as the main reason where explanation is provided.
Do not comply but do not explain	<ul style="list-style-type: none"> 19% do not provide explanations for the omission of policy information.

Base: 366 reports

Source: KPMG China analysis

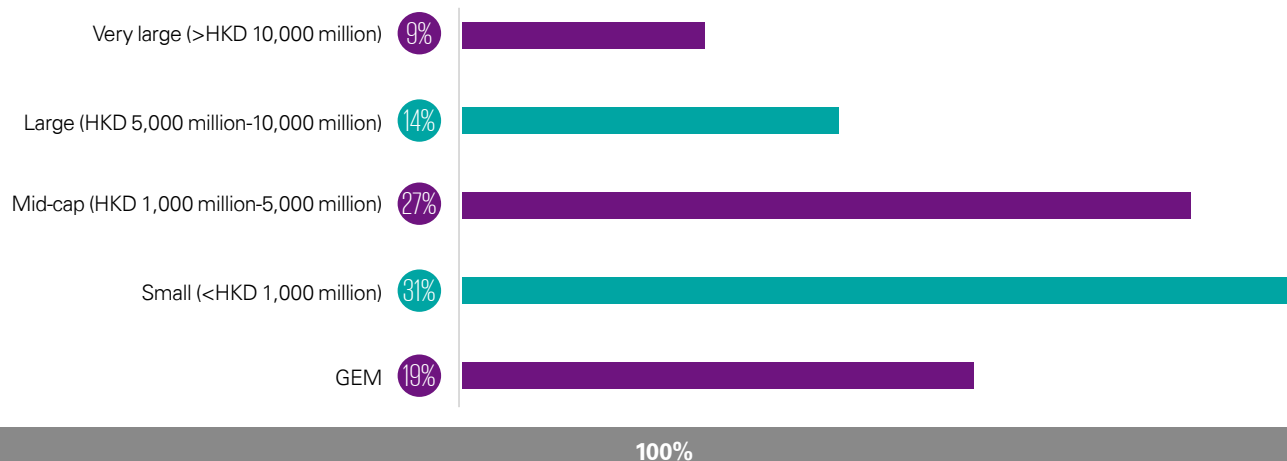
Breakdown of companies not explaining omission (19%) – By sector

Base: 70 companies

Source: KPMG China analysis

10.3 General Disclosures

Breakdown of companies not explaining omission (19%) – By market capitalisation



Base: 70 companies

Source: KPMG China analysis

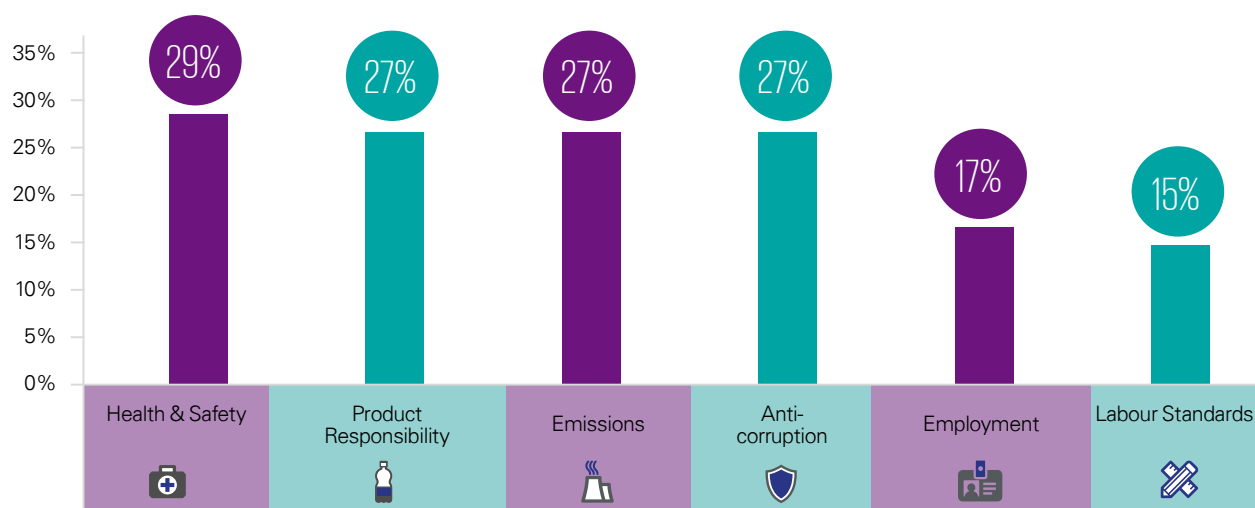
Most non-disclosures are not explained

There is no particular sector or market capitalisation difference in those companies not explaining, except that 'Very large-cap' companies are more likely to explain, perhaps due to more experience in ESG reporting.

When a company does not report on certain Aspects, it could be because it considers the Aspect to be immaterial, the company might not have respective management policies, or other reasons. Failing to explain omissions, therefore, not only falls short of regulatory requirements, but also decreases transparency and could diminish trust.

While some companies explain that omission is due to low significance of Aspects considering their business circumstances, only a minority have presented materiality assessment results to support these claims.



(2) Compliance with relevant laws and regulations**Non-disclosure rate regarding information on compliance with laws and regulations**

Note: This graph only includes the Aspects which require the inclusion of information on the compliance with laws and regulations that have a significant impact on the company.

Base: Companies that report on the respective Aspect (Health & Safety: 366; Product Responsibility: 351; Emissions: 352; Anti-corruption: 357; Employment: 362; Labour Standards: 347)

Source: KPMG China analysis

“Companies should note that a balanced report that reflects both positive and negative aspects of performance has greater credibility for readers.”

Compliance information is not clear for a number of companies

Some companies report that they commit to complying with relevant laws and regulations. Yet, it is less clear whether any non-compliance with laws and regulations that could have a significant impact on the company has actually occurred during the reporting period. Particular care should be taken in reporting this information, as its exclusion may suggest that the company:

- Does not have records of the relevant information due to the absence of a related monitoring system, which can amount to significant potential business risk; or
- Chooses not to disclose when there is non-compliance, which undermines its transparency.

On the former point, companies should assess whether they have an effective system in place to capture the relevant information in order to monitor its operations and reporting to regulators.

On the latter point, companies should note that a balanced report that reflects both positive and negative aspects of performance has greater credibility for readers. Companies are advised to revisit their reporting practices to ensure the information is provided where applicable.

11

Looking ahead

As social and environmental changes continue to reshape the business landscape, the demand for companies to be more transparent regarding ESG issues is set to persist. Companies may feel immediate pressure from developments, including:

- The launch of China's national carbon emissions trading scheme in 2017
- The emergence of ESG ratings provided by research firms to help investors understand companies' ESG risks and opportunities
- The continued growth in investment that incorporates ESG factors into decisions to better manage risk and generate long-term returns.

Carbon emissions will be a hot topic. The increasing risk of natural disasters will make investors pay more attention to how companies manage their physical risks. In addition, disclosure on carbon performance may come up next in light of the increasing awareness of carbon emissions.

Things are moving fast in the ESG space. Businesses need to act now to review and change their operating and reporting practices to stay competitive.



12

About KPMG's Sustainability Services

How we can help

KPMG is one of the pioneers of sustainability consulting, giving KPMG China a level of experience few can match.



Local knowledge, global experience

Our network combines specialist sustainability expertise with in-depth understanding of the business landscape in your country. At the same time, our member firms are connected through our Global Center of Excellence for Sustainability Services and can access the best international experience for whatever challenge your organisation faces.



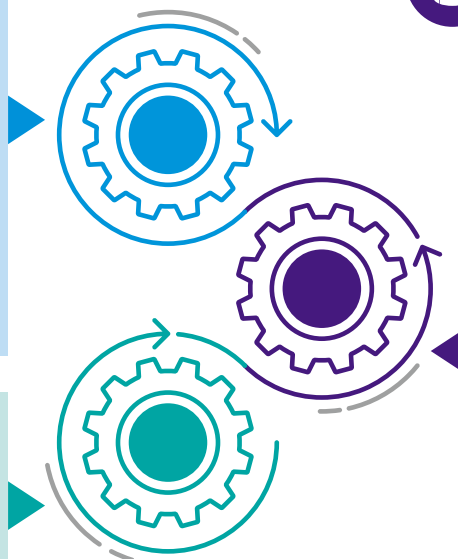
Industry focus and insights

Our business in China has established industry or sector groups, enabling targeted, industry-specific experience and advice to be delivered where needed. This focus on industry- and country-specific knowledge means we can deliver trained professionals who have an intimate knowledge of your specific business issues, as well as an overriding commitment to strive for high-quality services.



Multidisciplinary team of professionals

Our teams work side by side with KPMG professionals from tax, audit and advisory, including sector specialists, management consultants, tax accountants and experts in IT, supply chain, infrastructure, international development and more. You will not receive generic advice and one-size-fits-all methodologies from us; instead, you can benefit from a hand-picked multidisciplinary team.



We can support your organisation in various ways, including by helping you with the following:

Specialists in ESG reporting and assurance

- Understand what environmental and social information you should report
- Choose the right reporting approach and frameworks for your business
- Integrate financial and non-financial information in your reporting
- Report information for specific purposes, such as sustainability indices and CDP
- Benchmark the quality of your reporting against industry peers
- Provide independent assurance for your internal and external reporting systems
- Provide independent assurance of your ESG performance reporting
- Understand and comply with carbon reduction and carbon reporting legislation worldwide



Specialists in ESG risk management and governance consulting

- Perform ESG risk and opportunity analysis
- Pinpoint the ESG issues that are most important to your business, value chain and stakeholders for prioritisation
- Conduct stakeholder mapping and engagement
- Review and develop ESG governance frameworks
- Benchmark environmental and social practices and performance against sector peers
- Review and design processes and systems for effective strategy implementation
- Establish KPIs and targets



About KPMG China

KPMG China operates in 16 cities across China, with around 10,000 partners and staff in Beijing, Beijing Zhongguancun, Chengdu, Chongqing, Foshan, Fuzhou, Guangzhou, Hangzhou, Nanjing, Qingdao, Shanghai, Shenyang, Shenzhen, Tianjin, Xiamen, Hong Kong SAR and Macau SAR. With a single management structure across all these offices, KPMG China can deploy experienced professionals efficiently, wherever our client is located.

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In 1992, KPMG became the first international accounting network to be granted a joint venture licence in mainland China. KPMG China was also the first among the Big Four in mainland China to convert from a joint venture to a special general partnership, as of 1 August 2012. Additionally, the Hong Kong office can trace its origins to 1945. This early commitment to the China market, together with an unwavering focus on quality, has been the foundation for accumulated industry experience, and is reflected in the Chinese member firm's appointment by some of China's most prestigious companies.



Contact us



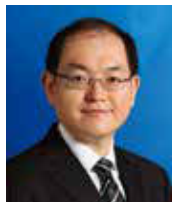
Hong Kong

Maria Cheng

Partner, Head of Business
Reporting and Sustainability
KPMG China

T: +852 2978 8153

E: maria.cheng@kpmg.com



Northern China

Patrick Chu

Partner, Business
Reporting and Sustainability
KPMG China

T: +86 (10) 8508 5705

E: patrick.chu@kpmg.com



Eastern and Western China

Brenda Wang

Partner, Business
Reporting and Sustainability
KPMG China

T: +86 (21) 2212 2468

E: brenda.wang@kpmg.com



Southern China

Anthony Ng

Partner, Business
Reporting and Sustainability
KPMG China

T: +86 (755) 2547 3318

E: anthony.ng@kpmg.com



Financial Services

Terence Fong

Partner, Business
Reporting and Sustainability
KPMG China

T: +852 2978 8953

E: terence.fong@kpmg.com



Financial Services

Jason He

Partner, Business
Reporting and Sustainability
KPMG China

T: +86 (10) 8508 7193

E: jason.he@kpmg.com



The road ahead: The KPMG Survey of Corporate Responsibility Reporting 2017



Navigating change: KPMG Sustainability Services



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