KPMG

The ESG reporting landscape

A recipe for the “Alphabet Soup”

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Introduction

"Alphabet Soup" is not a good nickname to have when it comes to corporate reporting, but it is the phrase that has become synonymous with the environmental, social and governance (ESG) reporting landscape.

The main ingredients are the plethora of voluntary reporting frameworks, principles and standards (SASB, GRI, TCFD, CDP, CDSB, IIRC to name a few of this season's suppliers). But that is not all. There are certification bodies, industry specific charters and ESG specific ratings agencies and indices all mixed in too.

Good reporting is trying to achieve enhanced trust from all stakeholders

It's all too easy to get bogged down by this soup when trying to meet the growing demand for non-financial indicators and disclosures and lose sight of what good reporting is trying to achieve – enhanced trust from all stakeholders in the board and management of the business and their ability to steward its value and impact on society.

The situation is changing, fast

There is broad recognition that the soup needs sieving and blending – that global standardisation is required in order to achieve comparability along with relevance. Consolidation initiatives, such as those from the International Business Council of the World Economic Forum (the "WEF IBC"), as well as the International Financial Reporting Standards Foundation ("IFRS Foundation"), are making great strides towards a future state where there is a consistent global baseline of information provided. Initiatives, such as those from the EU, creating the Corporate Sustainability Reporting Directive ("CSRD"), the EU Taxonomy Regulation and Sustainable Finance Reporting Directive ("SFRD"), are also driving the pace of change.

Consolidation of the soup is vital

Consolidation of the soup is required in order to achieve consistent and comparable reporting. However, it is important not to forget why the soup exists in the first place. Everyone has different tastes, and all of the different ingredients in the soup were created to solve different needs.

We need to understand what the soup includes and why it is still important

Just like making soup, trying to please everyone by including every possible ingredient is not generally the best approach. Neither is serving a bland broth with no contents, substance or individuality. It is equally important to appreciate that tastes can vary over time and across geographies and industries. Thus, understanding what the so-called alphabet soup includes, and why those ingredients are there is important in understanding how to create effective reporting that meets stakeholder needs. It also helps to understand the challenges of consolidation, and why a quick to prepare "ready-meal" or single global recipe or comprehensive standard is not necessarily where we are heading. More achievable is a building blocks approach, whereby there is a global baseline of standards, which can be supplemented by local, regional or sector specific requirements.

In this article, we set out a high-level guide on how to look at the alphabet soup's ingredients and use them to create effective business-centered reporting that incorporates appropriate ESG information.

From a UK perspective, we must understand which of the soup's ingredients aim to support reporters to provide information that supports the core objectives of the annual report, and which offer extras or add-ons to supplement that, supporting the creation of accompaniments such as sustainability reports or other ancillary reporting, rather than the main course of the annual report.

Why does the soup exist?

01

Businesses do not operate in a vacuum

UK company law has long recognised that businesses do not operate in a vacuum. Value creation is only possible where the workforce, customers, or suppliers are keen to enter into a relationship with the company. The same applies where low standards of business conduct leave a business exposed to significant legal and reputational risks. In turn, businesses can have considerable effects on internal and external stakeholders, society, and the natural environment.

02

Investors want to understand how businesses are creating, enhancing and protecting value

Investors want to be able to compare across industries, jurisdictions and business types to identify growth opportunities and measure enterprise value.

03

There are many different parties encouraging value creation storytelling

Many different bodies have attempted to help companies to articulate value to this investor audience. They have released principles and frameworks to encourage and guide the articulation of better decision-making and long-term value creation.

04

There are other parties encouraging reporting on the business's impact

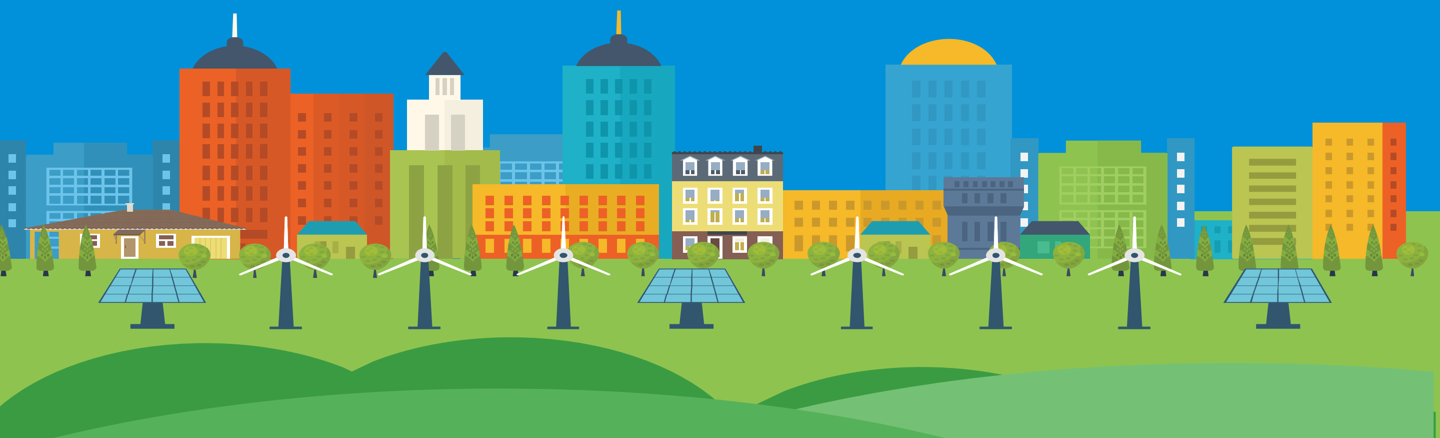
Others have released detailed standards to encourage reporters to provide relevant and high-quality information on the impact that the business has on the environment and the communities in which it operates. This information may be relevant to enterprise value, but it could be relevant only to broader stakeholders.

05

There are strong drivers from the financial sector

Financial regulators have intensified pressures on the banking and asset management industries to show how they consider matters such as climate-related risks to financial stability in their portfolios. There is a strong push from governments and others to align private sector financial flows with clear, environmentally sustainable and resilient growth. This has driven the creation of other sets of principles and requirements.

Each contributing body to the alphabet soup has a different objective, depending on the set of stakeholders they are supporting. Some bodies are clearly attempting to solve different problems.



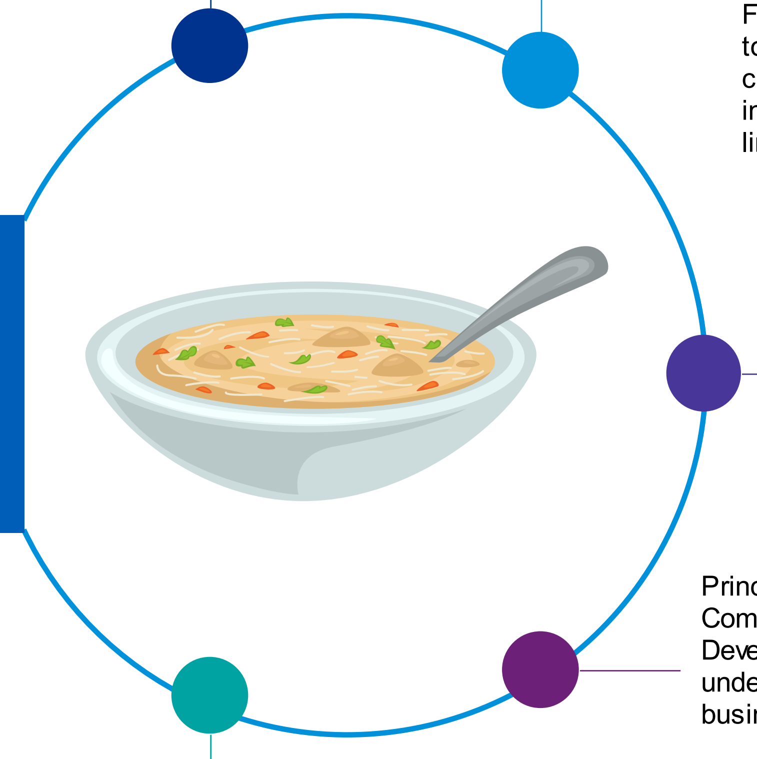
What are the ingredients?

There are principles and frameworks to encourage and guide the articulation of better decision-making and long-term value creation. There are detailed standards to encourage reporters to provide relevant and high-quality information on the impact that the business has on the environment and the communities in which it operates. The fact that there are too many different ingredients does not imply that the quality of some of the ingredients is not high.

Each contributing body to the alphabet soup has a different objective, depending on the set of stakeholders they are supporting.

The most established set of standards is the Sustainability Reporting Guidelines of the Global Reporting Initiative (“**GRI”**), which have supported best practice in reporting economic, environmental, and social impacts in stand-alone sustainability reports for over 20 years.

More recent initiatives, such as the work of the Sustainability Accounting Standards Board (“SASB”) or the Task-force for Climate-related Financial Disclosures (“TCFD”), directly respond to the demand for better integration of ESG considerations into mainstream business and investment practice to make financial effects and links to long-term business health clearer to see.



In June 2021, the SASB merged with the International Integrated Reporting Council (“IIRC”) to create the Value Reporting Foundation (“VRF”). The Integrated Reporting framework from the IIRC encourages the production of value relevant information by considering six types of capital, including financial, manufactured, natural, human, social and community, and intellectual.

Principles, such as those set by the UN Global Compact (“UNGC”), as well as the UN Sustainable Development Goals (“SDGs”) are valuable tools in understanding how to report the impacts of the business.

Ratings agencies, scorers and indices have proliferated to try to seek the “answer” on how to measure value and are used extensively by investors. Some (for example CDP) use surveys to create a data repository of information, providing gradings when certain defined thresholds are met. Others (for example MSCI and Sustainalytics) combine third party data with company engagement to provide their scorings. A common complaint from companies and investors alike is the inconsistency of scores from even the most well-recognised agencies, whether that is driven by different focus areas, or in some cases, inconsistent data sources.

Why can the soup be hard to digest?

The problems with reporting can be summarised as:

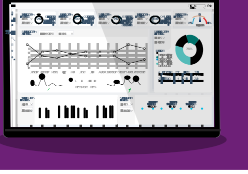
Range of expectations: Different stakeholders want different information, because they use it for different purposes. Governments can seek transparency on specific ESG topics, such as gender pay gap, to uncover potential structural problems. Civil society organisations demand accountability on matters that are relevant to their constituencies. A company's key stakeholders want to understand how ESG affects long-term value creation and viability from a management viewpoint (including resources, relationships, risks and uncertainties), whereby some investors prefer standardised financial information that can directly support capital allocation and stewardship decisions. Unless you understand that, you can't get good reporting. Good is not the same for everyone, and there is no one "good standard" or set of requirements.

Materiality is a concept separately understood by both accountants and sustainability professionals, but these groups often talk at cross purposes on this topic. Unless there can be clear articulation of what the board view as the objective of the annual report and what topics are therefore material, annual reports will continue to grow to try to satisfy everyone – or be criticised for going dark on areas of concern.

Thematic focus: Sustainability reporting is a broad topic with different themes of differing relevance or importance to different user groups. Unlike financial reporting, where it is comparatively simple to determine whether particular standards are relevant or not (e.g. either a company holds inventory, or it does not), topics such as carbon emissions, climate change impacts, labour rights and diversity will impact every company to some degree. These themes may be of particular priority to certain report users, at certain times, or in certain industries, irrespective of their actual impact on the value of any particular company. Whether they should be disclosed or not should depend on the circumstances, but in practice, some reporters include content just to "tick boxes" on each currently topical theme.

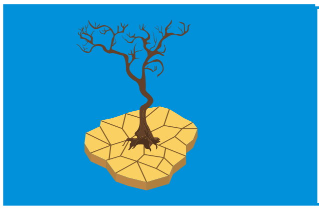
Structure of guidance materials: The components in the soup include principles (i.e. fundamental assumptions or categories of information to include), frameworks (conceptual structures to follow) and standards (operational requirements), as well as a range of other formats. Alignment to principles is possible without the direct comparability achieved from standards, but equally, the rigidity of standards can stifle the relevance of company-specific reporting that arises from principles. In financial reporting, the combination of conceptual frameworks, principles-driven standards and years of accepted practice and precedent allow for a good degree of comparability and relevance. Sustainability reporting is not as mature.

Level of contextualisation:
Presentation of content ranges from quantitative data with no contextual information, to pure narrative description with no quantitative link. Which type of content is most insightful depends on the purpose for which the user wants the information, and this is difficult to define or predict.



Why can the soup be hard to digest? (cont.)

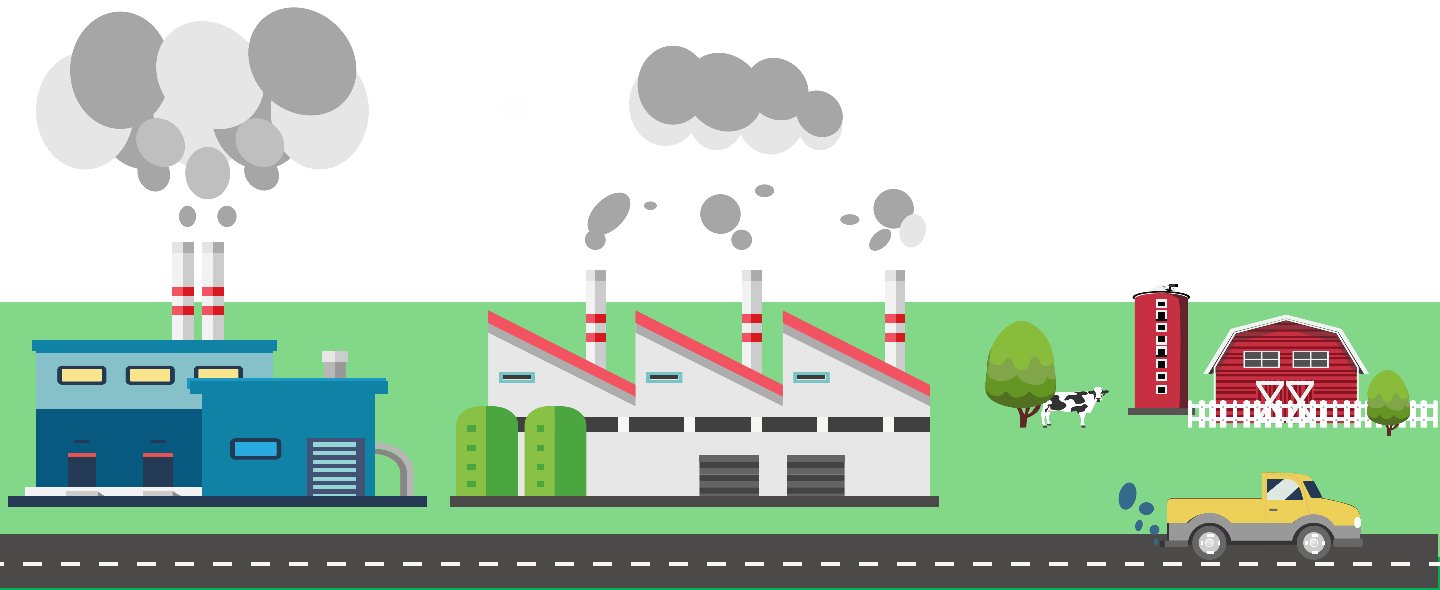
Industry-, entity-, or region-specific focus: "Good" does not look the same everywhere. There are huge differences in the requirements for different industries or sectors alongside local legal requirements and trends. Some have specific reporting requirements (e.g. banking).



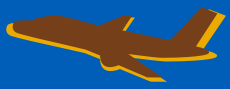
Horizon shift: Understanding financial position and performance is not sufficient to understand business value. Factors that get to the core of the business, such as its purpose and how it acts to protect and enhance its brand and culture by considering the interaction between profit and consideration of people and planet, are key.

Source: The "soup" contains ratings agencies and indices that make use of third-party data. This may be solely third-party data, or in conjunction with data provided by the company. This adds complexity, as reporters need to appreciate the process used by these bodies to create the rating to understand what data is required.

Understanding how to report effectively on or measure, impacts, long-term value, and financial implications is incredibly complex. If it was easy, then there would not have been so many different attempts to provide businesses with the tools to report. The response to a perceived lack of relevant information and comparability of reporting has been to bring out new frameworks that will "solve" some/all of the issues.



Who is writing the recipes?



It is now generally accepted that introducing new ingredients to the soup contributes to the complexity of flavours rather than making the soup more palatable. What is needed is effective recipes that consolidate the raw ingredients into manageable pre-made components.

Initiatives such as the work of the International Business Council of the World Economic Forum to compile a set of baseline universal metrics (the WEF metrics) are important, not only for providing a pre-mixed ingredient, but also for drawing global attention to the problem and driving the pace of change. The aim of the metrics is to ensure that investors have the ability to measure how well companies are doing on ESG across industry sectors and geographies. The WEF metrics are drawn from existing standards (e.g. GRI and SASB) and provide a practical "ready meal" solution for companies deciding what to report.

There have been numerous initiatives to align and compare the frameworks. The Statement of Intent to Work Together, from five of the most influential players demonstrated their shared vision to support efforts to create a global corporate reporting system. This subsequently led to the Prototype Climate-Related Financial Disclosure standard, which was released to give a future global standard setter a running start.

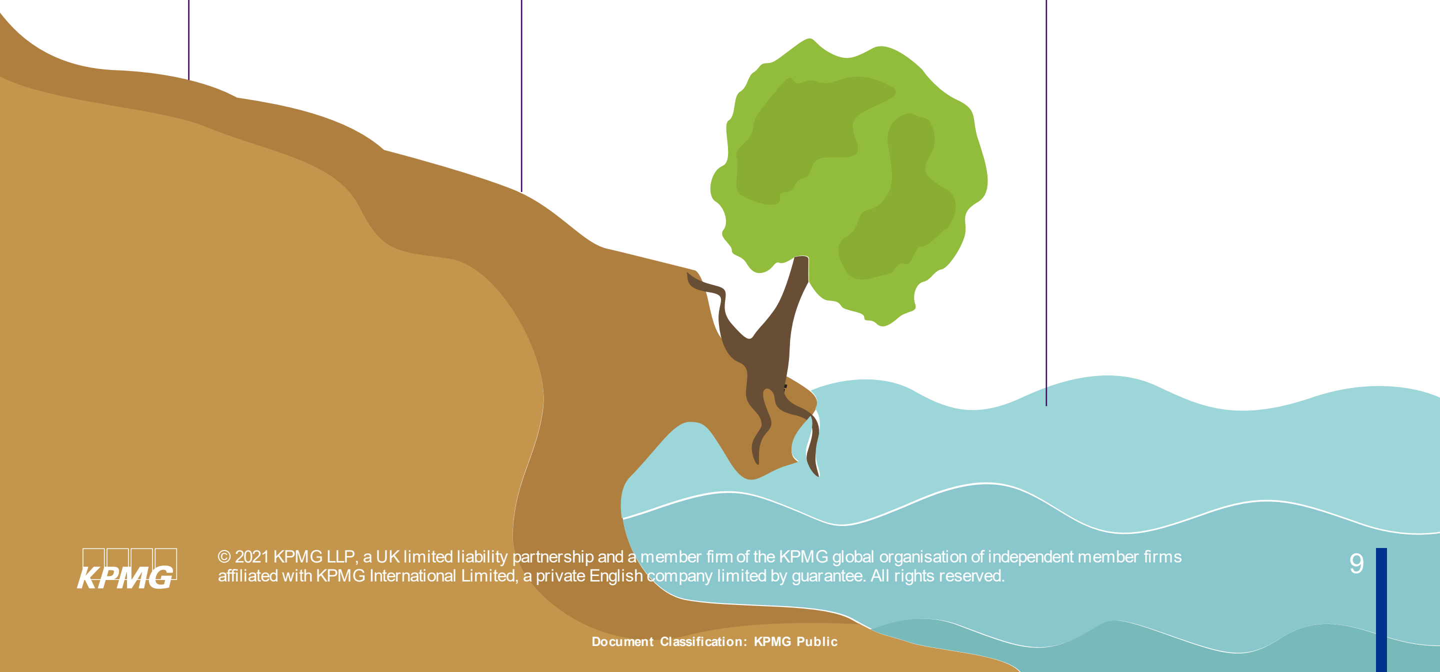
Who is writing the recipes? (cont.)

The announcement of a consultation by the IFRS Foundation around setting up an International Sustainability Standards Board (ISSB) to sit alongside the International Accounting Standards Board (IASB) that sets the IFRS standards was met with global excitement. This was the result of the upswell of calls for a global non-financial reporting standard in order to achieve some level of comparability between different companies, sectors and countries and to ensure that at least a base level of content is included. The IFRS Foundation is not attempting to start from scratch. Instead, it will build on the work of many of the existing players to create global standards, equivalent to IFRSs.

Such a global framework will also have the advantage of being more easily subject to assurance, a key quality indicator for investors when reviewing non-financial information. As with IFRS, there will always be local and sector variations on what is material to report, differences in the structure, level of detail and style of reporting. These standards are expected to form the basic building blocks that jurisdictions can use and supplement local and public policy reporting requirements. However, by encouraging companies to follow the same universally relevant principles-based standards, there is a fighting chance of achieving the maturity of reporting that has arisen for financial reporting from the use of IFRS.

This recipe book from the IFRS Foundation is a fundamental step. However, even though the pace of the project is unprecedented, it will take time for standards to be drafted, consultations to run their course, and standards to be released and adopted. The IFRS Foundation has been clear that the strategic direction of the new international sustainability reporting standards board will have an investor focus on enterprise value and prioritise climate first, meaning that ISSB standards on other vitally important elements of ESG will be further away. In the meantime, initiatives like the WEF metrics provide an interim solution.

The need for accessible recipes that can be created now is still huge. To create those recipes, it is important to understand the different flavours that all the soup ingredients offer, how they were created and how they relate to each other.



What are the different flavours for this soup?

Just like the different cuisines that lead to different types of soup, there are different perspectives on reporting that drive how businesses will report. In the diagram here, we have presented a summary map of the alphabet soup.

The first level to consider is to map out what we want from our ESG reporting. Are we approaching our reporting from the perspective that our business has a role to play in achieving the SDGs and delivering change for people and the planet, or are we building ESG into our investment case for financial capital providers?

Those might have looked like clear opposites in the past but today there is a clear spectrum of risks and opportunities between sustainable development and financial stability. These are our “sweet” and “savoury” which, in the right combination, enhance the flavours in our soup.

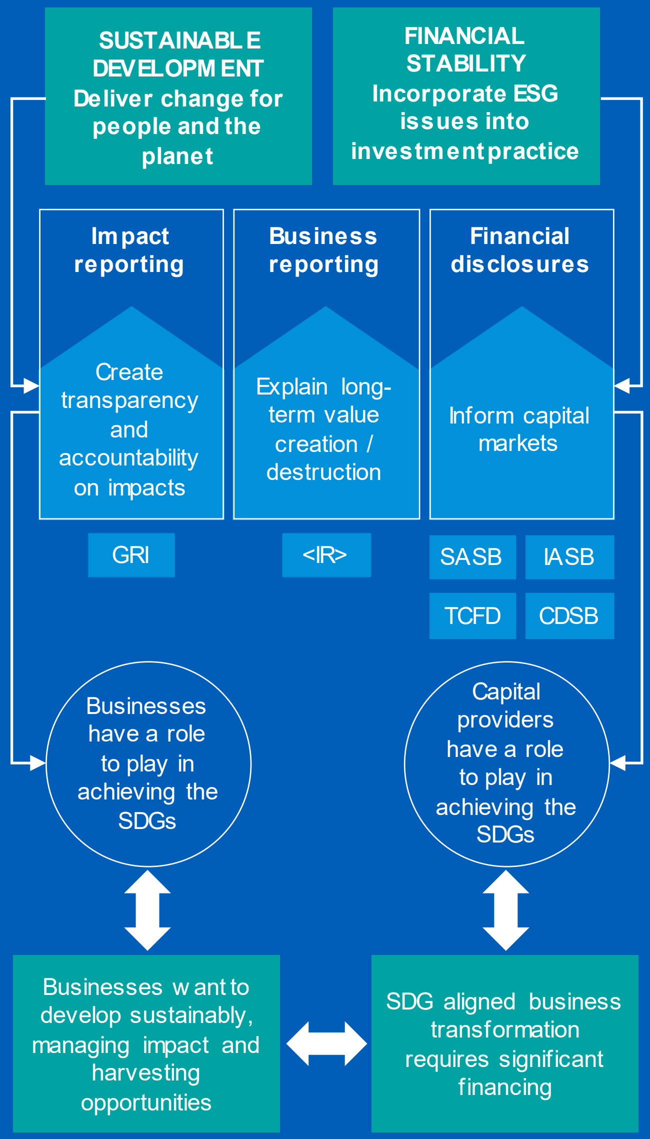
These different perspectives lead to different types of reporting within the suite of corporate reporting publications:

— Impact reporting would most directly result from the sustainable development approach and is dominated by the multi-stakeholder approach of GRI.

— In the middle is business reporting, characterised by initiatives such as the Integrated Reporting (“<IR>”) framework, which recognises that value is driven from a broad range of capitals, and provides a framework to articulate that value effectively.

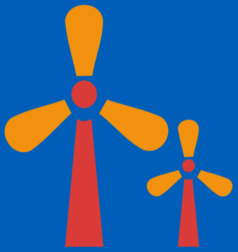
— Reporting to investors or to inform capital markets includes both financial disclosures under IFRS standards as well as sustainability-related financial information from standards such as SASB, supported by frameworks such as TCFD.

Ultimately, these types of reporting are linked and there is a continuum between them. For example, a business approaching their reporting from the perspective of acting responsibly and managing their impact will still need to set out the business case for funding their work. A business approaching from the perspective of ensuring financial stability needs to articulate their licence to operate, which includes their impact.

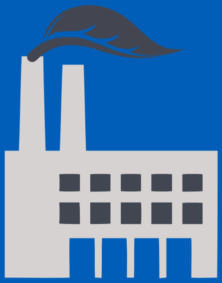


What is the answer – what is the best recipe?

The answer is that there is no single “right” answer because all these perspectives or flavours need to be considered. What is right is unique for each business and depends on their objectives, stakeholders, industry, geography, management and size. If there was a single right answer, then the problems discussed in this document would have been solved many years ago.



The best chef can flex any recipe to suit their customers, based on their tastes and needs. It is important to remember the purpose of the UK annual report, which is to provide decision-relevant information to providers of financial capital. Many of the ingredients in the soup (e.g. GRI) are aimed at broader stakeholders, and therefore, unless care is taken, can lead to too great a depth of content in an annual report. However, just like a good chef combines the right ingredients depending on who is eating the food, good reporters combine the right elements or frameworks for them, depending on who is using the report. In each report, they include matters that genuinely drive performance, or long-term value, or impact, using the frameworks as tools to determine what is material for their target audience.



Ultimately, good ESG reporting in the annual report just needs to articulate enough of the value creation story to explain the long-term value of the business and how that is safeguarded, as well as the license to operate that comes from understanding the business’s impact. This is a journey that is likely to take several reporting periods.

In the future, new global standards will provide a baseline level of reporting aimed at satisfying the needs of investors. The WEF’s universal metrics are designed to help businesses accelerate on that journey. Whilst these metrics have the purpose of facilitating stakeholder capitalism and investor-focused reporting, the metrics are largely driven from GRI, our impact reporting framework. Using the WEF metrics provides a starting point for the impact reporting most relevant to investors. The set of metrics have also been tested against a broad selection of other stakeholders to validate their relevance.

Conclusion

Our advice is to focus on preparing reporting that puts your target audience and the way that your business works at the centre. Instead of asking the question we always hear – "what does everyone else do?" – our steps to effective reporting are:

01 Decide what perspective you want for your reporting

Are you articulating your investment case only, or your business case as well as your impact case? Remember that, by definition, the strategic report is aimed at shareholders, and therefore, including enough of your investment case is mandatory.

02 Understand the internal perspective

What topics matter to my business? What drives my performance now and into the future? What makes a difference? What story am I trying to tell?

03 Understand the external perspective

Who am I reporting to? What do they need to know? What are they asking for? What do they currently always misunderstand about my business?

04 Structure your annual report around the mandatory requirements

The building blocks of UK mandatory reporting (purpose, strategy, business model, risks, trends and factors, governance, financial statements) are great foundations for articulating your business case.

05 Look to frameworks to guide you

They are supposed to do different things, but once you understand the areas that are material to different users, you can pick the right elements and the right framework for the report you are writing.

06 Map your content to any framework used

It is important that readers interested in particular disclosures can find them. Indexes are useful to ensure content can be located quickly.

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