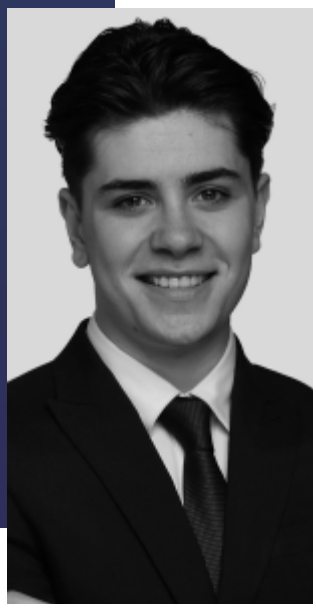
ARTICLE

ESG Reporting from a Governance Perspective



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ESG reporting should not be boilerplate, instead, it's an organisation's chance to tell its story, using case studies and real examples in order to produce something bespoke, meaningful and informative. An ESG report should reflect your geography, your sector and your culture. Increasingly there has been an emphasis on the "E" in ESG. However, climate change and the environment are only one component and social and governance factors should be given equal attention.

It's been very easy to focus solely on the "E" as Climate change is so topical, and climate related disclosures have been easier to measure. However, a company should give equal attention to ethics and culture – the way it does things – too (the "S" and "G"). The directors should no longer be, after all, focussed solely on simply generating a return for shareholders but considering the needs of its wider stakeholders and the community.

Within the UK, ESG reporting continues to develop and its significance, impact and importance to companies and their stakeholders is growing. The UK is a leader of sustainable finance in the world, with a focus on assisting issuers and investors with the transition to a low carbon economy. This is supported by the recent work of the Taskforce on Climate-related Financial Disclosures (TCFD), which has championed more effective climate-related disclosures.

When making ESG statements and disclosing information on sustainability reporting there should be a prominent focus on the alignment of governance, the business model and strategy, risk management as well as metrics and targets. Investors have shown a greater interest in companies that are complying with the TCFD framework, which is why the UK government published legislation expanding the framework to apply to large private companies on April 1 2022. Investors want to see how companies are responding to ESG and applying the disciplines and learnings to their operations.

The framework provides companies with an easier and more structured way to provide their climate-related disclosures to stakeholders. The framework identifies the 4 target areas which should be addressed. These target areas are governance, business model and strategy, risk management and the metrics and targets of the company.

In terms of governance, the arrangements that have been made for the assessment and consideration of climate-related issues should be made clear. Details surrounding the company's climate risk profile and how climate-related issues are overseen should be made available in ESG reports. Most importantly, the board should ensure that climate reporting is fair and balanced and focuses on the intention of making a difference instead of simply ticking a box.

The business model and strategy are the second part of the framework that should be clearly set out in order to create an effective report on climate-related disclosures with particular focus on the company's business model and strategy and future plans relating to sustainability and growth. Targets should be stated, especially regarding net-zero, as well as the expenditure needed to reach these targets. The Annual Report and Accounts are an opportunity to share this information with investors and stakeholders.

Risk Management is another key aspect of climate reporting, as it provides transparency of the way climate-related risks are

handled and monitored. Documenting and explaining the systems and procedures for monitoring and identifying risks provides stakeholders with comfort and builds trust. Companies should demonstrate the controls that have been introduced to both mitigate risk and support the ongoing viability of the company over the longer term. All this information should be disclosed along with possible scenarios and assumptions in the reports.

Finally, a company should identify for investors the metrics and targets used in relation to climate-related issues. Information should be provided that shows the effects of climate-related issues on the performance of the company, whether it be the company's impact on the climate, or how the climate will affect the company.

For effective ESG reporting, companies should be looking to make all information readily available and easy to find in their annual reports, which could be contained via a sustainability report. One area that all companies should consistently look to improve is scenario reporting. In the UK, 204 in scope publicly quoted companies, large private companies and limited liability partnerships complied with the TCFD reporting requirements in regard to climate-related issues. This largely shows the success and capability of the framework developed by the TCFD and the UK's position as a leader of sustainable finance in the world.

This can further be seen through the actions of the International Financial Reporting Standards (IFRS) Foundation through the creation of its new International Sustainability Standards Board ("ISSB") that will develop a comprehensive global baseline of high-quality sustainability disclosure standards. This structure aims to give investors with global investment portfolios a more reliable standard of ESG metrics. This is vital because ESG and climate reporting can be so broad, therefore standardising disclosures provides investors with more reliable information to make important decisions.

The IFRS Foundation announced during COP26 three significant developments to provide the global financial markets with high-quality disclosures on climate and other sustainability issues. The intention being to create a global baseline for companies to meet when making sustainability reports and disclosing information for ESG reporting. The impact this will have on the global markets is considerable, as it will allow investors to have access to more standardised information on ESG, supporting investment decisions. This also provides support for boards in demonstrating that their businesses are making a positive impact on the environment, and that the company's procedures and strategies are developed to positively impact climate change.

In the USA there are currently no mandatory ESG disclosures at the Federal level, despite the fact that the SEC requires all public companies to disclose information that may be material to investors, with some of this information being ESG related risks. With the SEC being the principal regulator of public markets in the USA, it faces criticisms that it does not go far enough with its requirements for companies to report and disclose information. ESG related bills have reached Congress, but none have been passed into law. However, a significant number of public companies choose to use the TCFD framework voluntarily.

In California, the Climate Corporate Accountability Act was passed in the Senate in January 2022, which requires companies with total annual revenue of $1 billion in California to publicly disclose information on direct greenhouse gas (GHG) emissions and indirect GHG emissions from electricity companies used. This further extends disclosures to be made on other indirect emissions from the company's supply chain, company travel, water usage, amongst other actions. So, change is being seen but, on a state-by-state basis.

Could the impact of the ISSB be the force for changing the global markets' need to attract investors and push companies into disclosing more detailed environmental reporting?

As previously stated, it is also important to note that ESG reporting is not limited to environmental issues and risks. Whilst climate change and carbon emissions, pollution and waste, natural resource usage and environmental opportunities such as renewable energy are all important factors, they only make up the "E" of ESG.

The Social and Governance aspects of ESG are equally as important. There are many other areas which require disclosure such as employee welfare, diversity and inclusion, health and safety measures, supply chain and anti-slavery measures, anti-corruption measures and data protection and privacy.

Effective compliance or reporting is possible with good corporate governance within a company. A board should demonstrate that its governance is robust and report on its corporate behaviour, governance around climate-related risks, board oversight and structure, board diversity, executive pay and whistleblowing arrangements.

No company exists in a bubble and the way it behaves and impacts wider society is just as important as its profitability. Good governance is the ultimate "change enabler" and should be at the heart of everything you do. Being able to articulate the "How" as well as the "What" is now a key requirement for corporate reporting and a real differentiator in an increasingly competitive world. Whether the person reading your annual report or visiting your website is a potential customer, supplier, employee, or investor, they will have a choice in how they spend their time and money. Effective ESG reporting can help them choose you. ■

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