FINANCE, ESG
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The ABCs of ESG reporting: What are ESG and sustainability reports, why are they important, and what do CFOs need to know

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Read this blog to discover more about **ESG reporting** compostable straws to embedding sustainability into their business practices, processes, product development, operations, and strategy. Many organizations are rejigging their business models, re-organizing corporate structures, and spending substantial time, money and resources to embed sustainability into core strategies. As a result of this investment, many have come to see **environmental, social, and governance (ESG) reporting**, not as a regulatory burden, but as a tool to attract investors and financing. Of course, companies want to do good and be ethical and responsible. But they also want to shine in the eyes of public, stand above the competition, and attract investors and financing. Reporting **ESG performance** in **ESG reports** is a way to make this happen. Before anyone can begin to prepare their processes for **ESG compliance**, we must build our understanding of ESG, how it different from sustainability and CSR efforts, and what it means to investors and for today's CFOs.

What is ESG reporting?

ESG reporting is the disclosure of environmental, social and corporate governance data. As with all disclosures, its purpose is to shed light on a company's ESG activities while improving investor transparency and inspiring other organizations to do the same. Reporting is also an effective way to demonstrate that you're meeting goals and that your **ESG projects** are genuine — not just greenwashing, empty promises, or lip service.

Since ESG reports summarize the qualitative and quantitative benefits of a company's ESG activities, investors can screen investments, align investments to their values, and avoid companies with the risk of environmental damage, social missteps or corruption.

What's the difference between ESG and sustainability?

ESG and sustainability are sometimes used interchangeably, but there are some notable differences.

- Generally speaking, sustainability refers to a company's relationship to the environment, where ESG extends that relationship to social responsibility and corruption.

- ESG is an external investment framework, or a form of metrics, that helps companies communicate their initiatives and investors assess the company's performance and risk. On the other hand, sustainability is seen as an internal framework that guides the organization's capital investments. In other words, sustainability is the motivation, ESG is the reported outcome.

- Since ESG is a reporting framework, it is more relevant to publicly traded companies looking to attract and inform investors or any other business looking to attract financing.

What's the difference between ESG and CSR?

ESG aspires to be a set of disclosure standards that companies complete to communicate sustainability initiatives. Stakeholders, like investors, use ESG reports to screen their investments. Corporate social responsibility (CSR) is a business model where a company's activities enhance the world around them.

As an example, US retailer, Patagonia has very strong CSR. Everything the company does is governed by its CSR. It urges conscious consumption to a point where it would sacrifice revenue for its values. Instead of pushing sales, the company offers repair services for its products, urging longevity over consumption. It resells its used products. And it actively rebels against fast fashion retail business models, ensuring its materials are sustainable and human resources are paid a living wage.

What is the current state of ESG reporting?

On June 7th, 2021, G7 finance ministers announced a commitment to mandate climate reporting in line with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD). While a universal standard does not yet exist, ESG reporting does exist in the form of regional reporting frameworks, voluntary standards, and national legislation that vary significantly. Oftentimes, organizations will include ESG reporting into their annual reports to demonstrate how sustainable the business is.

Read the CCH Tagetik quick guide and discover **today's ESG challenges** and how **CCH Tagetik ESG and Sustainability Performance Management** enables you to comply with evolving **ESG requirements** while optimizing scoring, reporting, planning, and performance.

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What do ESG reports include?

ESG reports include qualitative and quantitative information pertaining to its three key topics.

Environmental: What is an organization doing to be a steward of the environment? The environmental umbrella covers:

- How a company is combatting climate change
- What a company is doing to reduce carbon emissions
- How the company is preserving biodiversity, improving air and water quality, combatting deforestation, or responsibly managing its waste
- How the company is responsibly using resources and its supply chain
- What the company is doing to reduce its emissions?

Social: What is an organization doing to improve lives? The social umbrella covers:

- How a company nurtures its people and workplace
- Gender, BIPOC, and LGBTQ+ inclusivity initiatives
- The company's employee engagement
- Data protection and privacy
- Community involvement
- Human rights and labor standards

Governance: What is an organization doing to stay ahead of corruption and ensure its investments remain sustainable in the future? The governance umbrella covers:

- A company's internal controls

compensation, audit committee structure, shareholder rights, bribery, lobbying, political contributions, and whistleblower programs

What is an ESG score or rating?

As ESG has become a priority for investors and companies alike, ESG scoring aspires to grade organizations on its ESG efforts. Like a credit score or a bond rating, an ESG score denotes a company's ability to meet its ESG commitments, its performance, and its risk exposure.

Assigned by third-party providers, ESG scores are calculated based on a set of ESG metrics. Each of these agency uses a different set of criteria to score organizations.

Who assigns ESG scores?

There are a number of third-party providers that assign ESG scores. Notable organizations include:

- Bloomberg ESG Data Services
- Sustainalytics ESG Risk Ratings
- Dow Jones Sustainability Index Family
- RepRisk

What are ESG regulations?

Currently, the EU has the most sophisticated set of ESG regulations, which were developed to help the EU increase sustainable investing and to further the EU Green deal, which is the EU's promise to combat climate change and environmental degradation by:

- Eliminating net emissions of greenhouse gases by 2050
- Decoupling economic growth from resource use, and;
- Leaving no person or place behind.

In order to meet their climate objectives, the EU currently has the most established framework around ESG regulations. The strategy hinges on two pillars:

1. A reimagining of incentives for financial markets and corporate governance. These are primarily covered by the Sustainable Finance Agenda and the Sustainable Corporate Governance Initiative.

2. Transparency into the ESG impacts, good and bad, of an organization's activities and their sustainability initiatives.

The latter directly involves ESG reporting, which is coming to regulatory shape through:

> The EU Taxonomy
> The EU Taxonomy is a classification system of environmentally sustainable economic activities. The EU taxonomy aspires to provide companies, investors and policymakers with standard definitions for what's considered environmentally sustainable. This would prevent companies from greenwashing their products or activities, incentivize sustainable activities, and funnel investments to the most sustainable organizations.
>
> The Sustainable Finance Disclosure Regulation
> Known as SFDR, this regulation defines disclosure obligations that organizations must follow to demonstrate how they consider sustainability risks in their decision making, and how they report strategy, goals, and ESG impacts to investors. This regulation came into effect in March 2021.
>
> In the SFDR, Financial Market Participants (FMPs) must disclose 18 mandatory indicators and choose at least two more from 46 optional indicators. These indicators are based on the Principal Adverse Sustainability Impacts Statement (PAIS) and requires companies to undergo a significant amount of data analysis.
>
> New Corporate Sustainability Reporting Directive (CSRD)
> The CSRD is the revised version of the EU regulation, the Non-Financial Reporting Directive (NFRD), a standard that laid down the disclosure rules for non-financial and diversity information by large companies. The CSRD is the tougher, revised version of the NFRD and is expected to go into effect in 2022/2023.
>
> At the time of writing, the NFRD rules requires that all large companies and all listed companies, provide the following as minimum information:

- The outcome of policies
- The principal risks related to the undertaking's operations including: its business relationships, products or services which are likely to cause adverse impacts in these areas; and how the undertaking manages such risks
- Non-financial key performance indicators

An amended version of the NFR Directive has also been implemented into the Slovak Act on Accounting No. 431/2002 Coll.

What are other notable ESG frameworks?

Currently, companies have a long leash when it comes to ESG disclosure. In many cases they are free to present ESG information in a way they consider to be most useful. That said, the use of recognized frameworks is recommended. Here are just a few:

Global Reporting Initiative (GRI) is a framework that helps companies disclose both the positive and negative impact their business has on the environment, the economy, and society. GRI's focus is on helping companies communicate their ESG impacts and how they manage these impacts. GRI is the most referenced ESG framework among all industries, receiving 83% of total references to ESG frameworks.

The Sustainability Accounting Standards Board (SASB) are a set of standards that help companies collect and share ESG data that affect the firm's business decisions and explain the financial impact of sustainability. It's worth noting that the GRI and SASB joined forces in 2020 and have since published a guide to how organizations can use the two standards together. GRI is known for its high-level scope, while SASB gives companies industry-specific guidelines using a financial lens.

The Task Force on Climate-related Financial Disclosures (TCFD) is a framework that provides principles-based recommendations for managing and reporting focused primarily on climate risks. It focuses most on financial risk disclosures associated with climate to aid banks, shareholders and investors scrutinize an organization's ESG efforts.

Carbon Disclosure Project (CDP) is an international non-profit focused on creating standards that companies can use to disclosure information pertaining to GHG emissions, and regional government organizations disclose decarbonization and environmental protection efforts.

Streamlined Energy and Carbon Reporting (SECR) is a framework created by the UK Government that guides organizations on how to report on their carbon emissions and energy usage on an annual basis. The goal of the framework is to streamline existing carbon reporting frameworks for greater transparency and comparability, while making it easier for companies to monitor and reduce their carbon emissions.

The Workforce Disclosure Initiative (WDI) is an investor collective that formed to help companies communicate labour practices to stakeholders. It aims to improve transparency and accountability on workforce issues by providing companies with a framework for disclosing comprehensive and comparable workforce data.

Closing thoughts

Way back in 2017, Morgan Stanley released a study that found that 86% of Millennials were interested in sustainable investing, or investing in profitable companies that operate, while having a positive social or environmental impact. The study also found that millennials were twice as likely than the overall investor population to invest in companies targeting social or environmental goals, and that 72% of Gen Z believed that responsible investing could improve sustainability outcomes.

Fast forward five years, it’s safe to assume sustainability has become one of the reigning priorities in the mind of the investor — and one that is very closely aligned with the investor’s perception of a company to be profitable for the long term.

With 80% of N100 firms across the globe now reporting on sustainability, a global framework for ESG is a question of when, not if.

In the coming weeks, we’ll continue to explore ESG in a blog series that will cover everything from what investors look for in ESG reports to how to improve your ESG report card.

Learn how **CCH Tagetik can help you streamline your ESG reporting** while improving your ESG plans, contact us.

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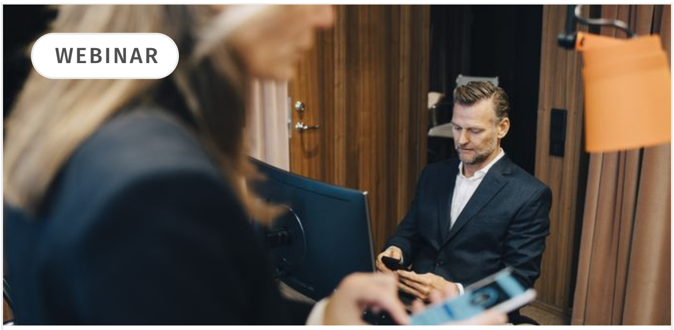

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