GPPC

Perspectives on ESG Reporting

EMEA roundtable – The future of ESG reporting explored

On Tuesday 30th November, the GPPC[1] brought together 20 professionals representing various stakeholder groups in the corporate reporting ecosystem[2] to explore Environmental, Social, and Governance (ESG) corporate reporting and assurance of the future. Individuals from across EMEA (Europe, Middle East, and Africa) were invited based on their knowledge and expertise relative to ESG reporting and assurance matters. The roundtable was conducted virtually with technical operation based in Brussels.

The EMEA roundtable was one of a series of regional discussions, held under the Chatham House Rule[3], that explore the current ESG reporting landscape and what incremental ESG and climate-related disclosures can be made to address market participants' and society's broad interest in ESG and climate issues. Grounded in the understanding that there may be a disconnect between what current accounting and auditing reporting practices require and permit, and what some investors and stakeholders are expecting and demanding, the discussion was designed to explore potential approaches to better align corporate reporting and assurance standards with stakeholder and societal objectives.

The report below draws out key points that were made by the participants at the roundtable discussion. The roundtable participants' remarks are quoted (in italics) throughout the report. In accordance with the Chatham House rule, attribution of quotes is by category of participant rather than name and organisation. It is designed to help understand the perspective from which comments were made, rather than to suggest that any position is typical or otherwise of a particular stakeholder group. For a full list of participant categories, please see Appendix A.

1. **Where we are:** exploring current gaps between what is desired and what is delivered, with a focus on climate

1.1. Many participants expressed that more needs to be done to capture climate related risks

The roundtable participants discussed that reporting needs to change to better account for climate related risks, and indeed wider ESG risks. Participants communicated that connectivity of financial and ESG reporting is very important going forward, both the way risks are factored into financial reporting - including around how to report future cash flows – and the management narrative residing outside of the core financial statements.

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1 The Global Public Policy Committee (GPPC) is the global forum of representatives from the six largest accounting networks: BDO, Deloitte, EY, Grant Thornton, KPMG, and PwC, which has as its public interest objective the enhancement of quality in auditing and financial reporting.

2 Participants represented stakeholder groups including investors and asset managers, investor associations, corporate preparers and ESG leaders, business organizations, those charged with governance (TCWG) including audit committees and corporate boards, auditors/assurers, and professional bodies

3 When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.

"Everyone is in violent agreement that we need better reporting and that is the journey we are on. There are differences of views between folks, Investors and often companies and professional accountants what is required by current standards."

Assurers and professional bodies

1.2. There are different opinions about what has caused the gap between the current and desired features of financial reports, as well as what it will take to close that gap

Participants discussed that the status quo is not delivering the information investors want and observed a difference of opinion about why.

Some felt that current IFRS standards are broadly adequate, and the issue is the application of them. In particular, there was a view that climate is often a material financial risk and should be factored into financial statements under current standards:

"The way financial statements at the moment measure climate risks and liabilities is not that off. Maybe there is some improvement possible in disclosures, but the basic way climate risks are accounted for in principle is not off."

Academics and policy makers

"I think it's more the application of standards rather than the standards. Our starting point - as the IASB has said - is you can do this based on the current standards. That is the starting point, we are all learning as we go a long and we would ask companies to start on that journey both through TCFD reporting but also thinking about the risk of climate change in your financial statements. There may need to change some standards down the road, but as a starting point it's about incorporating the risk into the current standards and the current framework."

Academics and policy makers

Others argued it was because (despite the guidance issued by IASB and IAASB) current reporting and auditing standards lack the specificity, or in some cases even the permission, to enable companies and auditors to meet expectations. An example was the IAS 36 impairment test. Where the recoverable amount of assets is based on their value in use, future cash flows are required to be estimated on the basis of the assets in their current condition and future restructurings are not permitted to be taken into account. Forecasted cash flows are also required to represent management's best estimate of future cash follows, which would not necessarily represent a net zero scenario, and instead be a projection based on a number of possible future outcomes.

Related to this, it was noted that the output from COP 26 would not result in a net zero / 1.5C outcome, but instead an increase in temperatures above this level. It was also noted that differences in the timeframe of interest may be significant. Participants expressed that climate-related risks may be of long-term significance, but without the kind of short-term impact that would be reflected in annual accounts.

"Financial statements' reporting and disclosures depend on several factors such as the timeframe within which climate-related risks evolve and materialize. While risks may exist, the impact of those risks on a particular period's financial statements may not be material."

Academic and policy makers

1.3. With respect to ESG disclosures outside financial statements, the Roundtable discussed that divergent standards are key to the transparency gap

In relation to ESG disclosures, the participants thought that challenges arose more from the existence of multiple reporting frameworks, the lack of a clear overall framework and the need to create new data collection processes:

> *"The data definition is not sufficient - we do not know what indicators are requested. There is so much interpretation all around within the company, with auditors. We are really struggling at a late point in time."*
>
> *Companies and business organizations*

The discussion quickly progressed to include comments on financial reporting today and non-financial reporting and the related assurance.

> *"It's a new environment re non-financial information. Where the auditors start to think about materiality, about possible testing, about the system of internal controls. In Europe we use ISAE 3000[4] is very high level, not detailed and robust enough to support through decisions. Inevitably [we] need more practical guidance on how to apply this concept by ISAE 3000."*
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> *Academics and policy makers*

1.4. Many participants identified materiality as the key criterion for identifying ESG factors that need particular focus

When asked where else to focus, responses drew on the concept of materiality through the investor lens. This led some to express support for SASB's approach to standards[5], and a desire for companies to form a materiality assessment that stakeholders can then challenge.

> *"Looking at the materiality and saying that what is most important for individual companies, the danger is to say we have climate change and a social risk, or other environmental risks, part of this is about the board doing the analysis to understand what are the most important ESG risks and telling their investors about it. Which is why a lot of investors support SASB because it has the materiality lens."*
>
> *Academics and policy makers*

[4] International Auditing and Assurance Standards Board International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information.*

[5] SASB describe their work as 'identifying the subset of ESG issues most relevant to financial performance in each of 77 industries… based on extensive feedback from companies, investors, and other market participants as part of a transparent, publicly-documented process'

There was a view that, while the current extension of reporting around the "E" of ESG is welcome, the focus is too narrow – and a greater focus on materiality would widen it and topics related to the "S" (e.g., social/human capital, diversity) and "G" (e.g., governance/board oversight) are increasingly important.

"What about 'G'? We know about biodiversity; we know about environment. What about 'G'? 'G' deserves a full place. Long term risks for companies to highly correlate how many risks are in the governance of a company."

Assurers and professional bodies

1.5. There was also some concern that regulations are not as coherent as they could be

A further view was that differences in agenda and timeline between different regulations are having unintended consequences. In particular, some argued that obligations on corporate reporting are lagging. This results in investors having to find alternative data sources, which are not subject to the same rigor as is expected of direct corporate reporting.

> *"… the sustainable finance reporting directive -- there are clear requirements that investors assess all kinds of sustainability data for the portfolios. That is an obligation to comply with and yet, not an obligation for companies to report. So, this is driving us into the hands of third-party data providers that have very diverging views on the same company."*
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> *Academics and policy makers*

2. **Where we should go:** The role of ESG in corporate reporting of the future

2.1. The Roundtable discussed that the link between financial reporting and management narrative needs to be clearer and more coherent

Some participants argued that a key step forward would be more intrinsic connection between the assumptions and views set out in the management report with the assumptions that sit behind financial reporting.

> *"The point about cash flows is that the front-end assumptions link to resulting numbers. For example, impairment testing is about cash flows and does need to factor in climate."*
>
> *Academics and policy makers*

> *"We expect the companies in which our members are investing in to be actually managing ESG risks to their long-term value, looking at materiality, saying what is most important, for individual companies so the board need to do the analysis and telling investors about it. We need a framework for companies to talk about the risks that they see, the impact on longer term value and what we expect companies to be reporting on."*
>
> *Academics and policy makers*

Participants noted that an extension of the view outlined above was the argument that there really ought not to be a meaningful distinction between financial and non-financial information. There is a set of information investors seek – whether that is financial or non-financial, it ought to be reported coherently and robustly.

> *"I don't like to distinguish between financial information and non-financial information anymore. This is the information investors need. We need to treat it all in the same way".*
>
> *Companies and business organizations*

> *"A step change is needed on how sustainability information is sometimes thought about, which is, how we run our business, and then there is the sustainability information that we need to provide about how we run our business, where in reality the two are interlinked. What ultimately will be needed - as governments bring in more regulation and from a climate perspective, we move to a lower carbon economy - is to have those two put together in what you might call an integrated way and then report on it in that way. There may be a distinction at the moment, but within a very short time there will be no distinction at all. You are looking at the overall report on how the business operates."*
>
> *Companies and business organizations*

2.2. An important role for assurance

Some participants argued that assurance has an important role to play, and ought to reflect the interconnectedness of financial and non-financial management views and accounts.

> *"There are multiple different types of ESG Metrics, and you can imagine technical expert audit in any assurance in one in those different areas. So, you can imagine lots of different assurance can add up, but what you are all describing is you don't want assurance on the individual metrics. You want assurance on the business as a whole. It reinforces integration - the two parts of the report coming together, as it were. "*
>
> *Academics and policy makers*

> *"Assurance is important. In terms of reliability and comparability of this information just like Assurance is important in terms of the role, in terms of the capital market, in terms of financial reporting. Equally important in terms for non-financial reporting as financial reporting. It's two sides of the same coin. All this information is needed by investors, stakeholders and the financial community to assess the long term of the entity."*
>
> *Companies and business organizations*

3. How to achieve the desired future state

As evidenced by the above discussion topics, a key area of focus for participants was on **clarifying standards or developing new standards** – with a range of views of how significant an overhaul is needed. In addition, there were three other major discussion themes.

3.1. Change management is key

A key theme expressed throughout the roundtable was that new regulation and standards ought to be introduced in a way that reflects the reality of needing to implement change, including the need for new forms of data collection and assurance. A participant expressed concern that:

> *"In the next two years we are expecting CSRD, EU sustainability standards, IFRS, social taxonomy and these are just a few things we are looking ahead at. I have to tell you methods, processes, IT systems they have to be prepared to bring the data together which is needed by the financial community. We are absolutely willing to deliver that, but it will take some time for us. As long as we have 5, 6, 7 frameworks to fulfil, this is really a struggling process."*
>
> *Companies and business organizations*

Another participant noted that there was also the need for the focus to shift to the longer term:

> *"We are busy developing information systems and tools. When we aim at a long-term perspective, there is a fundamental change in how these work."*
>
> *Companies and business organizations*

An additional key aspect discussed by participants was the need for financial and ESG reporting to be brought together:

> *"Right now, there are often two separate areas for financial and non-financial reporting, which need to be brought together."*
>
> *Assurers and professional bodies*

3.2. A global baseline

Many participants highlighted the recently announced ISSB at the IFRS Foundation and linked this to the need for consistent reporting requirements:

> *"I would like one global framework which I can work on and make us more transparent and comparable to other companies, that our stakeholders get what they want and need".*
>
> *Companies and business organizations*

A participant relatedly opined on how a 'building blocks' approach might operate, with jurisdictions potentially having different government policy objectives:

> "*Building block 1 is the global base line of information which is needed by investors in capital markets. Building block 2 issues will be jurisdiction specific public policy issues. The system has to accommodate the local jurisdiction initiatives that will be public policy driven by the Government in those jurisdictions to get the reporting that they think they need in their jurisdiction. It is naïve to think that these public policy issues in Europe would be the same in North America, South America and Asia. But as long as we get the global baseline of investors in the capital markets it will be a huge win."*
>
> *Companies and business organizations*

3.3. Skills

Some participants also emphasized the need to have different kinds of skills. It was noted that all parts of the eco-system are looking for similar skills, for example, understanding of Scope 3 emissions, and the relative lack of such experts is a challenge in the ability of reporting to deliver what is needed.

> *"The boundary is a big problem. So is finding people who are fully conversant with what scope 3 gasses are. That's an enormous challenge for companies. One of the real issues is systems and controls to gather the data in the first place."*
>
> *Academics and policy makers*

3.4. Everyone needs to contribute

The final theme, that sat behind the entire conversation, was the view expressed by participants that getting to a change at scale and at the necessary pace is a team game and everyone in the ecosystem has a role to play to drive positive change – including preparers, assurers, standard setters, policy makers, investors, and others.

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EMEA roundtable

Appendix A: Participant Categories

Participant Category	Description
Companies and business organisations	Publicly-traded companies or organisations that represent them
Investors and investor associations	Investment funds or associations representing investors
Academics and policy makers	Professors of accounting or civil servants with a role in corporate governance
Assurers and professional bodies	Auditors at GPPC member firms or leaders at professional bodies

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Appendix B: Quantified responses

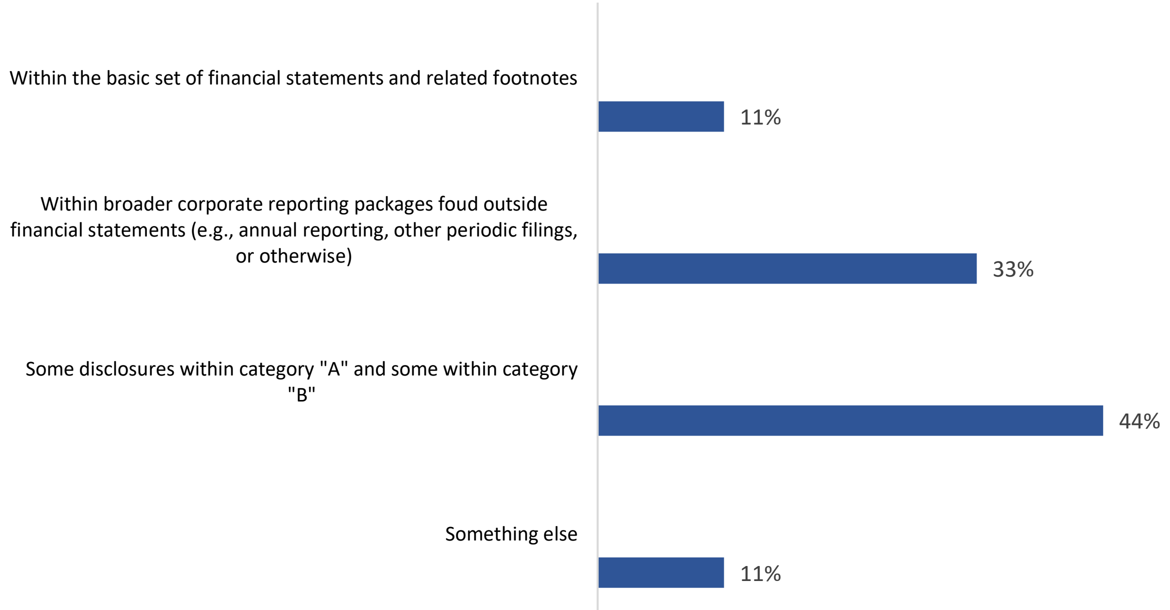
During the discussion, a number of probing questions were asked to catalyse debate. The results are below. These reflect the views of participants at the start of each discussion section. They are not purported to be representative of wider stakeholder opinion, nor opinion once informed by the discussion. They are included here for completeness. Participants did not have to answer every question; and in most cases could select more than one option.

<u>**Probing question 1:**</u>

What do you believe is driving the gap between what investors and others expect companies to present in their financial statements regarding climate risks and the information that is currently being presented? Select all that apply.

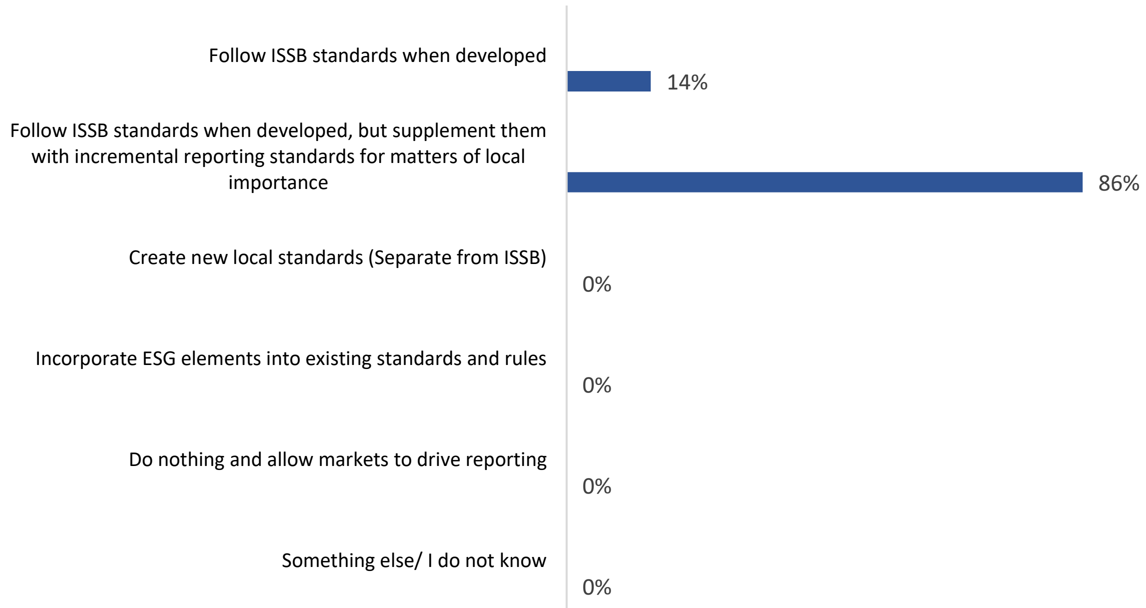
<u>**Probing question 2:**</u>

Where do you think companies should report ESG disclosures?



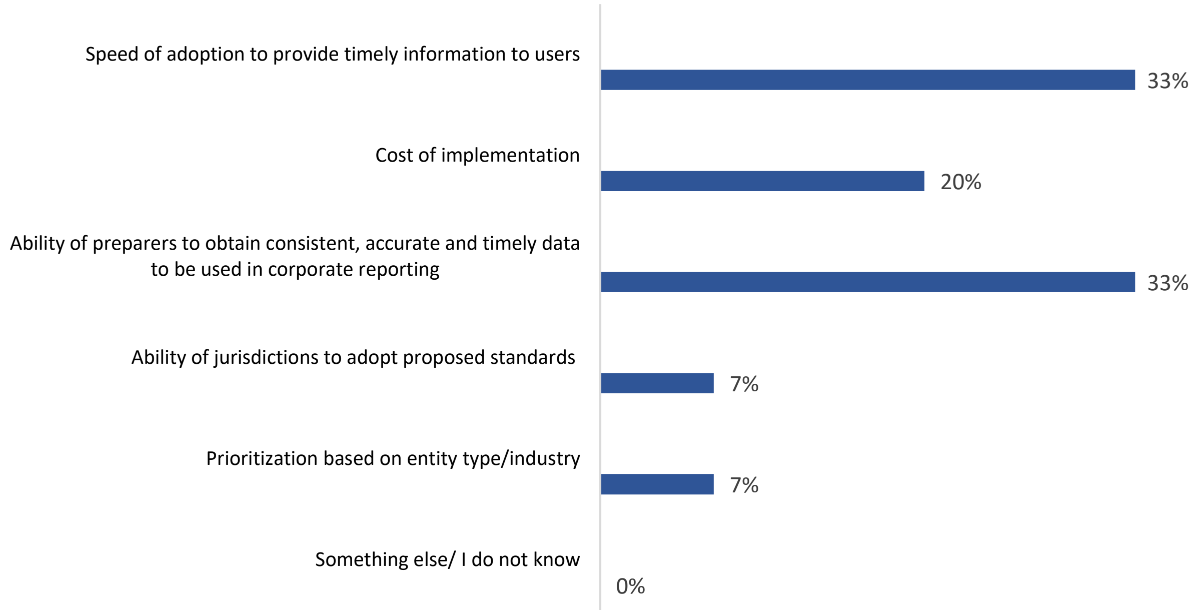
Probing question 3:

Which approach do you believe should be adopted for corporate reporting around ESG matters?



Probing question 4:

What factors do you believe standard setters and regulators should consider when developing reporting requirements specific to ESGs? Select all that apply.

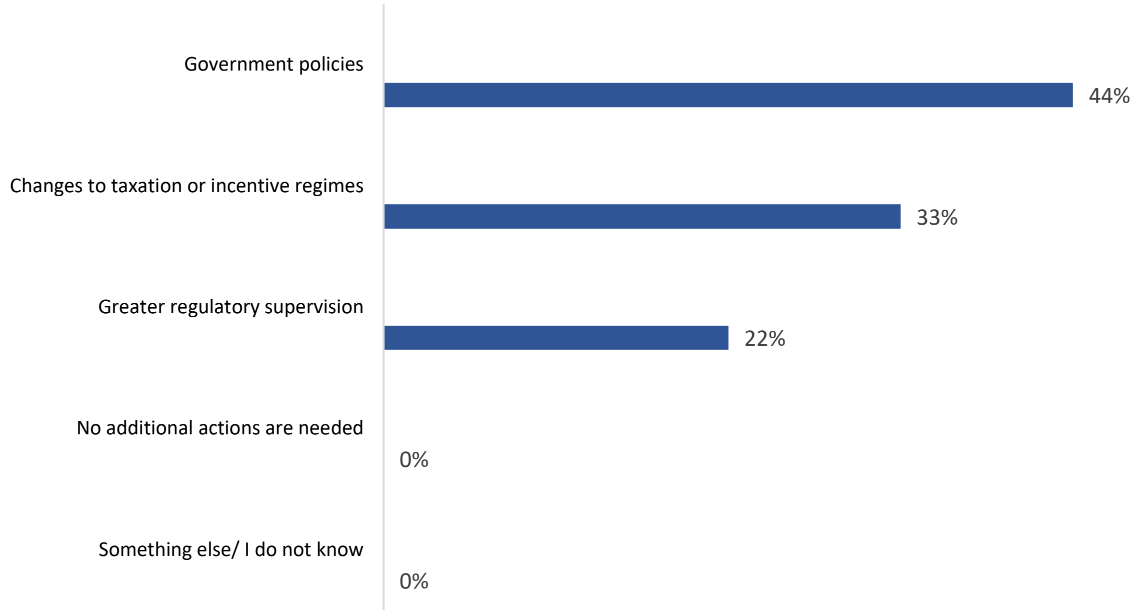


Probing question 5:

What do you consider the major obstacles to the reporting and use of ESG information? Select all that apply:

Probing question 6:

Other than changing ESG corporate reporting standards, what actions do you believe should be taken to help companies meet their sustainability goals and address investors' needs?



Government policies
44%
Changes to taxation or incentive regimes
33%
Greater regulatory supervision
22%
No additional actions are needed
0%
Something else/ I do not know
0%