The Basics of Sustainability Reporting

EU Non-Financial Reporting Directive

Since the implementation of the European Union's Non-Financial Reporting Directive (NFRD), Directive 2014/95/EU,[(1)] more than 11,700 listed companies, banks, insurance companies and other companies designated by national authorities as public-interest entities have been required to disclose information related to:

- environmental matters
- social matters and treatment of employees (including diversity)
- human rights
- anti-corruption and bribery
- diversity on company boards (in terms of age, gender, educational and professional background)

Currently, this information must be disclosed according to internationally acceptable guidelines, of which there are many (refer to Appendix 1 - International Reporting Frameworks).

In 2017, the EU published its non-binding methodology guidelines for reporting non-financial information (2017/C 215/01),[(2)] in which it is stated:

> '*The aim of these guidelines is to help companies disclose high quality, relevant, useful, consistent and more comparable non-financial (environmental, social and governance-related) information in a way that fosters resilient and sustainable growth and employment and provides transparency to stakeholders.'*

Companies currently required to report on environmental, social and governance (ESG) risks are those with more than 500 employees. However, on 21 April 2021, the Commission adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD), [(3)] which would amend the existing reporting requirements of the NFRD. The proposal would see an extension of the scope to all large companies and all companies listed on regulated markets (except listed micro-enterprises), plus it would see the removal of the minimum 500 employee threshold. This could mean that nearly 50,000 companies in the EU will need to follow EU defined sustainability reporting standards in the future. The date for implementing the changes will depend on when the directive is enacted into law but assuming this to be October 2022, companies will be required to begin reporting using a new EU standard from 2024 in respect of their 2023 results.

In an EU press release dated 21st April 2021 [(4)], there is an acknowledgement that SMEs will be spared the burden of reporting to the same level of large corporations but there remains an intention to develop a proportionate reporting scheme:

> *'The proposal would not put any new reporting requirements on small companies, except for SMEs with securities listed on regulated markets. In addition, to limit the burden on listed SMEs, they will be allowed to report according to standards that are simpler than the standards that will apply for large companies. The reporting requirements of this proposal would also not apply to SMEs with transferable securities listed on SME growth markets or multilateral trading facilities (MTFs).*
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> *That said, many SMEs are facing growing requests for sustainability information – typically from banks that lend them money and large companies that they supply. The transition to a sustainable economy is likely to mean that collecting and sharing sustainability information becomes common*

business practice for companies of all sizes. Therefore, in parallel to the new rules proposed today for large companies, the Commission is also proposing the development of separate, proportionate standards for SMEs. SMEs listed on regulated markets could use these simpler standards to meet their legal reporting obligations, while non-listed SMEs could choose to use them on a voluntary basis. These standards would be carefully adapted to the capacity of SMEs. They would make it easier for SMEs to report information to banks, large-company clients and other stakeholders. They can help SMEs play a full role in the transition to a sustainable economy. Furthermore, the requirements for listed SMEs would apply only three years after they apply to other companies, given the economic difficulties faced by smaller companies as a result of the COVID-19 pandemic.'

In its most recent survey of the world's top companies, the time has come – The KPMG Survey of Sustainability Reporting 2020 (KPMG IMPACT, December 2020, (5) KPMG disclosed:

- of 5200 companies assessed worldwide, the most commonly used reporting standards or frameworks were Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB) and International Standards Organization (ISO).
- a sustainability reporting rate of 77% in Europe

UK Non-Financial Reporting Initiative

The United Kingdom, is aiming to introduce a new law requiring Britain's largest companies to report on climate-risks and opportunities (6):

The UK will become the first G20 country to enshrine in law mandatory TCFD-aligned requirements for Britain's largest companies and financial institutions to report on climate-related risks and opportunities.

From 6 April 2022, over 1,300 of the largest UK-registered companies and financial institutions will have to disclose climate-related financial information on a mandatory basis – in line with recommendations from the Task Force on Climate-Related Financial Disclosures. This will include many of the UK's largest traded companies, banks and insurers, as well as private companies with over 500 employees and £500 million in turnover.

The Taskforce on Climate-Related Financial Disclosures (TCFD) is an industry-led group which helps investors understand their financial exposure to climate risk and works with companies to disclose this information in a clear and consistent way.

Materiality

The European directive on non-financial reporting and increasing stock exchange requirements to report environmental, social and governance risks are leading companies to consider which non-financial information matters are important to them and their stakeholders, and therefore what they should report.

GRI defines materiality as: *'Material topics are those that reflect an organization's significant economic, environmental and social impacts; or that substantively influence the assessments and decisions of stakeholders.'*

Seeking input from a wide range of stakeholders is essential to ensure that an organisation not only considers the impacts of its activities on its own shareholders, investors, management teams, employees, neighbours etc but also recognises and considers the impact on stakeholders connected with its upstream and downstream supply chains.

It is for each company to determine which material areas are of concern based on their commercial activity and to use the opportunity to identify where they can make a positive, value-adding contribution. In conducting risk analysis, companies must not hide from the fact that some of their commercial activities may be responsible for a consequential negative impact on local and global environments and communities. It is important that the organisation considers both positive and negative actions and impacts when making decisions about where to prioritise resources for the benefit of all stakeholders and the environment.

Climate risk and carbon reduction are high on the agenda for many companies in current times. One only needs to note how many companies are committing to reducing emissions and to climate neutrality by a fixed point in time to understand the importance of climate action for the organisation and their stakeholders. Indeed, there is a growing trend to link corporate carbon emissions to global climate goals, with some companies going so far as to sign up to Science Based Targets initiative. (7)

Science-based targets provide a clearly defined pathway for companies to reduce greenhouse gas (GHG) emissions, helping prevent the worst impacts of climate change and future-proof business growth. Targets are considered ‘science-based’ if they are in line with what the latest climate science deems necessary to meet the goals of the Paris Agreement, that is, limiting global warming to well-below 2°C above pre-industrial levels and pursuing efforts to limit warming to 1.5°C.

Biodiversity in general is not necessarily high on the list of important material areas for organisations but in their 2020 Sustainability report KPMG describes increasing awareness about the impacts that industry has on the wider environment and a recognition that it is a high-risk area of concern for investors and other stakeholders.

There isn’t a standard framework to which companies can turn when conducting a material impact assessment but there are useful sources of information which can help a company in the process of determining which areas of materiality are relevant for the organisation, for example:

- The Essentials of Materiality Assessment (8)
- The reality of materiality: insights from real world applications of ESG materiality assessments (9)
- Sustainability Strategy: Simplified (10)
- GRI 103: Management Approach 2016 (11)

There may be a temptation to proclaim all material areas high priority, but organisations must prioritise and focus on the areas which are of greatest risk / impact for the organisation and its stakeholders.

Key Performance Indicators

Defining areas of materiality is the first step in defining, setting and communicating targets and goals. Setting clear targets and goals is beneficial for stakeholders, it is a sign of ambition and sets benchmarks against which the organisation can be measured and held accountable.

Key performance indicators (KPIs) are a quantifiable measure used to monitor and evaluate performance against specific goals and targets.

Individual KPIs should link directly to a material area, they should be used consistently over a period of time and if the organisation is to make a meaningful impact through its activities, they should be ambitious.

UN Sustainable Development Goals

Many organisations make the connection between the UN SDGs and their targets, goals, materials areas and KPIs, as evidenced through company reports, organisation websites and social media channels. Introduced in 2015, the 17 UN SDGs help organisations translate their sustainability programmes into visual, relatable and impactful communications but taken alone they have limited value. Only by connecting with relevant UN SDGs, identifying clear materiality priorities and measuring against key performance indicators will companies be able to stake a credible claim to being progressive and becoming truly more sustainable.

For further information on relating UN SDGs and Key Performance Indicators please refer to the UEIL document **Key Performance Indicators for Sustainability Reporting,** (12) or visit our website.

References

1	EU's Non-Financial Reporting Directive (NFRD)	https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095
2	EU's Guidelines on non-financial reporting (methodology for reporting non-financial information) (2017/C 215/01)	https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017XC0705(01)&from=EN
3	Proposal for a Corporate Sustainability Reporting Directive (CSRD)	https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0189
4	Questions and Answers: Corporate Sustainability Reporting Directive proposal	https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_1806

5	The Time has come – The KPMG Survey of Sustainability Reporting 2020 (KPMG IMPACT, December 2020,	https://home.kpmg/xx/en/home/insights/2020/11/the-time-has-come-survey-of-sustainability-reporting.html
6	A Roadmap towards mandatory climate-related disclosures	https://www.gov.uk/government/news/uk-to-enshrine-mandatory-climate-disclosures-for-largest-companies-in-law
7	Science based targets	https://sciencebasedtargets.org/net-zero
8	The Essential of Materiality Assessment	https://assets.kpmg/content/dam/kpmg/pdf/2014/10/materiality-assessment.pdf
9	The reality of materiality: insights from real world applications of ESG materiality assessments	https://www.wbcsd.org/Programs/Redefining-Value/Redesigning-capital-market-engagement/Resources/The-reality-of-materiality-insights-from-real-world-applications-of-ESG-materiality-assessments
10	Sustainability Strategy: Simplified	https://corporate-citizenship.com/our-insights/sustainability-strategy-simplified/
11	GRI 103: Management Approach 2016	https://www.globalreporting.org/media/f3jf30vv/gri-103-management-approach-2016.pdf
12	Key Performance Indicators for Sustainability Reporting	https://www.ueil.org/wp-content/uploads/2022/01/1.-Key-Performance-Indicators-for-Sustainability-Reporting-January-2022.pdf

Further Reading

1	ESG Disclosure Handbook (WBCSD)	https://docs.wbcsd.org/2019/04/ESG_Disclosure_Handbook.pdf
2	KPIs for ESG	https://effas.net/pdf/cesg/KPIs_for_ESG_3_0_Final.pdf
3	UEIL Member Sustainability Reports	https://www.ueil.org/sustainability/structure/

Appendix 1 – International Reporting Frameworks

The principles and contents described in Guidelines on non-financial reporting (methodology for reporting non-financial information) (2017/C 215/01) build largely on frameworks such as:

- CDP (formerly the Carbon Disclosure Project)
- the Climate Disclosure Standards Board
- the OECD Due Diligence Guidance for Responsible Supply Chains from Conflict-Affected and High-Risk areas, and the supplements to it
- the Eco-Management and Audit Scheme (EMAS) and the related Sectoral Reference Documents
- the European Federation of Financial Analysts Societies' KPIs for Environmental, Social, Governance (ESG), a Guideline for the Integration of ESG into Financial Analysis and Corporate Valuation;
- Global Reporting Initiative
- Guidance for Responsible Agricultural Supply Chains of FAO-OECD
- Guidance on the Strategic Report of the UK Financial Reporting Council
- Guidelines for Multinational Enterprises of the Organisation for Economic Cooperation and Development
- Guiding Principles Reporting Framework on Business and Human Rights
- ISO 26000 of the International Organisation for Standardisation
- the International Integrated Reporting Framework;
- Model Guidance on reporting ESG information to investors of the UN Sustainable Stock Exchanges Initiative;
- the Natural Capital Protocol
- Product and Organisation Environmental Footprint Guides
- the Sustainability Accounting Standards Board
- the Sustainability Code of the German Council for Sustainable Development
- the Tripartite Declaration of principles concerning multinational enterprises and social policy of the International Labour Organisation
- the United Nations (UN) Global Compact
- UN Sustainable Development Goals, Resolution of 25 September 2015 transforming our world: the 2030 Agenda for Sustainable Development
- UN Guiding Principles on Business and Human Rights implementing the UN ‘Protect, Respect and Remedy’ Framework.