How can ESG reporting fuel positive change?

Fourth ESG reporting maturity assessment

July 2022

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Contents

Foreword

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For each of the past four years, EY assessed the ASX200's sustainability reports to get a snapshot of ESG reporting in Australia.

This year, the assessment found that companies are continuing to improve their reporting maturity in the context of the mass emergence of new standards and frameworks, and ever increasing demand from investors, customers and other stakeholders.

The steps some companies are taking to improve sustainability reporting are admirable. Reporting on sustainability governance is strengthening rapidly, closely aligned to the real-world escalation of sustainability action and organisational accountability. Companies are responding well to evolving standards, investing in much needed systems, processes and capability. In short, more integrated and connected reporting is on the rise which should ultimately give investors access to the high-quality, connected and comparable data they demand[1].

While we strongly believe what gets reported gets managed, it's important to remember reporting isn't for organisations to get better at producing data or telling a story. Sustainability performance data must be used internally and externally to drive decision making in order to maximise positive and minimise negative sustainability impacts.

Given the process of sustainability reporting, which already takes up significant resources, and will only get even more complex and integrated, we must not lose sight of the bigger picture. Reporting has an important role internally to inform and drive a sustainability lens. This is how we ensure businesses act to continually shift sustainability outcomes in the right direction.

With the rapid growth in reporting requirements and the welcome interest and engagement from across business functions, we need to stay true to the original intent of sustainability first principles and ensure sustainability impact is front and centre in the transformation.

This report explores both the positive progress made by the ASX200 in 2021 and the areas of sustainability reporting maturity that now need urgent focus. It also explores how companies can harness sustainability reporting and assurance to push organisations beyond compliance – and lays down a bold challenge for organisations to embrace wholesale change to support their sustainability ambitions.

The assessment is designed to underscore the urgency to expedite the complex corporate transformations required for businesses to drive the change needed for future generations to thrive on this planet.

Assessment methodology

Our assessment considered general reporting characteristics, including form, application of standards, assurance and the Sustainable Development Goals (SDGs). It also evaluated the maturity of reporting against nine criteria using the EY Sustainability Reporting Maturity Model. The criteria are drawn from frameworks and guidance for good reporting and leverage our experience of guiding, writing and reviewing sustainability reporting.
They are:

Content

- Vision and strategy, Governance and management, Metrics and targets, Business model / Value chain, Supply chain

Quality

- Materiality, Context, Balance, Impact and outcomes

For the first time, we assessed a sample of the NZX100 sustainability reports, although the results of those assessments have not been included in this report. In 2023, this report will seek to expand it's scope to include New Zealand and report on the progress within the NZX100.

[1] *https://www.ey.com/en_au/assurance/is-your-esg-data-unlocking-long-term-value*

1 Key findings

Steady improvement acknowledged, but incremental progress isn't good enough.

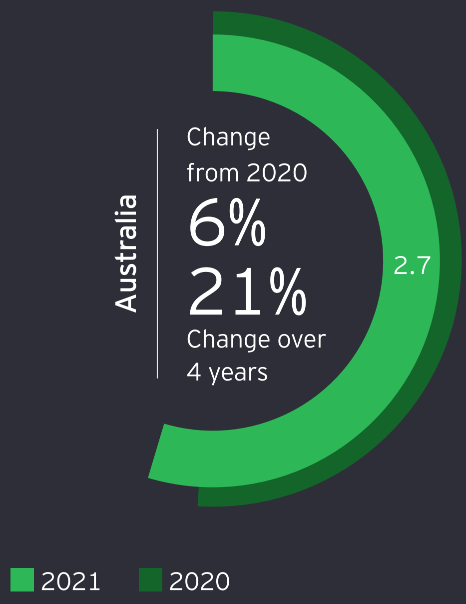
Gradual increase in maturity continues

The assessment found a 6% year on year increase in average maturity score, with the biggest increases seen for the criteria **Governance and management** (up 19%), and **Vision and strategy**, **Materiality** and **Metrics and targets** (all up 8%). This aligns to what has been observed in practice.

Not surprisingly, top-listed ASX50 companies tend to outperform those at the lower end of the list. However, the gap is narrowing with top end improvement rates declining and some companies in the lower listing grades maturing rapidly after just a couple of years of reporting. For example, the ASX 150-200 and 100-150 improved 27% and 24% respectively over the four-year assessment period, compared with 16% in the top 50. Notably, between 2020 and 2021, the average maturity score for the top 50 plateaued.

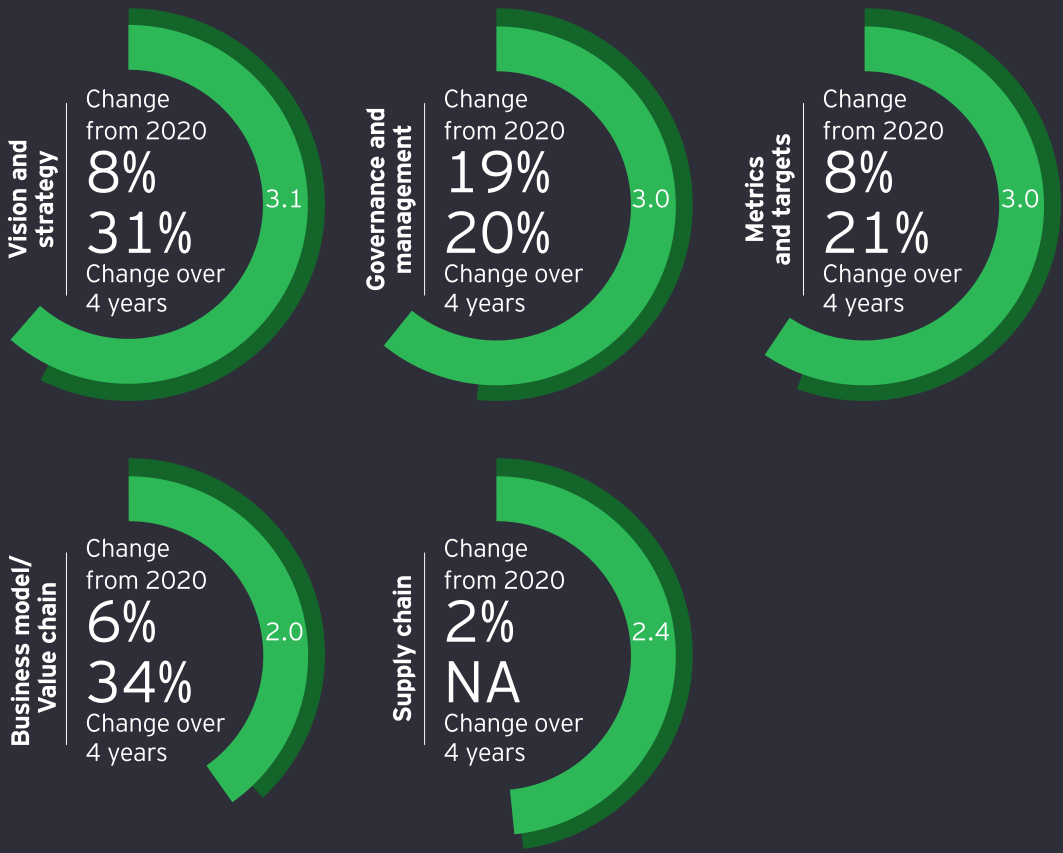
Percentage of companies included in the assessment producing some form of reporting:

Overall results

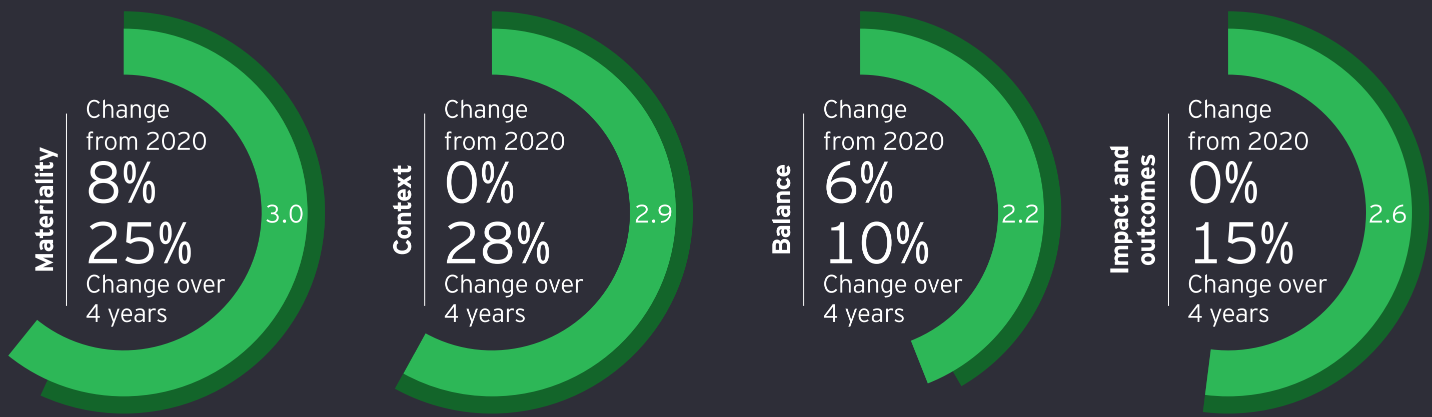


Maturity scores by criteria element

Content



Quality



2021 2020

**Rings depict average score for 2021 and 2020 assessments (out of 5)*

10%

increase in Balance over the four years

the smallest increase in all nine criteria over this period

In 2021, on average companies have performed strongest in the criteria of **Vision and strategy, Governance and management, Targets and metrics,** and **Materiality**. This reflects a top-down approach to sustainability and, encouragingly, sets a solid foundation for future improvement.

Pleasingly, likely in response to investor demand for more metrics and better progress measurement[2], our assessment finds that companies are increasing their number of sustainability key performance indicators (KPIs) and aligning some targets and commitments to material sustainability areas. This is helping stakeholders to understand how metrics are linked to sustainability strategy and allows for year-on-year comparisons of progress.

However, many reports are still missing balanced disclosure and explanations of the desired or actual outcomes these metrics are tied to. **Balance** has improved the least over the four years, with an increase of just 10% over this period - the smallest increase across the nine criteria, followed closely by **Impact and outcomes** at 15% over the same period.

This suggests that while companies are deep in the weeds of improving data and grappling with integration, they may not always be demonstrating impact and outcomes in sustainability performance.

Impact and outcomes reporting will take time to mature as organisations and standards look to better measure and communicate outcomes.

Balance in sustainability reporting can be problematic for some organisations where disclosing negative performance or challenging circumstances differs to corporate communications or legal advice. Companies need to recognise that discerning readers, especially investors, find a balanced story of performance that reflects the reality and context of a challenge and the response inherently credible. Whereas these readers are likely to express disbelief or concern if organisations present a universally rosy picture of performance. In its extreme form, a lack of balance can lead to claims of greenwashing – a key Australian Securities and Investments Commission (ASIC) focus area for financial products.

As well as **Impact and outcomes** and **Balance**, our assessment found **Business model/Value chain** was a laggard criteria. In other words, companies are reporting the data but failing to articulate the business context and connection to value – or to tell a balanced story about their sustainability performance.

Companies also score low against the **Supply chain** criteria. This is a more challenging area for reporting particularly where there is a limited causation to the impact areas. However, it is no less and sometimes even more important to be working throughout the supply chain to impact change.

[2] *Is your ESG data unlocking long-term value? | EY Australia*

Spotlight on ASX sectors

The assessment finds the Materials and Consumer Staples sectors as leading in overall maturity, with the Information technology sector scoring the lowest. Detailed scores for each sector are outlined in the Appendix on page 20, and notable sector insights coming out of the assessment are highlighted below.

Materials

This sector has seen a jump in **Governance and management** (up 19%), and **Vision and strategy** (up 11%). It now sits well above the ASX average across the segments. This sector comprises more than 25% of the ASX200, so is a strong driver for overall maturity improvements in the ASX.

Energy

In the Energy sector, **Governance and management** has improved (up 8%), but we have not seen a corresponding increase in **Materiality** or **Vision and strategy**. In addition, notably low scores were observed in **Supply chain** and **Business model/value chain**.

Consumer staples

Maturity has increased across the board for this sector, particularly in **Materiality** (up 28%) and **Supply Chain** (up 25%). Regulatory requirements and consumer pressure in response to modern slavery worker exploitation scandals could be attributed to driving enhanced accountability and disclosure in **Supply Chain**.

Health care

This year's most improved sector driven by a strong connection to social purpose heightened by the pandemic. Having been the least mature ASX sector in 2020, average maturity in **Healthcare** increased by 51%, with big jumps in **Vision and strategy** (up 46%), **Governance and management** (up 55%) and **Impact and outcomes** (up 68%).

Utilities

Average maturity has fallen for this sector (down 12%), partly due to an increase in new ASX entrants. This sector is notably below average on **Business model/value chain** – a concern in an industry fraught with ESG risk and under intense pressure from decarbonisation.

Financials

After moving early to adopt more advanced reporting in the early years of assessment, maturity in this sector has fallen below average. This is due to new entrants and other sectors improving at a faster pace during 2020-2021. We also note poor scores on **Impact and outcomes**.

Communication services

Maturity has increased in the areas of **Materiality**, **Vision and strategy**, and **Governance and management**. This sector includes some leading reports and the increase in maturity is consistent with that of the entire ASX as a whole.

Information technology

While starting from a low base, this sector has significantly improved in **Vision and strategy**, **Governance and management**, and **Metrics and targets**. However, it continues to fall behind the average particularly in the area of **Business model/value chain**.

Average score per sector for ASX200 (2021)

Sector	Total score
Materials	3.3
Consumer staples	3.1
Industrials	3.0
Utilities	2.8
Real estate	2.8
Communication services	2.5
Energy	2.5
Health care	2.5
Financials	2.5
Consumer discretionary	2.2
Information technololgy	2.0

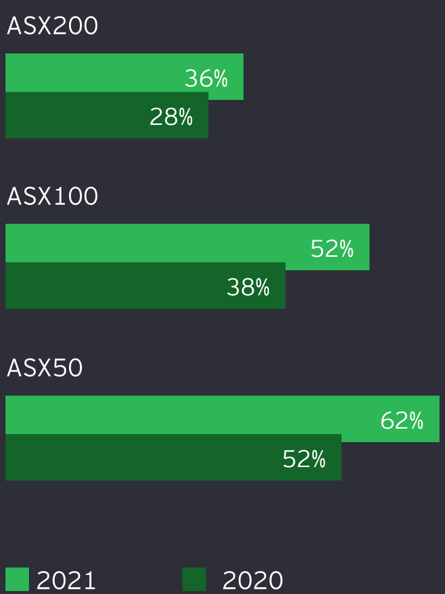
**Refer to Appendix for the sector maturity scores against each criteria.*

Assurance is on the rise

The assessment found a 29% increase in ASX200 companies using assurance to underpin the quality and credibility of their sustainability disclosures – the most significant shift in assurance uptake over the four years of assessment.

Within the ASX200 36% of companies sought assurance. Within the ASX100, the proportion increases to 52%, and in the ASX50 this increases to 62%, demonstrating that assurance is sought most by the largest companies.

Proportion of reporters that sought assurance:



Importantly, data shows that companies obtaining external assurance have a corresponding increase in maturity of reporting. However, it's hard to assess causality. Is this because more mature reporters are likely to obtain assurance? Or could it be that assurance itself drives more transparent and robust reporting, helping companies to move rapidly up the maturity curve?

Maturity scores for companies that attain assurance versus those that don't in 2021:

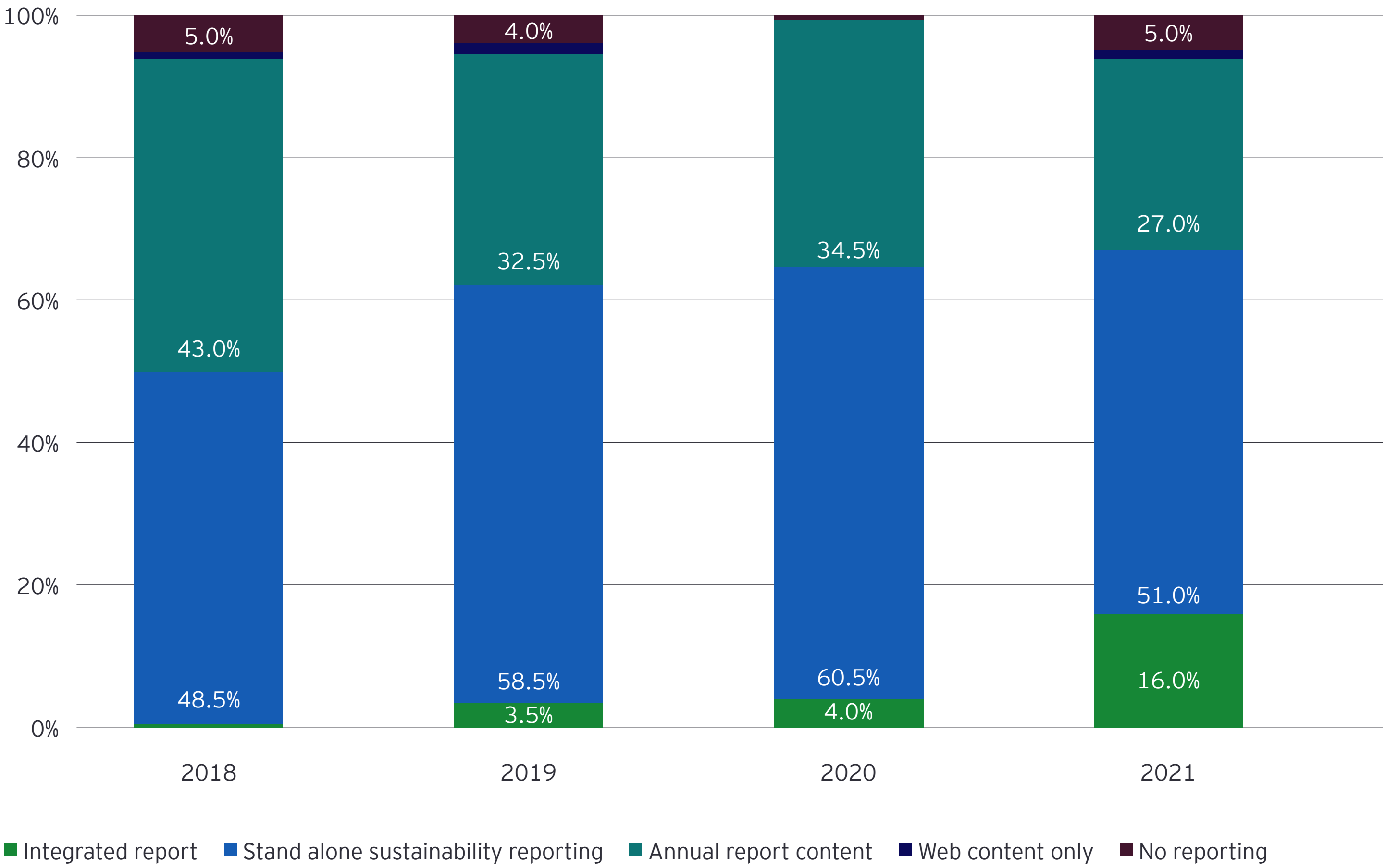
Integrated reporting gains momentum as standards evolve

In 2021, in advance and aligned to the expectations of the ISSB standards, the companies assessed moved towards more integrated reporting. As more businesses considered the non-financial risk implications on enterprise value and future revenue flows, 16% of ASX200 produced an integrated report – up from 4% on the prior year, and a significant jump from four years ago.

16%

produced an integrated report

Form of reporting over four years



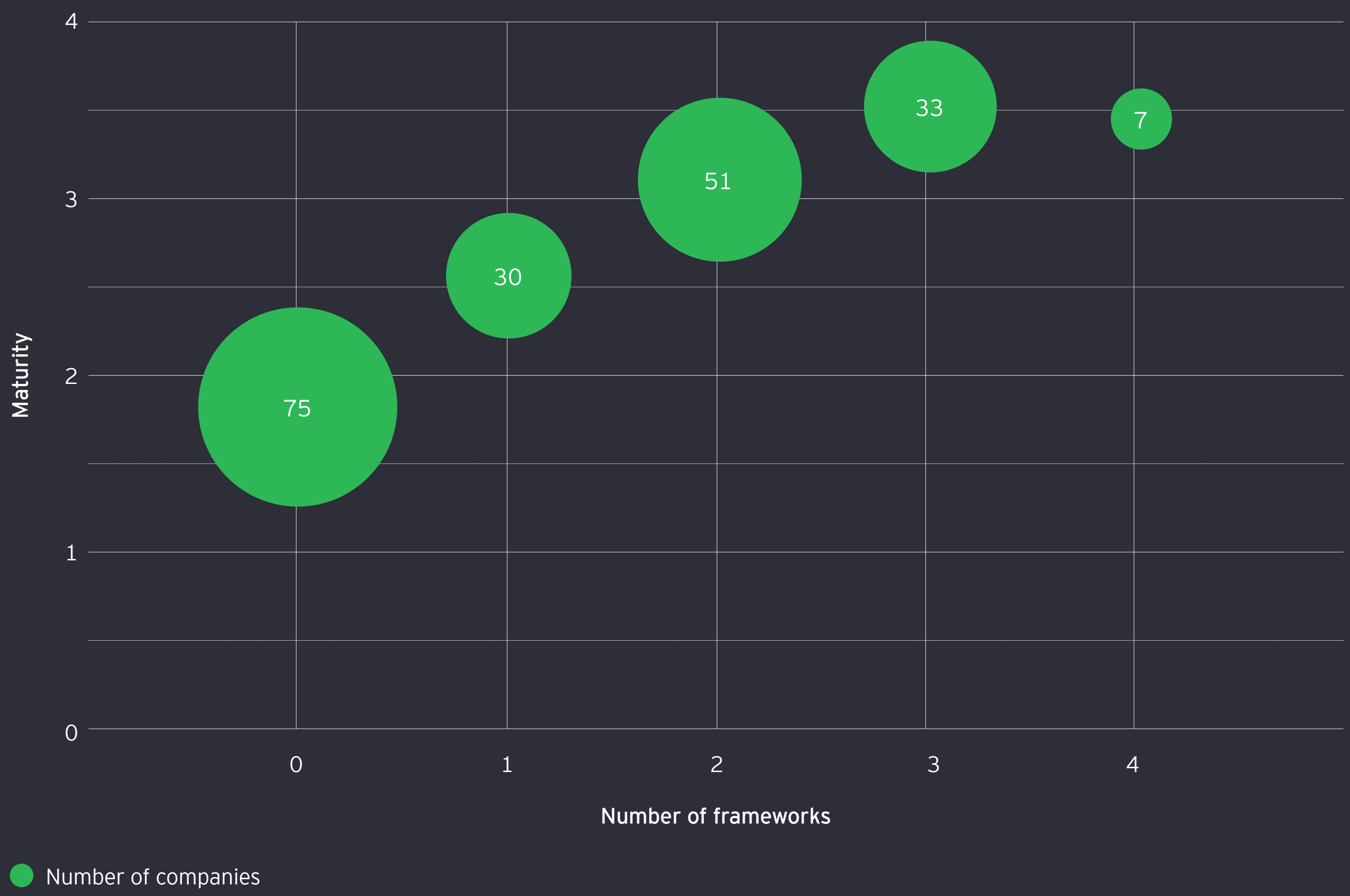
Evolving standards are pushing companies towards connected reporting

Companies are grappling with an ever-expanding set of sustainability reporting frameworks (as outlined in the Appendix on page 22). Promisingly, our assessment found a correlation between the number of frameworks a company reports against and their maturity score, with a 48% average increase in maturity noted for companies that apply at least one of the key frameworks.

It is interesting to note that the highest maturity scores come from companies that apply the Integrated Reporting Framework. This is good news for the ISSB, as the Integrated Reporting Framework, maintained under the auspices of the Value Reporting Foundation is a key driver of the new standards, (as described on page 22).

The higher maturity scores could be a result of the more mature reporters having the systems and processes in place to better track their data and manage their material areas – not necessarily an indication that their reporting is more connected. However, having these systems and processes in place bodes well for the transition towards integrated reporting.

Maturity scores for companies who report against one or more reporting frameworks:



ISSB is likely to connect sustainability reporting to enterprise value and integrate it with financial statements. This will certainly help to overcome investor frustrations around comparing and connecting sustainability metrics and is expected to become mainstream. The writing is on the wall: corporate and financial reporting will be required to consider the non-financial value a company creates for its stakeholders and how it measures that value. In many ways, climate change is leading the way in this regard, but as the most recent EY Global Climate Risk Disclosure Barometer observed (which found that only 15% of companies feature climate change in their financial statements[4]) there is still more work to do.

Companies cannot just report on sustainability through a narrow, investor-only lens. Customers, community groups, regulators, and employees – all critical sustainability audiences – have many questions and concerns beyond the connection of ESG to financial performance. And communicating with these audiences requires storytelling.

As companies try to shape sustainability data and its narrative to meet the needs of multiple audiences, guidance and standards including the Global Reporting Initiative (GRI) standards will be increasingly important. The GRI standards are explicitly designed to help organisations make better decisions that create economic, environmental and social benefits for everyone. Reporting against them helps to surface the real stories that will resonate with non-investor stakeholders.

How does the ISSB impact existing reporting frameworks?

Considerations of non-financial value are now becoming significantly more important. Sustainability reporting standards have converged, culminating in the formation of the International Sustainability Standards Board (ISSB), which sits under the International Financial Reporting Standards Foundation (IFRS).

The ISSB incorporates or considers a number of pre-existing frameworks, including the:

- Task Force on Climate-Related Financial Disclosures (TCFD)
- Climate Disclosure Standards Board (CDSB)
- Value Reporting Foundation, which itself comprises the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB)
- Global Reporting Initiative (GRI)
- World Economic Forum (WEF)

The pace and form of implementing these standards in Australia and New Zealand is still in play, with regulators, and accounting and assurance bodies working together to support the transition.

[3] *2021 EY Global Climate Risk Disclosure Barometer | EY - Global*

Materiality improving in line with evolving materiality concepts

8% increase on prior year

The assessment shows that companies are continuing to grapple with **Materiality**, with scores improving by 8%. This is to be applauded given the current confusion surrounding materiality reporting.

All standards agree that sustainability impacts and reporting should be informed by materiality assessments that consider the relative importance of specific sustainability topics. However, they fail to agree on the best way to apply the materiality principle to prioritise action. Materiality has continued to evolve over the years, with the concepts of double and then more recently dynamic materiality being introduced.

What might not appear financially material today can very quickly become a business-critical issue tomorrow. We've experienced this across the world with COVID-19 and the change in the economic landscape as a result. Overnight, health and hygiene became a central focus for business.

Companies should undertake materiality assessments incorporating scientific limits such as planetary boundaries when identifying and prioritising environmental impacts. This means knowing with great accuracy, the environmental resources an organisation relies upon across its value chain, the planetary limits within which these resources can be drawn down and the operational parameters that need to be maintained to preserve this balance. The same can be said for social impacts.

What is double materiality?

The EU's non-binding guidelines to the Non-Financial Reporting Directive endorse the concept of double materiality. Where traditional materiality has looked at topics that are important to the business versus those that are important to the business' stakeholders, double materiality encompasses:

1. **Financial materiality** resulting from impacts on the company – the sustainability matters that can increase or decrease enterprise value (aligned to the SASB definition of materiality).
2. **Environmental and social materiality** resulting from the impacts of the organisation and its activities on the economy, environment and people (aligned to the GRI definition of materiality).

What is dynamic materiality?

Dynamic materiality is about anticipating how present and future issues may become financially material over time. A company's impacts can become financially material overnight when driven by sufficient stakeholder interest. It is therefore prudent for businesses to take a broader (double materiality) view of what is material for them.

Targets and commitments aligned to material areas

8%

increase on prior year

Another area of gradual improvement has been in **Metrics and targets**, with an increase of 8%. In response to the evolution of reporting frameworks and standards and investor demand for more granular data[4], our assessment finds that companies are increasing their number of sustainability KPIs and aligning some targets and commitments to material sustainability areas.

This progress is helpful, but investors are still frustrated with the inability to easily compare company performance. Even mature metrics like safety reporting are difficult to compare with different boundaries and definitions applied. Industry standards like GRESB, ICMM, SASB are beginning to play an important role in this regard.

But, if we actually want to know whether a company is sustainable in its own right, we also need to link it to the real world. We must start defining how sustainable a company needs to be, and by when, for long-term restoration to occur.

Sustainability governance is increasingly sophisticated and robust

19%

increase on prior year

The standout improvement across our nine criteria was in **Governance**, where scores increased by 19% compared to the prior year. On average, the ASX200 has jumped from 'developing' to 'established' in this criterion, indicating that reports now have detailed discussions of sustainability governance and management. This aligns with what we are seeing in the market, with boards driving a stronger focus on ESG and senior executives further engaging in and maturing their approach to sustainability data and disclosures, including CFO consideration of impacts on financial statements.

It's an encouraging sign because robust governance is a critical enabler of sustainability integration. Governance will be key to meeting changing stakeholder expectations, balancing near and long-term value creation, building risk resilience and seizing the growth opportunities of the sustainability agenda. So it is heartening to see sustainability being integrated in the oversight responsibilities of boards, including with the establishment of Sustainability Committees.

However, leaders cannot rest on their laurels. In many organisations, the main driver of sustainability initiatives appears to be governance – not management. This begs the question: sustainability may be a consideration in capital investment decisions signed off by the board, but is it firmly embedded in every day decision making?

[4] *Is your ESG data unlocking long-term value? | EY Australia*

2 Can assurance help to move the dial?

36%

of ASX200 companies use assurance

2021 also saw a significant jump in companies using sustainability reporting assurance, which increased by 29% on the previous year. While the ASX recommends a listed entity should "disclose its process to verify the integrity of any periodic corporate reporting" in principle 4.3 of its Corporate Governance Principles and Recommendations, and the ISSB ED1 includes the principle of Fair Presentation, there are currently no assurance requirements for sustainability information. We expect this to change in the near future as ESG information increases in scope, scale and importance, investors demand better data, and standards for reporting and assurance evolve. We believe corporates are taking up voluntary assurance both in anticipation of future compliance requirements and also to differentiate their reporting to investors.

The assessment found the scope and scale of non-financial assurance is incredibly variable – not surprising given its voluntary nature. Traditionally, assurance has focused on establishing the integrity and validity of disclosures, including statements and reports, or checking the veracity of numbers against criteria and standards. While we expect the scope and scale of this type of assurance to grow, and are witnessing this occurring in leading organisations, we believe expanding the breadth of assurance to include principles-based assurance is needed to drive confidence in the robustness of sustainability performance information.

Thinking ahead, assurance could also extend to validating the substance of impact. Thanks to the efforts of bodies like the Copper Mark, Responsible Steel and the International Council on Mining and Metals, heavy industries are already being assured for sustainable production practices.

What if we expanded assurance beyond standards compliance to also include assessing:

- Strategy in the context of planetary boundaries?
- Real-world impacts and outcomes by assuring implementation and activity?
- Performance improvement timing in the context of where the world needs to be by 2030?

It's up to all stakeholders – regulators, companies and assurance providers – to come together to drive an impact-focused assurance approach that pushes attention away from reporting and onto action.

3 Future reporting must reflect deeper understanding and clear impact

Companies are doing better at addressing emerging reporting requirements but must not lose sight of impact.

As this assessment shows, companies are improving in the maturity of their reporting, reflecting a top-down approach to sustainability and drive for more and better information from stakeholders.

Within organisations, we observe the elevation of ESG reporting to the C-suite with Chief Financial Officers and Chief Executive Officers, and now the Chief Sustainability Officer, increasingly driving the conversation as part of a wider convergence of non-financial and financial issues.

It is expected that this focus at the C-suite and board level will only increase with the continually evolving reporting landscape (and potential future regulatory changes as a result of the forthcoming ISSB standard).

This further reaffirms that, when it comes to ESG reporting, we have to continue to do better. Doing better includes:

- Using reporting frameworks and applying reporting principles, particularly balance and context
- Investing in better systems and processes
- Obtaining assurance to give confidence on data reported
- Moving towards reporting on impact

The ESG reporting process is a deeply important mechanism that allows companies and boards to understand their current position and chart a path to better ESG performance and drive positive impact.

As ESG continues to elevate throughout an organisation, companies need to acknowledge the investment required to bring the level of reporting up to that of financial reporting.

Consideration for further improvement include:

- Better systems and processes to make reporting more efficient, robust and timely, so resources can be diverted to action
- Reporting that shows a deeper understanding of correlating sustainability factors, such as how biodiversity impacts climate change
- Developing the ability to consider materiality through the double lenses of inbound and outbound impact, and unpacking the concept of dynamic materiality so the company knows how to track issues of unfolding impact and when to include them in materiality assessments
- Better linkage between sustainability metrics and financial information, with reporting data pushed continually into the business, so sustainability risks and impacts are considered in all decisions at all organisational levels
- A reporting move from outputs (risk assessments, goals and initiatives) to outcomes (demonstrated actions or impact addressing the problem)
- Meaningful assurance over sustainability implementation and impact

Appendix

Average score per sector for ASX200

Sector	Vision and strategy	Governance and management	Metrics and targets	Business model / Value chain	Supply chain
Materials	3.7	3.7	3.6	2.6	3.0
Consumer staples	3.3	3.3	3.7	2.1	3.6
Industrials	3.4	3.2	3.2	2.3	2.5
Utilities	3.0	2.7	3.2	2.2	2.8
Real estate	3.3	3.2	3.2	2.0	2.3
Communication services	2.9	2.9	2.4	1.9	2.3
Energy	3.1	3.5	2.8	1.5	1.5
Health care	2.9	2.5	2.4	2.3	2.6
Financials	2.8	2.7	2.8	1.9	2.0
Consumer discretionary	2.4	2.5	2.5	1.7	2.4
Information technology	2.6	2.4	2.2	1.0	2.0

Average score per sector for ASX200

Sector	Materiality	Context	Balance	Impact and outcomes	Total score
Materials	3.7	3.4	2.8	2.9	3.3
Consumer staples	3.6	3.4	2.4	2.6	3.1
Industrials	3.4	3.4	2.3	3.3	3.0
Utilities	3.0	2.7	2.7	3.0	2.8
Real estate	3.5	2.8	2.1	2.6	2.8
Communication services	3.0	2.6	2.1	2.5	2.5
Energy	2.8	2.8	2.4	2.3	2.6
Health care	2.5	2.7	1.8	2.6	2.5
Financials	2.8	2.8	2.0	2.5	2.5
Consumer discretionary	2.3	2.3	1.6	1.9	2.2
Information technology	2.2	2.2	1.6	2.0	2.0

Current sustainability reporting standards and frameworks

Framework	Audience/ focus	Commentary	The How: Reporting approach?	The What: Metrics to report against
ISSB	Investors	Developing a comprehensive global baseline of high-quality sustainability disclosure standards. Value Reporting Foundation, which include SASB and <IR> will be consolidated into the ISSB.	√	√
Value Reporting Foundation				
SASB	Investors	Research-based financially materiality metrics by sector. Specifically requested by BlackRock, State Street and many others in the investment community. (Merging with <IR> to form Value Reporting Foundation)	X	√
Integrated reporting	Investors	Framework for providing a concise and holistic story about how an organisation created value across six 'capitals'. (Merging with SASB to form Value Reporting Foundation).	√	X
GRI	Stakeholders and impact	Most commonly used framework for sustainability reports. Important principles and extensive range of metrics.	√	√
TCFD	Investors	Accepted standard for analysing and reporting financially material climate-related risks and opportunities.	√	X
SDGs	Impact	Sets the global context for companies to better understand their sustainability impact.	X	X
WEF	Investors	Set of metrics and disclosures focused on four themes, People, Planet, Prosperity and Principles of Governance.	X	√
CDSB	Investors	Formed the basis for the TCFD recommendations and sets out an approach for reporting environmental information, including climate change and social information in mainstream reports.	√	X

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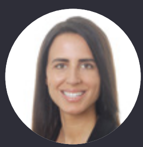

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