New Zealand Insights: How can ESG reporting fuel positive change?

Fourth ESG reporting maturity assessment

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Contents

Foreword

Gerri Ward
Director, EY New Zealand
Climate Change and Sustainability Services

For each of the past four years, EY has assessed the ASX200's and NZX50's sustainability reports to get a snapshot of ESG reporting across Australia and New Zealand.

This year, our assessment found that companies across the region are continuing to improve their reporting maturity in the context of the mass emergence of new sustainability reporting standards and frameworks, and the ever-increasing demand from investors, customers and other stakeholders for transparency and strategic responses.

For the first time this year, we have included the signatories to the Climate Leaders' Coalition pledge, as well as the NZX50 companies, in order to get a gauge on how these leading companies are doing on their sustainability reporting journey.

The steps some companies are taking to improve both their sustainability reporting and the application of their sustainability strategies are commendable. 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 and regulations; investing in critical systems, processes and capabilities. 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.

While we strongly believe what gets reported gets managed, it's vital to remember the point of reporting isn't just for organisations to get better at producing data or telling their story. Sustainability performance data must be used internally and externally to drive good decision-making in order to maximise positive – and to minimise negative – social and environmental impacts.

This report explores both the positive progress made by the companies analysed, and the areas of sustainability reporting that now need urgent focus in order to drive real change. It also explores how companies can harness sustainability reporting and assurance to push their organisations beyond compliance – and lays down a bold challenge for organisations to embrace wholesale change to really 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 leading practice reporting and leverage our experience of guiding, writing and reviewing sustainability reporting.

The nine criteria are:

Content

- Vision and strategy, governance and management, metrics and targets, business model / value chain, supply chain

Quality

- Materiality, context, balance, impact and outcomes

In addition, the level of assurance and the inclusion of modern slavery reporting, TCFD disclosures and SDG targets was noted.

Each reporting category was ranked between 1 and 5 according to the drivers above.

This report is a companion publication of our snapshot of ESG reporting in Australia, where we have assessed the ASX200's sustainability reports: See our fourth ESG reporting maturity assessment.

1 Key findings

Sustainability reporting maturity continues to improve steadily.

The number of total companies assessed in 2021-2022 was 135, compared with 102 in 2020-2021, as this year we chose to also include those signatories to the Climate Leaders' Coalition pledge.

Key insight 1: A gradual increase in maturity continues

In New Zealand, our assessment found that sustainability reporting maturity has increased across all of the above-mentioned categories across the board. The average score has gone from 1.52 (out of 5) in 2020-2021, to 2.59 in 2021-2022: a 70% increase. This is significantly above the improvement noted in Australia this year of only 6%, which may reflect improvements in reporting with the anticipation of mandatory climate risk reporting from 2023. This may also reflect of the inclusion of CLC signatories the first time which may have skewed the average higher, as these organisations have commitments to non-financial reporting. However, New Zealand continues to lack Australia in terms of overall performance, with the average Australian score for 2021 of 2.7.

The quality of New Zealand's reports was strongest for vision and strategy, with an average score of 3.24. It was also noted that some New Zealand reports scored highly across all criteria (three companies scoring averaged above 4 in all categories) and internationally would be recognized as leaders.

Key insight 2: Vision is out of step with governance

In Australia, we saw companies who set a clear vision and strategy also displaying strong results in governance and management, which allows these organisations to track progress towards that vision. In New Zealand, however, our research showed that governance and management lagged vision and strategy. The risk here is that setting goals and targets are not backed by the critical support of the Executive and Board or well-established management processes.

Likely in response to investor demand for more metrics and better progress measurement,[2] our assessment found 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. This suggests that while companies are deep in the weeds of improving data and grappling with integration, they may not always be demonstrating how this relates towards progress to their sustainability vision.

Key insight 3: Good reporting equals good results

Of the companies assessed, the highest-ranked was NZ Post, which scored 4.8 across the board, and whose excellence in sustainability reporting has long been recognised as an exemplar. NZ Post can rightly be proud of its track record in sustainability strategy, reporting, governance, and in delivering against key metrics and targets. In Australia, the highest-scoring company was Telstra (4.9 overall).

> “We were the first business in NZ to adopt the International Integrated Reporting Framework, which isn’t just about reporting, it’s about shaping how we think, plan and make decisions as a business.
>
> NZ Post Annual Report 2021

Key insight 4: GRI is still the most preferred framework

The Global Reporting Initiative ('GRI') framework is still New Zealand companies' favoured reporting method, with 19 companies reporting against the GRI last year. (17 used the Taskforce for Climate-Related Financial Disclosures ('TCFD') framework, 13 used the Integrated Reporting (<IR>) Framework, and eight companies use all three). We are seeing encouraging convergence of the abundance of international reporting standards. In March, the International Financial Reporting Standards (IFRS) Foundation and GRI announced a collaboration agreement under which their respective standard-setting boards, the International Sustainability Standards Board (ISSB) and the Global Sustainability Standards Board (GSSB), will seek to coordinate their work programmes and standard-setting activities. At COP26, the IFRS Foundation announced that it would establish the ISSB to develop a comprehensive global baseline of investor-focused sustainability disclosures for the capital markets. ISSB and GRI, the leading global standard-setter for multi-stakeholder focused sustainability reporting, further announced that they will join each other's consultative bodies related to sustainability reporting activities.

The New Zealand Super Fund 's award-winning annual report reports against both the GRI and <IR> Frameworks, and is an excellent case study of the way clear, honest and transparent reporting can demonstrate how active investment decisions have added value over the year.

> "
> We aim to meet global best practice reporting standards as a marker of our commitment to world class governance and transparency, and as a means of walking the talk with our investee companies, with whom we encourage disclosure on ESG and performance.
>
> NZ Super Fund CEO Matt Whineray,
> The Guardians of New Zealand
> Superannuation Annual Report

Key insight 5: Sustainability reporting is a journey

Of the companies assessed this year, eight[1] of them chose to report their non-financial performance against the GRI, <IR> *and* TCFD frameworks. Meridian Energy's reporting, for instance, demonstrates very clearly their commitment to sustainability, how sustainability is actively embedded into their business, as well as the many commitments they have made against international and domestic commitments, such as the SDGs, the UN Global Compact, and the Climate Leaders' Coalition. Meridian's reporting is another example of genuine integration of the reporting of social and environmental performance alongside financial and economic performance. As with Z Energy, Contact, BNZ, and some of the other leaders in sustainability reporting in New Zealand, Meridian's non-financial reporting has evolved over the years to incorporate the ever-expanding scope of international reporting frameworks, while still telling a clear and meaningful story.

We expect to see greater incorporation of the many various reporting frameworks in the coming year, as the TCFD mandatory reporting period kicks in in New Zealand in FY23, and the ISSB delivers a global baseline of sustainability disclosures to meet capital market needs.

[1] Z Energy, Spark, Sanford, Meridian, Fujitsu, Downer, Contact Energy, and BNZ.

How does the ISSB impact existing reporting framework?

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

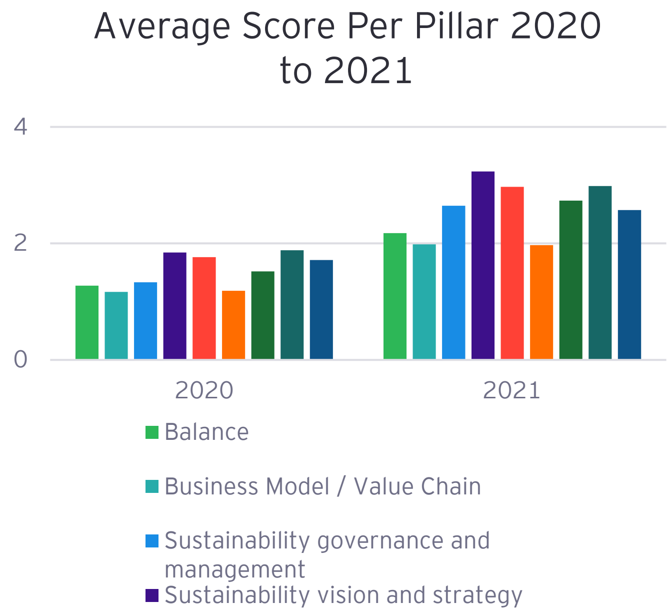
The ISSB incorporates or considers a number of pre-existing frameworks, including the:

- Task Force in 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 to support the transition.

Key insight 6: Government and agriculture sectors scored highest

Our assessment showed that the highest-performing sectors this year were the government (3.11) and agriculture (3.2) sectors. Sanford (which scored 4.6) continues to lead the way in sustainability reporting, having been recognised for several years for the quality of its integrated reports. Our insights show that those that score highest in vision and strategy are – perhaps expectedly – those that might come under the most public scrutiny, and are therefore the most conscious of the need to validate their sustainability progress. The financial sector, for instance, tends to do best in vision and strategy pillar.



Key insight 7: Materiality is progressing in line with evolving standards

Our assessment shows that companies are continuing to grapple with *materiality*, with scores improving by 80.5% in this category. This is notable due to the current complexity surrounding materiality reporting.

Materiality has continued to evolve over the years, with the concepts of double, and then more recently, dynamic materiality being introduced.

All standards are in agreement that sustainability impacts and reporting should be informed by materiality assessments[2] 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.

Issues that 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's stakeholders, double materiality encompasses:

1. Financial materiality resulting from impacts on the company – the sustainability matters that can increase or decrease enterprise value.
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.

[2] https://www.ey.com/en_nz/assurance/how-materiality-can-help-reporting-meet-the-demands-of-investors

Key insight 8: Assurance declines slightly, NZ lags behind Australia.

Of the reports assessed this year, 26 companies (19%: a 9% decrease) sought third-party assurance to underpin the quality and credibility of their sustainability disclosures. As could be expected, those organisations that sought assurance had greater reporting maturity than those that didn't. By comparison, we saw the most significant jump in Australian companies using sustainability reporting assurance in the past four years, with a 29% increase on the previous year. We expect this to change in the near future as sustainability 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.

Key insight 9: Regulation is the strongest lever

When compared with our Australian counterparts, New Zealand reporting companies scored lowest in the categories of Balance (2.05) and *Supply chain* (1.98).

Balance in sustainability reporting can be problematic for some organisations where disclosing negative performance or challenging circumstances may contradict their 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. In its extreme form, a lack of balance can lead to claims of greenwashing – a key Commerce Commission focus area in terms of the Fair Trading Act.

The other lagging criteria, *Supply chain* is a challenging area for reporting, particularly where there is a limited directly attributable causation to the impact areas. However, it is no less – and sometimes even more – important to be working throughout the supply chain to create change.

It is our view that two key pieces of legislation will address these lagging areas in New Zealand. The Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021 will require around 200 large New Zealand financial institutions to start making climate-related disclosures from financial years commencing in 2023, subject to the publication of climate standards from the External Reporting Board (XRB). This legislation will require New Zealand's largest companies to report the effects of climate change throughout their supply chain.

Further down the track, the Ministry for Business, Innovation and Employment is currently considering submissions on proposed Modern Slavery legislation that aims to achieve freedom, fairness and dignity in the operations and supply chains of entities and to address modern slavery and worker exploitation, both in New Zealand and internationally.

In summary

Our key insight from this year's reporting maturity assessment is that quality reporting equals quality performance. Increasingly, Boards and investors are demanding – and getting – better, more transparent, and more integrated information from their organisations. This aligns with what we are seeing in the market, with high-performing Boards driving a stronger focus on sustainability and senior executives further engaging in and maturing their approach to sustainability data and disclosures, including CFO consideration of impacts on financial statements.

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. It is encouraging to see sustainability being recognised as a key value driver, rather than a story to be told when times are good.

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? As our recent piece "Enough" asserts: the time for incrementalism has passed, and the time for meaningful action is upon us. It is up to leading organisations to act – and quickly – on their publicly-stated sustainability commitments. They must build on their impact and clear decision-making frameworks so that their investors and stakeholders can see that their reporting is driving outcomes – and is not just an output – of their organisation's future sustainability.

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 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

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