The current state of ESG reporting in the engineering and construction industry

Building a better working world

Iconic images from the 1930s of construction workers eating lunch on a girder atop 30 Rockefeller Plaza in New York may have been more publicity than normal practice, but health and safety in the construction industry have nonetheless come a long way in the last 100 years. Today, incidence rates of nonfatal injuries and illnesses are down significantly from just 20 years ago (1.7% in 2019 vs. 4.1% in 2000[1]). The fatal injury rate, however, is 9.7[2] per 100,000 workers, so it's no surprise that improving health and safety on the construction site remains a top focus for the industry.[3]

Health and safety and the high reliance on labor mean social aspects of the environmental, social and governance (ESG) agenda have been and will remain a high priority for the engineering and construction (E&C) industry. Similarly, governance has long been a hot topic in the sector given the size and complexity of contracts, competitive bidding processes, and the need to engage with both public and private stakeholders and to prevent bribery, corruption and anticompetitive behaviors. The environmental agenda is in focus across all industries, but buildings and construction are responsible for 39% of carbon emissions globally.[4] Carbon reduction and environmental initiatives are therefore a business imperative for contractors.

Today, these areas form the core pillars of ESG agendas at E&C firms, which, like many industries, are continuing to enhance their focus on ESG and communicate the impacts to stakeholders. The focus has evolved from traditional philanthropy and employee volunteer work to more holistic integration of these topics in business strategy as recognition of their importance in growth and risk management has grown. Effective ESG programs now underlie corporate risk management and strategic business imperatives.

[1] U.S. Bureau of Labor Statistics industry injury and illness data

[2] Ibid., National Census of Fatal Occupational Injuries in 2019

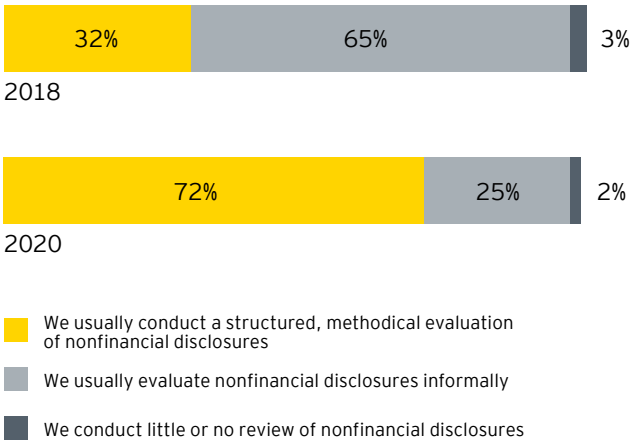
[3] *Understanding perceptions and opinions on ESG in construction,* GlobalData

[4] World Green Building Council

Increasing stakeholder expectations and growing regulatory requirements

Stakeholders' expectations are also driving companies to develop and promote their ESG agendas. A recent EY survey showed 98% of investors indicate they evaluate ESG performance based on corporate disclosures. And as Figure 1 highlights, most indicate they now conduct a structured and formal review of ESG disclosures.

Figure 1: Percentage of investors that conduct a structured and formal review of ESG disclosures



Source: 2020 EY Climate Change and Sustainability Services Institutional Investor survey

This focus is pushing boards and management teams to both do more and report more. There is a prevailing consensus that private enterprise needs to be a force for change to address the major challenges facing our planet and society.

Millennials are **three times more likely** to seek employment with a company because of its stance on social and/or environmental issues.[5]

President Biden's recent bipartisan agreement on the Infrastructure Investment and Jobs Act (IIJA) will provide the opportunity for the construction industry to meet these expectations and will put unprecedented focus on reducing carbon emissions and create additional imperatives for owners and contractors to deliver projects in an ever more environmentally sensitive way. Construction companies have already made impressive progress and continue to develop new ways of working that further reduce the environmental impact of their projects. The latest developments include porous concrete, permeable asphalt parking and aerobic granular sludge systems that increase wastewater throughput with 50% lower energy requirements. The industry has also now completed a LEED Platinum-certified commercial office tower, hospital and professional sports stadium. Indeed, the engineers will push these technological advancements into design, and contractors will create this sustainable infrastructure that benefits all.

The IIJA will drive significant investment in not just infrastructure, but *sustainable* infrastructure. We have already begun to see requests for quotes include stipulations for contractors to supply information regarding their own carbon footprint, but also to implement "a plan of continuous improvement … to develop and set a science-based target that is aligned with reduction pathways to limit global warming to 1.5 degrees C or less." This turns a movement for change into a business imperative for contractors who will have to compete for projects and win based on their sensitivity and commitment to ambitious ESG goals.

Not surprisingly, the current regulatory environment has continued to emphasize the ESG agenda, with the SEC, for example, announcing in February 2021 that it will review companies' climate change disclosures. In early March, the SEC announced its plans to establish a task force to develop initiatives to proactively identify ESG-related misconduct. The initial focus will be to identify any material gaps or misstatements in issuers' disclosure of climate risks. Recent comment letters are asking companies to address why their annual reports do not include the same detail as their sustainability reports. In July, Chairman Gensler remarked that he had asked SEC staff to develop a mandatory climate risk disclosure rule proposal for the commission's consideration by the end 2021.

[5] *Millennials Really Do Want To Work for Environmentally-Sustainable Companies, According to a New Survey of Large Company Employees,* Governance & Accountability Institute, Inc.

Benchmarking the US engineering and construction industry on ESG

Providing investors, regulators and stakeholders with the level of detail they require around ESG has become a significant but important undertaking for all companies, and increasingly a part of the CFO agenda. The EY 2020 *DNA of the CFO* survey showed 70% of CFOs said the growing focus on ESG concerns have a major impact on the CFO role. As they say, "what gets measured, gets managed," and effective reporting communicates progress against ESG goals by producing and disclosing credible data to drive business value. The data collected can also provide insights to process improvements, including potential efficiencies or cost savings.

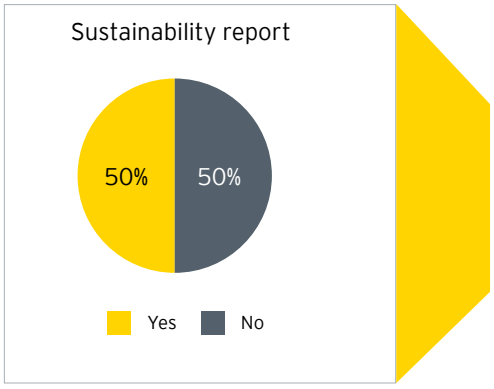
Reporting to stakeholders on ESG issues is a challenging undertaking. Identifying which standards to follow, what to measure and which metrics to compile is difficult, not least because there are myriad different entities across the ESG space providing everything from standards, goals and guidance to company-level assessments. The principle areas include:

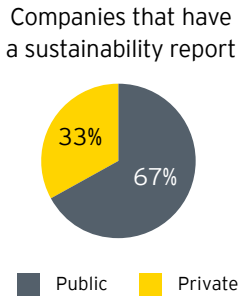
- Standards setters such as Global Reporting Initiative (GRI) and Sustainability Accounting Standards Board (SASB) that publish guidance for voluntary disclosure
- International goals and guidance, including Sustainable Development Goals (SDGs) and the Task Force on Climate-related Financial Disclosures (TCFD)
- Disclosure-based sustainability scores, including the Dow Jones Sustainability Index (DJSI) and Carbon Disclosure Project (CDP) that request data from companies via questionnaires
- Ratings agencies such as S&P, MSCI and Sustainalytics that create assessments of companies based on public and/or private information

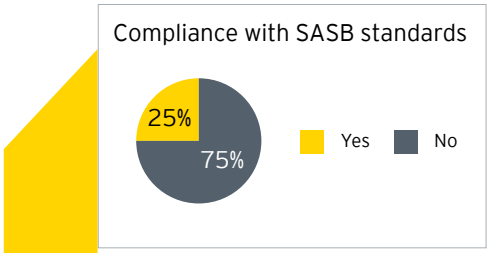
Environmental, social and governance reporting by engineering and construction companies

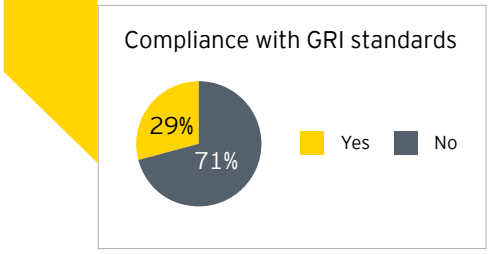
An EY Engineering & Construction Sector study

Fifty percent of the top* 24 E&C firms in the US publish a separate sustainability report, in addition to their annual reports.









* The largest 24 engineering and construction companies in the United States, as determined by a combination of ENR's Top Design Firms, Top Contractors and Top Specialty Contractors listings.

The lack of clarity around what and how to measure, combined with a lack of consistency both between companies and around specific disclosures, are all barriers to overcome.

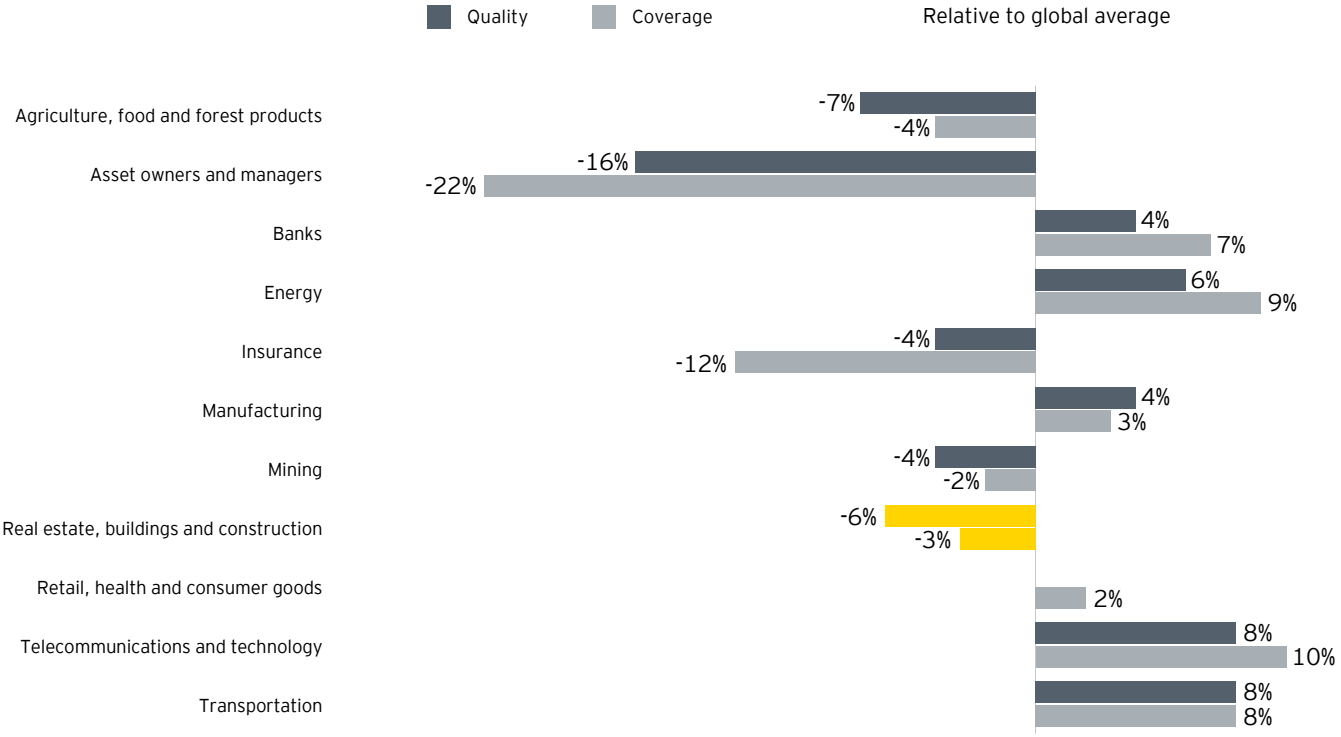
Our EY US Engineering & Construction Industry team performed a review of ESG-related disclosures of the top 24 E&C companies in the US (9 public and 15 private) and evaluated them against 24 metrics covering ESG issues. Our study shows that even within the top 24 US contractors, disclosures to date are very mixed:

- Leaders are making disclosures against at least 20 of the 24 metrics (80%-plus), while the bottom tier are covering only around one-third.
- Half of the companies reviewed produce a stand-alone sustainability report, in addition to their annual reports; of those that produce one, 67% are public companies and 33% are private. Furthermore, among those stand-alone reports, 25% were in compliance with SASB standards, while 29% were in compliance with GRI standards.

This variability in disclosure among companies in the E&C sector makes comparability difficult. That said, the wider EY 2021 *Global Climate Risk Disclosure Barometer* placed real estate, buildings and construction marginally below average with coverage of 67% of the Task Force on Climate-related Financial Disclosure (TCFD) recommendations and quality of disclosure at 36% of the maximum possible score.

Developing an effective ESG program is more important than simply ticking boxes by achieving a breadth of (potentially boilerplate) disclosure. Furthermore, an important component of any ESG strategy is to define what is material to determine appropriate metrics and goals. Materiality should drive the quality and extent of disclosure, including management approach, metrics and context. E&C companies have identified areas such as decarbonization, LEED certification, diversity and inclusion, community development, and employee safety and well-being as the most material issues.

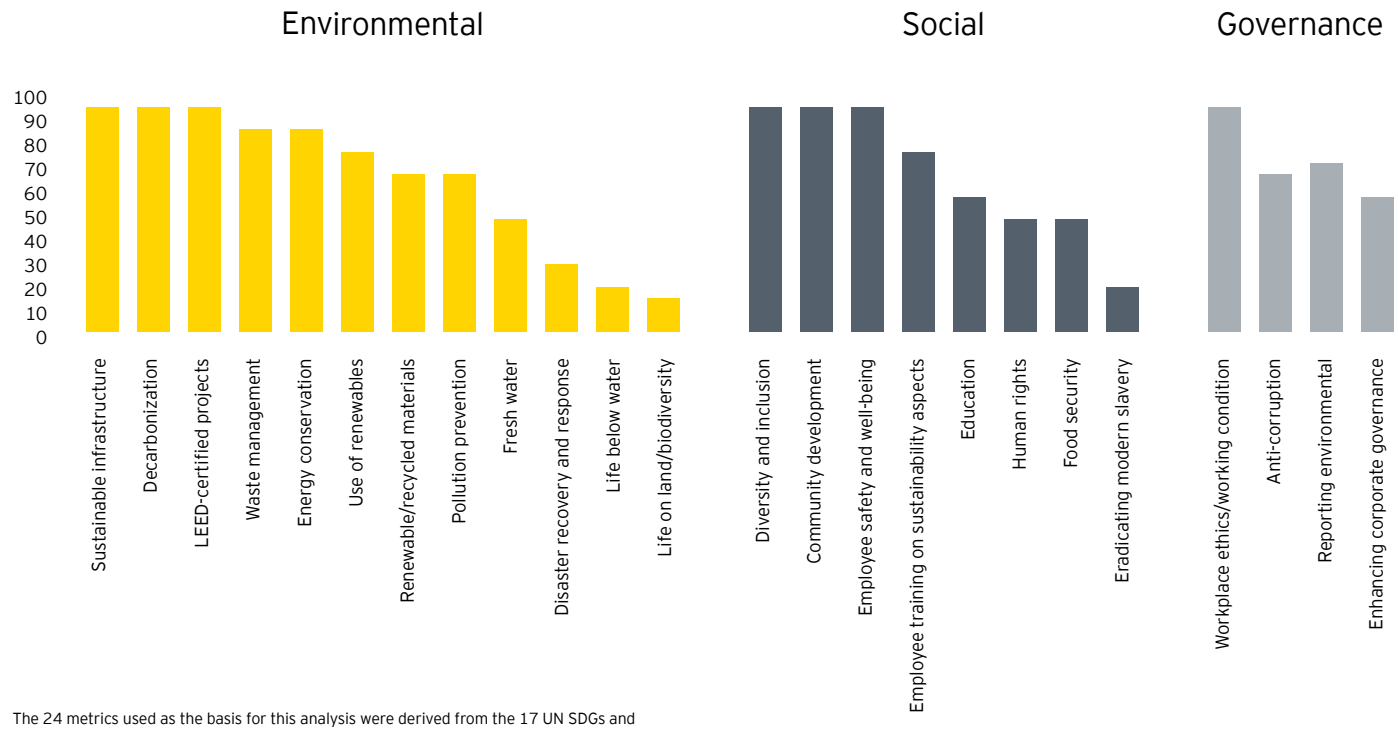
Figure 2: Reporting on TCFD quality and coverage



Source: 2021 EY *Global Climate Risk Disclosure Barometer*

Most leading US contractors are also reporting against goals in areas such as sustainable infrastructure, waste management, energy conservation, use of renewables, pollution prevention, renewable/recycled materials, employee training on sustainability and workplace ethics/working conditions. Examples of progress in these areas are plentiful, with impressive gains being made in areas such as waste management, where millions of tons of construction waste have been diverted from landfills, or employee safety where internet of things (IoT) sensors have been installed to allow for real-time monitoring of jobsite conditions. One other particularly noteworthy area is education, where certain E&C companies have long-standing programs and associations aimed at minority- and women-owned businesses, subcontractors, construction managers as well as smaller contractors and entrepreneurs.

Figure 3: Percentage of top 20 US E&C firms' reporting by ESG metric[6]



[6] The 24 metrics used as the basis for this analysis were derived from the 17 UN SDGs and Moody's ESG risk parameters.

The path to credible reporting

Setting goals, establishing what to measure, identifying which metrics to compile and ensuring that everything is done in a way that complies with standards is a challenging process. A complex ESG landscape means, at present, that there is no right answer, but the reporting programs of leading organizations have four essential components. These hallmarks ultimately help deliver companies that are better run, more responsible and that make decisions to deliver the necessary product, service and business model innovations that contribute to a flourishing society. Steps to consider:

1. Obtain CEO endorsement of initiatives.

The CEO's signing onto and involvement in ESG-related activities at a global or sectoral level is important to align corporate purpose with stakeholder needs.

Leading CEOs from across all industries are taking pivotal roles in helping develop standards, goals and guidance. In the E&C sector, CEOs have joined initiatives such as CEO Action, the largest CEO-driven coalition that pledges to advance diversity and inclusion within the workplace.

2. Set ambitious ESG goals, measure and report progress.

Create time-bound, quantitative, context-based goals that align to strategic topics to the organization.

Climate related pledges and goals are becoming increasingly common with ambitious but achievable targets being established, including those arising out of COP26, the 26th iteration of the Conference of the Parties to the UN Framework Convention on Climate Change (UNFCCC), which brought together the 197 members of the convention to take concerted action on climate change. Several E&C companies have identified 2030 as an appropriate year by which to achieve environmental targets. Examples of environmental goals set for 2030 include reducing on-site greenhouse gas and water consumption by 50%, achieving Science-based net zero emissions, and delivering a 50% reduction in scope 1 and 2 emissions and waste generation. Companies are also considering their wider supply chain with select annual sustainability reports now highlighting reductions in scope 1, 2 and supply chain emissions. Alongside climate targets, leading companies are setting goals across material topics such as:

- Improving the mental health and well-being of a million people by 2025 (One Million Lives)
- 100% of the company's solutions will contribute to progress against the UN SDGs by 2025
- Engage the workforce in 50,000 hours of global science, technology, engineering, arts and mathematics (STEAM) volunteering that enhances diversity and inspires the next generation by 2025

Research shows that assurance is becoming an important part of reporting on nonfinancial information. The World Business Council for Sustainable Development reported in 2020 that of its 158 member companies, 94% of reports reviewed have some form of assurance on their sustainability disclosures through external assurance or internal audit assurance (vs: 81% in 2014[7]). The topics most commonly being assured are greenhouse gas emissions and water and waste. Assurance around diversity and inclusion is becoming more common, especially since human capital is now required in the 10-K and to be responsive to large investor demands. Human rights and supply chain metrics are also beginning to be included in scope.

3. Participate in industry-leading initiatives.

Taking a leading position on industry-level activities and initiatives that transform value chains.

Acting on climate change is a high-profile area to consider, but industry-leading actions should span ESG. Recent noteworthy examples from E&C companies include establishing gender targets across senior leadership roles and the wider workforce, amending credit facilities to include borrowing costs linked to sustainability and diversity goals and embedding net zero, resilience and social value targets into client account management programs and the work the company bids for.

4. Be vocal on climate.

Support various policy mechanisms that seek to combat climate change.

E&C companies should not merely outsource emissions to a subcontractor or third parties, but focus on ensuring that the overall carbon footprint of each project is reduced. This means integrating low-carbon technologies and processes into engineering, procurement, construction and installation. This encompasses both sustainable engineering for customers' operations and fully reducing the footprint of their own fabrication, marine and construction activities.

Embedding ESG across the organization, including purpose, culture, goals, value chain considerations, incentives and disclosures, shows that companies are genuinely embracing multi-stakeholder capitalism.

[7] McKinsey Sustainability Reporting Survey

ESG materiality and integrating ESG into business strategy

Understanding where your company is on the ESG maturity curve is a helpful and important step to further develop an ESG agenda. An essential component on this journey is the shift from ad hoc reporting on single sustainability initiatives to a much more integrated approach where ESG is a central tenet of business management and planning. Figure 4 highlights the different traits of basic, established, advanced and leading companies in relation to ESG.

Effective sustainability and ESG programs help bridge the gap between companies and their stakeholders as sustainability-led actions help improve business performance. Firms with good performance on material sustainability issues significantly outperform firms with poor performance on these issues, suggesting that investments in sustainability issues enhance shareholder value.[8]

Figure 4: The ESG maturity curve, where are you headed?

Basic

- There is no defined leader or accountable party for sustainability
- Governance structure and accountability are not defined
- No board reporting
- Informal or no strategy in place
- Sustainability is not aligned to business strategy
- Internal and external communications are limited
- No compensation based on sustainability

Established

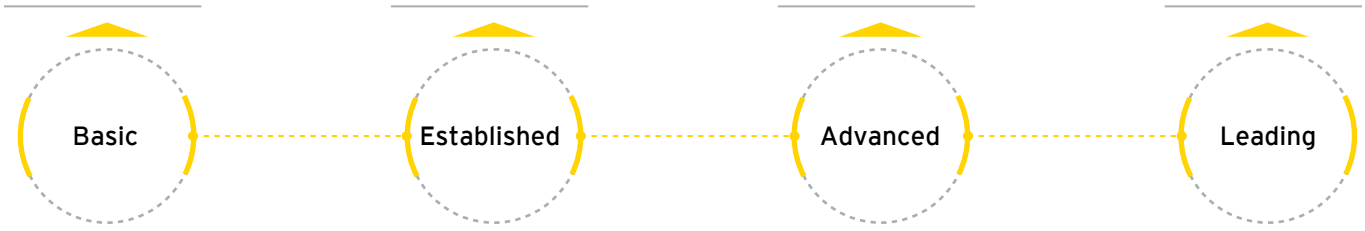
- Leadership is a middle manager
- Ad hoc reporting on single sustainability initiatives to board
- Formal but basic strategy is in place and principles are defined within BUs
- No central planning or coordination at corporate level
- An informal group provides input to decision-making on an ad hoc basis
- Internal and external communications are limited
- Informal, BU-specific or personnel-specific incentives and compensation on an ad hoc basis

Advanced

- Senior executive leads sustainability but only as an additional responsibility
- Senior executive has stipulated that this is a priority with governance structure and accountability
- Infrequent board reporting
- Business strategy and objectives in relation to sustainability are well defined
- Individual training plans relevant to sustainability-specific roles; performance linked to performance management and compensation
- Executive-level cross-functional steering committee

Leading

- Governance structure and accountabilities are defined at the board level
- Reporting on sustainability performance is integrated into regular board reporting
- Senior executive leading sustainability
- Sustainability is integrated into business management and planning
- Clearly articulated and holistic strategy with targets, timelines, accountability and budget
- Sustainability performance linked to performance management and compensation based on specific KPIs
- Cross-functional steering committees present at both an executive level and an operational level



Source: EY analysis

[8] *Active Viewpoint: Environmental, Social and Governance,* Martin Currie, citing "Corporate Sustainability: 'First Evidence on Materiality,'" *The Accounting Review*

10 reasons to care about ESG, Bank of America Merrill Lynch

While many sustainability and ESG programs will directly contribute to financial performance by enhancing revenue, reducing cost and improving margin, it is also important not to overlook more intangible benefits that improve brand value. The earlier examples of construction companies reducing incidences of nonfatal injuries and illness or of millennials being three times more likely to seek employment with a company because of its stance on social and/or environmental issues are cases in point. Sustainability-led actions that help improve business performance include:

- Integrating sustainability and business strategy and aligning to purpose
- Engaging with stakeholders to prioritize issues and create value
- Linking sustainability goals with relevant stakeholder and world challenges
- Establishing cross-functional teams and accountabilities to drive performance
- Innovating to create sustainability sustainable assets to capture larger market share and address unmet customer needs

Figure 5: Integrating sustainability and ESG with company and stakeholder engagement

Source: EY analysis

ESG reporting and the pillars of a strong ESG program

High-quality ESG reporting is unlikely to be achieved in isolation or through an ad hoc approach. While there are leading practices specific to reporting ESG information, a strong ESG program has six pillars that will drive long-term value. Disclosure comprises the fifth pillar, and its effectiveness will be a function of success in other areas, namely good governance, an effective assessment of materiality, appropriate metrics and goals and standardization of data collection.

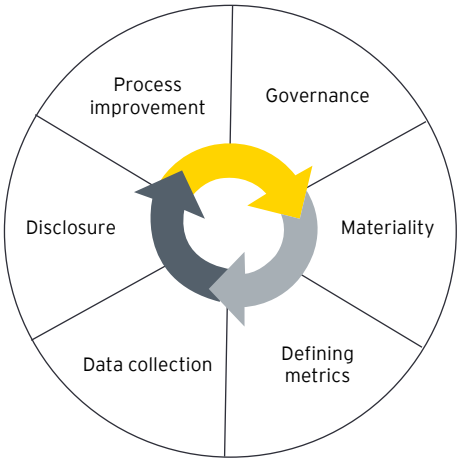
For E&C firms to thrive in this new era of accelerating transformation and stakeholder capitalism, they will need to embrace ESG as a strategic business imperative. This means addressing heightened expectations by understanding how your company is viewed by all stakeholders. Delivering improved business performance from your ESG strategy will come from the development of aggressive goals, and measuring and reporting progress against those goals in order to drive stakeholder engagement and value as well as integrating ESG into broader strategy relating to capital allocation, supply chain management, marketing, partner choices and investments.

Figure 6: Considerations for an ESG program that drives long-term value

Disclosure
- Report in line with relevant frameworks, standards and guidance
- Consider audience(s)
- Focus on material topics and align to goals
- Maintain quality

Standardize data collection
- Formalize processes and controls
- Involve internal audit

Determine appropriate metrics and goals
- Define suitable criteria considering objectivity, reliability and consistency
- Leverage reporting frameworks



Establish strong governance
- Involve the board, including evaluation of the appropriate board oversight structure on ESG issues
- Align performance-based incentives

Define what is material
- Engage with stakeholders
- Evaluate and embed ESG into strategic (e.g., scenario planning) and operational considerations
- Consider business strategy, risks and opportunities

Source: EY analysis

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