01 | 2020

CORPORATE SUSTAINABILITY REPORTING

ASSET MANAGER PERSPECTIVE

Companies' activities have an impact on the world around them in ways that may not be priced into their market value. Their operations may in turn be affected by changes in their surroundings, either physical or social. How companies manage their use of natural and social resources can have a bearing on their ability to create value. As a long-term, global investor, we benefit from information on companies' exposure to sustainability risks, how these are managed, and relevant performance metrics.

Corporate sustainability reporting is growing, but needs further standardisation to ensure relevance and comparability. A good next step would be reporting requirements based on a core set of globally accepted, financially material and standardised sustainability metrics. Over time, a coherent standard responding to the needs of both investors and other stakeholders is needed.

Sustainability disclosures should be subjected to similar internal governance procedures as financial disclosures, with a final sign-off from the board. As a starting point, companies can look to the industry-specific standards developed by SASB, and base broader social and environmental disclosures on the GRI Standards. Our public expectations of companies on selected sustainability topics provide further guidance.

Date 03/03/2020

The Asset Manager Perspective series articulates Norges Bank Investment Management's views and reflections on issues topical for the financial industry. They are not meant to be definitive; rather they are intended as timely contributions for the benefit of all market participants. The series is written by employees and is informed by our investment research and our experience as a large, long-term asset manager.

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ISSN2387-6255

Investors increasingly see environmental and social performance as relevant when evaluating a company's business and prospects. Requests from investors, alongside growing calls for corporate accountability from other stakeholders, have led companies to increase disclosure of their environmental and social impacts, the opportunities and risks these entail, and how they are managing them. Such disclosures, often referred to as sustainability reporting, are to a large extent not standardised.

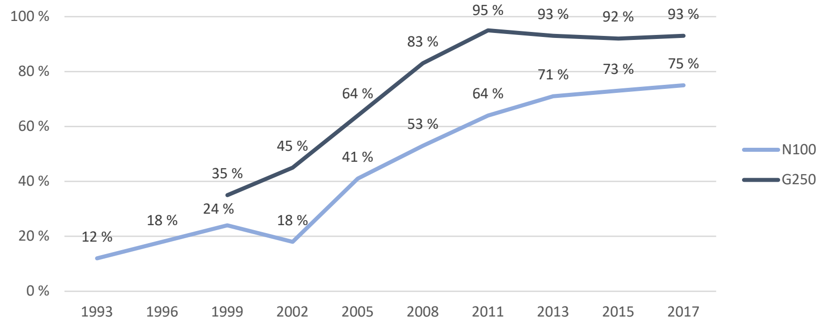
The lack of standardised and financially relevant sustainability reporting can hinder the ability of investors to systematically consider companies' environmental and social performance in their decision making. Conversely, good sustainability reporting contributes to well-functioning financial markets and may help overcome principal-agent problems between shareholders and company management.

In this paper we look at the growth of corporate sustainability reporting and the main standards that are used. We then provide an asset-manager's perspective on the key elements of meaningful reporting. We describe the starting point in financial materiality, what types of information are useful for investors and how sustainability disclosures could be integrated into financial reports. We conclude by discussing the need for further standardisation of reporting.

The growth of sustainability reporting

The measurement and reporting of corporate sustainability performance have increased over the last 25 years. Whereas fewer than 20 companies reported their environmental, social and governance (ESG) data in the early 1990s, this number stood at nearly 9,000 by 2016.[1] According to a comprehensive global study of sustainability reporting, 93 percent of the 250 largest global companies report on corporate responsibility. This reporting covers topics such as the quantification of climate-related financial risks, carbon reduction targets and companies' responsibility to respect human rights.[2]

Figure 1: Share of companies with corporate responsibility reporting
Adapted from: KPMG (2017)[2]



Note: N100: 100 largest companies by revenue in each of 49 countries; G250: The world's 250 largest companies by revenue according to a Fortune 500 ranking of 2016.

1 *Amel-Zadeh, A. & Serafeim, G. (2018), "Why and How Investors Use ESG Information: Evidence from a Global Survey", Financial Analysts Journal.*
Note that the terminology describing sustainability reporting is generally inconsistent. ESG data, non-financial reporting and corporate social responsibility reporting are often used interchangeably.

2 *KPMG (2017), "The Road Ahead – The KPMG Survey of Corporate Responsibility Reporting 2017".*

The increase in sustainability reporting has been driven by two concurrent trends. The first is a desire by governments, employees, civil society and some investors for greater corporate accountability for environmental and social impacts. The second is a growing call from investors for information beyond a company's financial statements that can affect its valuation. As a consequence of these trends, disclosures often integrate the distinct perspectives of a company's impact on the external world, and of the financial relevance of these impacts to the company itself.

Although more companies report some sustainability information, the level of detail and quality continue to vary significantly. We have assessed companies' reporting on climate change, water management and children's rights since 2008. Analysing the reporting against indicators for governance, strategy, risk management and disclosure of performance metrics, we find that the overall quality still remains too low. In our 2019 assessment of climate-related disclosures, only one-fourth of companies analysed reported at par with our expectations. In general, larger, growing and less closely held companies with higher analyst coverage tend to disclose more data.[3] There is evidence that superior sustainability performers choose high-quality disclosure, while poorly performing companies choose low-quality disclosure.[4]

It is challenging to develop a reliable, comparable and complete picture of a company's sustainability performance. One main distinction between traditional financial reporting and sustainability reporting is the lack of standard units of accounting for the latter. While financial statements are generally based on value flows and stocks denominated in a monetary unit, sustainability issues are less transactional in nature, and often expressed in physical units such as carbon emissions or in concepts such as governance structures. Furthermore, it is difficult to assess the completeness of a sustainability report. This is due to differing and evolving views on what topics fall within the realm of corporate sustainability, and which of these are material to individual sectors and companies.

Emerging reporting standards

As a result, a multitude of sustainability reporting frameworks have emerged, with different motivation, approach and thematic focus. Reporting frameworks varyingly prescribe principles for *how to report* with respect to scope, content and presentation, and more detailed standards for *what to report* in terms of specific indicators, metrics or other items of information. The principle-based frameworks can be implemented through the detailed standards. Examples of principles-based approaches include the recommendations by the Task Force on Climate-related Financial Disclosures (TCFD), the International Integrated Reporting Framework and the Climate Disclosure Standards Board Framework. The main standards across sustainability topics include those from the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB). CDP also has its own reporting require-

3 See supporting evidence in Serafeim, G., & Grewal, J. (2017), "The Value Relevance of Corporate Sustainability Disclosures: An Analysis of a Dataset from One Large Asset Owner", SSRN Working Paper.

4 Hummel, K., & Schlick, C. (2016), "The relationship between sustainability performance and sustainability disclosure – Reconciling voluntary disclosure theory and legitimacy theory", Journal of Accounting and Public Policy.

ments and gathers responses to detailed questionnaires on climate change, deforestation and water management.

The standards developed by SASB support companies in reporting financially material sustainability information to investors. SASB has developed an overview (the materiality map) which identifies topics that are *reasonably likely to impact the financial condition or operating performance of a company* in different industries. For each sector and topic, SASB has defined a limited number of accounting metrics for companies to report on.

The GRI Standards are the most widely adopted standards for sustainability reporting globally. They are designed for organisations to communicate their most important economic, social and environmental impacts. While some of the standards are universal, for instance regarding a company's strategy and governance, most of them are topic-specific and should be used if the topic is material to the company. The target audience of the standards is broader than just investors. A topic is deemed to be material by GRI if it reflects a company's significant sustainability impacts or is important for its stakeholders.

The different approaches to materiality of these two reporting standards have consequences for the metrics they prescribe. For instance, a mining company reporting on biodiversity impacts under the GRI Standards will be expected to report details on its operational sites, direct and indirect impacts and mitigating actions *in, or adjacent to, protected areas and areas of high biodiversity value*. If reporting according to the SASB standard, the company would be asked to provide *proven and probable reserves in or near sites with protected conservation status or endangered species habitat, expressed in metric tons and grade (in percentage metal content)*. Both standards seek to gauge the miner's involvement in areas with high biodiversity value. However, the GRI requirement aims to achieve a more complete and detailed understanding of the company's impact on the broader environment, while the SASB metric primarily seeks to represent the business' exposure to issues that could affect future revenues.

Although the GRI Standards are the most widely adopted, they may not fully meet the succinct information requirements of investors more focused on financial relevance. SASB's standards, although relatively new and less widespread, complement the GRI Standards in this regard. However, the SASB standards have certain gaps compared to GRI. For instance, SASB does not give much guidance on how to describe the integration of sustainability into governance, risk management and strategy. GRI also covers other topics than SASB, such as tax transparency, and is developing broader human-rights reporting designed to align with the UN Guiding Principles on Business and Human Rights.

While these standards represent a strong foundation for sustainability reporting, there is a long way to go before it reaches the same level of rigour as financial reporting. For information to be useful for investors it needs to be relevant, comparable and reliable. Companies need to improve and unify their approach to defining which topics to report on, what information to include and how to present it. The alignment and consolidation of standards will be key to achieve this.

In the following we provide our perspectives on the main elements of meaningful corporate sustainability reporting: what topics to report on, which information to include, and how to present the information.

Financial materiality and broader outcomes

Norges Bank Investment Management manages the Government Pension Fund Global on behalf of the Norwegian government, with the objective of ensuring a high long-term return. We have a vested interest in how companies manage their use of natural and social resources, through their governance structure, business strategies and risk management, as this has a bearing on their ability to create long-term financial value.

Research indicates that a company's environmental and social performance can affect its revenues, costs and risks. Such performance can even affect the long-term viability of the business model itself.[5] Examples of potential financially relevant information include greenhouse gas emissions, water usage, energy-saving measures, and activities to develop new, sustainable products.

Corporate sustainability reporting can also contribute to positive market outcomes. It has been associated with more accurate analyst forecasts and lower costs of capital for disclosing firms.[6] Broadly speaking, by reducing informational asymmetry, high-quality corporate disclosures can contribute to the stability of financial markets and a more efficient capital allocation in the economy.[7] It seems likely that such benefits will be largest when applicable reporting is universal. This is particularly relevant for large, diversified investors whose long-term investment horizons are linked to global economic growth.

As a starting point, companies need to provide information on social or environmental issues which are financially material to their business. We rely on both information related to the current performance of a company (i.e. how and where it creates value today) and information on drivers of value that may be predictive of its long-term performance. Companies are generally required to report certain financially material information as part of their listing obligations. However, interpretations of materiality and views on the potential impact of sustainability factors, such as climate change, vary. In line

5 While the financial relevance argument is debated in the academic literature, the consensus seems to be in favour of a small positive relationship between firms' sustainability and financial performance. For a meta-study, see: Margolis, J., Elfenbein, H., & Walsh, J. (2009), "Does it Pay to Be Good…and Does it Matter? A Meta-Analysis of the Relationship between Corporate Social and Financial Performance", Working Paper, Harvard University; On the comparatively higher stock returns of companies with high social capital during the financial crisis: Lins, K., Servaes, H., & Tamayo, A. (2017). Social Capital, Trust, and Firm Performance: The Value of Corporate Social Responsibility During the Financial Crisis, The Journal of Finance.

6 Dhaliwal, D., Li, O., Tsang, A. & Yang, Y. (2011), "Voluntary Nonfinancial Disclosure and Analyst Forecast Accuracy: International Evidence on Corporate Social Responsibility Disclosure", The Accounting Review; Chen, Y., Hung, M., & Wang, Y. (2018), "The Effect of Mandatory CSR Disclosure on Firm Profitability and Social Externalities: Evidence from China", Journal of Accounting and Economics.

7 Leuz, C., & Wysocki, P. (2016), "The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research", Journal of Accounting Research with our long-term investment horizon, we encourage companies to adopt a broad interpretation of financial materiality in deciding which topics to report on.

Although financial materiality is a natural lens through which investors assess companies on environmental and social issues, companies also need to report more broadly on sustainability. Companies have a wide set of stakeholders, and we believe that boards should consider the broader environmental and social consequences of business operations and account for associated outcomes.[8] Such outcomes may themselves become financially material over time, especially for diversified investors whose long-term return depends on sustainable economic, environmental and social development. Many investors also look at companies' reporting of environmental and social outcomes when monitoring their investment portfolio, or assessing more aggregated sustainability implications. Furthermore, research indicates that sustainability reporting in itself can contribute to improved social and environmental impacts.[9]

Exposure, management and performance metrics

There are three types of sustainability information which are especially useful to investors: companies' exposures to financially material topics, how these are managed and relevant performance metrics.

Determining whether a company is exposed to a specific sustainability issue can, in some cases, be a simple assessment of its industry and country of headquarters. However, understanding the extent of that exposure often requires much more detailed information about the nature and location of a company's supply chain, operations or customers. It would be beneficial if companies share this information with investors where commercially practicable. This information could include the location and type of assets, lists of suppliers or country-by-country revenue.

We also see a need to understand how companies manage relevant sustainability risks and opportunities. This includes the company's governance of sustainability issues, including whether there is board-level oversight, and whether the issues are integrated into strategic decision-making and risk management processes. Policies and initiatives companies have in place are also relevant information. In our public expectations, we set out how companies should manage significant sustainability issues, and we regularly perform extensive reviews of companies' disclosures to assess their management of these.[10] In Table 1, we provide an overview of typical indicators that form part of this assessment.

8 This is based on standards such as the G20/OECD Principles of Corporate Governance, the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights.

9 For examples on increased water safety and reduced greenhouse gas emissions following introduction of mandatory reporting see: Bennear, L., Olmstead, S. (2008), "The Impacts of the "Right to Know": Information Disclosure and the Violation of Drinking Water Standards", Journal of Environmental Economics and Management; Jouvenot, V. & Krueger., P (2019), "Reduction in Corporate Greenhouse Gas Emissions under Prescriptive Disclosure Requirements", Working Paper.

10 For an updated list, see https://www.nbim.no/en/publications/expectation-documents/. In 2019, we performed 3,941 company assessments.

Table 1: Management indicators

Pillar	Typical indicators
1. Governance	• Board oversight • Management responsibility • Presence of policy
2. Strategy and implementation	• Content of policy/strategy • Integration into strategic planning • Corporate culture, training & incentives • Value chain engagement • Stakeholder engagement
3. Risk management	• Risk assessment/due diligence • Risk mitigation/grievance mechanisms • Risk monitoring
4. Metrics and targets	• Qualitative goals • Quantitative targets • Performance metrics • Third-party verification

Although qualitative disclosures can be informative, financial investors also rely on quantitative data about their investee companies. Relevant, comparable and reliable key performance indicators are necessary to fully understand a company's response to a sustainability issue and its potential financial implications. Examples of performance metrics companies could disclose are: scope 1, scope 2 and, as relevant, scope 3 greenhouse gas emissions (MT CO_2-eq), total water withdrawal and consumption (m^3), and total number and percentage of facilities audited to a social responsibility code of conduct, non-conformance rate and associated rate of corrective action. Using internationally recognised calculation methodologies where they exist, such as the Greenhouse Gas Protocol, ensures consistent calculations.

Reporting on metrics that are standard in an industry allows comparability, and aids investors' portfolio analyses. Companies may wish to supplement industry-wide metrics with others specifically relevant to the company. For certain topics, such as human rights, anti-corruption, deforestation and ocean sustainability, there are few standardised and meaningful performance metrics available. More work is needed by companies, standard-setting organisations, investors and other stakeholders to jointly develop these.

Integrated and accessible disclosures

For investors to confidently use sustainability information, it needs to be readily accessible and subject to similar quality control as other information companies provide to financial markets. It also needs to be timely, balanced and cover all relevant operations and value chains.

Financial disclosures, such as annual reports, are central sources of information for investors, and companies could integrate financially material sustainability information into these. Some sustainability information traditionally seen as non-financial may be directly relevant in financial statements – for instance in assumptions underlying impairments, fair value measurement and estimated useful life of assets.[11] Other sustainability information could be integrated into existing descriptions of strategies, outlooks, risks and business models.

Disclosed in an integrated way, descriptions and sustainability metrics should become coherent with the financial statements. As part of reporting integration, sustainability information should be subjected to similar internal governance procedures as financial disclosures, with a final sign-off from the board. While the reported information does not necessarily need to be assured or verified by a third-party, the data-collection process and documentation should be rigorous enough to allow for this. Over time, we believe that assurance of sustainability reporting may become the norm.

Information on sustainability issues which are not financially material could be disclosed through other channels than the financial report. Currently, companies respond to a large number of questionnaires sent by rating agencies, indices, investors, NGOs and others about their sustainability practices and performance. These questionnaires are often based on topic-specific or proprietary frameworks, making it difficult for companies to satisfy all requests without disclosing the same information in several different ways. As standards and technologies for information gathering and sharing evolve, we believe that publishing information in company reports and on websites will be sufficient. It should not be necessary to respond to questionnaires if a company has published complete and standardised information elsewhere.

However, we recognise that in the absence of a fully agreed-upon standard and accessible and comprehensive reporting from companies, many actors will continue to send questionnaires. For now, we see the merits in companies reporting climate, water and deforestation information through the CDP platform to increase accessibility and comparability.

11 IFRS (2019), In Brief, IFRS Standards and climate-related disclosures

Standardisation of reporting

The existing sustainability reporting frameworks represent positive steps towards an improved understanding of companies and their sustainability performance, and should be applied where practicable. However, being numerous and voluntary they contrast with the more concentrated and mandatory frameworks for financial reporting. Financial reporting is dominated by the US Financial Accounting Standards Board and the International Accounting Standards Board, the standard-setting bodies for US Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) respectively. The IFRS standards are currently mandatory in more than 140 jurisdictions and permitted in many more, a position unparalleled in the realm of sustainability reporting.

The low degree of standardisation in sustainability reporting hinders investors in systematically considering companies' environmental and social risks and opportunities in their decision making. Due to the lack of mandatory reporting, many companies only partially implement the standards that exist. Recent surveys show that a large majority of investors believe that sustainability reporting should be mandatory and are in favour of having one global sustainability reporting standard.[12]

There are signs that regulatory endorsement of sustainability reporting is intensifying. Examples include the EU Directive on Non-Financial Reporting and the China Securities Regulatory Commission's consideration to mandate ESG disclosure for listed companies and bond issuers. Stock exchanges are promoting or mandating sustainability reporting in line with the Sustainability Principles of the World Federation of Exchanges.[13] The IASB is, furthermore, updating its guidance on management commentary, where it would expect companies to address material environmental and social issues, and present relevant metrics.

We support the ambition of having one global reporting standard that would address the needs of both investors and other stakeholders, replacing all existing standards. However, we see the development of this as a long-term and complex undertaking. Standard-setters are well aware of the confusion created by the different reporting frameworks and are through the Corporate Reporting Dialogue seeking to refine and align overlapping reporting metrics.[14] As a next step, standard setters could seek agreement on a set of widely accepted industry-specific and financially material metrics. These could be used as a core in all reporting frameworks, including in financial accounting standards as relevant.

12 Mackintosh, I. (2019, May), "The Corporate Reporting Dialogue 'Better Alignment' project: Driving better alignment and cutting clutter in -business reporting -introduction and .provocation. Presentation at IIRC Conference on Integrated Reporting, London, UK; McKinsey & Company (2019, August), More than values: The value-based sustainability reporting that investors want, https://www.mckinsey.com/business-functions/sustainability/our-insights/more-than-values-the-value-based-sustainability-reporting-that-investors-want?cid=eml-web

13 See https://www.world-exchanges.org/our-work/articles/wfe-sustainability-principles

14 See https://corporatereportingdialogue.com/better-alignment-project/

Conclusion

Improving the ability of markets to incorporate sustainability risks and opportunities is in our interest as a long-term, global investor. We would like to see more relevant, comparable and integrated disclosures from companies that allow investors to assess companies' exposures to, management of and performance on sustainability risks and opportunities. There is a particular need for consistent performance metrics, robust and standardised at least at the industry level, which allow portfolio-level analysis.

Although measuring sustainability performance is complex, it is feasible. Accurate financial reporting can also be challenging, but has found solutions through broadly accepted standards. Practices for measuring sustainability are developing, and a number of metrics have now become well recognised. We welcome existing efforts to align reporting frameworks. Further consolidation of standards and metrics is necessary to achieve a simpler and more coherent basis for corporate sustainability reporting.

Aligning reporting frameworks will help, but as long as they are voluntary, their uptake seems likely to remain partial and selective. As they develop or introduce measures to increase corporate sustainability reporting, regulators and stock exchanges should consider how they can contribute to internationally harmonised disclosures. They should accommodate for the fact that this is still a nascent field where both standards and practices are in development. Mandating principles for reporting and referring to existing standards will often be more appropriate than developing new standards. We believe a good start would be reporting requirements based on a core set of globally accepted, financially material and standardised sustainability metrics.

For now, diverse reporting standards should not stop companies from reporting on financially relevant sustainability matters and significant environmental and social consequences of their operations. As a starting point, companies can report industry-specific SASB metrics and base their broader disclosures on the GRI framework. Companies can also look to our topic-specific expectations for further guidance.