March 2023

Goodbusiness

Friday 5

Special Edition: Sustainability Reporting and Materiality

This is our first Friday 5 Special: a new, occasional edition of our weekly round up where we take a deep dive into a sustainability topic, bringing you clarity on what's going on and analysis of what it means. We'll be sending these out from time to time when we feel we have something important to say, but you can also continue to expect the Friday 5 you know and love in your inbox. And if you aren't already a subscriber to Friday 5, you can sign up here.

Over the past year, we've found ourselves repeating the same phrase when asked by clients about the sustainability reporting landscape: "it's changing quickly". From emerging regulations to newly-developed global taskforces, sustainability reporting is evolving at a pace hitherto unseen. In this Special Edition of Friday 5 we look at what's happening and, crucially, what it means.

Don't know your TCFD from your ESRS? If you are looking for an 'at a glance' guide to what's changing and what it all means, this is for you.

Change is coming. How will the advent of new reporting standards impact both the reporting process and the outcome? We've given it some thought.

Making materiality matter. Materiality is often another 'to do' on the list, rather than a tool for change. Find out how to change that here.

Reporting is the start, not the end. It's easy to lose sight of the point of all of this – sustained and transformational change. More on that here.

We're here to help. From first steps to embedding change, find out more about how we work with clients at all stages of their journey.

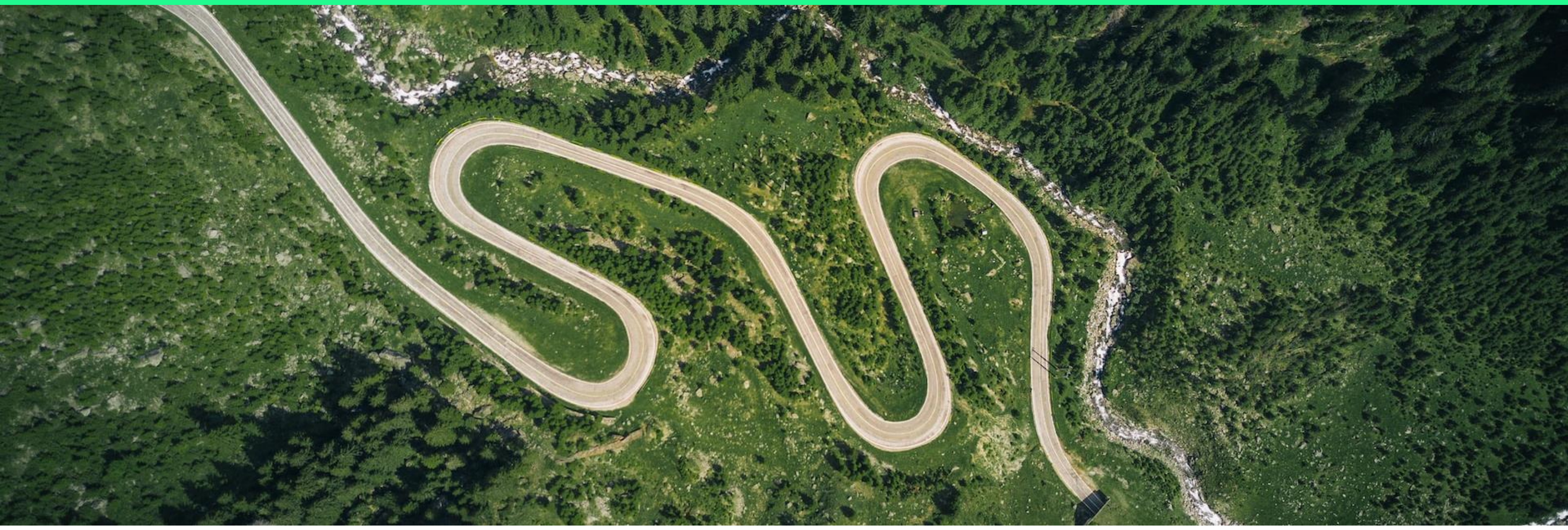
Letter from the editor

This newsletter dives deep into non-financial reporting and what it means for businesses who are trying to find their way through the mass of emerging regulation, and for those who may just be starting out on their reporting journey.

As businesses grapple with new reporting regulations, we want to make the case as strongly as possible for ensuring that as the resources devoted to non-financial reporting grow, so too does the value that the business gets out of it. How do you design a materiality assessment that informs business decision making as well as ticking a box? What does the data you collect and report on tell you about where your business is doing well and where more work is needed? Where are the points of failure in your organisation that may put achieving your sustainability vision and targets at risk? How, to summarise, do you keep the summit in view even as you scale the sides of the reporting mountain?

Some growing pains are to be expected: this is a fast changing landscape and it will take a while to establish how best to navigate it. The result, we expect, will be worth it – better, higher quality reports that allow for more comparability and that support those companies that are excelling to stand out. And in the meantime, our message remains the same: don't get lost in the detail, but keep focused on the purpose of all of this, which is to deliver transformational change around sustainability, which is so urgently needed.

Whether you're a large business grappling with the implications of new European legislation, or whether you are just starting to think about reporting on your sustainability impacts, the changing landscape raises questions for everyone. We hope this special edition of Friday 5 prompts some reflection on these questions. As ever, we'd love to hear from you. Get in touch if you want to talk.



1. The lay of the land: in a fast-changing sustainability reporting landscape, what do you need to know?

Before we get started: you may have seen 'sustainability' and 'ESG' reporting used interchangeably in the past. Both describe non-financial reporting, but 'ESG' is generally understood to imply data-driven reporting with investors as the key audience. We've used 'sustainability' throughout this report, which we feel offers the wider definition of non-financial reporting for multiple stakeholder groups.

To understand where sustainability reporting is going, we first need to know where it's been.

Corporate sustainability reporting – the public disclosure by companies of key metrics and information related to environmental, social, and governance (ESG) impact – emerged into the mainstream in the early 2000s with the publication of the first set of Global Reporting Initiative (GRI) sustainability reporting standards. Since then, this space has expanded significantly, with the launch of numerous new voluntary standards, frameworks, and platforms for ESG disclosure. Today, the reporting world is littered with acronyms – GRI, TCFD, SASB, CDP, to name just a few – defining (largely voluntary) reporting standards for companies to follow (or not, as they choose), each setting out its own collection of overlapping but distinct indicators to be disclosed.

This increasingly fractured landscape has led to calls for the standardisation of sustainability reporting to allow companies to focus their efforts on a universal set of disclosures and to provide comparable evaluation metrics for investors. In response, in 2021 the International Financial Reporting Standards Foundation – the same body responsible for the global rules on financial accounting – began work on a set of international sustainability standards (ISSB standards), which could eventually be adopted by countries worldwide.

But governments haven't been waiting around for the ISSB standards to be finalised (the first two of which will be released later this year). Major pieces of legislation are making sustainability disclosures mandatory for certain companies in some jurisdictions. From the EU's European Sustainability Reporting Standards (ESRS) to the US Security Exchange Commission's (SEC) proposed new disclosures on climate change, countries worldwide are beginning to draw up their own rules to dictate the nature, frequency, and scope of sustainability information that businesses are required to provide their stakeholders.

This is a turning point in corporate disclosure. Sustainability reports (or at least the information contained therein) are no longer a 'nice to have' or a signal of corporate best practice. In the next few years sustainability disclosures will be coming into law – and under the microscope. What does this mean in practice? Read on to find out!

2. A look into our crystal ball: what's on the horizon, and why should you care?

What does sustainability reporting look like in a more regulated world? There are many ways that we expect sustainability disclosure – and the process of preparing for it – to change in the coming years.

First: the process. With increased regulation comes increased rigour. Companies disclosing to meet regulatory requirements will need to enhance their existing data collection systems to collect more datapoints and to ensure that the information is both accurate and, if regulations require, auditable. As we've previously noted, this will likely involve introducing systems of control and collection akin to those used in financial accounting. Companies can expect data collection to become a lot more difficult – and costly.

Second: the output. The advent of sustainability disclosure regulation could mean the end of the standalone sustainability report as we know it. Aside from legal regulations dictating where this information must be published (often in specific corporate filings), reporting will become increasingly data driven. Companies will find it challenging to present legally required information alongside visual, narrative content in a cohesive way and will need to seek out new reporting formats as a result.

From our perspective, this is no bad thing. While there are many stakeholders with an interest in sustainability information, it's not necessarily true that all of them want information presented in the same format. It could well be time to explore breaking out sustainability disclosures across different channels and platforms. More storytelling, more video, more interactive content for some. And for others, tabulated data to show trends and progress towards targets and detail about action plans.

Third: the outcome. What does regulated sustainability reporting mean for businesses in the long term? There's no easy way to tell, but we have a few ideas. More rigorous data collection will naturally strengthen companies' own oversight of sustainability topics and ability to act on them. This is important because regulated sustainability reporting will also mean stakeholders will be able to easily see how companies are stacking up against each other, allowing investors, customers, and business partners to make meaningful decisions about engaging with businesses. Equally, companies themselves will be able to assess how they stack up against competitors – starting, we hope, a race to outperform each other in the sustainability space.

We are heading into territory that is, to some extent, uncharted. Staying abreast of what is needed, while remaining focused on making sure your organisation's sustainability goals and strategy are robust and ambitious, will leave you best placed for success. Preparation and planning is key!

3. Living in a material world: making your materiality assessment deliver real value

Among the many bits of sustainability jargon to get your head around, 'materiality' is one of the trickiest.

The concept originates in finance, where it refers to information that is likely to influence investors' decisions about a company. This is called 'financial materiality' and it looks at issues that impact a company's financial performance and ability to create economic value.

Somewhat confusingly, the term materiality has also been adopted by the sustainability world to describe information about companies that meets the needs of stakeholders *other* than investors. Sometimes called 'impact materiality', this looks at the external impacts of an organisation on communities and the environment.

Increasingly, there have been calls to recognise the relevance of sustainability topics through both an impact and financial lens. Thus, 'double materiality' was coined, referring to sustainability topics that are either financially material to the business, material from the perspective of the business's impact on the world, or – sometimes - both.

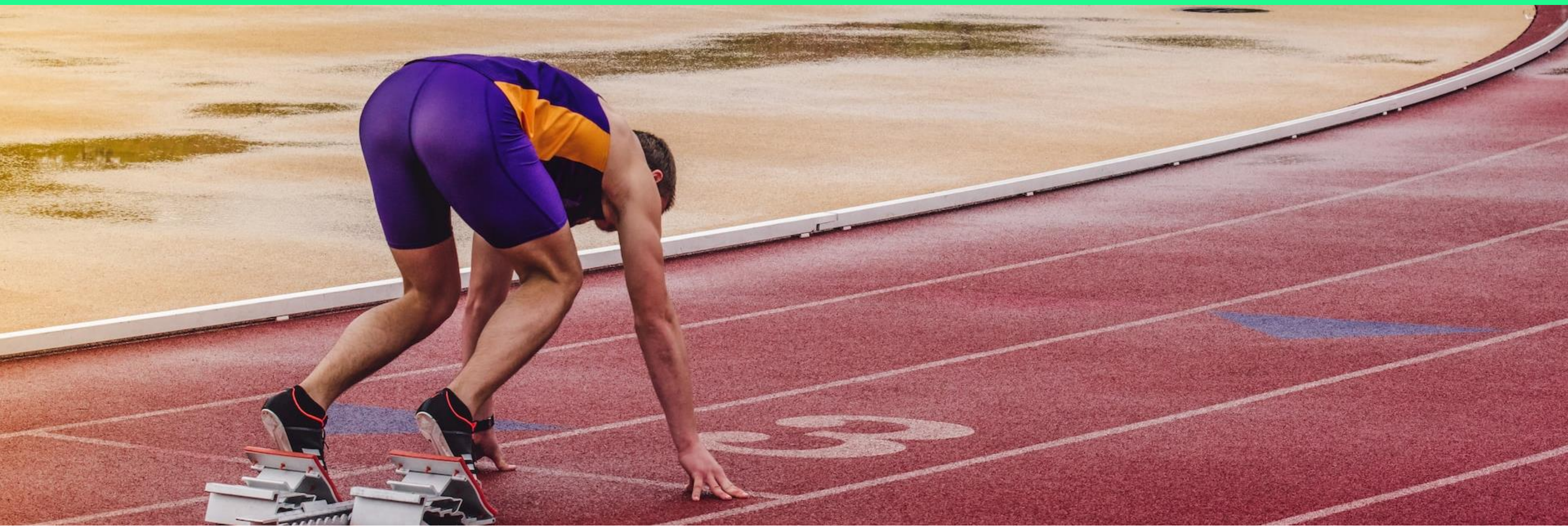
Still with us? Wondering why it all matters?

As sustainability disclosures become regulatory requirements, understanding the definition of materiality being used in these regulations is vital to ensure compliance with these regulations. For example, The EU ESRS takes a double materiality approach, requiring companies to disclose information about topics impacting their business *and* about impacts they have on the world. By contrast, the US SEC is looking at financial materiality for its upcoming mandated climate disclosures – meaning it only requires information on climate change impacts on the businesses, and not on how the business's operations contribute to a warming planet.

The definition, legal and otherwise, of what information is 'material' is part of a broader conversation about what matters to investors. If, as we believe they should, investors are to consider the long-term social and environmental impacts of their decisions (due to financial implications or simply because investors want to create more good in the world) it's important that this information is available. Mandating that companies disclose these details is a good way to ensure this.

While we welcome this expanded view of materiality, clear and detailed guidance on how to conduct double materiality assessments is still missing. This is frustrating, as it's hard to see how results can be truly comparable with no agreed methodology, but also exciting, since it leaves us free to focus on developing an interesting process that delivers meaningful insights.

Technical discussions aside, any materiality assessment is an opportunity to learn more about how your business interacts with sustainability, and to learn about what your stakeholders think about the issues that matter, so you can respond appropriately. It's critical not to lose sight of this – if you can embrace the chance to delve deeper into the sustainability issues relevant to your business, you'll find real insights are waiting.



4. The race has just begun: turning talk into action

We have explored what sustainability reporting might mean for individual businesses as they think about their reporting process and business outcomes. But what does it mean for corporate sustainability in the long term? After all, reporting isn't the end goal – it's merely a reflection of a business's performance and an expression of its future direction. If businesses don't take action on their sustainability impacts, all the reporting regulations in the world won't count for much in terms of delivering the kind of transformational change we want to see.

In the short term, sustainability reporting means looking inward, knuckling down on data collection and investing in better data collection systems and structures. This will be onerous for all businesses, but especially for those that have been quietly and comfortably doing very little. It's tempting to wonder if this will cause a slowdown in actual progress on sustainability: as businesses direct resources towards developing audit trails and tracking down indicators, it may be that there's no bandwidth left for ambitious action. But we don't believe this will be the case – at least, not in the long term and not for companies that embrace sustainability disclosure for what it is: a driver of sustainability performance. After all, according to research on the impact of mandatory sustainability disclosures across 25 countries, both the amount of negative sustainability incidents and their significance decreased after mandatory sustainability disclosure was introduced.

You might also wonder if regulation of disclosure will lead to the standardisation of sustainability strategies. Again, we don't think so. While reported data might become more consistent, there will remain a huge need for companies to be strategic in what they are doing to improve their sustainability performance and how they are leveraging this to differentiate and build their brand. After all, financial reporting has been standardised for decades, but companies' commercial strategies remain as varied and individual as the companies themselves.

There's an age-old business adage about measuring and managing that you are no doubt familiar with – the saying holds true for sustainability data. Deeper understanding of sustainability performance allows for more confident target-setting, which itself lends to bolder action. Even the process of disclosure helps with this – if you must regularly engage with stakeholders to understand the magnitude of your impacts (à la ESRS's double materiality requirements), it follows that you are much better positioned to act on those impacts. Furthermore, as businesses are made to move from retrospective disclosures – covering sustainability performance throughout the year – to forward-looking disclosures focused on strategies to manage sustainability risks, the way businesses think about sustainability will have to change.

In short, sustainability disclosure is not a finish line, but a precursor to what really matters: business change. Those that approach (and embrace) it as such will have a head start in this race.

5. Good Business: Confused? Concerned? Don't have time? We're here to help you

With over 25 years of experience helping businesses of all sizes adapt to the evolving expectations of stakeholders and find ways to create value from sustainability, we're here to help.

We provide our clients with meaningful and high-impact sustainability services that help them identify where they should focus their efforts, set goals that stretch and inspire, and then communicate this to stakeholders.

If you're just starting to get your head around this, then get in touch for a copy of our guide to the latest sustainability reporting regulations and see whether, and how, your business will be affected.

If you're grappling with the best way to decide where to focus your efforts, then our tailored materiality process can help you explore and understand your material issues and provide actionable and relevant insights to support investment and decision making. Materiality assessments are often too focused on processes, neglecting real and meaningful information about the issues that matter and, crucially, how to respond to them. In contrast, our approach focuses on outcomes and dives deep into the significant issues, focusing on what is important and how the business should take action.

If you're focused on reporting, talk to us. We help clients choose the right data collection systems for their business, gather the data they need, analyse it, and present it, creating engaging, best-in-class sustainability reports and communications that work for different audiences. Crucially, we can help bring the business along with you, demonstrating the value of the data you're collecting and ensuring key stakeholders understand the opportunities reporting can deliver when done well.

And if you are further on your journey, we can support with target setting, policy development, sustainability training, leadership engagement, and programme development, to embed best practice and drive change.

In the end, reporting is only part of what is needed to deliver transformational sustainability change. It's a vital one – nothing says 'commitment' like putting clear and ambitious targets out into the world – but reporting alone won't get you where you need to go. So let's not lose sight of the real prize: sustained, sustainable change.

For more information about our services, contact our Managing Partner David Lourie at david@good.business

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Thoughts on our new format?
Strong opinions on something we've said?
Ideas of what you'd like to see covered in future special editions?

We'd love to hear from you!

Get in touch at Friday5@good.business,
or head on over to our LinkedIn page to join the conversation.

For more information about our services, contact our Managing Partner David Lourie at david@good.business

We are Good Business.
We help clients deliver transformational change that builds their business and brands. We deliver change through sustainability strategy, climate services, behaviour change, and purpose and values. We work with FTSE100 and global multinational companies as well as SMEs, foundations and charities around the world. We are pioneers of the power of good. For the past 25 years, we've been working hard to demonstrate that what is good for business is good for the world, and that what is good for the world can also be good for business. It's been a long road, and an idea whose time feels as if it has finally come. We are seeing a growing urgency in the discussions we have with all of our clients about the need to act on the major challenges of our time. The time for transformative change is now.