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HOW TO READ AN ESG REPORT FROM INVESTORS' PERSPECTIVE?

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The HKEx issued the consultation conclusion on ESG Reporting Guide and related listing rules (the "Consultation Conclusion") in December 2019. The Consultation Conclusion has made certain changes to the existing ESG Reporting requirements and will be effective for listed companies with accounting year beginning on or after 1 July 2020. Some key changes include:

- New mandatory disclosures on ESG governance structure, reporting principles and reporting boundaries
- All previously recommended disclosure of Key Performance Indicators (KPIs) in subject B: Social will need to be disclosed on "Comply or explain" basis
- Changes in KPIs disclosure include disclosing scopes 1 and 2 greenhouse gas emission information, setting targets to some environmental KPIs, employment types of workforce and work related fatalities in the past three years
- Added KPIs disclosures include climate change, ESG risks along the supply chain, environmentally preferred goods and services and anti-corruption training

Points of focus for investors

Unlike audited financial statements with notes to the accounts in an annual report, the format and structure of ESG report may vary from one company to another. Apart from the KPIs that are required to disclose mandatorily, the rest of the report is qualitative in nature and may contain some forward-looking information. So, how should investors read an ESG report and what needs to be focused becoming a challenge nowadays.

Strategic Relevance

ESG is not just about reporting. The value that ESG shall create depends very much on how company integrates ESG practices into its daily business operations. During the process of value creation, Board should understand how the business model may be affected by ESG-related issues, whether it remains sustainable, and how the company may respond to the challenge.

ESG related issues or risks may impact a company's business operations and affect their sustainability in the long-run and achievement of goals and objectives. These risks may include earthquake, typhoon, drought, constant rise in sea level, global warming, etc. Having said that, ESG issues may bring opportunities to companies, for example producing environmentally friendly products to meet market demand or integrating ESG into business model to promote improving health and well-being, reducing environmental impact, enhancing livelihoods, responsible business practices, etc.

Investors may assess whether the board has considered the relevance of ESG risks and opportunities to their business model thoroughly by evaluating the ESG aspects as stated in the HKEx ESG reporting guide or even broaden the scope to cover other aspects that are made available in international standards or UN Sustainable Development Goals. This allows investors to assess how well prepared the company is strategically for changes in its operating environment.

Board's oversight

The board has the ultimate responsibility to manage and mitigate ESG related risks. Investors may assess how the board carries out its oversight responsibility. It is important that the board considers and evaluate a range of sustainability-related issues and they have access to necessary information and expertise on ESG related matters. The board should understand how ESG matters affect the company's overall risk profile and to determine the metrics for monitoring ESG performance.

ESG Governance

ESG governance means whether there are dedicated resources to manage ESG issues at operational level and whether there are appropriate channels to report emerging ESG issues back to the board. Investors may assess whether the company has established some related taskforces within the organisation structure such as ESG committee, ESG working group or sustainability reporting committee.

These kinds of taskforce normally include senior management, operational management members and in-house ESG professionals with necessary ESG knowledge about the industry. Besides, there should be a well-defined terms of reference for the taskforce to specify their role and responsibilities. On the other hand, investor shall also assess whether the company has incorporated ESG risks into the companies' enterprise risk management framework including identifying, assessing, prioritising, implementing responses and monitoring ESG risks.

Materiality

To understand a company's long-term prospects, investors may focus on those issues that they believe to be most relevant or material to any particular business. Company should explain which ESG issues they see as most relevant or "material" to their business. According to GRI, material aspects are as those that reflect the organisation's significant economic, environmental and social impacts; or that substantively influence the assessments and decisions of stakeholders including investors. Investors may assess whether companies have explained how these material impacts may affect their business strategy, financial and operational performance.

Reporting framework

There are different ESG reporting frameworks in the market such as GRI, UN Global Compact, the International <IR> Framework, Task Force on Climate-related Financial Disclosures (TCFD), etc. Listed companies in Hong Kong, as a minimum, are required to fulfil the mandatory disclosure and "Comply or Explain" requirements as set out in the HKEx ESG Reporting Guide. Before going into the details of an ESG report, investors may need to obtain an understanding and knowledge over the reporting requirements of these standards, their purposes of reporting and the concerns they would like to address to facilitate their reading of an ESG report. For examples, TCFD expects companies to report on the financial impact that climate-related issues may bring to their business model where GRI aims to enable third parties to assess environmental impact from the activities of the company and its supply chain.

Independent Assurance

According to the HKEx Revised ESG Reporting Guide, listed companies may seek independent assurance to strengthen the credibility of the ESG information disclosed. However, investors should be mindful that there is currently no widely recognised assurance standard for ESG report assurance. Companies need to decide which part of the report need independent assurance such as specific ESG data, reporting principles or even on compliance with one or more reporting standards. Investors should understand that not all companies assure their ESG report in the same manner.

Finally, as ESG reporting practices vary among listed companies, investors are recommended to study more ESG reports as references to facilitate their understanding of industry specific ESG related issues and for comparison purpose.

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