point of *view*

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Sustainability reporting and disclosure
What does the future look like?

pwc

Evolving stakeholder expectations driving transformation

- Sustainability reporting has become more mainstream, as companies respond to stakeholders' expectations for more transparency regarding how environmental, social, governance, and other non-financial measures impact their strategy, operations, and long-term prospects. This is because financial metrics, in many instances, tell only part of a company's value story. In today's economy, companies' values are increasingly underpinned by intangibles such as brand, talent, and customer base, making non-financial factors potentially important to investment decisions.

- However, some stakeholders' needs may not be met due to disparate sustainability information being reported by peer companies, multiple mechanisms being used to communicate such information, and an increasing volume of information being provided without linkage to a company's core strategy.

- As the information needs of stakeholders has evolved and market demand for sustainability reporting has increased, a proliferation of sustainability related frameworks, rankings, metrics, and indices have been developed. We see a benefit to greater global harmonization as a means of enhancing the consistency and comparability of sustainability reporting.

- Companies should consider focusing on their data quality, processes, and controls to produce a meaningful set of disclosures for their stakeholders. They should also stay informed of emerging developments, trends, and regulations and comment on relevant proposals to ensure their views are included in the ongoing dialogue.

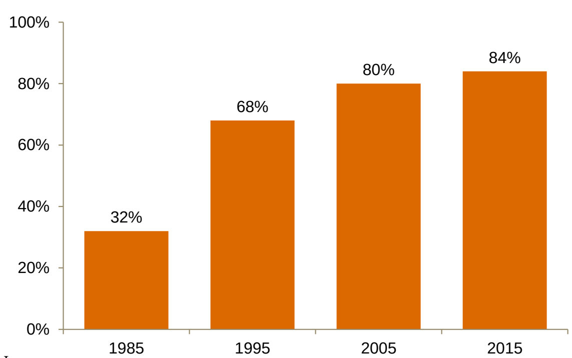
Why the reporting landscape is changing

In today's business environment, global trends such as urbanization, geo-political uncertainty, and resource scarcity are increasingly impacting a company's ability to sustain long-term value. As a result, the way businesses create value and the context in which they operate continues to change. The information needs of stakeholders are also changing, and they increasingly expect greater transparency about how companies are addressing sustainability risks and opportunities.

Investor impact

As economies shift away from bricks-and-mortar operating models to technology-driven models, more of a company's valuation is underpinned by factors such as its brand, customer base, depth of talent, and other non-financial factors that are not captured in traditional financial statements. The evolving impact of non-financial information is demonstrated by the fact that "implied" intangible asset value (the difference between a company's market value and book value) comprises 84% of total market value of the S&P 500, as compared to 32% 30 years ago.[1]

Intangible asset value as a % of market value - S&P 500



January 1, 2015
Source: Ocean Tomo

The investment community is able to factor a broader range of non-financial information into their decisions, including environmental, social, and governance (ESG) matters. They are also using ESG-specific investment screening tools (e.g., Bloomberg ESG integration) to assess how well a company manages sustainability matters like resource scarcity. Further, they are becoming more vocal in expressing their views to companies in which they invest.

These trends are likely to continue for the foreseeable future. According to PwC's 2016 Global Investor Survey, over 60% of investors agree that business success in the 21st century will be redefined by more than financial profit. In a related metric, 84% of CEO's in PwC's 2016 Global CEO Survey believe their companies are expected to address wider stakeholder needs.

Reporting frameworks

A number of organizations have provided frameworks for sustainability reporting. While companies are not required to follow this guidance, those that voluntarily disclose these matters may find strategic and operational benefits from using an established framework.

In the US, the Sustainability Accounting Standards Board (SASB) has issued guidance for disclosing sustainability metrics at an industry level.

The Global Reporting Initiative (GRI) developed "Sustainability Reporting Guidelines" that also include industry guidance. According to the GRI more than 5,000 organizations used its guidelines in 2015.[2]

The International Integrated Reporting Council (IIRC) has developed the Integrated Reporting Framework. It includes guidance for public companies on how to integrate sustainability into their annual reports. The framework is intended to help companies demonstrate how they create value.

CDP (formerly the Carbon Disclosure Project) maintains a global natural capital disclosure database where more than 4,500 companies and 100 cities have self-reported their environmental information. It also provides an independent rating system to benchmark corporate disclosure and performance on environmental stewardship.

With the proliferation of voluntary reporting frameworks, efforts to attain greater global harmonization have emerged. One leading example is the Corporate Reporting Dialogue, an initiative of the IIRC. The Corporate Reporting Dialogue includes eight principal organizations, including the SASB, GRI, and CDP, and was created with the goal of establishing guidance for reporting to investors, creditors, and other stakeholders.

[1] Ocean Tomo LLC, *Annual Study of Intangibles Asset Market Value*, 2015.

[2] Source: GRI Sustainable Disclosure Database – database.globalreporting.org

...and continues to evolve

The initiative is designed to respond to market calls for greater coherence, consistency, and comparability among corporate reporting frameworks and related requirements, and aims to:

- communicate about the direction, content, and ongoing development of reporting frameworks and guidance;
- identify practical means by which respective frameworks and guidance can be aligned and rationalized; and
- share information and express a common voice on areas of mutual interest, where possible, to engage key regulators.

Evolving reporting requirements

In addition to voluntary reporting frameworks and guidance, there are a growing number of mandatory sustainability reporting requirements for publicly traded companies. The European Union, for example, adopted a directive in September 2014 that, when implemented, will require disclosure of ESG information, including information about human rights, anti-corruption, and bribery issues by certain large companies.

> **We need to acknowledge that investors in 2016 may have fundamentally different views about what information is important to them compared to investors 30 years ago...**
>
> *SEC Commissioner Stein, April 13, 2016*

Stock exchanges, particularly in emerging markets, have also implemented initiatives requiring increased disclosure of ESG-related matters. For example, the Shenzhen, Shanghai, and Johannesburg Stock Exchanges have guidelines and listing requirements intended to enhance disclosure of ESG information. In November 2015, the World Federation of Exchanges—with member exchanges representing a total market capitalization of $64 trillion—issued guidance on reporting ESG information, and identified 33 ESG indicators that may be of concern to exchanges. While the guidance is not mandatory, it is another resource for global exchanges to consider in adopting or enhancing ESG-related listing requirements.

More recently, the SEC issued a Concept Release requesting public input related to the disclosure of a range of business and financial topics under Regulation S-K, including information relating to public policy and sustainability matters. And the Financial Stability Board recently established a task force with the goal of issuing, by the end of 2016, specific recommendations for voluntary, climate-related financial disclosures.

Emerging legal and reputational risks

As the unprecedented volume of ESG information continues to be disclosed, it is increasingly being scrutinized by stakeholders. For example, consumer purchasing decisions may be driven by a company's ESG-related claims about its operations or the performance of its products. Nongovernmental organizations (e.g., human rights organizations) may decide to launch an activist campaign based on the ESG information a company reports or fails to report. And for investors, ESG information may be one of the factors considered in deciding to buy, sell, or hold an investment or file a shareholder resolution to influence a company's ESG practices.

As a result, new legal and reputational risks have emerged. In some circumstances, stakeholders have filed product liability and class action securities lawsuits against companies, claiming companies' inaccurate or misleading ESG-related statements induced them to purchase products or securities. In turn, companies' reputations and stock prices can suffer.

In response, organizations that publish sustainability guidance are beginning to take action. In 2015, GRI established Sustainability and Reporting 2025—a collaborative project to promote a global dialogue on the future of sustainability reporting. Output included the publication of analysis papers and GRI's proposed roadmap for the future of reporting.

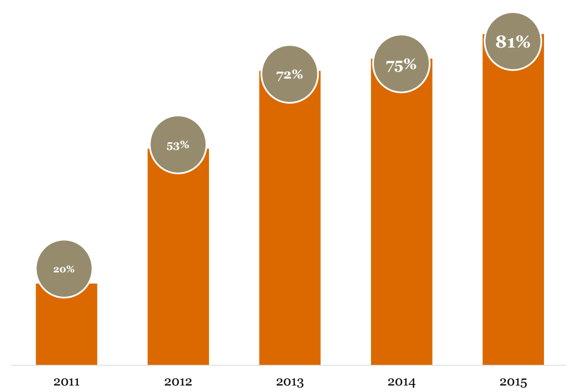
In addition, the work at SASB continues, with the board recently completing provisional guidance for 79 industries in 10 sectors. 2016 marks a period of consultation and public outreach by SASB intended to enhance the usefulness of its guidance before finalization. SASB has engaged industry experts to conduct outreach to better understand sector-specific perspectives of investors and companies, as robust public input will be critical to its process. SASB is also currently seeking public input on its Rules of Procedure, which will establish the processes, practices, and procedures for its future activities.

The road forward: Increased engagement and collaboration

How companies are responding

With views emerging among stakeholders that a company's sustainability practices are important to its long-term value creation, companies are now disclosing a wider variety of ESG and other non-financial information. In recent years, voluntarily issuing a sustainability report has become routine among many large companies. Why? It allows them to proactively communicate with their stakeholders and provides a vehicle for demonstrating accountability and transparency on sustainability related matters.

S&P 500 companies issuing sustainability reports



Source: Governance & Accountability Institute, Inc 2016 Research – www.ga.institute.com

Companies are also communicating sustainability information via websites, press releases, social media postings, and through participation in alliances such as CDP.

The challenge for companies? The determination of which sustainability metrics are material and decision-useful to their stakeholders, and then the implementation of appropriate processes, systems, and controls to produce them reliably. However, with multiple frameworks that can be considered, and increasing requests for information from stakeholders, companies are challenged to develop data gathering processes and systems that allow them to communicate sustainability matters with clarity and confidence.

Therefore, leading companies in sustainability reporting are sharply focused on evaluating suitable reporting frameworks and improving their data quality, processes, and controls used to produce a meaningful set of disclosures. They are refining their communication approach by clearly connecting their stakeholder information needs and their sustainability strategy. They are also working to more effectively use their sustainability information internally to improve performance on sustainability issues that are most important for long-term value creation.

In summary

As voluntary sustainability reporting continues to evolve, companies may want to carefully consider what non-financial information is material to their stakeholders and develop robust processes and controls to produce high-quality data. At the same time, regulators and other participants should continue the important work of developing requirements that serve stakeholder needs and meet market demands. Importantly, companies should stay informed of emerging developments, trends, and regulations, actively participate in the dialogue, and provide written comment on relevant proposals to ensure their perspectives are heard. Global collaboration to harmonize frameworks and metrics will also be important to achieving greater consistency and comparability across reporting entities.

Contact Information

To have a deeper discussion about our point of view on sustainability reporting, please contact:

Sara DeSmith
Sustainable Business Solutions Assurance Leader
Phone: 973-236-4084
Email: sara.desmith@pwc.com

Beth Paul
US Strategic Thought Leader
National Accounting Services Group
Phone: 973-236-7270
Email: elizabeth.paul@pwc.com