impact investing institute

Reporting of Environmental, Social and Economic Outcomes

October 2020

Briefing paper

This paper sets out the Institute's position on reporting of environmental, social and economic outcomes. It advocates for mandatory public interest reporting and the integration of environmental, social and economic outcome themes and metrics in annual reports published by organisations. The paper's purpose is to inform our recommendations to and engagement with UK, EU and international authorities, and other key stakeholders.

Contents

Executive summary

- The Institute's vision is for transparent, consistent, comparable reporting of environmental, social and economic outcomes. We believe this drives mitigation of negative impacts and delivery of significant positive impacts, including those that enhance long-term enterprise value creation.
- Stakeholders (consumers, investors, civil society, policy makers) increasingly expect organisations to contribute to achieving the Sustainable Development Goals (SDGs) and creating a more sustainable world. Equally, the way in which an organisation contributes to people, planet and prosperity is material to its ability to create long-term enterprise value.
- Organisations should therefore measure, manage and report their social, environmental and economic outcomes – positive and negative, intended and unintended – in a manner proportionate to their size. This information is critical not only to an organisation's strategy but also to the wider public interest, and it enables stakeholders to hold boards, asset owners and their investment managers to account.
    - Outcomes that are material to an enterprise's ability to create long-term enterprise value should be reported alongside financial information in an integrated annual report.
    - Outcomes that are material for society, the environment and the economy, even if they are not yet material for enterprise value creation, should be reported through communication channels suited to the enterprise's various stakeholders ('public interest reporting').
- All reporting of environmental, social and economic outcomes should use consistent principles and measures and disclose the methodology applied in defining their materiality. This vision for enhanced environmental, social and economic outcome reporting assumes a reimagining of current integrated reporting structures.
- It is important that standards for reporting environmental, social and economic outcomes converge at a global level. Over time, they should be developed to a level, and have a status equivalent to global financial reporting standards, to ensure that reporting of environmental, social and economic outcomes is comparable and robust.
- An international governance body needs to develop and house global standards, and to steward their translation into different country- or region-level requirements.
- Various stakeholders, including standard setters, governments, regulators, auditors, and technology and data providers, have a vital role to play in developing and embedding standardised and mandatory reporting of environmental, social and economic outcomes.
- Measurement and reporting with depth and quality depends on improvements to data availability, methodology and technological solutions. It is important not to allow a search for the perfect to drive out or delay the good. Setting appropriate goals and incentives, for the short-, mid- and long-term, will encourage the speedy emergence of best practice.

Part 1 – Context

Sustainability reporting

Sustainability issues are critical to the future of the planet and the well-being of people and the economy. Global socio-economic and environmental challenges are mounting, and stakeholders and societies want organisations to make and declare their positive contributions to a more sustainable world.

Consumers are increasingly looking to buy from organisations that make a positive contribution to the environment and society. Likewise, investors and savers want to 'do good' with their money by investing in organisations that recognise their responsibility towards the environment and society.[1] Consequently, investment managers are finding that expectations are growing for them to be more transparent and accountable for the way in which they put clients' assets to work and to demonstrate how they are fulfilling their stewardship obligations.

For enterprises, sustainability issues are critical components of a business model with implications for strategy, influencing both near- and long-term prospects. Organisations' motivations for managing and reporting on sustainability issues differ but span purpose, differentiation, regulatory requirements, risk management, brand reputation and stakeholder engagement.

An increasing body of evidence shows that organisations which embed consideration of sustainability issues into their business models derive benefits that deliver outperformance for investors.[2] Conversely, those that do not do so can find their commercial success hindered and their brand value eroded; e.g. the automotive sector and emission concerns; technology companies and their perceived responsibility for data misuse; multi-nationals and supply chain or local tax issues.[3]

Sustainability reporting is the process of gathering and communicating information on sustainability issues.[4] By reporting sustainability information as well as financial information, a more complete picture of an organisation is presented. Through the measurement and reporting of progress on sustainability issues, organisations can manage and articulate their full scope of business risks as well as the contributions that they make to the wider world.

Presenting sustainability information alongside financial information helps build robustness and transparency into the overall corporate reporting process, which is an important input for informed decision-making by investors and other stakeholders. Through sustainability reporting, stakeholders can hold boards and investors to account for their contribution to wider society.

1 According to recent research by DFID, 68% of UK savers want their investments to consider impact on people and planet alongside financial performance. **Investing in a Better World: Results of UK Survey on Financing the SDGs**, DFID (2019)

2 **Digging Deeper into the ESG-Corporate Financial-Performance-Relationship**, DWS (2018)

3 **Stock Performance Study Shows Companies Should Take Environmental and Social Factors Seriously**, Pippa Stevens, CNBC (Feb 7)

4 Sustainability includes ESG reporting, both of which are a subset of what is commonly called 'non-financial reporting', especially in EU regulation. This can be a confusing term when talking about non-financial, including sustainability issues, that are in fact financial!

Reporting environmental, social and economic outcomes, or 'impact reporting'

An organisation's impacts are the changes (positive or negative, caused directly or indirectly, wholly or partially, intended or unintended) in social, environmental, or economic outcomes caused by its activities. A social, environmental or economic outcome is the result of an action or event, which describes an aspect of social, environmental or economic well-being. An example of an environmental outcome is an increase or decrease of water usage or carbon emissions; of a social outcome, fair treatment of suppliers or employee well-being; and of an economic outcome, job creation or destruction, or geographic relocation.

Traditionally, sustainability reporting has focused on how an organisation manages issues to avoid harm, mitigate financial risk and manage its reputation. The disclosures used are often related to activities or outputs, which serve as proxy measures for outcomes – in other words, there is believed to be a causal link between the activity or output and the outcome.

For example, 'total number and rate of employee turnover during the reporting period, by age group, gender and region' is often used as one of the proxy indicators for understanding outcomes of employee satisfaction, productivity and equity. Likewise, stakeholder engagement, complaints tracking and the number of employees from a local area might be used to measure the impact of an organisation's activities on a local population.

> The activities of businesses are moving out of the realm of materiality to people and planet and are becoming material to their ability to create financial value.

There can be cases when research on the causal link between an output and an outcome is so strong and contextual factors are so well understood, that measuring the output is practical and sufficient as a measure of outcome and impact (change in outcome). Carbon emissions and environmental degradation are an example of this. Since activity and output measures are within an organisation's control, information on a company's performance on these measures can typically be reliably collected and subsequently more easily assured.

However, throughout this paper, we refer to the ambition for 'outcomes reporting' because measurement of the actual outcomes and impact (changes in outcomes) that result from an organisation's actions is a more effective form of measurement for uncovering risks and opportunities. This is especially the case in relation to many social issues, where local contextual factors influence outcomes and the causal link between proxy measures and the outcomes actually experienced by people is therefore less certain.

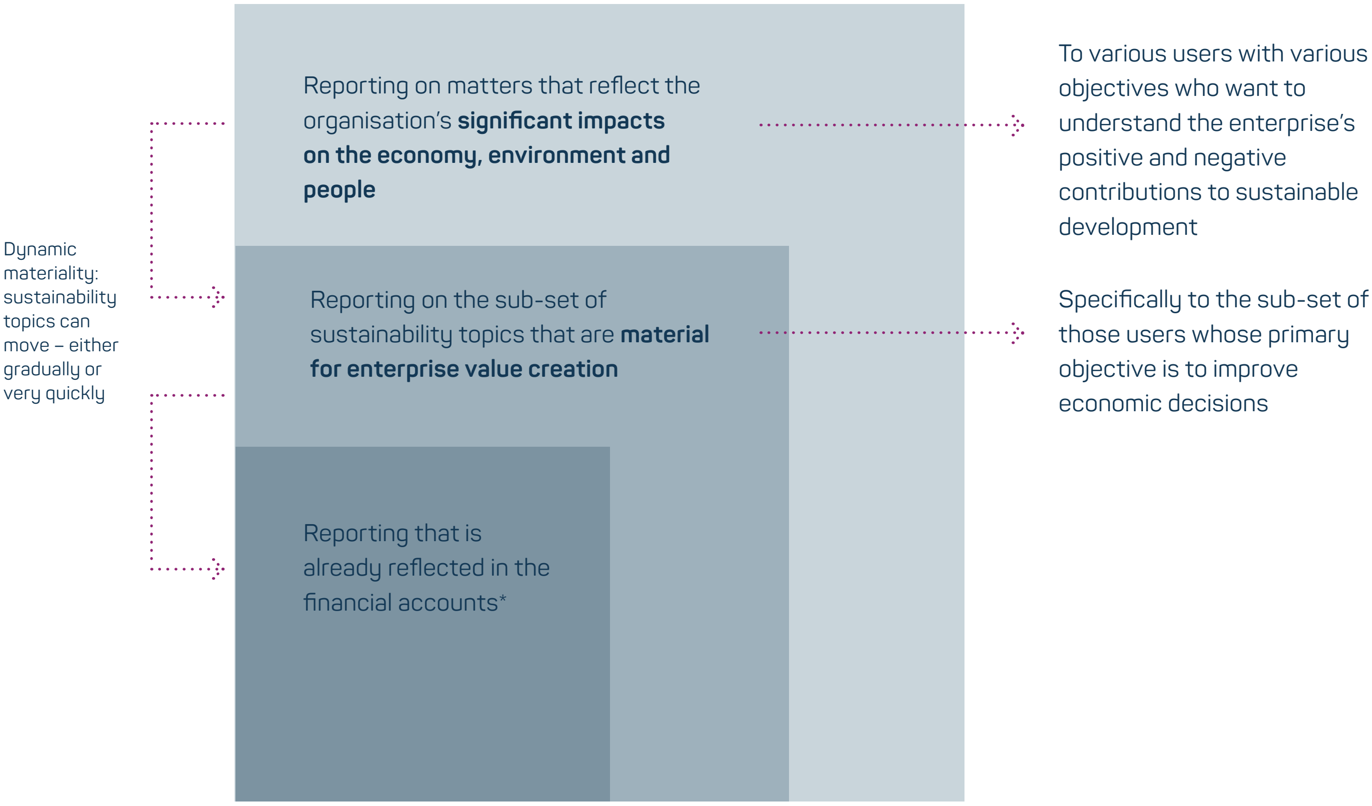
Reporting on outcomes is also important if users of the information are to be able to interpret the extent to which organisations enable sustainable development. By comparing outcomes to relevant evidence-based thresholds[5] as well as context-specific development priorities (for example, articulated in the SDGs), users of sustainability reporting can determine the extent to which different organisations are contributing to the global goals.

"Leading practitioners need to prioritise sustainability issues that are material to the strategy and business model of their organisations and/or to the environment, society and economy.

5 See **https://sciencebasedtargets.org** for an example of an initiative for evidence-based thresholds for GHG emissions

With rapidly accelerating climate change, significant global inequalities and widespread unsustainable business practices, the environmental, social and economic outcomes of the activities of a business are moving out of the realm of materiality to people and planet and becoming material to the ability of the business to create financial value. This concept of shifting boundaries is understood as 'dynamic materiality'.[6] Environmental, social and economic outcomes should therefore be considered key components of corporate reporting, key influences on business strategy and key factors in investment and stewardship decisions. Reporting on outcomes has the potential to enable the transformation of capital market systems to meet society's need for a sustainable future.

Dynamic materiality



*Including assumptions and cashflow projections

Source: Impact Management Project

6 **Dynamic Materiality And Core Materiality: A Primer For Companies And Investors**, Bob Eccles, Forbes (Jan 17)

Outcomes and impact reporting in practice[7]

As a starting point, organisations need to anchor measurement of changes in their environmental, social and economic outcomes (their impacts) in their purpose, strategy, operations, and culture.

Leading practitioners need to prioritise and establish impact objectives for the specific sustainability issues that are material to the strategy and business model of their organisations and/or to the environment, society and economy. The sustainability issues and objectives, set to minimise negative impacts and increase positive impacts, should be identified and prioritised based on a well-documented and transparent materiality assessment.

These impact objectives, often expressed through a statement of corporate purpose, should be tied to clear (and where possible, standardised) metrics and KPIs. They should reference evidence-based environmental and/or social thresholds where possible. Identification of priority sustainability issues and impact objectives and measures should relate to an organisation's sector, as specific themes are of particular importance to specific sectors.

Organisations should consider the governance of sustainability information, including environmental, social and economic outcomes. The responsibility and oversight for the collection, assessment and reporting of this information should rest with the board (or specific board members).

7 See **Technology-enabled impact reporting practice across the investment chain**, Impact Investing Institute and Deloitte (2019), particularly Section B, 'Why organisations measure and report', from p.46

The future of sustainability reporting

The Impact Investing Institute advocates for an evolution of sustainability reporting to include better reporting of environmental, social and economic outcomes. This would help to anchor impact – changes in outcomes – in organisational purpose, strategy, culture and operations, and facilitate transparency, consistency and comparability.

Current practice for reporting of environmental, social and economic outcomes is constrained by a multitude of problems, including:

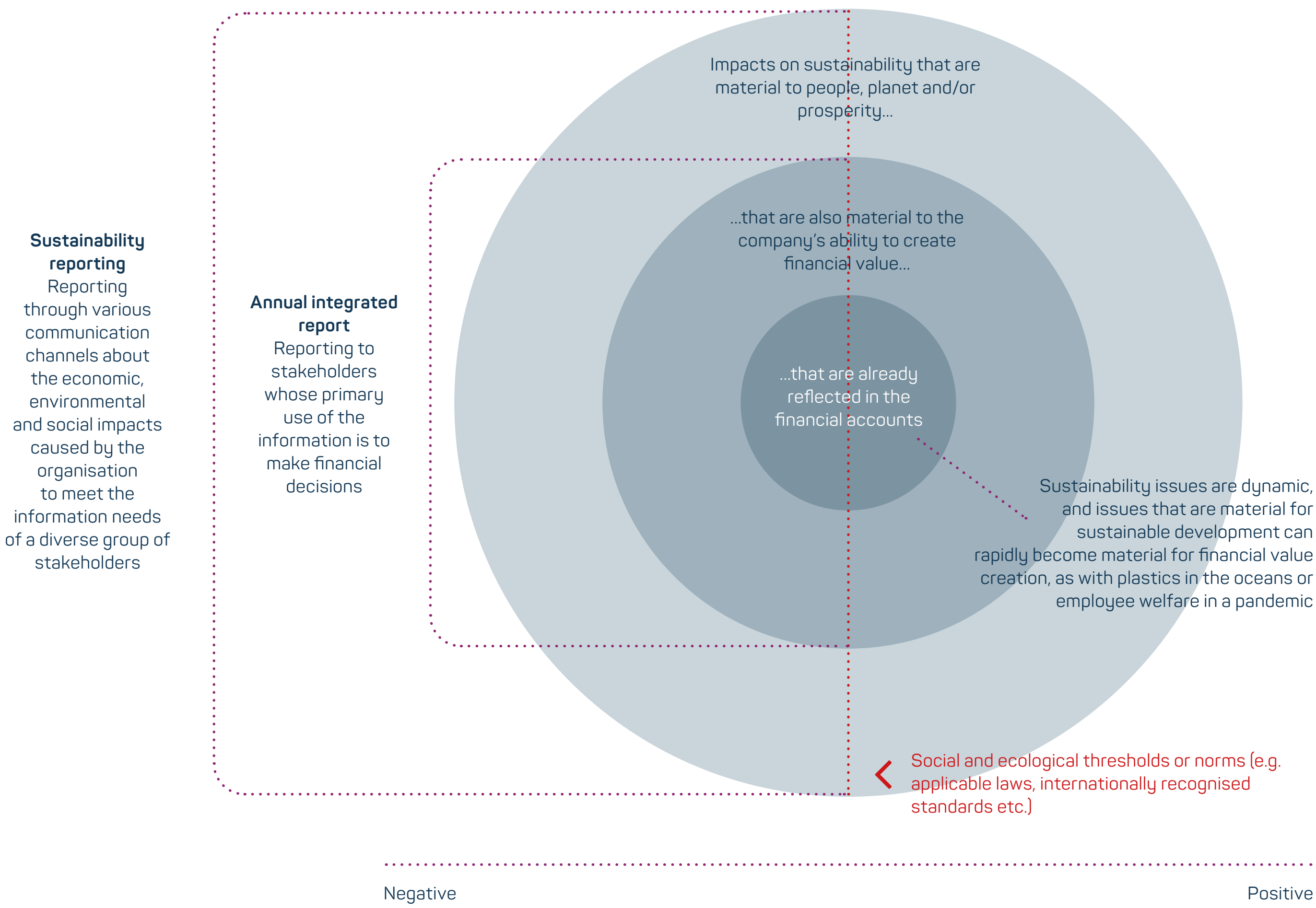
- **Lack of standardisation and a plethora of competing standard-setters:** in 2016, there were almost 400 reporting approaches categorised as focused on sustainability.[8] Despite this plethora of approaches, there are only a handful of standard-setters which have invested heavily to build independent and representative governance structures, similar to that of financial standard-setters. Progress amongst these more developed approaches is encouraging, and recently, five global framework- and standard- setting institutions (CDP, the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC), and the Sustainability Accounting Standards Board (SASB)) announced their intention to work together towards a shared vision of comprehensive corporate reporting. However, there is still more to be done to improve coherence between standard-setters so that stakeholders are able to compare and evaluate the performance of different organisations.
- **Inaccessibility of data:** sustainability reports tend to package data in formats that hinder automated analysis, such as pdfs, and sustainability data is presented via a 'black-box' methodology, for which organisations must often pay. This makes information less accessible and omits important context, making data less useful for decision-making.
- **Weak link between impact and value creation:** there is limited recognition of sustainability information, including environmental, social and economic outcomes, as a driver of long-term enterprise value creation, especially beyond the topic of carbon disclosure and some other 'green' activities. This results in the demotion of sustainability information, whereby it is not given the same prominence nor level of assurance as financial information.

8 **Impact Reporting Landscape**, Taskforce on Growing a Culture of Social Impact Investing in the UK (2018)

Sustainability reporting, within the context of broader financial reporting practices, should therefore evolve over time to:

- include both positive and negative environmental, social and economic outcomes, intended and unintended, that are material to the organisation's ability to create long-term enterprise value. This information should be integrated with financial reporting in an annual integrated report;
- include both positive and negative environmental, social and economic outcomes, intended and unintended, that are material to sustainable development, even if they are not yet material for enterprise value creation. This information ('public interest reporting') should be reported through various channels to meet the needs of a diverse group of stakeholders;
- be subject to assurance which renders all sustainability reporting reliable. Assurance for information in the annual report should be equivalent in robustness to that for financial reporting; and
- be accessible not only to investors but also to a wider set of users.

Reporting spectrum and communication channels



Source: Impact Management Project

Part 2 – Recommendations

There is a global need and demand for capital to be allocated more effectively, and for all those along the investment chain to be held to higher standards of accountability. Measurement and reporting enable this. Currently very few organisations report their impact, and they do so without consistency. In order to achieve both effectiveness and accountability, we support four key recommendations.

A. Convergence of global standards for sustainability reporting

Sustainability reporting standards should be global. Supply chains are global; investors and capital flows are global; urgent challenges such as climate change or pandemics can only be tackled globally. Global standards can effectively counter the risks of regional solutions not meeting the needs of cross-border capital flows and multinational enterprises, as well as the risks of non-participation by some countries.

Sustainability reporting standards should fit together with financial corporate reporting standards and solutions so as to streamline the corporate reporting process and reduce additional burdens on businesses, including costs and risks. The use of global standards will enable comparability at the level of measurement, while also allowing for flexibility in legislation and regulation in individual nations and regions.

Finding ways to enable more collaboration and joint work by the leading global standard-setting organisations will be critical in accelerating the emergence of a global system of sustainability reporting standards – one which includes reporting of environmental, social and economic outcomes and impacts, and which is integrated with financial reporting practice.

The Impact Management Project (IMP)

The IMP's Structured Network is made up of 15 global standard-setting organisations[9] (including CDP, CDSB, GRI, IIRC and SASB, whose statement of intent to work together towards a shared vision of comprehensive reporting we support). Together they have the ingredients for a harmonised system of principles, frameworks and disclosure standards for measuring, managing, and reporting impacts on sustainability issues. These leading standard setters have invested in the governance and due process necessary to build legitimacy through global multi-stakeholder consultation. They therefore represent the fastest route to a global system of standards that can serve the full range of use cases for sustainability information – financial risk management, longer-term value creation, meeting the legitimate public interest of stakeholders, and contribution to goals such as the SDGs.[10] Such a system could be backed by policy makers. The IMP is facilitating these 15 organisations as they work together to present this system in a way that is easy for companies and investors to navigate.

9 The **IMP Structured Network** comprises B Lab, CDP, CDSB, GIIN, GRI, GSG, IFC, Integrated Reporting, OECD, PRI, SASB, Social Value International, UNDP, UNEP, United Nations Global Compact, and the World Benchmarking Alliance

10 The SDGs provide targets and useful reference points for producers and users of sustainability information, rather than a reporting framework

Standardisation and alignment of practices for both financial and sustainability reporting will not only add robustness to sustainability reporting practices but also decrease additional resource requirements. Standards should build on the work of standard setters within the IMP Structured Network, who have proven applicability and legitimacy, and are well-placed to work in concert to provide a global solution that meets the needs of all users.

The architecture of global standards for sustainability reporting has three main components:

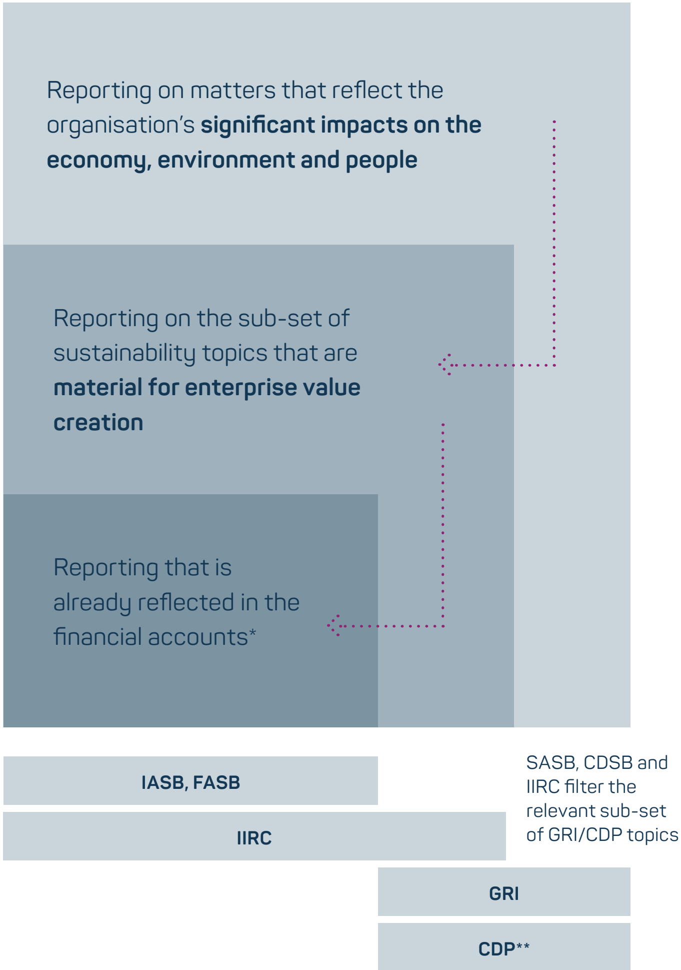
1. Principles of sustainability reporting (e.g. completeness, timeliness, etc.), and framework for determining and disclosing the set of environmental, social and economic outcomes.
2. To meet the needs of investors: metrics for disclosing the sub-set of environmental, social and economic outcomes that are material to the organisation's ability to create enterprise value.
3. To meet the public interest needs of wider stakeholders: metrics for disclosing which of an organisation's impacts are material to society, the environment and the economy – and therefore material to sustainable development. These metrics are linked to and interdependent with (2) above: the public interest perspective is material to long-term value creation and a subset of public interest impacts will affect near- to medium-term financial performance.

Two complementary standard-setting organisations, SASB and GRI, are well-placed to provide this complete system. These organisations' standards are robust and well-tested and provide an effective basis for the formation of a single sustainability disclosure system, which can be adopted by national standard setters. Together they provide good coverage of the needs of users of sustainability information.

SASB identifies sustainability topics that are likely to be financially material in the short or medium term and are therefore typically most relevant for investors and stewards of financial system stability, such as securities market regulators and central banks. GRI takes a wider view of materiality: it requires organisations to report against topics that substantively influence the assessment and decisions of a broader range of public interest stakeholders including civil society, trade unions and others. The combined standards are complementary and provide the basis for implementing the OECD's Guidelines for Multinational Enterprises (MNE Guidelines), which are government-backed recommendations for responsible business conduct.

Benchmarking will encourage organisations to set and achieve their impact goals in a way that is comparable and accessible, thereby contributing towards the convergence of global standards in environmental, social and economic outcome reporting. The World Benchmarking Alliance (WBA), also part of the IMP's structured network, is developing a range of corporate benchmarks in order to clarify what society expects from businesses with regards to the SDGs, and how businesses can contribute to meeting these expectations.

Standards address distinctive materiality concepts



*Including assumptions and cashflow projections
** Reflects the scope of the CDP survey, insofar as it functions de facto as a disclosure standard for climate, water and forests, as well as the scope of CDP's data platform

B. Mandatory reporting of environmental, social and economic outcomes – both those that are material to an organisation's ability to create long-term enterprise value, as well as those which are material to sustainable development ('public interest reporting').

Organisations should be mandated to report the positive and negative environmental, social and economic outcomes which are material to their ability to create long-term enterprise value. This information should be reported, to the greatest extent possible, alongside financial information in an annual integrated report. This vision for enhanced sustainability reporting assumes a reimagining of current integrated reporting structures.

Organisations should also be mandated to report, through communication channels suited to their various stakeholders, the outcomes that are material for society, the environment and the economy, even if they are not yet material for enterprise value creation. This type of sustainability reporting would serve the public interest and enable all stakeholders to better assess the wider impacts of organisations, both positive and negative, on the environment and society. Reporting of environmental, social and economic outcomes helps to monitor as well as enhance or mitigate such impact.[11]

All reporting of environmental, social and economic outcomes should use consistent measures and disclose the methodology applied in defining the material sustainability issues.

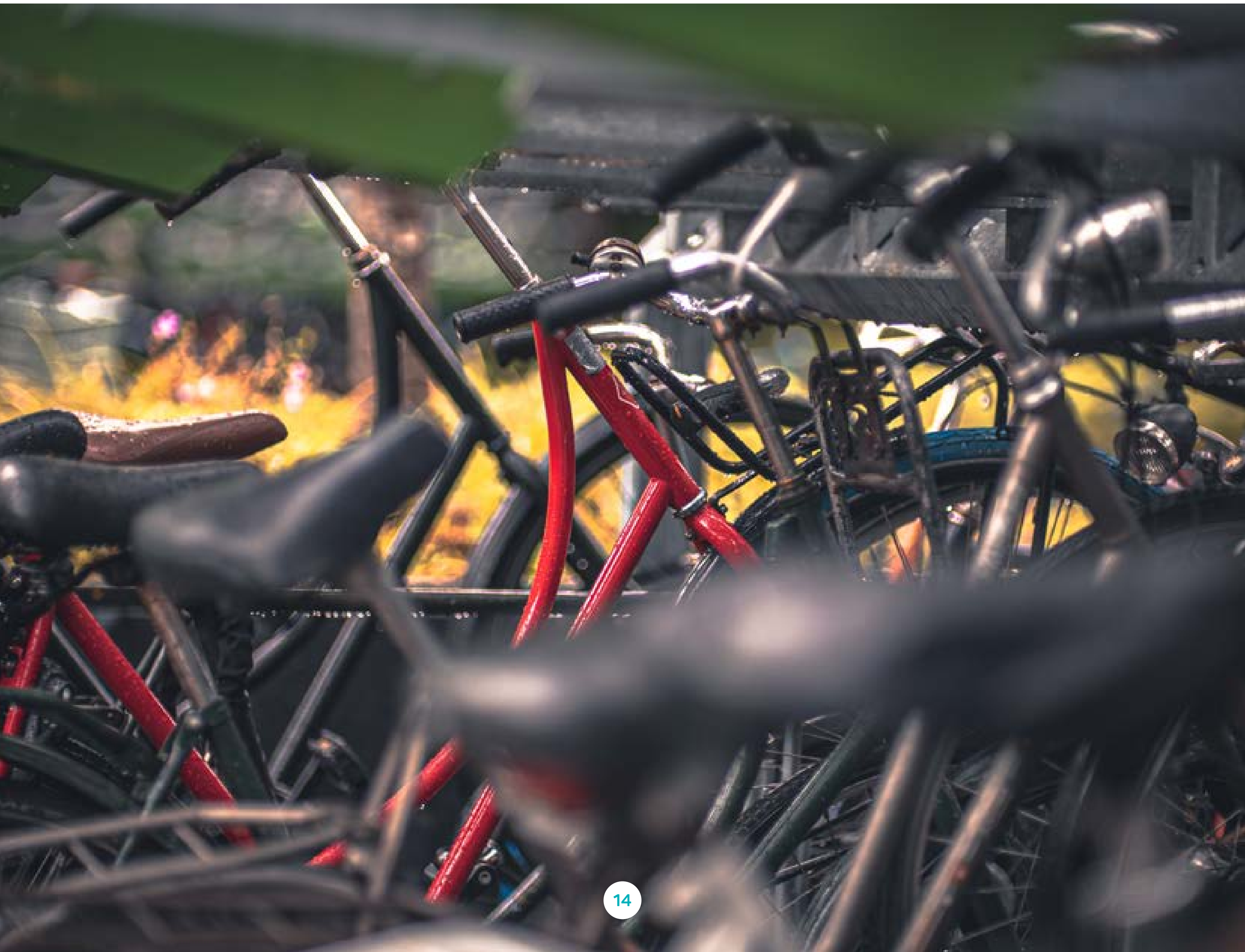
11 This is consistent with the recommendations of Sir Donald Brydon CBE, in his report of the independent UK review into the quality and effectiveness of audit: **Assess, Assure and Inform – Improving Audit Quality and Effectiveness** (2019).

C. Creation of a governing body for global standards of sustainability reporting

Although standards like GRI and SASB are global, they are currently public goods, voluntary standards, predominantly adopted by US- and EU-based organisations. In order to translate them into mandatory, global reporting standards they need to be developed and housed in an international governance body. This could be one that already exists, or a new body created from existing bodies or newly developed, backed by policy makers around the world, which can steward the translation of the global reporting standards into different country-level requirements (similar to how the International Financial Reporting Standards Board (IFRS) governs financial statements).

D. Creation of public depositories of data, metrics, KPIs, tools and approaches

Data, metrics, KPIs, benchmarks, tools and approaches need to be accessible by and distributable to all. Publicly available depositories, properly governed, will be key to reducing the burden on organisations of reporting on environmental, social and economic outcomes. These depositories can be developed and maintained in part using public and/or philanthropic funds, but should be developed with and owned by market participants.



Part 3 – Additional notes on our recommendations

Detailed standards for reporting of environmental, social and economic outcomes should be implemented as a gradual process over time to reduce the immediate burden on reporting organisations and to ensure that they have the time to implement and adapt best practices.

In time, annual integrated reports and public interest 'sustainability reports' or 'impact reports' should be made mandatory for both public and private organisations beyond a certain threshold (revenue and/or employee number). For organisations below the threshold (e.g. SMEs), a less onerous application of the reporting standards should be developed and applied.

To elevate information on environmental, social and economic outcomes to the same relevance and quality as financial information, key elements should be subject to equivalent rigorous internal and external controls, including assurance.

Technology

Technology relevant to reporting of environmental, social and economic outcomes will be critical to accelerating progress. Organisations should engage with technology and data providers to adopt and integrate digital technologies into their measurement and reporting systems. Technology and data providers should develop efficient tools to reduce the time and cost burden on reporting organisations and work with third parties or develop service arms to help organisations use their technology and data effectively. Ideally these activities should be incentivised in order to accelerate adoption.

- **Data aggregation:** technology and data providers should develop consistently structured data sets for specific, priority sustainability issues by sector, and build a critical mass of high-quality data and insights to enhance the understanding of and approaches to outcome measurement and reporting. Ultimately, existing data standards (like XBRL or SDMX, used for financial information) should be used for sustainability data to increase accessibility and minimise cost implications for reporting organisations.
- **Assurance:** technology and data providers need to help validate impact measurement and reporting by gathering evidence to substantiate claims and comparing to and contrasting with relevant market data. This already happens to a limited extent (e.g. to support the issuance and application of use of proceeds for green/sustainable/social bonds). The requirement needs to be proportionate to the size of the organisation to avoid excessive additional assurance costs. In addition, initiatives that work on advances in the use of existing publicly disclosed information, on a sector or theme basis, should be encouraged; e.g. those from the World Benchmarking Alliance. This will allow companies, data preparers, investors, users and other stakeholders to work together on practical improvements in reporting and disclosure.

Legislation

New legislation relating to corporate transparency should ensure that organisations improve their approach to reporting of environmental, social and economic outcomes – and the resulting opportunities and risks. In the short- and mid-term, new legislation should support the development of environmental, social and economic outcome measurement and reporting frameworks.

Part 4 – UK and EU messages and country-specific recommendations

Our message to the UK government, regulatory authorities and other decision-makers:

- Despite the impact of Covid-19 on the economy and society, we cannot take our eye off the ball on important reforms that will make our economy more robust and resilient in the future.
- Covid-19 makes the need to unlock pools of private capital, such as pension funds, to fund essential sectors such as healthcare development and housing, even more pressing.
- Impact investment delivers a measurable, positive social and/or environmental benefit alongside a financial return.
- A more effective, robust and standardised approach to reporting impact is a critical part of attracting more private capital into impact investment. Mandatory reporting will allow investors to gauge how their money will be put to work.
- Organisations must be given adequate time to prepare for the introduction of mandatory reporting.
- Individuals and institutions must be confident that their savings and investments are being appropriately deployed, so any reporting must be overseen by a public body which can ensure consistent standards.
- As suggested by the Financial Reporting Council (FRC) in their recent paper on the future of corporate reporting, organisations should initially be accountable to wider society through a public interest statement.

UK-specific recommendations

- Government needs to decide on a single body to be the national standard setter (aligned with convergence of global sustainability reporting standards, including standards for reporting on social, environmental and economic outcomes).
- Accept in principle the FRC's suggestions, and advocate, initially, for large listed companies to be mandated to issue a public interest statement.
- Re-interpret the public interest statement as a sustainability report for all outcomes that are material to society, the environment and the economy, even if they are not yet material for enterprise value creation.
- Relevant regulators and government departments such as FRC/ARGA and BEIS should convene a group (or groups by sector/theme) of impact reporting practitioners across the investment chain who can steer a programme of work to inform good practice standards and regulatory guidance, with the Institute's participation.

Our message to the European Council, regulators and other decision-makers:

- Further development of non-financial reporting within the EU is commendable, however it should be driven by the ultimate goal of global convergence of non-financial reporting standards.
- A common non-financial reporting standard is required to enable stakeholders to access comparable impact investment data. However, it should balance the ability of individual organisations to define and report on environmental, social and economic issues which are material to their business model and the wider society.
- The Non-Financial Reporting Directive (NFRD) requires companies to disclose information "to the extent necessary for an understanding of the development, performance, position and impact of [the company's] activities." This means companies should disclose not only how sustainability issues may affect the company, but also how the company affects society and the environment. This concept of 'double-materiality' requires further definition and should be based on the existing materiality standards developed by SASB and GRI.
- For sustainability measurement and reporting to be credible, it requires high-quality independent assurance, and assurance requires triangulation (validation of data through cross-verification from more than two sources). A triangulated assurance standard is essential for non-financial reporting to be credible.

EU-specific recommendations

- Streamline EU legislation concerning corporate transparency to minimise competing requirements between EU directives, and to ensure alignment between corporate and investor disclosure obligations. Organisations' reporting responsibilities under the NFRD should align with those of financial firms under the Sustainable Finance Disclosure Regulation (SFDR) and the Green Taxonomy.
- Expand the Green Taxonomy to include objectives relating to social factors.
- Base a common non-financial reporting standard on the principles and content of existing standards and frameworks, including: GRI, SASB, TCFD, UN Guiding Principles Reporting Framework (human rights), CDP, CDSB, and ShareAction's workforce disclosure initiative standard.
- Clarify the concept of 'double-materiality' set out in the Accounting Directive and link it to an issuer's public interest obligations. Incorporate the existing materiality perspectives provided by SASB and GRI.
- Mandate disclosure of organisations' materiality assessment process.
- Ensure that standards for reporting are developed, adopted and embedded before regulators rush into digitisation of disclosure at a detailed level.
- Expand the existing XBRL and EFTG systems (which organisations are using for financial information) to be used for non-financial information so that the cost implications to organisations are minimised, and reporting is accessible.
- Broaden the NFRD scope to include all large public interest entities (500 employee threshold), large non-listed companies and large companies not established in the EU that are listed in the EU regulated market.

The Impact Investing Institute is an independent, non-profit organisation which aims to accelerate the growth and improve the effectiveness of the impact investing market. It does this by raising awareness of, addressing barriers to and increasing confidence in investing with impact. Our vision is for lives to improve, as more people choose to use their savings and investments to help solve social and environmental challenges, as well as seeking a financial return.

© Impact Investing Institute
www.impactinvest.org.uk