Environmental, social and governance (ESG):

A key approach to business resilience
### Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreword</td>
<td>01</td>
</tr>
<tr>
<td>Executive summary</td>
<td>02</td>
</tr>
<tr>
<td>Governance</td>
<td>04</td>
</tr>
<tr>
<td>Risk management</td>
<td>08</td>
</tr>
<tr>
<td>KPIs and targets</td>
<td>12</td>
</tr>
<tr>
<td>Reporting</td>
<td>18</td>
</tr>
<tr>
<td>Assurance</td>
<td>22</td>
</tr>
<tr>
<td>Looking ahead</td>
<td>26</td>
</tr>
<tr>
<td>About KPMG China</td>
<td>27</td>
</tr>
<tr>
<td>Contact us</td>
<td>28</td>
</tr>
</tbody>
</table>
Foreword

The COVID-19 pandemic has prompted companies and leaders to rethink and redefine their vision for success. The KPMG 2020 CEO Outlook\(^1\) found the priorities of corporate leaders are changing. Environmental, social and governance (ESG) matters have taken centre stage as stakeholders look to businesses to play a wider role in tackling social and economic challenges. In turn, companies have sought to respond, recover and enhance their resilience to the evolving environment.

Key changes in CEO’s thinking found in the survey\(^1\)

- In the midst of a health and humanitarian crisis, CEOs are focused on creating trusted, purposeful organisations that address critical societal challenges.
- CEOs are doubling down on transformation priorities to build the capabilities needed to succeed in the post-COVID future, e.g., in relation to ESG and supply chains.
- As well as crisis response, CEOs are positioning their businesses for long-term growth and prosperity.

While COVID-19 has brought about unprecedented disruption to societies and economies, the world is also recognising another threat with profound economic and humanitarian consequences. Prior to COVID-19, climate change had risen to the top of the agenda for leaders around the world, as shown in the 2020 annual meeting of the World Economic Forum in Davos, Switzerland. In 2020, over 20 national governments made net-zero carbon emissions pledges. China, the world’s biggest source of carbon dioxide and responsible for around 28 percent of global emissions, aims to hit peak emissions before 2030 and to reach carbon neutrality by 2060. Apart from the physical effects of climate change, companies in all sectors are feeling the economic impacts of the global transition to a low carbon and net zero economy.

The ESG space has continued to develop rapidly, with amplified ESG awareness and expectations among investors, regulators, and consumers. ESG-related investment is accelerating, even in the midst of the pandemic, driving investor demands for enhanced ESG-related disclosure and data. In Hong Kong, the release of further ESG disclosure requirements by the Hong Kong Stock Exchange (HKEX) is just one of a number of policies and initiatives recently launched to promote development in the market.

Investors are more interested than ever before in how companies take into account changes in the economic, social and environmental landscape and how they manage the related risks and opportunities. Companies, in turn, need to provide the information investors and other stakeholders need to assess how companies perform. This is by way of better business reporting, such that investments made in managing ESG are recognised by the capital markets.

In this report, we examine recent key ESG market developments, outline reporting trends and requirements, and consider good practices to address these matters. This report will be useful for companies looking for ways to better prepare and respond to the shifting ESG landscape, use ESG criteria to gain competitive advantages and create differentiation to position themselves for future growth.
ESG practices can help corporates become more resilient by getting them ready for the impact of emerging issues, and helping them maintain robust governance, risk management and controls. In addition, to build and retain trust among stakeholders in the current environment, it is imperative to ensure transparent and high-quality communication and reporting on ESG performance.

To illustrate how to incorporate ESG considerations to help foster greater corporate resilience, this report focuses on the following key issues: 1) ESG governance; 2) risk management; 3) key performance indicators (KPIs) and target setting; 4) reporting; and 5) assurance.

### ESG governance

**Key market developments/drivers**
Broader appreciation of the idea that good governance translates into better management.

**Related ESG disclosure requirements with reference to international/local reporting frameworks**
- Board oversight of ESG issues.
- Board’s ESG management approach and strategy, including the process used to evaluate, prioritise and manage material ESG-related issues and risks.
- Board’s review of progress towards ESG-related goals and targets and relevance to the business.

**The KPMG view/key takeaways**
- Ensure the Board structure addresses ESG in routine discussions.
- Diversify and introduce ESG expertise into the Board’s composition.
- Identify what ESG topics are material to the company.
- Provide directors with training and regular updates on ESG to ensure informed decision-making.

### ESG risk identification and management

**Key market developments/drivers**
The World Economic Forum (WEF) ranked environmental issues within the top five risks in terms of likelihood, with climate-related risks being the top two. Numerous jurisdictions in Asia, including mainland China, Japan, South Korea and Hong Kong (SAR) have committed to becoming carbon neutral by 2050/2060. This is going to instigate a complete transformation of their economies.

**Related ESG disclosure requirements with reference to international/local reporting frameworks**
- Climate-related disclosures on how significant climate-related issues are identified and mitigated, and description of the significant climate-related issues faced and actions taken to manage them.

**The KPMG view/key takeaways**
- Put climate high up on the Board and C-suite agenda and ensure it is considered in strategic planning, risk management and performance monitoring.
- Identify and assess climate risks that may significantly impact the short-, medium- and long-term operation of the company and its supply chain.
- Integrate climate risk considerations into the existing Enterprise Risk Management framework.
KPIs and targets

Key market developments/drivers
Investors and stakeholders have increasingly been asking companies to report ESG data in a more consistent and comparable way to inform effective investment decisions. The WEF created a core set of Stakeholder Capitalism Metrics (SCM) and disclosures that can be used by companies to align their mainstream reporting on performance against ESG indicators and track their contributions towards the UN Sustainable Development Goals (SDGs) on a consistent basis.

Related ESG disclosure requirements with reference to international/local reporting frameworks

- Metrics should be consistent, comparable and capable of verification and assurance.
- Relevant targets set.

The KPMG view/key takeaways

- Report KPIs and ESG information in a consistent way to track performance.
- Establish a consistent, verified and standardised ESG data management system.
- Set appropriate targets aligned with the global initiatives and S.M.A.R.T approach.

Reporting

Key market developments/drivers
Emergence of a number of international initiatives towards convergence of reporting standards. Apart from the WEF’s set of common metrics mentioned above:

- The five major non-financial reporting organisations (GRI, SASB, IIRC, CDSB and CDP) have published a Statement of Intent, committing to work together towards comprehensive corporate reporting.
- The IFRS Foundation Trustees have set out the strategic direction for a new board to develop sustainability reporting standards based on feedback to sustainability reporting consultation, signalling a new era in corporate reporting where the same rigour is demanded for sustainability reporting as for financial information.

Related ESG disclosure requirements with reference to international/local reporting frameworks

- Existence of a large number of voluntary and mandatory non-financial reporting requirements issued by governments, financial regulators, stock exchanges, industry bodies and non-governmental organisations (NGOs).

The KPMG view/key takeaways

- Pinpoint risks and issues with material financial implication to the business and transparently report on them in a concise way.
- Provide clearer communication of the interconnectivity between financial and non-financial ESG information.
- Review various ESG reporting frameworks for possible adoption, considering their comparability.

Assurance

Key market developments/drivers
The Hong Kong Institute of Certified Public Accountants (HKICPA) issued guidance in performing assurance engagement on ESG information.

Related ESG disclosure requirements with reference to international/local reporting frameworks

- Independent assurance encouraged to strengthen the credibility of disclosed ESG information.
- Clearly describe the level, scope and processes adopted for assurance in the ESG report where independent assurance is obtained.

The KPMG view/key takeaways

- Ensure robust internal data collection, audit and control processes are in place to support disclosures.
- Consider what disclosures key stakeholders would expect to have assured.
- Consider the assurance provider’s quality control and consistent application of internationally and/or locally accepted assurance standards to enhance confidence.
It is increasingly recognised that ESG is a key consideration for businesses, one that goes beyond philanthropic considerations but is a major factor in the sustained development of companies. Various ESG topics, such as climate change, present companies with risks and opportunities. As with any other financial and operational factors, the Board is expected to exert effective governance over ESG topics, by strengthening Board oversight, proactively managing ESG risks and opportunities, and ensuring ongoing dialogue on ESG topics both within the company and with various stakeholders.

With reference to the WEF’s guidance on climate governance, How to Set Up Effective Climate Governance on Corporate Boards: Guiding Principles and Questions, companies could apply the following principles to facilitate the Board’s sound governance of ESG matters.

David Ko
Head of Audit, KPMG China

"Sound ESG governance enables companies to properly manage and capitalise on different ESG risks and opportunities for the long-term prosperity of the company. As the highest governance body, the Board should evaluate the effectiveness of the existing governance structure and processes in addressing ESG topics to ensure adequate oversight over the company’s significant ESG issues."
Guiding principles for the Board’s effective governance of ESG matters

**Principle 1 – ESG accountability on Board**
The Board, as the ultimate governance body, is responsible for managing the ESG-related risks and opportunities and ensure resilience with respect to potential shifts in the business landscape that may result from ESG factors. Failure to do so may constitute a breach of directors’ duties.

**Principle 2 – Command of the subject**
Given the diversity of ESG topics, the Board should pay attention to whether the Board’s composition is sufficiently diverse in terms of knowledge, skills, experience and background to facilitate effective discussions and make informed decisions on potential ESG threats and opportunities.

**Principle 3 – Board structure**
Consider how ESG considerations can be integrated into the structure and committees of the Board. There is no one-size-fits-all structure for all companies, but it should draw enough attention and connect the Board and the management on ESG matters.

**Principle 4 – Material risk and opportunity assessment**
Ensure that management assesses the short-, medium- and long-term materiality of ESG risks and opportunities for the company on an ongoing basis. This informs how the company can take actions that are proportionate to the materiality of ESG to the company.

**Principle 5 – Strategic and organisational integration**
The Board should ensure that ESG systemically informs strategic investment planning and decision-making processes and is embedded into the management of risk and opportunities across the organisation.

**Principle 6 – Incentivisation**
The Board should consider including ESG targets and indicators in executive incentive schemes to align management’s incentives with the long-term prosperity of the company. Where appropriate, the extension of a similar approach to non-executive directors can also be considered.

**Principle 7 – Reporting and disclosure**
Material ESG risks, opportunities and strategic decisions should be disclosed to all stakeholders (in particular investors and regulators) in a transparent and consistent manner. Such disclosures should be made in financial filings, such as annual reports and accounts, and be subject to the same disclosure governance as financial reporting.

**Principle 8 – Exchange**
The Board should maintain regular exchanges and dialogues with peers, policymakers, investors and other stakeholders to encourage the sharing of methodologies and to stay informed about the latest ESG risks, regulatory requirements etc.
Example of an ESG governance structure

This sample illustrates how ESG matters could be integrated in the governance process.

At the Board level, a dedicated ESG committee can be established to assist the oversight of key ESG issues in a more systematic manner. The daily management function is allocated to a management-level working group, which in turn provides regular updates to the committee on the company’s ESG performance. For significant ESG topics, special taskforces with relevant subject matter expertise may be set up for more focused and in-depth discussion and management of these topics.

An effective structure ensures ESG considerations are integrated into planning and execution at different levels of an organisation, and the Board is informed with sufficient and appropriate ESG updates through an established management reporting relationship.
The KPMG view

The structure and processes a company creates to oversee ESG issues will vary depending on a number of factors, such as the size and complexity of the company’s operations (including its supply chain and whether operations are international), its industry, the magnitude of the company’s ESG risks and opportunities, the degree to which ESG issues are central to the company’s strategy, and the level of director expertise regarding relevant ESG issues.

Companies can ask these questions to help assess the robustness of Board oversight over ESG matters:

<table>
<thead>
<tr>
<th>Questions for the Board</th>
<th>Suggested action points</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Is the existing Board structure sufficient to facilitate discussion of ESG topics at the Board level? Is the responsibility being delegated to an appropriate subcommittee with relevant expertise on the topic?</strong></td>
<td></td>
</tr>
<tr>
<td>• Review the existing Board structure to see how ESG issues can be addressed in routine discussions of the Board or its subcommittees.</td>
<td></td>
</tr>
<tr>
<td>• Integrate ESG mandates into existing committee(s), or have a dedicated committee address the topic.</td>
<td></td>
</tr>
<tr>
<td><strong>Does the Board have sufficient awareness and understanding of the ways in which ESG issues (including climate change) may affect the business?</strong></td>
<td></td>
</tr>
<tr>
<td>• Review the composition of the Board and succession planning to include ESG-related expertise.</td>
<td></td>
</tr>
<tr>
<td>• Consider bringing in external advice for out-of-the-box opinions and ideas to keep the Board updated on ESG trends to allow informed decision-making.</td>
<td></td>
</tr>
<tr>
<td><strong>How does the Board determine what ESG topics would affect the company’s strategic competitiveness? And how should these ESG issues be governed?</strong></td>
<td></td>
</tr>
<tr>
<td>• Understand the process that management uses to determine the material ESG issues and their impact on finance, efficiency, risk, strategy and long-term performance.</td>
<td></td>
</tr>
<tr>
<td>• Work with management to establish metrics and KPIs that enable the Board to monitor management’s performance against goals.</td>
<td></td>
</tr>
</tbody>
</table>

Corporates should ensure the Board structure addresses ESG in routine discussions, clarify the Board’s oversight responsibilities and improve information flow.
How climate risks affect financials

The impact of climate change is diverse and multi-faceted and presents companies with different financial risks and opportunities. These risks, or opportunities, can stem from two major channels, namely physical and transition risks.

After COVID-19, climate change would be the priority ESG topic to the business community in the medium-to-long term. Environmental risks, including climate action failure, extreme weather and water crises, occupied all the top five risks in terms of likelihood in the WEF’s 2020 Global Risks Report. Climate change could affect the world for a lot longer than COVID-19, meaning its impact on corporates could be much more substantial and prolonged. In fact, according to KPMG’s 2020 CEO Outlook, 71 percent of responding CEOs said they want to lock-in climate change gains made as a result of the pandemic, with 65 percent saying that managing climate-related risks will play a part in whether they keep their jobs or not over the next five years.

In the foreseeable future, climate change will be one of the biggest ESG risks threatening all businesses as it can intensify the effects of existing principal risks. Companies need to have a real understanding of the related risks they face in the context of a highly connected world to develop better strategies to mitigate or respond to the impacts when they materialise.

Alva Lee
Partner, Risk Consulting, KPMG China
Physical risks

Physical risks stem from the direct impact brought by the physical changes in the climate. They may come in two forms, risks driven by acute events and risks driven by longer-term (i.e., chronic) changes in weather patterns.

<table>
<thead>
<tr>
<th>What it means</th>
<th>Possible impacts</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Acute</strong></td>
<td></td>
</tr>
</tbody>
</table>
| Acute physical risks refer to those that are event-driven, including increased severity of extreme weather events, such as cyclones, hurricanes or floods. The immediate impacts of acute events can translate to direct economic losses. | • Damage to physical assets  
• Disruption of supply chains  
• Disruption of infrastructure and utilities |
| **Chronic**    |                  |
| Chronic physical risks refer to long-term, sustained changes to the physical environment due to climate change (e.g., temperature increases and rising sea levels). Such changes are generally progressive and may not be felt immediately, but their effect will cumulatively add up and impact financial performance. | • Progressive damage to coastal real assets  
• Impact to agricultural yields and shifts in growing seasons  
• Human disease migration  
• Affect the availability and quality of water resources |
**Transition risks**
Transitioning to a low-carbon economy will involve addressing the mitigation and adaptation requirements related to climate change. Depending on the nature, speed, and focus of these changes, transition risks may pose varying levels of financial and reputational risk to organisations.

<table>
<thead>
<tr>
<th>What it means</th>
<th>Possible impacts</th>
</tr>
</thead>
</table>
| **Policy and legal** | Policy developments attempting to limit actions that contribute to the adverse effects of climate change or promote adaptation to climate change may have a direct impact on businesses. For instance, China’s commitment to go carbon neutral by 2060 could be a great example of transition risks from policies. There are also chances of litigation linked to corporate actions relating or contributing to climate change. | • Increase in operating costs  
• Write-offs, asset impairment, and early retirement of existing assets due to policy changes  
• Increased costs and reduced demand for products and services resulting from fines and judgments |
| **Technology** | Refers to risks associated with technological improvements or innovations during the transition to low-carbon economy. Common examples include the use of emerging technologies such as renewable energy, battery storage, energy efficiency, carbon capture, etc., which will affect the competitiveness and production costs of companies, and ultimately the demand for their products and services from end users. | • Reduced demand for products and services  
• Write-offs or early retirement of existing assets  
• Research and development expenditures in new technologies  
• Capital investments in technology development  
• Costs to adopt/deploy new practices and processes |
| **Market** | Mainly comes from shifts in supply and demand for certain commodities, products and services. Common examples include changing customer behaviour, uncertainty in market signals and increased cost of raw materials. | • Reduced demand due to shifts in consumer preferences  
• Increased production costs due to changing input prices  
• Abrupt and unexpected shifts in energy costs  
• Change in revenue mix and sources  
• Re-pricing of assets |
| **Reputation** | Risks tied to changing customer perceptions and the wider community on a business’s contribution to or detraction from the low-carbon transition. Common examples include shifts in consumer preferences, negative stakeholder feedback and negative press coverage from supporting projects with negative impacts on the climate (e.g., deforestation, fossil fuel extraction, etc.). | • Reduced revenue from decreased demand  
• Reduced revenue from decreased production capacity (e.g., delayed planning approvals, supply chain interruptions)  
• Reduced revenue from negative impacts on workforce management and planning (e.g., employee attraction and retention)  
• Reduction in capital availability |
The above physical impacts of climate change and transition risks brought by decarbonisation could have material impact on the book values of companies, yet it is still uncommon for companies to take into account such risks in their financial statements. Looking forward, companies will have to go beyond climate risks disclosures, and focus on how they are managing the risks and their effect on asset values.

The KPMG view

Climate change risks will remain one of the major risks for corporates for decades to come. With the lessons of COVID-19 showing the shortfalls of current risk management practices, corporates should take action now to ensure resilience in the face of upcoming risks of climate change, in particular the transition risks brought by governmental carbon neutrality targets worldwide as over 20 national governments have committed to a net zero target.

With the Chinese government’s latest pledge to become carbon neutral by 2060, major changes in the existing economic structure and transitions in energy supply would be inevitable. Companies should consider how the march to net-zero will affect their businesses, including their operations and supply chains, and implement the right strategic response. Companies may ask themselves:

- Does your company have adequate knowledge on the topic to understand and articulate the nature and scale of the potential financial impact?
- How are climate risks and opportunities within operations and across the supply chain considered in the enterprise risk assessment and management process?
- How does your company consider the short-, medium- and long-term time frames and climate scenarios in assessing the risks to the company?
- How do risk assessment results inform the response to climate risks and opportunities?
- How should your company measure progress and communicate its climate strategy effectively to investors?

Corporates should identify climate risks that may significantly impact the short-, medium- and long-term operations of the company and its supply chains, and consider integrating such considerations into the existing enterprise risk management framework.
KPIs and targets

Key drivers

There is a trend to embed ESG criteria into investment decisions. Investors are demanding corporate leaders improve sustainability performance to benefit their firms’ bottom line and generate greater impacts on the wider community. Investors measure the resilience of companies to long-term, financially relevant ESG risks by studying available ESG information, KPIs and performance. Therefore, there are greater expectations for businesses to disclose harmonised sustainability metrics in their mainstream reporting for easier benchmarking of performance.

Businesses of all shapes and sizes are looking for ways to include a wider range of ESG information and data into their decision-making. Some are simply seeking to properly quantify their broader carbon footprint for management and reporting. Others are trying to set ESG targets to drive their next wave of improvements. Thus, having a consistent, verified and standardised ESG data management system is important.

From a regulatory perspective, HKEX published the latest ESG Reporting Guide which focuses on issuers’ commitments and performance, rather than only “technical reporting”. Issuers have to determine KPIs and targets to measure and evaluate ESG performance, with an aim to improve ESG performance in the short, medium or long term. The new requirements cover the description of targets for emissions, waste, energy use and water efficiency, and the steps taken to achieve them.
There are greater market expectations for businesses to disclose a harmonised set of sustainability metrics in their mainstream reporting to more easily benchmark their performance, in particular within their industry sector. This demand will only accelerate in light of increased emphasis on climate change and the ongoing social and economic issues exacerbated by the COVID-19 pandemic affecting sustainable business performance.

Data management and KPIs setting
Operational inefficiencies, unreliable reporting, stakeholder dissatisfaction or compliance issues are the result of unsatisfactory ESG data management. The common problems for ESG data management and disclosure – generally speaking – are inconsistency, poor verification and a lack of standards.

KPIs

<table>
<thead>
<tr>
<th>External</th>
<th>Internal</th>
</tr>
</thead>
</table>
| **Reputation** | **Awareness**
A consistent and comparable ESG disclosure provides positive influence on reputation and brand value. | Strengthening of internal awareness of sustainability information at the Board and C-suite level. |
| **Credibility** | **Reliability**
Better data management increases the credibility of information for stakeholders. | More reliable information for the basis of management decisions. |
| **Quality** | **Decision making**
Advanced ESG data management to handle large amounts of data and complex combinations of data sources, as well as improving the quality of reporting. | Driving better decision-making based on higher quality ESG data and measurable targets. |
| **Ratings & Ranking** | **Continuous improvement**
Providing a solid foundation to improve the position in sustainability ratings and rankings, such as CDP or DJSI. | Systems, processes and internal controls around sustainability reporting improve with each assurance engagement. |

Common issues:
- Inconsistency of data over multiple systems that require process rewording and constant reconciliation.
- Inconsistent or unclear data ownership, leading to inaccurate reporting.
- Negative stakeholder engagement experience or poor report quality due to incorrect or duplicated information being communicated.

Across existing reporting frameworks and standards, the WEF has created a core set of “Stakeholder Capitalism Metrics”\(^{14}\) and disclosures that can be used by companies to align their mainstream reporting on performance against ESG indicators and track their contributions towards the United Nations’ Sustainable Development Goals (SDGs) on a consistent basis. By using this tool, companies can demonstrate to shareholders, stakeholders and society at large their commitment to measuring and improving their impacts on the environment as part of the transition to a low-carbon future.
Target setting

Target setting is also vital to achieve a long-term vision. A clear target is conducive to building business resilience and increasing competitiveness. Proactive engagement in target setting based on international standards offers a good opportunity to drive innovative and transformative business practices.

In our previous publication “Integrating ESG into your business”15 we discussed the steps involved in target setting. Here we discuss the key elements that can help a company set appropriate targets for emissions reduction, waste management, energy efficiency, water stewardship and other sustainability-related aspects with the S.M.A.R.T approach and introduce Science Based Targets initiative (SBTi).

Setting “S.M.A.R.T” targets

- **S**pecific – What specifically do you want to achieve?
- **M**easurable – How will you know when you have achieved the target?
- **A**ttainable – Is it something you have control over and can actually achieve?
- **R**elevant – Why is this target applicable to your business and how does it align with existing strategies?
- **T**ime bound – When do you want to achieve your goal?

Science Based Targets initiative (SBTi)

Larry Fink, the chief executive of BlackRock, the global investment management leader, warned of the increasing impact of climate change in early 2020: “Every government, company and shareholder must deal with climate change”. The latest research makes it clear that to meet the Paris Agreement’s temperature goals and avoid the worst climate impacts, global greenhouse gas (GHG) emissions will need to drop by half by 2030 and reach net-zero by 2050. In order to achieve this target, over 1,000 international companies have aligned their ambitions to the Paris Agreement through setting science-based targets.

The Science Based Targets initiative (SBTi) provides businesses with a clearly defined pathway to future-proof growth by specifying how much and how quickly they need to reduce their GHG emissions. Targets adopted by companies to reduce GHG emissions are considered “science-based” if they are in line with what the latest climate science says is necessary to meet the goals of the Paris Agreement – to limit global warming to well-below 2°C above pre-industrial levels and pursue efforts to limit warming to 1.5°C. SBTi are a key tool for the low-carbon transition and ensure companies are taking shorter-term action to reduce emissions at a pace that is consistent with keeping global warming below 1.5°C or well-below 2°C. They are standard practice for corporations to play a critical role in the transition towards a zero-carbon economy.
Why are companies setting SBTi?

**Address stakeholder expectations**
- i.e. long-term sustainability of business model

**Increase competitiveness**
- i.e. minimise energy & emissions-related costs

**Anticipate regulatory, policy and market developments**
- i.e. mitigate transition risks

**Seize opportunities behind the low-carbon transition**
- i.e. low-carbon products or services

55 percent of company executives say they have gained competitive advantages from setting science-based targets.16

79 percent of company execs say brand reputation was boosted from setting science-based targets.16

**Example**

KPMG has announced its intention to become a net-zero carbon organisation by 2030, as part of its continued focus on delivering growth in a sustainable way and providing climate solutions for KPMG firms, clients and society.

To underpin this goal, the global organisation has signed up to a series of new climate actions, including a 1.5°C science-based target, which will focus on achieving a 50 percent reduction of KPMG’s direct and indirect GHG emissions by 2030.

Raymond Ng
Vice Chairman/Head of Market Development/Head of Energy and Natural Resources, KPMG China

“We have made real strides in growing our business in a sustainable way and are sharing our own story while working with our clients on their ESG and sustainability agenda. We recognise that the climate crisis we all face globally means we must move further and take more aggressive efforts.”
Investors and stakeholders now expect companies to report on non-financial issues, risks and opportunities with the same discipline and rigour as financial information. Although every company is at a different stage in terms of reporting ESG factors material to their business, reporting KPIs and information in a more consistent and comparable way can build trust among stakeholders and shareholders.

The number of climate regulations and carbon reduction targets continues to increase. This means businesses will have to navigate an increasingly fractured regulatory landscape and enhance their collective commitment to the global climate agenda with carbon reduction plans. Target setting is challenging but is also an opportunity for businesses to have a better understanding of their current performance. Implementing reduction actions is also helpful in lowering operating costs and risks exposures.

Corporates can evaluate their performance on KPIs disclosure and the readiness of target setting by addressing the questions below:

- Does your company know how to set appropriate targets in emissions reduction, waste management, energy efficiency, water stewardship and other sustainability-related aspects aligned with the global initiatives and/or S.M.A.R.T approach?
- Does your company support target-setting and sustainability performance monitoring with internal engagement?
- How do your company’s KPIs and targets compare with others?
- Has your company tracked and disclosed comparative KPIs and ESG information?
- Does your company have a consistent, verified and standardised ESG data management system?
- Has your company reported KPIs and ESG information in a consistent way?

Corporates should set measurable targets aligned with global initiatives or the S.M.A.R.T approach and report ESG information in a consistent way to track performance of measures taken to achieve the targets.
Environmental, social and governance (ESG): A key approach to business resilience
Reporting

Key drivers

In an environment affected by a global pandemic and economic weakness, companies are increasingly being asked to focus on reporting on the matters and risks most relevant to the future of their business, rather than follow a list of prescribed disclosures. The result is a much greater emphasis on the business model and strategy as a basis for reporting.

Many companies face challenges setting themselves apart in demonstrating their value in ESG reports. Some companies may fill their reports with a list of ESG achievements. However, without due regard to the connection of these achievements to the business strategy and materiality to financial performance, such disclosures could give the impression that they consider their ESG activities as charitable acts—philanthropic gestures paid for by shareholders—rather than a routine investment in the viability of the business. Recognising the difference between reporting on sustainability and reporting on the sustainability of the business is key towards producing focused reports.

Another challenge is determining which reporting framework to follow, given the hundreds of frameworks and voluntary standards for ESG reporting. Among these frameworks are the HKEX ESG Reporting Guide, the Global Reporting Initiative (GRI) Standards, CDP, Sustainability Accounting Standards Board (SASB) and Integrated Reporting.

This results in companies applying reporting frameworks as they see fit, and hence a lack of directly comparable ESG information in the capital market. This lack of comparability lowers the usefulness of the information to investors for making capital allocation decisions.

Patrick Chu
Partner, Head of Business Reporting and Sustainability, KPMG China

Back to the fundamentals, we should also challenge ourselves on how we engage our stakeholders by way of ESG reporting. We need to address challenges regarding comparability, reliability and the relevance of information shared with key stakeholders. Quality reporting would make it easier for key stakeholders to understand and evaluate companies’ ESG performance and provide valuable feedback, i.e. a stakeholder-centric reporting. In preparing the ESG reporting, companies should take into account the following considerations: (1) a balance between positive and negative information; (2) forward-looking and historical information; and (3) quantitative and qualitative disclosures. In this context, quality reporting would begin to take hold as part of the broader and more holistic business management and corporate governance environment.
Recognising the urgent need to improve the comparability in ESG reporting for the capital market, there have been mounting efforts to simplify the reporting landscape with a consistent global framework. Among the recent market developments:

- International Financial Reporting Standards (IFRS) Foundation Trustees have set out the strategic direction for a new board to develop sustainability reporting standards based on feedback to sustainability reporting consultation, signalling a new era in corporate reporting where the same rigour is demanded for sustainability reporting as for financial information.18

Five framework- and standard-setting institutions of international significance, CDP, the Climate Disclosure Standards Board (CDSB), GRI, the International Integrated Reporting Council (IIRC) and SASB, outlined a vision for a comprehensive corporate reporting system in the joint Statement of Intent to Work Together Towards Comprehensive Corporate Reporting in September 2020.19

The WEF, in collaboration with KPMG and the other Big Four accounting firms, released in September 2020 a set of universal ESG metrics and disclosures that companies can report on, regardless of industry or region – Toward Common Metrics and Consistent Reporting of Sustainable Value Creation.20

Four pillars, 21 core metrics and 30 expanded metrics

Toward Common Metrics and Consistent Reporting of Sustainable Value Creation proposes a universal set of Core and Expanded ESG metrics and reporting disclosures that are aligned with the United Nations’ Sustainable Development Goals: Principles of Governance, Planet, People and Prosperity. The metrics are capable of verification and assurance, to enhance transparency, consistency and alignment among countries, industry sectors, corporations, investors and all stakeholders.

The core metrics are positioned as minimum requirements. In addition, there are a further 30 expanded metrics and disclosures that are more challenging to report against. These can help companies work towards greater depth, breadth and precision of reporting on the factors influencing long-term value. They can also provide companies a pathway for continuous improvement.

Nearly 85 percent of corporate respondents agreed that reporting on a set of universal ESG metrics and disclosures would be useful for their company.

Almost 65 percent are willing or able to report on the core metrics and disclosures in their mainstream annual report.

90 percent of corporates said that they agree that reporting a set of universal and industry agnostic ESG metrics and disclosures is useful for financial markets and the economy.

For more detail, please refer to the full report Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation.20
The ESG agenda has never been more important as it is recognised ESG issues can be financially material to businesses. ESG reporting is continuing to increase in importance for stakeholders including investors, creditors, central banks and regulators.

To build trust with stakeholders, companies need to transparently report on the risks and issues with material financial implications to the business. Instead of simply a range of ESG initiatives, stakeholders want to understand, from concise disclosures, which issues are of greatest risk or strategic significance to the company, how they are embedded into the core business activities, and whether there is strong executive leadership behind ESG efforts.

ESG risks, including climate risks, are likely to result in foreseeable financial impacts including losses and liabilities for many companies. As such, investors will be expecting clear communication of the interconnectivity between financial and non-financial ESG information. There may be further expectations for company leaders and directors to confirm that financials have taken into account the impact of ESG factors.

With respect to reporting frameworks, companies choosing to report using multiple standards or metrics may risk limiting their reporting effectiveness and impact, and increasing complexity and cost. The market is calling for comparable ESG information and moving towards a global consistent reporting standard. Reporting on the metrics outlined in the WEF report in mainstream annual reports is encouraged. It will provide comparability between businesses as well as the opportunity for companies to potentially get ahead and influence the development of emerging ESG regulations.

For leaders and boards taking a deeper look at the company’s ESG reporting practices, here are some questions to consider:

- What is the process management used to determine the ESG information to be disclosed?
- What are the ESG topics that align to the priorities of the company and its stakeholders?
- Do company disclosures demonstrate proactive ESG governance and leadership?
- How do the company’s disclosures compare with others?
- Have ESG impacts (e.g., climate risks) been considered in the accounts/financial statements?

Pinpointing transparently in a concise way and reporting the risks and issues with material financial implications to the business could be a first step to enhance the interconnectivity between financial and non-financial ESG information.
Environmental, social and governance (ESG): A key approach to business resilience
Assurance

**Key drivers**

ESG information and data are being used more and more in the marketplace to evaluate risk and make investment and business decisions. For this purpose, the information needs to be credible and so the assurance of ESG information is increasingly expected by regulators, shareholders, investors and other stakeholders:

- All information reported pursuant to the listing rules must be accurate.²¹
- Having ESG information assured could contribute to scoring improvements in various ESG related indices and rating programmes (e.g., the Dow Jones Sustainability Index, CDP, GRESB).
- The Financial Stability Board’s (FSB) Task Force on Climate-related Financial Disclosures (TCFD) states that effective disclosures “should be reliable, verifiable and objective”.²²

Metrics relevant to long-term value should be disclosed in mainstream annual reports and should stand up to assurance—investors expect ESG reporting to be as reliable as financial metrics/information.²³

Third-party assurance of ESG information is now practice for a majority of businesses worldwide, with 62 percent of the world’s 250 largest companies by revenue seeking assurance.²⁴ In Hong Kong, while assuring ESG information is not mandatory, listed issuers are encouraged by HKEX to seek independent assurance to strengthen the credibility of ESG information in the market.

The market offers a number of different models for ESG assurance to choose from. Even where a company has its information being “assured” or “verified”, lack of clarity on the assurance standard adhered to and the assurance level and scope adopted could still lead to doubt on the assurance quality and the level of confidence one could place on the information.
Determining the level and scope of assurance

Level of assurance

The level of assurance indicates the extent and depth of the work the assurance provider will undertake, and therefore the degree of confidence report users should be able to have. Assurance providers often offer two levels: “reasonable assurance” (i.e., high but not absolute) or “limited assurance” (i.e., moderate). The higher the level of assurance, the more rigorous the assurance process is. As a result of cost constraints and other feasibility issues, an organisation may choose to have a reasonable level of assurance for some indicators and limited for others.

For limited assurance, the level of assurance can vary significantly, from just above assurance that is likely to enhance the intended users’ confidence about the ESG information to a degree that is clearly more than inconsequential to just below reasonable assurance. For a reasonable assurance, sufficient appropriate evidence is obtained to support a high level of assurance. The difference in the level of assurance as per the internationally widely recognised assurance framework is illustrated in the diagram below:

Scope of assurance

All ESG disclosures, including claims made, policies and data, are potentially the subject of third-party assurance. In considering the scope of the assurance, a company should consider the following:

- **Strategy**
  What aspects of its ESG policies and performance are most material to the company.

- **Stakeholders**
  What disclosures the company’s main stakeholders would expect to have assured.

- **Systems and data processes**
  Robustness of internal data collection, audit and control processes.
As the market demands credible and comparable ESG data and information for decision making, companies should consider the assurance providers’ quality control and consistent application of internationally and/or locally accepted assurance standards. As a profession, CPAs are regulated and need to strictly adhere to accepted assurance and quality control standards. To further improve the assurance quality, in December 2020 the Hong Kong Institute of Certified Public Accountants (HKICPA) issued guidance to assist CPAs in performing ESG assurance engagement in accordance with the assurance standard HKSAE 3000 (Revised), which is equivalent to the globally accepted assurance standard ISAE 3000.

External assurance of ESG reporting, as with external audit of financial reporting, can provide management, the Board and external stakeholders with increased confidence in the quality and reliability of ESG performance data. In considering the approach to seeking assurance, the below are some questions management and Boards can ask themselves:

What has been done to ensure the ESG disclosures are reliable?

How robust are internal data collection, audit and control processes to support the disclosures made?

Have internal controls highlighted issues or activities that would benefit from external assurance?

Is there sector specific data that investors may use to assess the valuation of a company?

Are there particular aspects of performance that have been questioned by investors, customers, the media or NGOs and where assurance might be useful in building credibility and trust?

Robust processes and controls for data collection are fundamental to the reporting of accurate information. The Board and management should assess the quality of disclosures and consider what information may merit independent assurance to complement the internal processes as well as improve credibility.
Environmental, social and governance (ESG): A key approach to business resilience
Looking ahead

The scale and complexity of the sustainability challenges are expanding. There will be a greater need for companies to deepen their understanding of the connection between ESG and financial performance, strengthen their leadership on social and environmental issues and enhance transparency to increase trust.

ESG is the new normal and will maintain momentum. We suggest a few things to watch for:

The ESG disclosure landscape is evolving rapidly. Development is likely towards harmonisation of ESG reporting frameworks and further coalescence towards a global corporate reporting system that considers the interconnectivity between non-financial information and financial reporting. It is time for companies’ approach to reporting to evolve to provide a picture of how business value is being developed and protected. Increasingly, investors will push for better reporting, to see reports built around a company’s unique business model, addressing the unique factors that drive long-term value for that business.

The pandemic exposed the fragility of global supply chains and showed the importance of building the supply chain in a more resilient and sustainable way. Supply chains are critical strategically and operationally, but vulnerable to risk. Globalisation means supply chains have become complex, dispersed, opaque and inflexible. And there is no shortage of stakeholders ready to hold companies to account for their failings relating to issues such as forced labour, dangerous working conditions, information security lapses, quality issues, environmental waste and pollution.

Faced with the unexpected, companies need to have visibility and transparency over where their inputs come from and impending risk in order to lower their exposure to business disruption. Suppliers will in turn be asked to disclose ESG data for companies to use in setting their sustainable supply chain management strategies.

The pandemic has also highlighted how risks are interconnected. This is the same for climate change but with potentially much bigger impacts. The delivery of climate action involves many economic sectors. Companies should think through solutions and their implementation in a holistic way. This will not only take leadership within the company, but also collaboration across sectors and value chains. A value chain approach can help identify potential emissions reduction opportunities across the whole product/service life cycle. It also drives companies to embrace more holistic thinking for upstream and downstream emissions, as well as their direct emissions.

Disruptions and shifts in the business environment have continued to increase the significance of ESG and the opportunity for it to build business resilience. Stay tuned for further reports and insights into ESG developments and better business reporting.
About KPMG China

KPMG China is based in 28 offices across 25 cities with around 12,000 partners and staff in Beijing, Changsha, Chengdu, Chongqing, Guangzhou, Haikou, Hangzhou, Hefei, Jinan, Nanjing, Ningbo, Qingdao, Shanghai, Shenyang, Shenzhen, Suzhou, Tianjin, Wuhan, Xiamen, Xi’an, Zhengzhou, Hong Kong SAR and Macau SAR. Working collaboratively across all these offices, KPMG China can deploy experienced professionals efficiently, wherever our client is located.

KPMG is a global organisation of independent professional services firms providing Audit, Tax and Advisory services. We operate in 146 countries and territories and in FY20 had close to 227,000 people working in member firms around the world. Each KPMG firm is a legally distinct and separate entity and describes itself as such. KPMG International Limited is a private English company limited by guarantee. KPMG International Limited and its related entities do not provide services to clients.

In 1992, KPMG became the first international accounting network to be granted a joint venture licence in mainland China. KPMG was also the first among the Big Four in mainland China to convert from a joint venture to a special general partnership, as of 1 August 2012. Additionally, the Hong Kong firm can trace its origins to 1945. This early commitment to this market, together with an unwavering focus on quality, has been the foundation for accumulated industry experience, and is reflected in KPMG’s appointment for multi-disciplinary services (including audit, tax and advisory) by some of China’s most prestigious companies.
<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
<th>Contact Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Patrick Chu</td>
<td>Partner</td>
<td>T: +86 10 8508 5705 E: <a href="mailto:patrick.chu@kpmg.com">patrick.chu@kpmg.com</a></td>
</tr>
<tr>
<td>Brenda Wang</td>
<td>Partner</td>
<td>T: +86 21 2212 2468 E: <a href="mailto:brenda.wang@kpmg.com">brenda.wang@kpmg.com</a></td>
</tr>
<tr>
<td>Anthony Ng</td>
<td>Partner</td>
<td>T: +86 755 2547 3318 E: <a href="mailto:anthony.ng@kpmg.com">anthony.ng@kpmg.com</a></td>
</tr>
<tr>
<td>Sophia Liang</td>
<td>Partner</td>
<td>T: +86 20 3813 7657 E: <a href="mailto:sophia.liang@kpmg.com">sophia.liang@kpmg.com</a></td>
</tr>
<tr>
<td>Pat Woo</td>
<td>Partner</td>
<td>T: +852 3927 5674 E: <a href="mailto:pat.woo@kpmg.com">pat.woo@kpmg.com</a></td>
</tr>
<tr>
<td>Derek Yuen</td>
<td>Partner</td>
<td>T: +852 2978 8173 E: <a href="mailto:derek.yuen@kpmg.com">derek.yuen@kpmg.com</a></td>
</tr>
<tr>
<td>Eddie Ng</td>
<td>Partner</td>
<td>T: +852 2143 8874 E: <a href="mailto:eddie.ng@kpmg.com">eddie.ng@kpmg.com</a></td>
</tr>
<tr>
<td>Irene Chu</td>
<td>Partner</td>
<td>T: +852 2978 8151 E: <a href="mailto:irene.chu@kpmg.com">irene.chu@kpmg.com</a></td>
</tr>
<tr>
<td>Alva Lee</td>
<td>Partner</td>
<td>T: +852 2143 8764 E: <a href="mailto:alva.lee@kpmg.com">alva.lee@kpmg.com</a></td>
</tr>
<tr>
<td>Terence Fong</td>
<td>Partner</td>
<td>T: +852 2978 8953 E: <a href="mailto:terence.fong@kpmg.com">terence.fong@kpmg.com</a></td>
</tr>
<tr>
<td>Jason He</td>
<td>Partner</td>
<td>T: +86 10 8508 7193 E: <a href="mailto:jason.he@kpmg.com">jason.he@kpmg.com</a></td>
</tr>
<tr>
<td>Arion Yiu</td>
<td>Partner</td>
<td>T: +852 2143 8599 E: <a href="mailto:arion.yiu@kpmg.com">arion.yiu@kpmg.com</a></td>
</tr>
<tr>
<td>Laura Yang</td>
<td>Associate Director</td>
<td>T: +86 21 2212 2402 E: <a href="mailto:laura.yang@kpmg.com">laura.yang@kpmg.com</a></td>
</tr>
<tr>
<td>Catherine Chung</td>
<td>Associate Director</td>
<td>T: +852 2685 7677 E: <a href="mailto:catherine.chung@kpmg.com">catherine.chung@kpmg.com</a></td>
</tr>
<tr>
<td>Yan Wong</td>
<td>Assistant Manager</td>
<td>T: +852 2978 8906 E: <a href="mailto:yan.wong@kpmg.com">yan.wong@kpmg.com</a></td>
</tr>
<tr>
<td>Adrien Chan</td>
<td>Assistant Manager</td>
<td>T: +852 2685 7922 E: <a href="mailto:adrien.chan@kpmg.com">adrien.chan@kpmg.com</a></td>
</tr>
<tr>
<td>Benjamin Tong</td>
<td>Assistant Manager</td>
<td>T: +852 3927 3086 E: <a href="mailto:bc.tong@kpmg.com">bc.tong@kpmg.com</a></td>
</tr>
</tbody>
</table>

© 2021 KPMG Huazhen LLP, a People’s Republic of China partnership. KPMG Advisory (China) Limited, a limited liability company in China, KPMG, a Macau partnership and KPMG, a Hong Kong partnership, are member firms of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.
Environmental, social and governance (ESG): A key approach to business resilience
For instance, HKEX Main Board Listing Rules 2.13 states that: “…any announcement or corporate communication required pursuant to the Exchange Listing Rules must be prepared having regard to the following general principles: (1) the information contained in the document must be clearly presented and in the plain language format specified or recommended by the Exchange and/or the Commission from time to time; and (2) the information contained in the document must be accurate and complete in all material respects and not be misleading or deceptive …”, https://en-rules.hkex.com.hk/rulebook/213-0


‘The external assurance of sustainability reporting’, Global Reporting Initiative, 2013

Hong Kong Standard on Assurance Engagements (HKSAE) 3000 (Revised), Assurance Engagements Other than Audits or Reviews of Historical Financial Information


‘The external assurance of sustainability reporting’, Global Reporting Initiative, 2013