SUSTAINABILITY REPORTING

SGX-listed Companies to "Comply or Explain"


BY
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2018 will be a momentous year of change for Singapore. With the introduction of sustainability reporting on a "comply or explain" basis by the Singapore Exchange (SGX) for all listed companies, it could be a pivotal year that turns the tide on the reporting landscape for major environmental, social and governance (ESG) issues. Gone are the days when shareholders read annual reports only for the financial figures. With climate change, mounting demands on our environment and resource constraints, it is imperative for businesses to switch their focus from short-term profitability to long-term sustainable development.

WHAT IS SUSTAINABILITY REPORTING?

The notion of "sustainability" is rooted in the idea of sustainable development. In 1987, the United Nations Brundtland Commission referred to this as development that meets the needs of the present without compromising the ability of future generations to meet their own needs.

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"Sustainability reporting" is a broad term generally used to describe a company's reporting on its economic, environmental and social performance. The purpose of a "sustainability report" is to present a balanced representation of a company's management practices and performance beyond the financial results. Consequently, stakeholders will have a fuller and clearer understanding of the company's ability and strategy to maintain and improve its performance into the future.

Some definitions used are:

(a) "Sustainability reporting is the practice of measuring, disclosing, and being accountable to internal and external stakeholders for organisational performance towards the goal of sustainable development." – GRI Sustainability Reporting Guidelines

(b) "Corporate sustainability is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments." – Dow Jones Sustainability Index

"Sustainability reporting is becoming more relevant for companies, driven by the wider environment, the companies' own operations or along their value chain. It is important for senior management to integrate material ESG factors into their established risk management frameworks and to consider the associated risks and opportunities when developing their longer term business strategy. The practical and effective implementation of SGX guidelines will help companies focus their efforts on ESG considerations critical to continued business growth, and enable them to create real business value from their sustainability initiatives."

TAN WAH YEOW
Deputy Managing Partner, KPMG Singapore, Chair, Corporate Reporting Committee, ISCA

By adopting sustainability reporting, investors can obtain relevant information beyond mere financials to make a more comprehensive assessment of the company's prospects and quality of management.

WHAT ABOUT REGULATORY REQUIREMENTS?

Driven by SGX, some listed companies have embarked on sustainability reporting voluntarily since 2011. However, the local adoption rate for sustainability reporting remains low despite increasing worldwide popularity. This is rather an anomaly considering Singapore's position as the forerunner for many global initiatives. Based on a 2013 research[1] conducted by Singapore Compact and National University of Singapore Business School, only 30% (160 out of 537 companies) of SGX-listed companies in 2013 had some communication of sustainability in their annual reports. The same study also found that fewer than 4% (19 out of 537 companies) of SGX-listed companies used internationally-recognised sustainability reporting frameworks.

To take stock of the low adoption rate and to catch up with global counterparts, in October 2014, SGX had announced plans to increase the transparency of governance with sustainability reporting on a "comply or explain" basis.

On 5 January 2016, SGX published a consultation paper to seek public consultation on the draft sustainability guidelines. After considering the feedback received, SGX issued the Sustainability Reporting Guide (Guide) on 20 June 2016. The Guide applies to all listed companies effective from the financial year ending on or after 31 December 2017. Companies are required to issue the sustainability reports within five months after the financial year-end, but a grace period of up to one year will be given to publish their first report. To ease the adoption process, SGX allows a phased approach for full implementation.

Specifically, the primary components and principles are as follows:

Primary Components

- Identification of material ESG factors
- Explanation of policies, practices and performance
- Set targets for the forthcoming year
- Select an appropriate framework
- Board statement

Principles

- Board responsibility
- Stakeholder engagement
- "Comply or explain"
- Balanced reporting
- Report both risks & opportunities
- Performance measurement system
- Global standards and comparability
- Independent assurance is recommended but not compulsory

By making sustainability reporting mandatory, Singapore will be in line with Asia Pacific's trend in adopting sustainability reporting. The adoption rate of corporate reporting in Asia Pacific rose from below 50% in 2011 to 79% in 2015[2], mainly due to a surge in reporting in countries such as Taiwan, India, and South Korea,

[1] Singapore Compact and the NUS Business School, "Accountability for a Sustainable Future - Sustainability Reporting in Singapore among Singapore Exchange Mainboard-listed Companies 2013"

[2] KPMG, "Currents of Change - The KPMG Survey of Corporate Responsibility Reporting 2015"

[3] KPMG, GRI, UNEP & Centre for Corporate Governance in Africa, "Carrots and Sticks - Global Trends in Sustainability Reporting Regulation and Policy"

> "As the ESG factors have a significant impact on the prospect and sustainability of a company, it is useful for all companies to have a sustainability report as part of the annual report. This will also put us in line with global financial market practices."
>
> **HENRY TAN**
> **Managing Director, Nexia TS**

where voluntary and mandatory reporting requirements have been introduced. Globally, there is a surge in sustainability reporting instruments (that is, reporting guidelines, rules or regulations to reporting sustainability performance). The number of reporting instruments doubled from 180 in 2013 to more than 380 in 2016.[3]

Companies enjoy considerable flexibility under the Guide. For example, companies can select material issues within the five primary components to be reported; they also have the discretion on which reporting framework to apply, whether to obtain third-party assurance, and the speed of implementation.

> "The rules and Guide help companies rise to a respected standard in reporting risks and opportunities in sustainability. Our Guide results from SGX's extensive consultation with companies and investors to provide sufficient flexibility for all to participate."
>
> **YEO LIAN SIM**
> **Special Adviser, SGX,**
> **Former Chief Regulatory Officer, SGX**

> "I believe SGX's sustainability reporting requirements will improve the company's performance in non-financial areas by developing and promoting products and services that have a positive impact on society, the environment and economy, thereby preventing or minimising the negative impacts of business activity on these areas. Sustainability reporting complements financial reporting with the ESG aspects of the business and strategy to give investors better insight into issuers they invest in.
> SGX's Guideline on a "comply or explain" basis gives issuers the opportunity to explain their respective practices and/or reasons for any deviations to specific guidelines, thereby enabling investors to consider sustainability when making their investment decisions."
>
> **RAJNISH JUTA**
> **Sustainability Reporting Leader, Southeast Asia,**
> **Partner, Deloitte & Touche**

"Comply or explain" model

Under the "comply or explain" model, listed companies need to describe the sustainability practices with reference to five primary components. If a company excludes a primary component, it must describe what it does instead, with reasons for doing so.

SGX has similar enforcement powers over sustainability reporting as it does in other parts of the listing manual. As a result, an explanation on non-compliance without strong reasons may invite further queries and investigations from SGX.

PRIMARY COMPONENTS OF SUSTAINABILITY REPORTS

Companies should provide an accurate and balanced view without undue bias on the following five components in their sustainability reports:

(a) Identification of ESG factors

Companies are required to identify key "material" ESG risks and opportunities incorporating feedback from key stakeholders. Also, companies need to provide reasons for their choice and a description of the selection process. Factors assessed to be immaterial by companies may be excluded but they may present information on these factors on their websites to satisfy stakeholder interest.

Investors face a severe deficit of quality non-financial information[4] and the focus on materiality signals a clear change from sustainability reporting in the past. As a result, companies should include sufficient and relevant information to outline how a company is progressing in managing "material" ESG factors instead of presenting a laundry list of what the company has done. Materiality is a subjective concept and dependent on the management's judgement.

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> **"The definition of 'material' is based on the threshold at which an issue becomes important enough to a company and its stakeholders. Matters that cross that threshold are treated as material, and these may include matters of qualitative importance – not just tangible units – too. Companies should capture those matters that impact their largest stakeholders, discuss within departments and report these in details."**
>
> **KRISHNA SADASHIV**
> **Southeast Asia Leader, Climate Change and Sustainability Services, Partner, EY**

(b) An explanation of policies, practices and performance

A company should set out its policies, practices and performance in relation to each material ESG, providing descriptive and quantitative information.

(c) Targets for the forthcoming year

The sustainability report should set out the issuer's targets for the forthcoming year in relation to each material ESG factor identified.

(d) A chosen reporting framework

This is similar to adopting Financial Reporting Standards as the accounting framework for financial statements. The key difference is that the company has the flexibility to choose a sustainability framework that is suitable for its industry and business model to guide its reporting and disclosure, and explain its choice.

There are many commonly used sustainability reporting frameworks available, such as the Global Reporting Initiative's G4 Sustainability Reporting Guidelines, the International Integrated Reporting Council's Framework and the Sustainability Accounting Standards Board's standards, etc.

(e) Board statement

The sustainability report should include a board statement to explain the listed companies' sustainability actions and the board's oversight.

The board bears the ultimate

One of the key challenges of sustainability reporting is how to integrate sustainability impact and financial performance into day-to-day management decision-making.

responsibility for sustainability reporting. This is consistent with the Code of Corporate Governance issued in 2012, which states that "the board's role is to consider sustainability issues, for example, environmental and social factors, as part of its strategic formulation".

Such a statement will ensure that the board takes a more active interest in monitoring management's implementation of sustainability practices. As a result, it can provide an added degree of trust and credibility to stakeholders.

WHAT ARE THE BENEFITS?

Not too long ago, sustainability was seen by most companies as little more than a peripheral "green" issue – useful for reducing energy and waste disposal costs or supporting charities, but hardly critical to a company's core business. This view is changing due to:

(a) Value creation

Traditional financial reports provide only a historical snapshot of the company's performance whereas sustainability reporting is forward-looking. By adopting sustainability reporting, investors can obtain relevant information beyond mere financials to make a more comprehensive assessment of the company's prospects and quality of management.

The provision of disclosure on non-financial performance will also showcase a company's commitment to transparency and accountability to stakeholders. As such, sustainability reporting is also a way for companies to create trust and close the expectation gap with stakeholders, and consequently, incur lower cost of funding.

Based on a 2015 global survey of more than 3,000 managers and investors in over 100 countries[5], 75% of investors indicated improved operational efficiency and revenue performance from sustainability as a strong indicator to invest. Some 60% of the investors believe that strong sustainability performance reduces a company's risks and hence, cost of capital.

(b) Cost savings

In the process of preparing sustainability reports, companies need to review internal systems. This allows companies to identify inefficiencies, streamline the business and make improvements in decision-making and operational processes.

By adopting sustainability initiatives, CapitaLand saved over S$76 million in cost avoidance for utilities from 2009 to 2014. Similarly, Marina Bay Sands Singapore has also enjoyed significant cost savings through decreased water consumption per visitor by 57.4% and energy consumption per visitor by two-thirds from 2012 to 2014.

(c) Brand equity

Companies will be able to improve their brand equity by adopting sustainability

[4] EY, "The Evolving Dynamics of the Hedge Fund Industry - 2015 Global Hedge Fund and Investor Survey"

[5] MIT Sloan Management Review and The Boston Consulting Group, "Investing for a Sustainable Future - Investors Care More about Sustainability than Many Executives Believe"

reporting. A 2013 survey conducted by Boston College Center for Corporate Citizenship and EY[6] reported that more than 50% of surveyed companies issuing sustainability reports emphasised improvements in reputation.

CDL is ranked tenth in a global sustainability ranking of firms with market capitalisation of above US$2 billion, and Keppel Corporation is selected as a component of the Dow Jones Sustainability Asia Pacific Index 2013/2014. These are examples of firms that have boosted their global prominence as a result of their sustainability efforts.

On the other hand, based on a 2015 poll conducted by *The Straits Times*[7], consumers decided to boycott products from companies that were contributing to the haze caused by the burning of farmlands in Indonesia. A Singapore government agency also began legal action against some companies believed to be related to the irresponsible burning.

(d) Employee retention

Employee relationship may be strengthened as the company focuses on employee development, building an inclusive and diverse workforce and inculcating a positive work culture.

Via active engagement with employees, in 2014, Singapore Airlines was awarded the title of Singapore's most attractive employer at the Randstad Awards for the third year running. Some of these initiatives include flexible working arrangements, career development benefits, and wellness and health programmes.

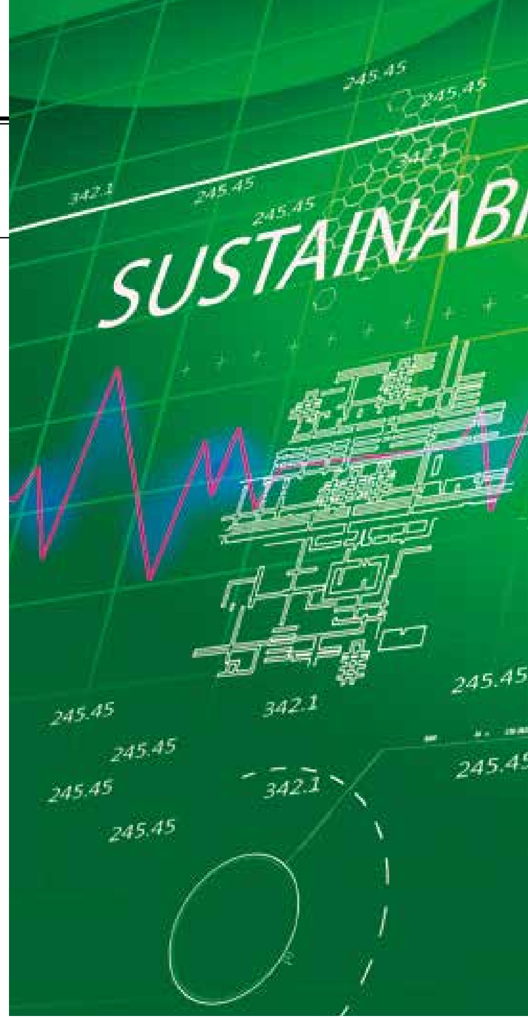
(e) Supply chain sustainability

With rapid globalisation, it is common to have complex supply chains involving numerous suppliers and contractors spanning different continents. Consequently, there are also rising levels of risk in regulatory, legal and consumer scrutiny in the corporate supply chain practices. Companies will be able to lower these risks and build a reliable supply eco system by selecting suppliers that comply with sustainability reporting frameworks.

For example, many big Indonesia palm oil companies have signed zero-deforestation agreements. It is also critical for these companies to ensure that their suppliers, which are typically small plantation owners, also adopt similar sustainable practices. This is because these companies may face public scrutiny, which could lead to actions such as boycotts of their products, if pollution is caused by their suppliers.

WHAT ARE THE CHALLENGES?

Despite the developments in Singapore,



the journey towards sustainability reporting is still a long one. Some of the stumbling blocks include:

(a) Compliance costs

The financial cost of sustainability reporting may be a burden, particularly for smaller companies that may not have the required resources to track the data required for sustainability reporting. The costs involved may exceed the benefits unless the stakeholders of these companies view environmental and social issues as major concerns.

(b) Conflicts between short-term profitability and long-term goals

One of the key challenges of sustainability reporting is how to integrate sustainability impact and financial performance into day-to-day management decision-making. While sustainability initiatives provide long-term benefits to companies, sometimes, the managers making such decisions may experience conflicts in their allocation of resources as prospects of short-term gains make them myopic.

Over time, the advantages that a company with quality sustainability reporting has over another would prove more apparent, widening the adoption to that of choice rather than mandate.

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> **"The topic of sustainability is an important one. At a macro level, it really is a force for good and aims to support the endurance of fair business practices, the environment, societies and lives. Everyone has a part to play, and businesses, with their interconnectedness to the environment and society, can truly make a positive impact. While there is recognition that the road to sustainability excellence is multi-pronged and needs to be embedded as part of our daily lives, sustainability reporting is an important part of the journey."**
>
> **FANG EU-LIN**
> **Sustainability & Climate Change Partner, PwC**

(c) "Cherry-picking" material ESG factors

Companies may "cherry-pick" the ESG factors they want to focus on and ignore others that do not meet their corporate priorities or those that are unfavourable. Although they are supposed to present an unbiased view, internal pressures may result in an alternative outcome. Based on the 2015 PwC SDG Engagement Survey[8], just 1% of surveyed companies plan to assess all the 17 sustainable development goals.

As a result, the data reported in sustainability reports are often incomplete, not linked to issues regarded as material, or not well related to the company's business strategy or financial performance.

(d) Different reporting frameworks

As companies apply different reporting frameworks, users of sustainability reporting may identify inconsistencies in disclosure practices and incomparable reporting.

There are some global initiatives to align the inconsistencies in the frameworks. For example, one of the global initiatives by the Task Force on Climate-Related Financial Disclosures is to build a commonly-used framework that promotes alignment and focus on financial risks stemming from physical and non-physical climate-related impacts to better meet the specific needs of users and preparers.

(e) Assurance

Notwithstanding that assurance on sustainability reporting is not compulsory in Singapore, it is an important tool to enhance the credibility and quality of the sustainability report. However, providing assurance will be a thorny issue as there are no standardised approaches on how a company should prepare and report its non-financial performance. Currently, there is also no standardised framework for sustainability assurance.

LOOKING FORWARD

Making sustainability reporting mandatory is only the beginning of the journey towards holistic corporate reporting. As the concepts of sustainability reporting may be new to many, the process of implementation will be challenging. And despite SGX's commendable intention, it is inevitable that some companies will view this as another compliance and checkbox-ticking exercise, and lose sight of the underlying objectives.

However these hurdles are not unique to Singapore and they form part of a necessary stage towards any new regime. Over time, the advantages that a company with quality sustainability reporting has over another would prove more apparent, widening the adoption to that of choice rather than mandate. Companies drawing from each other's experiences will enhance the overall quality of reporting, ultimately creating real business value for stakeholders from their sustainability initiatives. ISCA

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[6] Boston College Carroll School of Management and EY, "Value of Sustainability Reporting – A Study by EY and Boston College Center for Corporate Citizenship"

[7] *The Straits Times*, 9 October 2015, "Many will Boycott Products from Haze-causing Firms: Poll"

[8] PwC, "Make It Your Business – Engaging with the Sustainable Development Goals"; the 17 SDG refers to the sustainable development goals launched by United Nations to transform the world for the better by 2030.