



**INVESTOR DEMAND FOR ENVIRONMENTAL,  
SOCIAL, AND GOVERNANCE DISCLOSURES**  
*EXECUTIVE SUMMARY*



International  
Federation  
of Accountants

# Responding to Increasing Demand from Investors for ESG Disclosures

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The term ESG has emerged to describe the environmental, social, and governance issues that investors might consider in the context of corporate behavior and performance. Responding to the widespread concern that investors typically do not incorporate environmental, social, and governance criteria into their investment decisions, IFAC considered the current trends in investor demand for, and use of, ESG information. This summary includes the key findings of this research and its implications for professional accountants in business.

## Key Findings

### TO WHAT EXTENT ARE INVESTORS USING ENVIRONMENTAL, SOCIAL, AND GOVERNANCE INFORMATION?

ESG disclosures are increasingly used by investors to understand an organization's key ESG factors and how they impact overall performance over a longer time horizon. This is evidenced by four factors:

- The number of investors signing the United Nations' Principles for Responsible Investment;
- The increasing number of shareholder proposals comprising environmental, social, or governance resolutions;
- Surveys of investors that indicate an increasing number believe that ESG integration into the investment process maximizes beneficiaries' long-term interest, and that good governance and sustainability practices contribute to the creation of long-term shareholder value; and
- Research that shows how investors incorporating ESG information and analysis in their investment processes can outperform their peers.

Investors have an important role to play in promoting long-term sustainable organizational success. However, a lack of attention to ESG factors, and the passivity and short termism of some investors, can contribute to short-term thinking by companies.

### WHAT DRIVES SOME INVESTORS TO BE SHORT-TERM IN THEIR PERSPECTIVES AND ACTIONS?

The nature of short termism is hard to define. There is criticism of the shortening of stock-holding periods of many investors, as well as their readiness to take short-term investment positions, which may lead to short termism in companies. However, more significant challenges prevent institutional investors, who theoretically should take a longer-term perspective, from taking such a perspective and promoting ESG in companies in which they invest. The challenges include incentives that deter many from pursuing a stewardship role based on engagement; an investment chain that has lengthened by outsourcing management; and a lack of recognition that ESG factors influence an organization's ability to deliver adequate long-term cash flows and returns.

### **WHAT ARE THE INVESTMENT APPROACHES USED TO INCORPORATE ESG FACTORS?**

An increasing number of investors with a responsible investment philosophy are progressing beyond negative (excluding specific industries or sectors from an investment portfolio) and positive (using external ratings to select “best-in-class” investments) screening of companies. They are proactively encouraging companies through engagement and dialogue to improve a company’s value through greater incorporation of ESG factors into their investment processes. Such engagement leads to greater integration of specific ESG information and criteria into financial valuations associated with a company. This correlates with research indicating that an increasing number of investors are prepared to sacrifice some short-term performance to better manage long-term risks.

Challenges to mainstreaming ESG issues remain mainly because many investors perceive ESG issues as being complex and, therefore, difficult to articulate, assess, and integrate into investment decisions. This complexity is also driven by perceived inconsistencies and insufficiencies in ESG disclosures by companies. The result is that many investors marginalize ESG issues so they are treated with a compliance mentality rather than with a mindset that fosters the formal appraisal and measurement of material ESG factors.

### **WHAT INFORMATION AND DISCLOSURES ARE INVESTORS INTERESTED IN?**

Investors typically have proprietary approaches and models for assessing companies, but many seem to be gravitating to certain types of disclosures and key performance indicators (KPIs), which are set out in this summary.

Approaches to valuation and monetization are getting more sophisticated. Investors can assess financial outcomes of various ESG factors in terms of changes to cash flows and earnings impact, cost of capital, and asset values. They will, therefore, focus on material ESG factors and metrics related to the drivers of competitive advantage and sustainable value creation of a sector or individual organization that will ultimately drive financial performance.

### **WHAT ARE THE IMPLICATIONS AND LEARNING POINTS FOR THE ACCOUNTANCY PROFESSION AND PROFESSIONAL ACCOUNTANT IN BUSINESS?**

Professional accountants need to support their organizations in meeting an increasing investor demand for ESG information. They will need to ensure that both the organization and its investors receive a complete and relevant picture of organizational performance and impacts. Professional accountants should be well placed to bring the discipline and application of accounting rigor to the collection, analysis, and reporting of ESG data, and to support the incorporation of ESG factors into an organization’s management processes and systems.

Five key recommendations provide guidance on how the accountancy profession needs to respond to great investor interest and awareness of ESG factors.

# Implications of Managing and Reporting ESG Performance

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## **1. ENGAGE INVESTORS EFFECTIVELY TO DETERMINE THEIR INFORMATION NEEDS TO BETTER COMMUNICATE PERFORMANCE**

Professional accountants should work with their organizations to implement a structured and systematic approach to engaging investors to determine their ESG information needs. This will enable effective communication of an organization's ESG performance, and ultimately its ability to create and sustain value over time, and what this means for current and potential investors.

## **2. INCORPORATE ESG FACTORS AND PERFORMANCE INFORMATION INTO GOVERNANCE AND ACCOUNTABILITY ARRANGEMENTS TO IMPROVE INFORMATION AND DISCLOSURE QUALITY**

Professional accountants should work with their organizations to implement governance processes that help embed ESG factors in management and reporting processes. This will lead to reliable and high-quality non-financial (as well as financial) information that is needed by internal decision makers, as well as expected by investors.

## **3. LINK FINANCIAL AND NON-FINANCIAL PERFORMANCE AND OUTCOMES TO IMPROVE UNDERSTANDING OF SUSTAINABLE VALUE CREATION**

Professional accountants should work with their organizations to enhance understanding of the link between financial and non-financial drivers of performance and value. Integrated reporting will involve professional accountants being able to clearly present the linkage between financial performance and the organization's use of, and impact on, the significant resources and relationships upon which it depends to create sustainable value.

## **4. ENSURE MATERIAL, TIMELY, CONSISTENT, AND COMPARABLE INFORMATION TO IMPROVE THE USEFULNESS OF REPORTING AND GREATER TRANSPARENCY**

Professional accountants should work with their organizations to ensure that ESG disclosures meet investor needs by being material, timely, consistent, and comparable to improve the usefulness of reporting.

## **5. BRING TOGETHER DATA THAT MAY BE DISPERSED IN DIFFERENT PARTS OF THE ORGANIZATION OR ITS SUPPLY CHAIN TO SUPPORT INTERNAL AND EXTERNAL DECISION MAKING**

Professional accountants should work with their organizations to connect processes, systems, and data across various organizational functions, and within the extended supply chain. From a reporting perspective, greater collaboration and coordination between the finance and accounting functions, specialist sustainability, or corporate responsibility, as well as operational teams and suppliers, will be needed to help break down silos in the way information is managed and reported.

Integrated reporting will help organizations to address these recommendations by bringing together material information about an organization's strategy, governance, performance, and prospects in a way that reflects the commercial, social, and environmental context within which it operates. The process of integrated reporting can also help to drive good governance practices, including new systems and processes, to measure, analyze, and report an organization's ESG performance.

# Core Sector-Neutral ESG Metrics Demanded by Investors

Measurement Area	Typical Generic Metrics and Performance Indicators Investors Look For	Related GRI Indicators
<b>Environmental</b>		
Climate change Greenhouse Gas (GHG) emissions	<ul style="list-style-type: none"> <li>Total direct and indirect GHG emissions (scope 1 and 2) in tonnes/kilograms of CO<sub>2</sub> broken down by type of energy source. This could also cover a percentage of operations included.</li> <li>Total other direct GHG emissions (scope 3), including emissions from business travel by employees and supply chain</li> <li>Carbon price (or shadow)</li> <li><i>Example intensity measure</i>*: Tonnes/kilograms CO<sub>2</sub> as percent of turnover</li> </ul>	EN16, EN17
Waste and waste recycling ratio	<ul style="list-style-type: none"> <li>Total waste</li> <li>Type of waste (hazardous versus non-hazardous) produced by product and volume</li> <li>Percent of waste reused in the manufacturing process</li> <li><i>Example intensity measure</i>: Waste per person or square foot/meter and percentage recycled, or total waste per sales</li> </ul>	EN22
Water	<ul style="list-style-type: none"> <li>Amount of water consumed (e.g., cubic meters) by quality/source and percent water usage from recycled sources</li> <li><i>Example intensity measure</i>: Water consumption per unit of sales</li> </ul>	EN8, EN9, EN10
Fines/provisions	<ul style="list-style-type: none"> <li>Monetary fines and non-monetary environmental sanctions</li> <li>Environmental provisions as reported on the balance sheet</li> </ul>	EN28
Energy efficiency/renewable energy use	<ul style="list-style-type: none"> <li>Total amount of energy used by the organization (e.g., MWh, KWh or Joules)</li> <li>Amount of energy consumed that was generated from a renewable energy source</li> <li>Financial impact of emission reduction initiatives</li> <li>Energy saved due to conservation and initiatives to reduce energy consumption</li> <li>Capex expenditure in “green” technology or to facilitate more sustainable practices</li> <li><i>Example intensity measure</i>: Energy use per square foot/meter, or per sales</li> </ul>	EN3, EN4, EN5, EN6, EN7
Biodiversity	<ul style="list-style-type: none"> <li>Location/size of land owned, leased, managed in, or adjacent to protected areas and areas of high biodiversity (such as trees and vegetation as well as wildlife and endangered species) value</li> </ul>	EN11, EN12, EN13, EN14, EN15
<b>Social</b>		
Workplace health and safety	<ul style="list-style-type: none"> <li>Workforce accidents (total) and fatalities</li> <li>Lost time from accidents (number of hours or days)</li> <li><i>Example intensity measure</i>: Lost time injury frequency rate: i.e., lost time injuries per million man-hours (or total recordable injury frequency rate)</li> </ul>	LA7

\* Disclosure of environmental and social indicators can be improved by disclosing both absolute values and intensity measures. For example, energy efficiency can be measured in absolute terms by disclosing energy consumption. Indicators of intensity include per employee and per unit of revenue or production volume.

Measurement Area	Typical Generic Metrics and Performance Indicators Investors Look For	Related GRI Indicators
Human capital development: training and qualification	<ul style="list-style-type: none"> <li>• Training and qualification—total or average investment/expenses on training</li> <li>• <i>Example intensity measure:</i> Investment or training hours per FTE, or broken down by employee category</li> </ul>	LA10
Human capital management: staff turnover, maturity and diversity, absenteeism	<ul style="list-style-type: none"> <li>• Employee turnover rate</li> <li>• Maturity of workforce—age structure/distribution; employee average age</li> <li>• Diversity—percent women in workforce, percent minorities</li> <li>• Pay differential between men and women at different levels</li> <li>• Employee satisfaction (as a result of employee engagement)</li> <li>• Percentage of employees covered by collective agreements</li> <li>• Relationship with unions—strikes, days lost</li> </ul>	LA1, LA2, LA4, LA13, LA14
<b>Governance</b>		
Board effectiveness	<ul style="list-style-type: none"> <li>• Board composition—-independent directors as a percent of total board membership; separation of CEO and chair role; independent director composition of board committees, such as the audit committee</li> <li>• Board duration—length of individual board member terms (years)</li> <li>• Board remuneration—total amount of bonuses, incentives, and stock options; amount of stock based compensation; long-term vs. short-term hurdles (link between remuneration structures and organizational strategy)</li> <li>• Percent women at board level</li> <li>• Indication of risk management policies and implementation</li> </ul>	Profile disclosure 1.2, LA13
Stakeholder engagement	<ul style="list-style-type: none"> <li>• Frequency of key stakeholder engagement</li> <li>• Engagement mechanisms, e.g., meetings, surveys, briefings, use of on line media</li> <li>• Main issues arising from stakeholder engagement</li> <li>• Steps taken to respond to stakeholder feedback</li> </ul>	Profile disclosures 4.14-4.17
Conduct, litigation risks, corruption	<ul style="list-style-type: none"> <li>• Records of breaches of codes of conduct and the associated costs</li> <li>• Corruption—percent of revenues in regions with transparency rating (such as those developed by Transparency International) and/or number of business units analyzed for corruption risks</li> <li>• Total amount of remediation and fines and, where applicable, expenditure on reclamation and decommissioning</li> <li>• Payments to government(s) and total value of financial and in-kind contributions to political parties, politicians, and related institutions.</li> <li>• Voting right parity</li> </ul>	SO2, SO4, SO6

## How Investors and Companies Might Consider the Financial Implications of ESG Factors

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The metrics and KPIs listed in the chart are primarily lagging (i.e., results based) indicators of performance that do not necessarily provide an indication of whether an organization is addressing material ESG issues to achieve improved performance. Investors may also be interested in tracking leading indicators of future performance, which they will use to assess management credibility, either through active engagement with the management of companies or from effective business reporting.

Some investors and companies are also now on a journey toward better understanding the ESG impact on financial performance and valuations. Their focus is typically on identifying material ESG factors and KPIs related to the drivers of competitive advantage and sustainable value creation that will ultimately drive financial performance.

Linking ESG factors and KPIs to financial drivers of performance can be done in various ways, with many investors integrating ESG information into their traditional financial analysis. Investors can assess financial outcomes of various ESG factors in terms of changes to cash flows and earnings impact, cost of capital, and asset values. Linking environmental factors to financial performance in terms of cash flow and earnings impact is increasingly common although human capital information can also be incorporated into financial analysis where data is reliable. Using carbon dioxide as an example, investors may track measures such as carbon cost as a percentage of revenue; carbon cost as a percentage of earnings before interest, taxes, depreciation, and amortization; financial impact of carbon dioxide allowance trading; and impact of compliance costs on cash flows and earnings.

A list of useful resources, including reporting frameworks and guidelines, is included in the full-length *Investor Demand for Environmental, Social, and Governance Disclosures* report, available on the IFAC website ([www.ifac.org/paib](http://www.ifac.org/paib)). Key references include:

The International Integrated Reporting Council (IIRC): The IIRC, formed in 2010, is developing a globally accepted integrated reporting framework ([www.theiirc.org](http://www.theiirc.org)).

Global Reporting Initiative (GRI): GRI produces a comprehensive Sustainability Reporting Framework that is widely used around the world to enable greater organizational transparency ([www.globalreporting.org](http://www.globalreporting.org)).

Climate Disclosure Standards Board (CDSB): CDSB developed a Climate Change Reporting Framework designed to encourage a harmonized approach to the preparation of climate change-related disclosures that complement financial statements ([www.cdsb.net](http://www.cdsb.net)).

The IFAC Sustainability Framework 2.0 is available in Publications and Resources on the IFAC website ([www.ifac.org/paib](http://www.ifac.org/paib)).



