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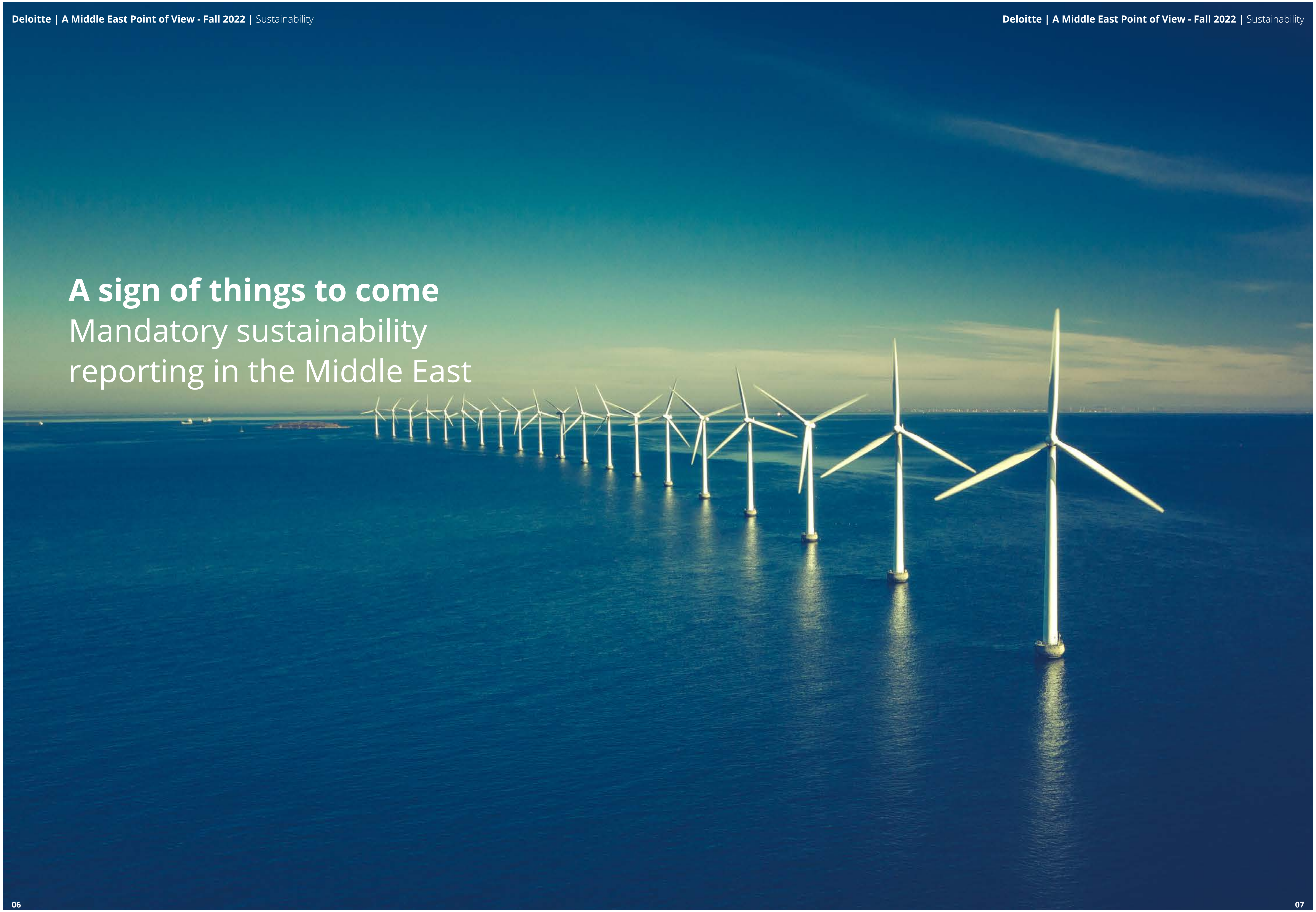

A sign of things to come
Mandatory sustainability reporting in the Middle East

In January 2021, the UAE Securities & Commodities Authority issued a circular that required all companies subject to the Joint Stock Companies Governance to complete a sustainability report as part of their set of Integrated Reports.

The requirement is not simply to issue a statement covering the company's view of its own sustainability (Environmental, Social, Governance) initiatives and concerns, but for a Global Reporting Initiative (GRI) standards-compliant sustainability report. Local market sustainability standards and requirements must also be met. Reports need to be completed on an annual basis, within three months of fiscal year-end.

The issuing of the circular was a surprising move. Indeed, many countries have, or are in the process of, adopting voluntary or mandatory sustainability disclosures but few have actually mandated the creation of a comprehensive annual sustainability report, and certainly not to the high quality of transparent and detailed reporting required by the GRI. In terms of sustainability reporting, it is certainly progressive.

What is a sustainability report and who is it written for?

Historically, many companies published a short statement of their limited Corporate Social Responsibility (CSR) initiatives on their website and included it in the front section of their annual financial reports. They typically focused on including philanthropic work (such as charity work, employee volunteering days) and limited environmental initiatives, such as office recycling schemes. The scope was often narrow and usually there was no clear link of these initiatives to the strategic objectives of the company or to targets. They were aspirational at best.

Over time, various stakeholders started to pay more attention to the inter-relationship between companies and the environment and society. These stakeholders included governments, regulators, stock exchanges, investors, suppliers, consumers, employees and the public at large. Against a backdrop of climate and societal change and awareness, stakeholders became more activist, ready to question working conditions, supplier arrangements and environmental impact, boycott goods and services, hold Boards to account, and disinvest. Gradually, non-financial information about companies' strategic view of, exposure to, and interaction with the environment and society began to be played into valuations as new risks and opportunities were identified and demands for more transparent and accurate non-financial information to inform the stakeholders was demanded.

As stated by the International Federation of Accountants (IFAC) in its June 2021 report: "Corporate reporting is changing. Quickly. Yesterday's focus on financial statements is giving way to an integrated approach to financial information, ESG or sustainability information, and broader non-financial information. In particular, investors and other stakeholders are increasingly demanding high-quality sustainability information, and reporting entities are looking to—and in many cases are being required to—provide it".[1]

In response, numerous companies developed various reporting mechanisms for such non-financial information, leading to a panoply of standards, reporting principles and guidance (see PoV Summer 2021).

Currently, the GRI is the most reported voluntary standard globally. A study by IFAC in June 2021 selected 1,400 companies across 22 jurisdictions, based on their market capitalization. Of these, 1,296, or 91 percent, reported ESG information, and of these, 69 percent referred to GRI as being the key reporting standard used.

> Today's GRI sustainability reports are detailed reports published by a company on its material non-financial performance information, incorporating Environmental, Social, and Governance (ESG) concerns. They demonstrate the strategy that companies have put in place to set goals, measure performance, manage sustainability-related impacts and risks, and explain how the company drives value for its stakeholders.

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Importantly, they must also be balanced and disclose a company's potential negative impact, as well as its positive impact on the environment, society, and economy. As their sustainability reporting continues to mature and evolve, companies will gain a better understanding of, and report on, how sustainability issues impact their business and where opportunities for competitiveness and shareholder value can be found.

How has sustainability reporting developed in the Middle East?

While most of the Middle East stock exchanges/regulators have issued guidance on how companies should report sustainability information, with Saudi Arabia issuing their guidance in October 2021, currently only the UAE has made it mandatory to report using GRI, bringing over 130 listed entities into compliance. Across the Middle East, there has been sporadic adoption of GRI reporting by companies in other countries, but not to the scale of the UAE. Nevertheless, many stock exchanges/regulators and companies are watching the UAE closely.

Outside the Middle East, there is an increasing need for companies to disclose specific climate-related financial disclosures rather than a full Sustainability Report, such as GRI, with:

- The European Union's Non-Financial Reporting Directive (NFRD) and proposed Corporate Sustainability Reporting Directive (CSRD) extending mandatory sustainability reporting to almost 50,000 companies in the EU.
- The UK's requirement for all premium listed companies to state in their Annual Report whether their disclosures are consistent with the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations, or to explain why not.
- The IFRS Foundation's announcement in November 2021 to establish a new International Sustainability Standards Board within the governance structure of the IFRS Foundation, which would deliver its ambition to introduce a global baseline of standards for sustainability-related disclosures, focused on meeting the information needs of investors globally when assessing enterprise value.

This movement for increased sustainability reporting will undoubtedly impact companies in the Middle East, which is why the current focus on the development of GRI reports in the region is a very important first step to build capabilities and meet initial expectations. It also prepares companies well for future sustainability reporting requirements, such as the expected IFRS standard of reporting.

The challenges of writing a GRI report

Companies seeking to write a GRI report will experience a number of challenges in meeting the GRI reporting requirements:

- The GRI is technically complex, with over 500 pages of detailed requirements and guidance providing a comprehensive sustainability reporting standard.
- Preparing a report in accordance with the GRI means that the company must investigate and report a full and balanced picture of its material topics and related impacts, as well as how these impacts are managed.
- A GRI report should cover issues which reflect the company's significant economic, environmental and social impacts, or that substantively influence the assessments and decisions of stakeholders. This requires an appropriate analysis of stakeholder engagement, seeking to respond to reasonable expectations and interests of stakeholders.
- When assessing the materiality of a topic, companies should take into account both, internal factors (mission, competitive strategy) and external factors, such as the interests of different stakeholder groups and broader social, environmental and economic interests, at the societal level.
- The GRI Standards provide specific key performance indicators (KPIs) to be measured, managed and reported for each suggested topic.
- A detailed and accurate index of disclosures needs to be prepared and presented, with omissions identified and appropriately explained.

The company may also meet practical hurdles:

- A sustainability report needs to include clear text that conveys important messages and specific disclosures, skills usually demonstrated by communications teams or public relations (PR) companies.
- The report needs to include statements and metrics on information that may not have been previously collated from across the company and publicly presented, such as emissions, water use, waste, diversity and inclusion.
- Sustainability reporting specialists, experienced in drafting the report and collating the information, may not be in the company and may not even be in the market (especially true of the Middle East, given the short history and low maturity of sustainability reporting).
- There are difficulties in outsourcing the production of the report to third parties: Few consultants and communication/PR firms have the wide skills and technical knowledge to cover drafting copy, collating and disclosing metrics, understanding and meeting GRI disclosure requirements.
- The financial auditor of the company cannot write the report on behalf of the company, as that would affect its independence.
- Internal reviews of the report including the copy, the metrics and the GRI disclosures, are difficult to complete if the review mechanism lacks the knowledge and experience of sustainability reports and disclosures. Accuracy is at risk and claims of compliance with the Global Reporting Initiative (GRI) may be false.

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Companies that are successful in preparing high quality sustainability reports usually adopt an approach that integrates the need to build their own capabilities within the company (in order to meet the short-term requirement of drafting a sustainability report), as well as the need to meet the challenges of more comprehensive climate-related financial disclosures and integrated reporting. These companies:

- Obtain Board support and sponsorship, with the COO and CFO closely aligned with the success and implementation of the project and strong relationships formed with Finance, Strategy and Investor Relations.

- Appoint a Chief Sustainability Officer, not only to oversee the company's sustainability initiatives, but also to oversee the stakeholder interaction including shareholder concerns and understand the ESG rating agencies' requirements, as well as manage the GRI reporting.

- Identify, recruit, and train a core dedicated Sustainability team to co-ordinate the preparation of the report. The GRI offer training and a certification process to build technical experience.

- Address and plan the detailed requirements of reporting, such as the development of strategy, identification of GRI requirements such as stakeholder engagement, material topic assessment, topic-based metrics and disclosures and the drafting of copy.

- Potentially outsource the drafting of copy to a third-party Communications or PR agency to ensure the text is accurate, readable, and coherent. However, facilitation, project management and oversight by the sustainability team needs to be strong to make this efficient.

- Build the capability to collate company-wide data to support disclosures and metrics internally, rather than outsource this function, as those best able to obtain and understand data are those within the company itself, not outsiders. Often, existing IT systems, data, and evidence, together with the network of collators within an organization tasked with collating ESG data and metrics, are of a relatively low quality, compared to those mature and efficient systems and processes supporting the collation of financial reporting data. The ESG data and metrics collation approach must be strengthened significantly to ensure accurate and consistent information is available for reporting.

- Seek technical GRI standards interpretation advice and insight, benchmarking to peers, insights on reporting and disclosures from external parties, with the aim of educating and informing the company's sustainability team, leaving a legacy of capability to manage and maintain the company's claim of GRI compliance and be prepared for future reporting requirements.

- Obtain external, independent, robust assurance over the company's claim of GRI compliance and the accuracy and appropriateness of the metrics presented. Of the companies reviewed through the IFAC survey and reported on sustainability, over 50 percent obtained some form of assurance.

The role of assurance

The GRI does not itself certify compliance of a company's sustainability report. It does not judge the outcome or quality of a company's report or whether a report is in accordance with the GRI Standards, as it states that impartiality is important for maintaining credibility of a standard setter. Instead, the GRI advises the use of external assurance for sustainability reports. Although the GRI standards do not require companies to obtain independent assurance in order to make a claim that the report has been prepared in accordance with the standards, companies are nevertheless required to explicitly report their approach to external assurance with a specific disclosure in the Index published in their sustainability report.

IFAC has noted that with investors increasingly incorporating sustainability matters into their asset allocation decisions, low-quality sustainability assurance is presenting a significant, global investor protection issue. It highlighted the fact that the International Company of Securities Commissions (IOSCO) is leading the way to understand the potential ramifications for investors.

Further, with the Financial Stability Board (FSB) and the Network for Greening the Financial System (NGFS) articulating the link between climate risk and financial stability, low-quality sustainability assurance is emerging as a financial stability risk as well. IFAC calls on the professional accounting profession to rise to the occasion and meet this emerging need. It says: "In a world where reliable sustainability information is becoming as important as financial information, we simply cannot leave it up to chance."

A sign of things to come?

Sustainability reporting is developing quickly in many countries: moving from a purely voluntary regime to one with multiple disclosure requirements, within a changing regulatory and compliance environment. The course has been set and, through the internationalization of stakeholders, the standards to which companies are expected to report will be raised in all markets. It is in the interest of Middle Eastern companies to not only observe what is happening in other more mature financial markets, as a glimpse of the near future, but to accept that change is coming, rapidly, and start preparing.

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Endnotes

1. "The State of Play In Sustainability Assurance," The International Federation of Accountants (IFAC), June 2021, Foreword, page 3.