CORPORATE REPORTING DIALOGUE (CRD)

REPORT FROM THE

ITALIAN “BETTER ALIGNMENT PROJECT” ROUNDTABLE

c/o Methodos Consulting Company,

Milan, 3 June 2019, 10.45-13.45

INTRODUCTION

On 3 June 2019 from 10.45am to 1.45pm, around fifteen differentiated Italian stakeholders gathered in Milan to participate in the Italian Roundtable aimed to elaborate and discuss on the questions posed by the CRD Survey relating to its "Better Alignment Project". The Roundtable was facilitated by Prof. Stefano Zambon (Secretary General, NIBR)

This is the Report that summarizes the numerous inputs and considerations put forward during the Roundtable.

The individuals and the associated organisations that attended the meeting are listed in the final page of the present Report.

David Astley from CDSB, Laura Girella from IIRC, and Stefano Di Iorio from Consob (Italian Stock Exchange Regulator) participated in the meeting as observers.

The Roundtable was opened by David Astley that provided the attendees with an overview of the situation of the Roundtables held in the other countries and some of the main issues emerged thus far.

Questions 1-3 – Sustainability Reporting discussion

1. ***To what extent are the CRD participants' reporting frameworks interlinked and work together to guide effective ESG reporting?***
2. ***To what extent do differences between the CRD participants' frameworks, if any, inhibit an organization's ability to report ESG information effectively to investors/stakeholders?***
3. ***To what extent is better alignment needed between CRD participants' frameworks to enhance the ability of organizations to report effectively?***

- Different definitions of materiality are problematic for report preparers (e.g. GRI vs. IIRC). This is made additionally difficult when regulation, i.e. EU NFRD, employs another definition.
- The differences in materiality outlook, i.e. investor vs stakeholder, results in differences in metrics and benchmarking. Exampled with differences that exist between SASB and GRI. There is a deep ambiguity even in the legislation: Non-Financial Statements must be useful for investors, but also for communities and territories. "It is like adding apples with pears", it has been observed.
- It was suggested that issues with differences in KPIs, scopes (e.g. intangibles dealt with explicitly inside <IR> and not in GRI sustainability reports) and audiences of the various sustainability frameworks and standards cannot be considered individually, but they seem connected to the different understandings and positions on materiality, which in turn depends on the diverse views on aims and intended users (investors vs. general stakeholders) underlying the above frameworks and standards. Until these aims and audiences are not somehow reconciled and made compatible, differences in the reporting models, scopes and KPIs will persist, and then in the materiality assessment. In other words, as a delegate put it, "which metrics for which aims for which stakeholders'?
- It is emphasised that investors are not homogenous – many different demands. They do, however, want information that is comparable and comprehensive, which can be included in their models/analytical tools. Therefore, also the notion of "investors" has to be clarified: to which investors we are addressing? Long-term institutional, general, specialized in ESG? Investors have the need for comparable information that can be inserted in their computerized valuation and assessment models.
- There is a connection between geography of companies and the relevance of ESG issues that has not been appreciated. Example given around human rights reporting – relevant for companies with big supply chains, but less so for others that operate in a legislatively developed market.
- The case of SNAM has been pointed out where the TCFD information is outside their Integrated Report.
- It was raised that there are other actors in the reporting landscape that play an important role, e.g. auditors. Example given of Italian audit firms association (Assirevi) saying they can only audit GRI-

aligned EU NFRD reports, which is troublesome as Italy's transposition includes requirement for audit, thus obliging de facto all the Italian Non-Financial Statements to be prepared according to the GRI standards (the only considered auditable according to the ISAE 3000 Rev).

- The connection between the report preparers and users is important. For example, reporters may include much information about integrated thinking and strategizing, which some investors may ignore as it is not linked to a monetary figure. Members of the discussion emphasise the importance of quantification – only narrative in itself, without some measures, can be perceived as a communication/marketing action.
- The differences of framing and language of the frameworks and standards produces barriers to understanding how they align and complement one another. Example given of the IIRC's six capitals and value creation framing which does not appear in other models/frameworks.
- In response to a slide by WBCSD's on its "Reporting Exchange" Indicator Library, it was widely thought that there were too many KPIs etc. for companies to navigate and make sense of.
- The Report by "Alliance for Corporate Transparency" was raised. It highlights that sustainability reporting is not getting to investors, which would require a better understanding of the impact of ESG and the ability to translate that into value for investors.
- Companies should not be trying to produce reports that speak to all their different perceived audiences, but a single report that can speak to all effectively.
- Believed that rating agencies etc. are also an important consideration for the confusion in the reporting landscape. It is difficult to imagine much change given transparency issues.
- We need to consider why companies are embarking on sustainability reporting – because they care about environment/society or because of profit – it is what investors want to hear and understand.
- The difficulty of navigating between regulatory requirements and voluntary frameworks/standards was discussed. It was mentioned that mandatory requirements can produce a sort of tick-the-box response from companies.
- Some of the participants believed that a single reporting framework was going to be required sooner rather than later, apparently by ESMA. This could be achieved by regulation requiring reporting against one of the frameworks/standards. Some delegates expressed their preference for an individual integrated report. Non-Financial Statement ex EU Directive considered as a useful first step to be seen as an opportunity rather than a compliance exercise.
- It was mentioned that CDP was a strange participant in the Project, as it was not thought of as a framework or standard. Mentioned that it would have been more useful to have an organization like WICI included instead.
- It was observed that EU NFRD is not helping the situation – crystallising differences and not encouraging alignment.
- It is believed that the CRD is also a battle of egos, which is not conducive to achieving the aims of the project and bringing about the change required. The "Better Alignment Project" is especially important for trying also to overcome these conflicts.
- It was raised that there are required expert readers of the ESG disclosures – more education is required to ensure more understanding. Risk reporting, which speaks more directly to conventional analysts, is improving and becoming more prominent.
- It was thought that the majority of CFOs are still very far away from having of these conversations – ESG/sustainability issues have not properly penetrated their realm. From this perspective, it was argued there is not much interest from investors and owners, who, instead, just want to see the financials.
- In this respect, if we want to improve practice, it is important to show the concrete benefits that can be achieved by owners and investors by adopting these forms of reporting. CRD should also consider this crucial point in its alignment effort.
- It was raised that these discussions and ambitions do not really speak to SMEs. The frameworks and standards are, for the most part, geared towards large, listed companies.
- Needs to be more fully appreciated that ESG issues are very sector-specific, both in terms of importance and the nature of them

Questions 4-6 – Integration discussion

4. ***Do organizations actively re-use or re-purpose ESG information collated for multiple purposes/requirements?***
5. ***To what extent are organizations connecting ESG information to financial performance and prospects within their annual reporting – and how important is this to investors?***
6. ***How do you envisage ESG reporting evolving over the next five years?***

- Report preparers agreed that they tried as best as possible to reuse information, both in external reporting, but also in internal reporting, management control systems, corporate strategies and objectives, strategic management, and MBO schemes. In one case, it has been noted the ESG/intangibles-related information is used for annual production awards for blue collars as well as in the Balanced Scorecard of the company. In this organization, Integrated Report has to be provided annually to workers as an outcome of trade union-management agreement.
- Difficult showing the relationship with financials, though.
- That said, there was a lot of frustration at the amount of recalculation as a result of divergent metrics and methodologies – better alignment in this nature would be of great benefit to companies. Unipol, a very large insurance company, declared that they have an office specialized just on this recalculative processes.
- In the next five years…
  - Greater focus on the value of impact (see University of Cambridge's recent report on "In Search of Impact") as well as a stronger tie to the SDGs and the risk profile of an organization.
  - Strong push towards integration of information on a spontaneous or a regulatory basis.
  - However, only a "regulatory push" could not be enough: in many cases reporting rules are not followed (see Management Commentary rules on environmental disclosure already present in the Italian Civil Code). A sanction or a reward policy should come together with a legislative change toward integration of information.
  - Fuller integration of information inside the organisations ("not only investors!") – much broader embedding of ESG information across the reporting world.
  - Risk focus has been very positive – greater focus on forward looking information. SDGs to become the common language for report preparers and users.
  - One report that is mandatory – no need for frameworks and standards.
  - SDGs more and more as a minimum common denominator for reporting.
  - SDGs as an opportunity.
  - Somewhere more in the middle – ESG reporting still exists, but far greater integration of information. If there is to be a single standard/framework, it must be investor driven.
  - In five years nothing will change, in ten years a lot (CFO representative).
- Question, more generally, about the motivations of a possible regulatory intervention – is it because the market does not presently care or is it because there is too much confusion so it is not possible to establish a common platform?

Question 7 – TCFD discussion

7. ***Which frameworks are most often used to support reporting on the TCFD recommendations on 4 key areas (governance, strategy, risk management, and metrics and targets)?***

There has not been a focused discussion on this question, since there was not a clear idea on the answer, owing also to the novelty of the application of the TCFD recommendations.

Question 8-10 – General questions

8. If participants in this roundtable had two key asks of the Corporate Reporting Dialogue what would they be?

Some of the key messages from the Italian stakeholders are:

- Accelerate the CRD alignment process: one participant argued that the CRD should indeed split up as an independent body and accelerate actual action.
- Coordination between the CRD members to be achieved in a quick way to make advocacy in order to influence public policy decision-makers before they may intervene.
- Frameworks and standards should coordinate between themselves before they speak to the market.
- "Please do not complicate things!"
- The process for longer-term alignment should be taken step-by-step, little-by-little, so as to ensure a smooth introduction of the new reporting standards/requirements, and especially the possible legislation should follow an slow evolutionary but constantly expanding trend.
- Better clarify the role of each of the frameworks and standards for companies and investors as well the real/genuine intentions and reciprocal availabilities of the bodies sitting at the CRD table.
- Take the egos out of the room and act for the benefit of society and the environment.
- Discussion of intangibles has so far not been included. Need to talk about this and the relationship between them and sustainability, possibly with the involvement of the specialized WICI Network, of which OIBR represents the Italian jurisdiction.

9. In looking through the online survey and discussing the questions today, is there anything they expected to discuss which was not covered?

The Italian stakeholders have two observations in this respect:

- It is not clear what is the role and space that the CRD would like to devote in its "Better Alignment" process and project to the representation of intangibles and intellectual capital (widely conceived). A clarification on this is a very delicate point for many of the present who are worried about the confusion in the marketplace that can be generated by a possible full overlapping between sustainability and intangibles that have a dimension on their own.

- There has been too little focus on the wider governance aspect of ESG. Governance is essential to understanding of the company and its engagement with sustainability. This is not just about the output, i.e. reporting, but the transformation within the organization. In a recent joint research made by Consob and Methodos, out of the 151 Non-Financial Statements produced in 2018 by Italian listed companies, zero of them reported the materiality analysis in their strategic plan and only 12 quote generic long-term value drivers, this implying that ESG issues are not really yet perceived as relevant variables to transform and guide organisations. The CRD should consider and possibly stress the fact that the adoption of a sustainability or an integrated report to be effective in a more profound way should correspond to a transformative process of the organisations concerned, which could embrace a change in the decision-making procedures and leadership mode. Italian stakeholders would support a wider approach to the CRD reporting alignment exercise that could foster also a transformation in the organisations, following an "Integrated Thinking" approach and without "reducing" the reporting to a mere communication effort. In particular, a working group of NIBR (the organization preceding OIBR) have developed a study and the associated KPIs to drive and measure the transformation within the organization. In such a sense, Italian stakeholders would respectfully suggest to the CRD to consider the indications provided by the NIBR guidance on "*Integrated Reporting <IR>: Focus on Integrated Thinking. A Handbook for the Change Journey*" published in 2016 and available in the IIRC website.

10. How important is sustainability reporting to the users of reports?

Evidently from what it has been said during the Roundtable, sustainability reporting may and can be a meaningful tool to users. It remains to be clarified, though, if the main users/audiences are intended to be the investors or, alternatively, the stakeholders, communities and territories. Another point that has been noted is that in Italy analysts do not seem to ask very often about ESG information, whilst on the contrary this appears to occur far more often in the international calls. But, on the other hand, today in Italy we assist to the phenomenon that many newcomers define themselves as “ESG analysts”.

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Methodos, Milan, 3 June 2019, 10.45-13.45

List of delegates

Riccardo Baraldi (ANDAF-Italian CFO Association)
Lino Cinquini (Professor of Management Accounting, Sant'Anna School of Advanced Studies, Pisa)
Marcello Colla (CFO, Etica Sgr)
Isabella Cristina (Partner, Mixura Consulting – in remote)
Pietro Gasparri (Senior Equity Analyst, Banca Akros, & AIAF-Italian Financial Analysts Association)
Davide Giolo (Board member, Italian Association of Young Chartered Accountants-UNDCEC)
Luca Grassadonia (Corporate Finance Partner, Kreston GV Italy, and CFA Italy)
Maria Luisa Parmigiani (Sustainability Manager, Unipol Group)
Elisa Petrini (Coordinator, Association "Impronta Etica")
Livia Piermattei (Managing Partner, Methodos Consulting SpA, and Nedcommunity – in remote)
Andrea Ragazzini (CFO, Stafer, and Sole Director, Sara Cirone Group Benefit Company)
Andrea Sartori (Senior Research Consultant, ALTIS School, Catholic University of Milan)
Emanuela Serina (Board member, Italian Association of Young Chartered Accountants-UNDCEC)
Sara Teglia (Project manager, Membership services, Association "Impronta Etica")
Daniele Virgillito (President, Italian Association of Young Chartered Accountants-UNDCEC)
Stefano Zambon (Secretary General, NIBR; University of Ferrara; and Chair, WICI Global Network)

David Astley (technical staff, Climate Disclosure Standards Board-CDSB – observer)
Laura Girella (technical staff, IIRC - observer)
Stefano Di Iorio (Senior Officer, Information Issuers Division, Consob-Italian Stock Exchange Regulator – observer)