Hong Kong Institute of CPAs

# ESG Assurance in Hong Kong 2023: An evolving landscape

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Hong Kong Institute of Certified Public Accountants
香港會計師公會

The Hong Kong Institute of Certified Public Accountants is the only body authorized by law to register certified public accountants. The Institute has more than 47,700 members and more than 12,700 students. Members of the Institute are entitled to the description "certified public accountant" and to the designation CPA.

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## ***Message from the chair of the 2023 Best Corporate Governance and ESG Awards Judging Panel***

Dear members,

Environmental, social and governance (ESG) or sustainability reporting is a key issue on the global agenda, as reflected in its growing importance in business and investment worldwide.

With the World Meteorological Organization predicting that global average temperatures will surpass 1.5°C above pre-industrial levels, for the first time in human history, within the next five years, an increasing number of companies have been placing greater emphasis on sustainable development and disclosing their ESG performance against international, as well as local regulatory benchmarks. The question of whether these companies have sought independent assurance of their ESG reporting, or particular aspects of it, is also being asked more frequently. From the perspective of investors and other stakeholders, independent assurance can help to validate the reliability and integrity of companies' ESG data and claimed performance and, more generally, give greater confidence that genuine progress is taking place.

At this stage, ESG assurance is not mandatory, even for listed companies, in most jurisdictions, including Hong Kong, unlike auditing of financial information, and requirements and expectations regarding ESG assurance vary from jurisdiction to jurisdiction. However, changes are happening quickly and, under the European Union (EU)'s Corporate Sustainability Reporting Directive (CSRD), some companies will need to adopt specific ESG reporting standards for financial years beginning on or after 1 January 2024, and the CSRD also makes it mandatory for reported sustainability information to be assured.

In Hong Kong, for listed companies, the Environmental, Social and Governance Reporting Guide (ESG Guide) (Appendix 27 and Appendix 20 of the Main Board (MBLR) and GEM Listing Rules (GEMLR), respectively) issued by Hong Kong Exchanges and Clearing Limited (HKEX) governs ESG practices and disclosures. The ESG Guide acknowledges the potential value of assurance: "The issuer may seek independent assurance to strengthen the credibility of the ESG information disclosed. Where independent assurance is obtained, the issuer should describe the level, scope and processes adopted for the assurance given clearly in the ESG report."

One of the challenges for assurers has been the lack of universal standards for ESG reporting, although some standards have been more widely adopted than others, such as those issued by Global Reporting Initiative (GRI). These adopt a multi-stakeholder in contrast to an investor-focused approach. However, with the recent publication by the International Sustainability Standards Board (ISSB) of the first investor-focused International Sustainability Standards (ISS), under the International Financial Reporting Standards (IFRS) framework, over time, there is expected to be increased commonality in, and harmonization of, ESG reporting by companies.

In addition to the reporting side, several different assurance standards have also been adopted internationally. To support our members in practice, in May 2022, the Institute published Auditing and Assurance Technical Bulletin (AATB) 5 (Revised) Environmental, Social and Governance (ESG) Assurance Reporting, providing practical non-authoritative support material to assist practitioners in performing ESG assurance engagements, in accordance with Hong Kong Standard on Assurance Engagements (HKSAE) 3000

## *Message from the chair of the 2023 Best Corporate Governance and ESG Awards Judging Panel (cont'd)*

(Revised) *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*.

Changes are happening in the ESG assurance landscape too. With the aim of providing a standardized assurance framework, the International Auditing and Assurance Standards Board (IAASB) recently issued a consultation draft of its proposed International Standard on Sustainability Assurance (ISSA) 5000, *General Requirements for Sustainability Assurance Engagements*. It is noted that the IAASB has drafted the standard to accommodate sustainability information prepared under any suitable reporting framework, including the ISSB, GRI, the International Organization for Standardization, and others. The IAASB's proposed standard supports use by both professional accountants and non-accountant assurance practitioners when performing high-quality sustainability assurance engagements.

In 2021, the Institute took the initiative to conduct a brief research and review of the status of ESG assurance in Hong Kong, covering all December 2020-year-end listed companies. In view of the rapidly developing landscape referred to above, this year, we decided to revisit the situation to assess whether any significant changes have taken place in the prevalence of ESG assurance in the Hong Kong market over the past two years and, if so, the nature of those changes. The 2023 research covered the sustainability/ ESG reports (or, where applicable, the sustainability/ ESG sections in annual reports) of all December 2022-year-end listed companies, amounting to approaching 1,900 entities.

Our research indicates that there have been noticeable changes in the market, particularly among larger companies. At the same time, an increasing number of firms of certified public accountants (CPAs) are investing resources into developing and enhancing their ESG-related services to serve the needs of their existing and potential clients.

We hope to see more companies seeking ESG assurance to demonstrate their commitment to being responsible and sustainable businesses, by providing sustainability-related information that is relevant, reliable and verifiable. By obtaining independent verification of their ESG performance, companies can build trust and credibility with stakeholders, including investors, who, increasingly, take ESG factors into account in their decision-making process. This story will certainly continue to develop in the years ahead.

**Loretta Fong**
**Institute President**
**Chair of the 2023 Best Corporate Governance and ESG Awards Judging Panel**

## ***Background***

Addressing ESG issues, particularly climate-related issues, is of utmost importance in tackling the urgent challenges that we face today. Most experts agree, failing to take timely action will result in irreversible harm to the environment, society, and economic stability. Collaborative and coordinated efforts from different stakeholders, including governments, businesses, investors, civil society organizations and individuals, are essential in order to implement effective solutions.

While companies may assert, and aspire to demonstrate, their commitment to implementing ESG initiatives, it is important for stakeholders to be able to monitor this and measure their underlying progress towards any interim and longer-term goals. Qualified third-party ESG assurers can play a vital role in helping companies to demonstrate the reliability and credibility of their ESG performance, metrics and reports, and help to prevent "greenwashing"[1], whether inadvertent or willful. Independent and objective reviews help ensure that the reported ESG actions align with the stated goals, contributing to transparency and building confidence and trust in ESG practices.

In terms of scope, our research study set out to find answers to the following questions:

1. What is the overall percentage of companies with ESG assurance?
2. What is the percentage of companies with ESG assurance, by market capitalization?
3. What types of assurance do companies obtain?
4. What is the scope of assurance sought?
5. What benchmarks do companies use to prepare their reports?
6. What types of assurance are provided by ESG assurers (i.e. what benchmarks are applied)?
7. Who are the assurers of ESG reports?
8. Are the ESG assurers the same as the financial statement auditors?
9. Is there a board-level ESG/ sustainability committee?
10. For those companies with a board-level ESG committee, how many committee meetings were held during the year?
11. For those companies with a board-level ESG committee, is there at least one member who has relevant accounting qualifications?
12. Whether companies have a target to achieve carbon neutrality by a certain date (e.g. by 2050)?
13. For those companies that have carbon neutrality targets, how many have corresponding interim targets in place?

[1] While there is no universally-accepted definition of "greenwashing", the Law Society in the United Kingdom suggests: Broadly, the term is used to describe untrue or misleading statements made about the environmental performance or impact of a business, product or service. This can include misleading statements made in:

- marketing materials
- companies' annual reports and filings
- communications to clients or other public statements

Greenwashing relates particularly to misleading claims that state or imply that an entity, product or service benefits the environment or people. This could be done inadvertently, negligently, recklessly or intentionally

## *1. What is the overall percentage of companies with ESG assurance?*

As for the results in 2021, the overall percentage of companies that obtained assurance on their ESG reporting is still quite limited among the **1,882 companies** researched. Although there is an observable increase, **with 141 (7.5%) of the companies** adopting external assurance, compared with only 85 companies in 2021 (4.5%), the increment can be considered moderate in absolute terms, although more substantial in terms of the percentage increase. The reasons for this may include that (i) the majority of local listed companies still do not see the business case, i.e., benefits over the costs of obtaining assurance; (ii) at this juncture, they do not have sufficient confidence in the processes undertaken and/or data provided to seek to have them assured; and (iii) as assurance is not a mandatory requirement, this finding could also indicate that companies are publishing ESG reports simply to fulfil the disclosure requirements of HKEX, and for image purposes, to meet the minimum expectations of the market.

In contrast, reviewing the **69 Hang Seng Index (HSI) companies** with 31 December 2022 as their financial year end, 36 of them engaged a third party to assure their reports, representing roughly 52% of the sample. Compared with the result for the much larger sample of listed companies overall, the HSI companies show a significantly greater proportion of assured ESG reports. This perhaps may not be a surprise, as the HSI encompasses some of the largest companies, with the most heavily traded shares, listed on the Hong Kong Stock Exchange. There is more pressure on HSI companies to demonstrate the credibility of their ESG performance in order to continue to attract international investors. Compared with the statistic from the corresponding group of companies in 2021, which was 47%, the 2023 figure of 52% reflects an incremental advancement.

Furthermore, when we looked at **large-market-capitalization (large cap) companies (≥HK$38 billion) generally**, there was a much more significant jump in the take up of assurance, **increasing from 20.1% to 41.6% of the total number** of large cap companies in the overall sample, i.e., more than double the percentage in the 2021 study. It appears therefore that:

- Larger companies are responding more rapidly to the fast-moving ESG environment.
- Like HSI companies, other large caps are also more influenced by the expectations and needs of investors and other stakeholders.

Other specific findings:

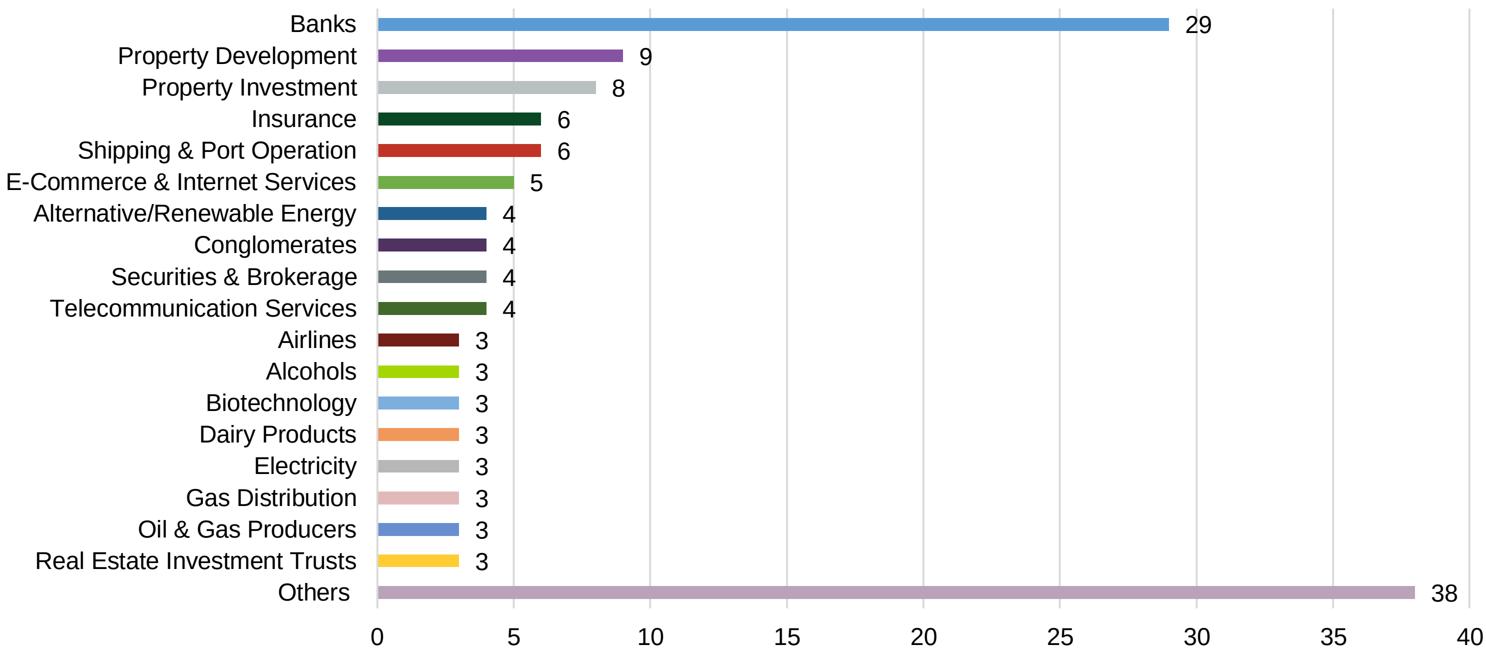
- Among the 141 companies that obtained ESG assurance, 29 of them (around 21%) were banks, easily the highest number of any of the sectors identified, as we also found in 2021, and well above the proportion of banks within the total number of companies studied. This may be due to the fact that the Hong Kong financial service regulators have been taking steps to promote green and sustainable finance and ESG reporting. The Hong Kong Monetary Authority (HKMA) has issued guidelines and frameworks for banks to assess and disclose their ESG risks and performance. In addition, at the international level, the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) gained increasing prominence over the past few years and TCFD recommendations were issued by the Financial Stability Board, which is an international body that brings together senior policy makers from ministries of finance, central banks, and supervisory and regulatory authorities.
- Engaging third-party assurers helps banks ensure compliance with these regulatory requirements and demonstrate their commitment to transparent and accurate ESG reporting.

## 1. *What is the overall percentage of companies with ESG assurance? (cont'd)*

In addition, investors, including institutional investors and asset managers, are increasingly incorporating ESG factors into their investment decisions. Engaging third-party assurers can help to meet those investor expectations, thus enhancing investor trust and confidence.

- In the figure below, the category labelled as "Others" constitutes 38 out of 141 companies with ESG assurance. These companies belong to various industries, each representing approximately 1-2 companies with ESG assurance; so, to simplify the presentation, we have aggregated all these statistics.

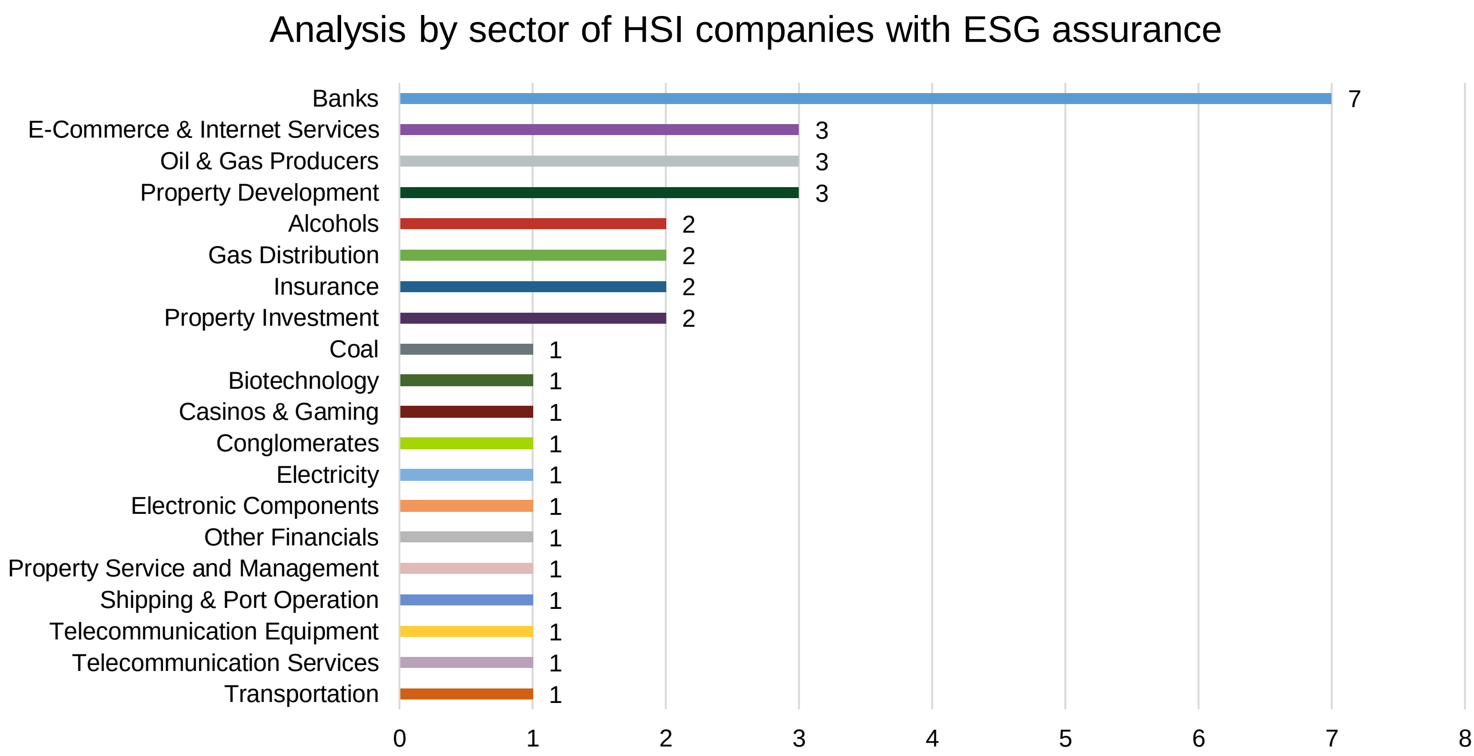
Analysis by sector of all listed companies with ESG assurance




- Earlier this year, the International Federation of Accountants (IFAC) in collaboration with the American Institute of Certified Public Accountants and the Chartered Institute of Management Accountants, released their third annual benchmarking study on global sustainability disclosure and assurance practices. The study revealed that the global trend for ESG reporting continues to grow. In their study report *The State of Play: Sustainability Disclosure & Assurance 2019-2021, Trends & Analysis*, it was found, especially for 2021, that 95% of very large companies globally (i.e., the top 100 or 50 "local" companies listed in each jurisdiction covered) had reported on ESG matters, and 64% of companies had obtained a certain level of assurance on some of the information disclosed. Specifically, in Hong Kong, it was reported that approximately 52% of the 50 largest listed companies, or 26 companies, had obtained an ESG assurance. This aligns with our observation on the HSI companies, and reflects a substantial uptake of ESG assurance among the largest listed companies in Hong Kong.

## *1. What is the overall percentage of companies with ESG assurance? (cont'd)*

- Although the ESG assurance rate in Hong Kong for the largest Hong Kong companies was lower than for the corresponding group in United States, where many major well-established corporations are listed and where the rate reached 82%, on a regional basis, Hong Kong compares more favourably. In Singapore, for example, the IFAC study found that main listed companies had an ESG assurance rate of only 38%.



## *2. What are the percentages of companies by market capitalization with ESG assurance?*

Our assurance research covered 1,882 companies with 31 December 2022 as their financial year end. Applying the same market cap thresholds as adopted in our Best Corporate Governance and ESG Awards 2023, to classify companies of different sizes under large (≥HK$38 billion), mid (HK$6 billion to <HK$38 billion) and small (<HK$6 billion) market cap categories, we arrive at the numbers of companies in each category covered in our study, indicated below. In general, the number of listed companies in the medium cap and small cap categories obtaining ESG assurance has seen a slight increase, but the extent of this increment is not as significant as that of large-cap companies, the percentage of which has doubled. In percentage terms, the increase for small-cap companies was also quite significant, but it was starting from a very low base.

| Categories | Number of companies | Number of the companies with ESG assurance | Percentage in 2023 | Percentage in 2021 (B/A * 100%) |
|---|---|---|---|---|
| Large | 137 | 57 | 41.6% | 20.1% |
| Mid | 336 | 49 | 14.6% | 11.6% |
| Small | 1,409 | 35 | 2.5% | 1.4% |

*All HSI companies were included in the large-cap category.

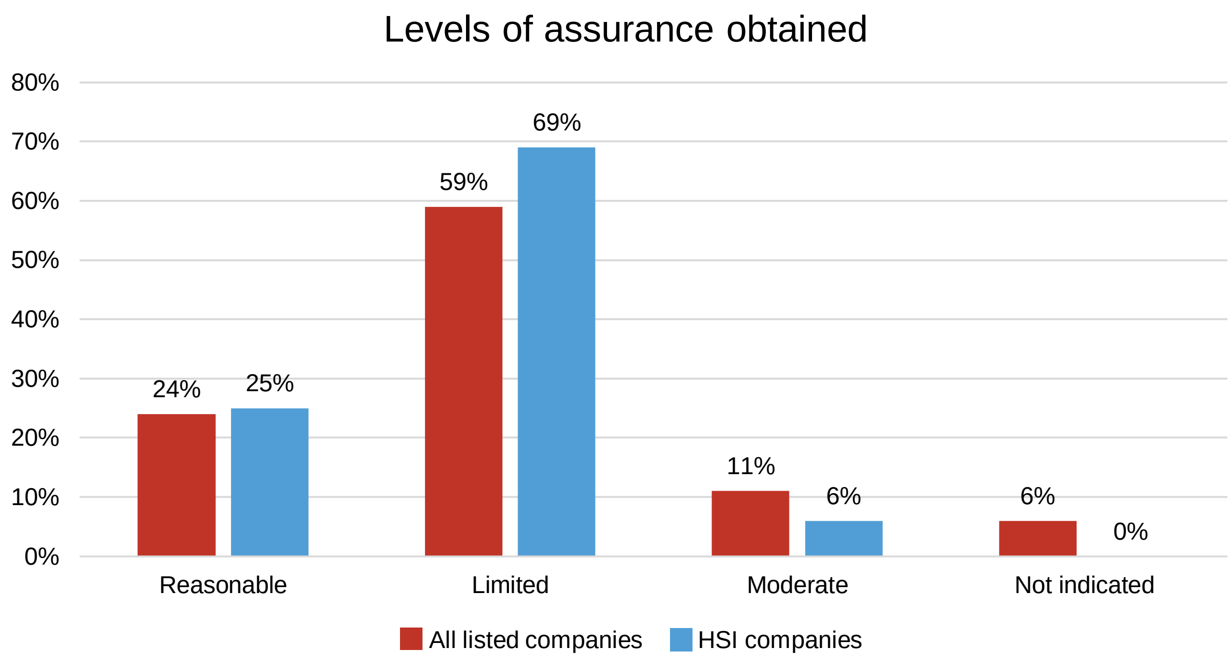
## *3. What types of assurance do companies obtain?*

The majority of the listed companies with assurance of their ESG reporting overall tended to obtain limited assurance on selected ESG material and statistics, with a similar observation for the HSI category. Amongst other reasons, this can be explained by the lower time and resources commitment required to obtain limited assurance than a more in-depth and extensive assurance. Under the ESG Guide at Appendix 27 (MBLR) / Appendix 20 (GEMLR) issued by HKEX, independent assurance of the ESG information disclosed is not a mandatory requirement. Instead, it is optional for companies that seek to strengthen the credibility of their ESG reports. This may be one reason why the mainstream approach to assurance is still to opt for limited assurance, even if reasonable assurance entails a more robust level of assurance, particularly where a CPA firm is the assurer.

As we found in our 2021 study, reasonable assurance is still not sought frequently. Amongst the possible reasons are:

- As ESG assurance is not mandatory, when they are starting out, companies may decide that it is more prudent to take a step-by-step approach to assurance.

- The cost and time required for obtaining higher levels of assurance will be greater, particularly where a CPA firm is the assurer, because, as explained below, this would require a more in-depth assessment. Without any legal or regulatory obligation, or clear guidance from regulators, companies are likely to prioritize other immediate business needs over extending their voluntary ESG assurance.




- Companies may not have sufficient confidence in their own systems and processes for data gathering, analysis and management, at this stage, to be willing to have these subject to detailed scrutiny.

- Some companies may have less awareness and understanding of the benefits and value of seeking higher levels of ESG assurance; and that this can bring greater discipline to companies' own processes, so that the data and information produced internally will be more

## *3. What types of assurance do companies obtain (con’d)?*

accurate and reliable and, therefore, more decision-useful for the company itself, not only its external stakeholders.

Some assurance engagements were conducted according to AA1000 Assurance Standard (AA1000 v3), which is a principles-based framework that reflects performance in accountability, responsibility, and sustainability, issued by AccountAbility, a global consulting and standards firm working in the ESG sphere. Under this framework, there are two levels of assurance, namely “Moderate” and “High” level of assurance. Among the companies adopting this framework, all of the assurance was conducted at the moderate level of scrutiny, which seems to be more akin to limited assurance, where the work performed and the evidence gathered is more restricted.

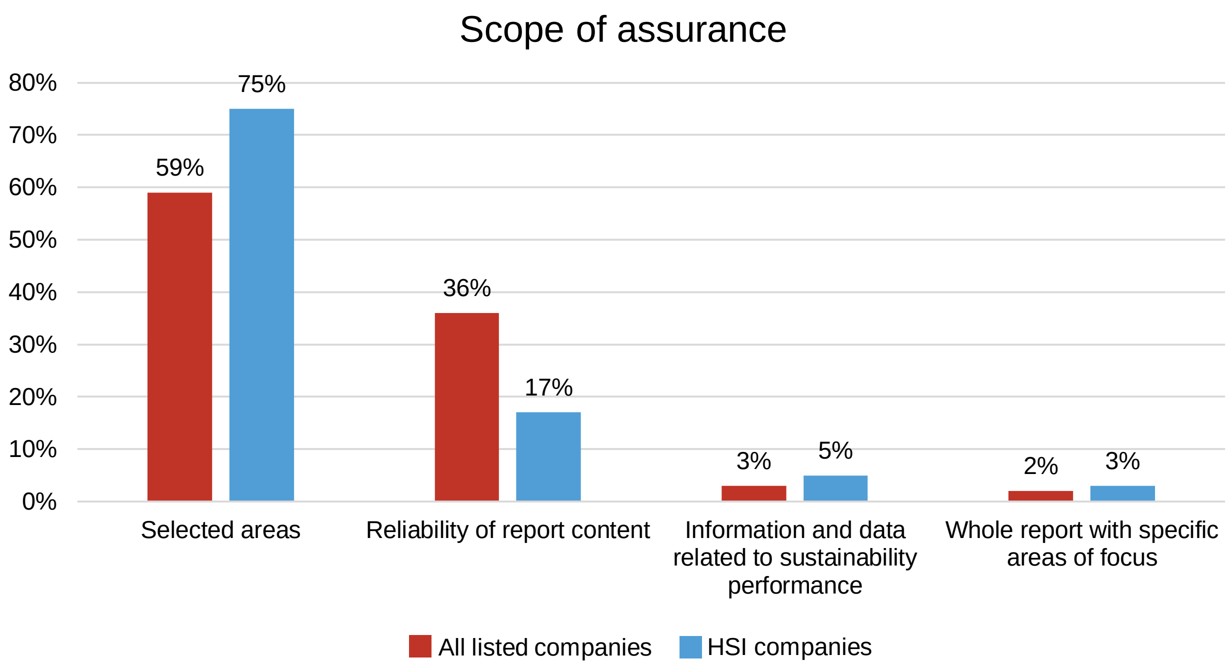
For a CPA assurer to provide reasonable assurance, on the other hand, this would usually require a greater understanding of the internal processes and controls that a company has in place. The assurer will check metrics and disclosures, tracing them to their source to confirm their accuracy. It would also involve efforts to ensure that the company presents a balanced report that is relevant to stakeholders. Limited assurance, meanwhile, relies more on representations made by the company as an information source. It generally entails less verification of source documents, as well as a less detailed understanding of processes and controls and a lower level of scrutiny of source data. However, other assurers also use other terminology and/ or use similar terminology but may conduct a different type or extent of work. Unfortunately, these differences can sometimes result in a lack of clarity in the market and make comparisons difficult. One of our findings was that, where reasonable assurance was obtained, in almost all cases, the assurer was not a CPA firm and the assurance was commonly on the report content generally, rather than on selected data.

Around 6% of companies that obtained assurance did not indicate specifically the level of assurance obtained, but just stated that independent or external assurance had been conducted.

The above observations are similar to our findings in 2021.

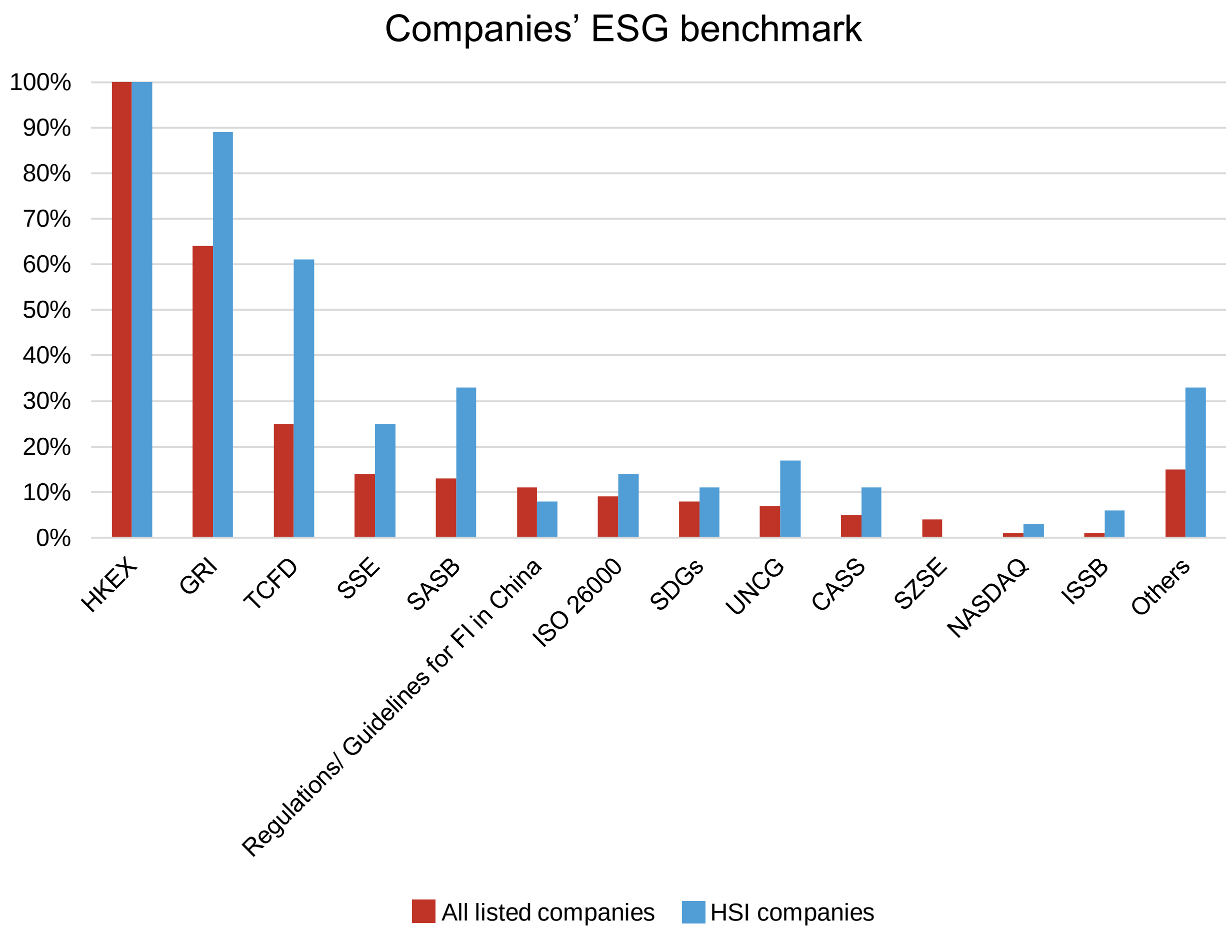
## *4. What is the scope of assurance?*

We observed that it is still a common practice for companies to cover only selected ESG information/ data in their assurance engagements. Comparing the bar charts below, three quarters of the HSI companies (69) assured selected areas of ESG information, whereas the percentage for all listed companies with assurance (141) was 59%. However, this latter figure increased from 47% in 2021, which tends to suggest that companies may see the benefits of homing in on selected data that is of greater relevance to stakeholders and the company (e.g., greenhouse gas emissions), and seeking a more focused and robust assessment of that. A distinction here is that assurance on the reliability of the report content generally (36% overall vs 17% for HSI companies) while seemingly being more extensive, would almost inevitably also be at a higher level, because the work required to verify the whole of the report content in more detail would be very substantial, depending, of course, on the amount of hard data contained in the relevant report.



## *5. What benchmarks do companies use to prepare their reports?*

All the companies with ESG assurance will have prepared their ESG reports in accordance with the Appendix 27 of the MBLR/ Appendix 20 GEMLR. On top of this mandatory requirement, most of them followed or made reference to one or more other standards. The GRI was the second-most-widely-referenced framework adopted by listed companies, which is line with our 2021 study. Furthermore, we also found companies making reference to the guidelines of other stock exchanges, such as the Shanghai Stock Exchange, Shenzhen Stock Exchange and Nasdaq Stock Market. This will generally be the case where companies are listed in more than one market.




Remarks:

- The above percentages do not add up to 100 as many companies prepared their reports with reference to two or more standards.

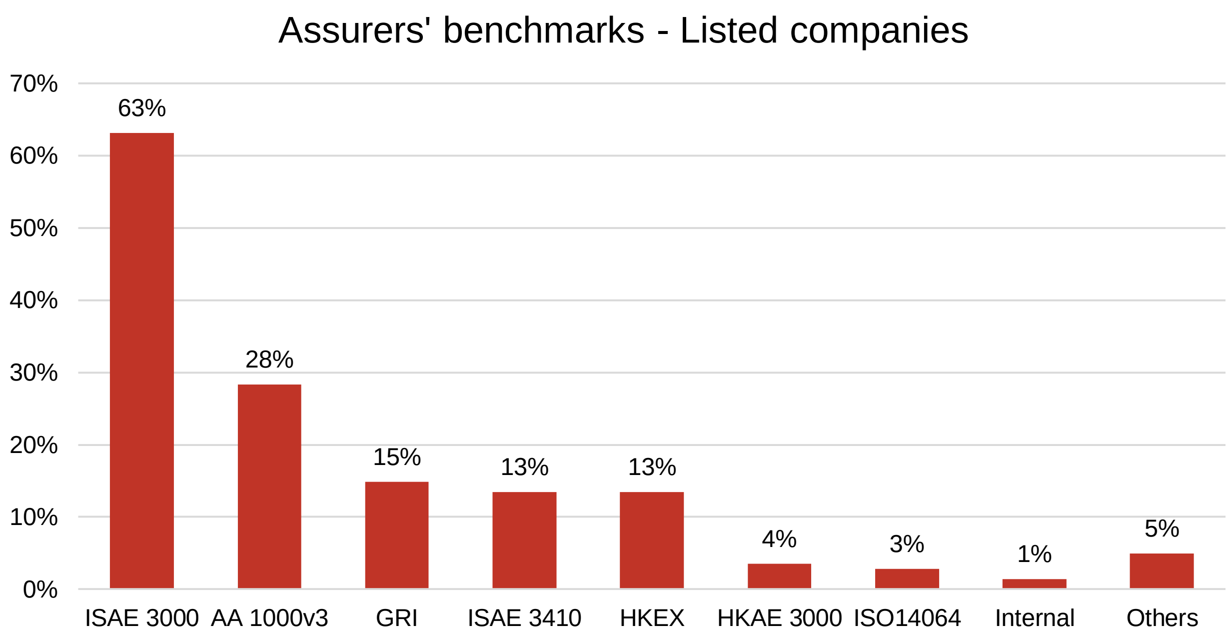
- The future prevalence of the application GRI standards may be affected by the recent publication of the first two, investor-focused, ISS by the ISSB, namely IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures*, although it is expected that a significant amount of capacity building will be needed before these new standards can be widely adopted and applied. Another factor will be the implementation of the CSRD in the EU, for some companies with financial years commencing on or after 1 January 2024, which mandates the use of European Sustainability Reporting Standards.

## *6. What types of assurance are provided by ESG assurers (i.e. what benchmarks are applied)?*

The International Standard on Assurance Engagements (ISAE) 3000 (Revised) *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* issued by IAASB, continued to be the most commonly adopted assurance standard, with 63% of assurance reports in the study referring to it. IAASB is an independent international standard-setting body that sets auditing and assurance standards.

Similar to our 2021 research results, the next most widely-referenced benchmark for all listed companies with assurance was the AA1000 v3, which was referred to in 28% of assurance reports.

With the increasing global awareness of the need to reduce carbon emissions and the pressure for companies to set a target date for achieving carbon neutrality, we found that ISAE 3410*, Assurance Engagements on Greenhouse Gas Statements*, was also adopted by some assurers.

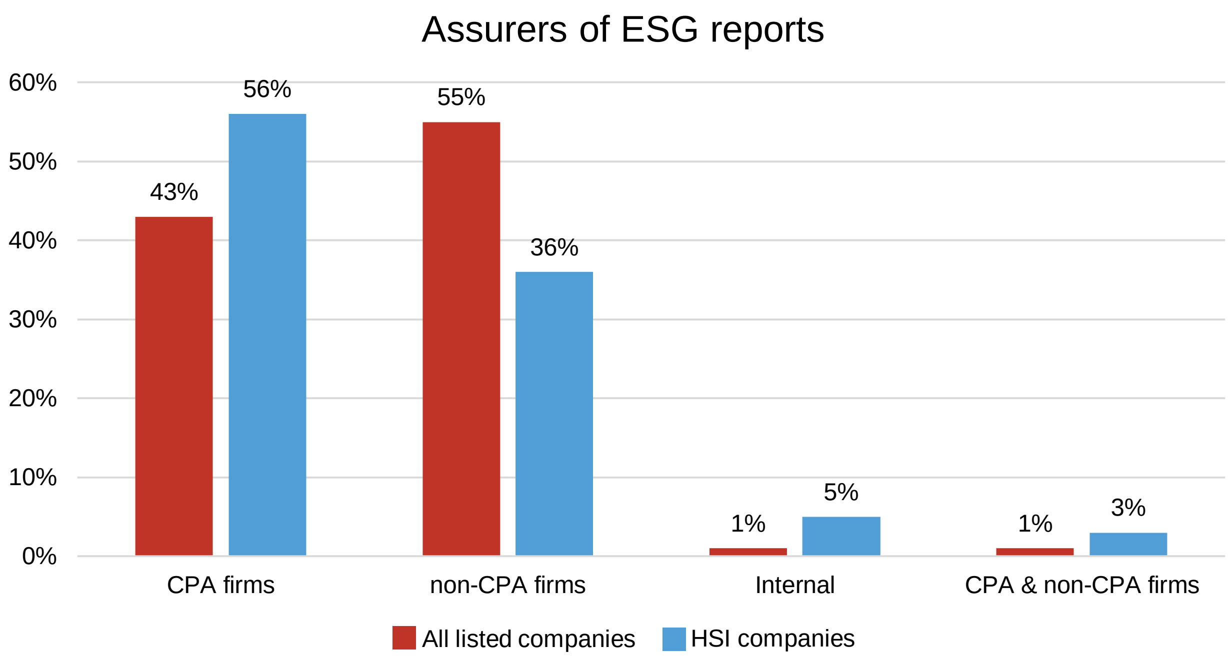



*Language of "adoption"*

In relation to questions 5 and 6, and in line with the observation made in our 2021 study, we noted that difference terminology was used by assurers to describe the way in which standards or benchmarks were used or taken into account. These included terms such as "in accordance with", "pursuant to", "according to", "based on", "with reference to". It appears that the former three terms were more indicative of close compliance with a particular benchmark than the latter two. In particular, companies and assurers seemed to consider that they had greater flexibility to make use of certain parts, rather than the whole, of the relevant standard or benchmark when they used either of the terms "based on" or "with reference to".

## *7. Who are the assurers of ESG reports?*

CPA firms assured 43% of the reports of all the companies that obtained assurance, while 55% was carried out by non-CPA firms. In one case, two companies within the same group were observed as having obtained two sets of ESG assurance, which served two different purposes, one for green bonds and loans, and another one for the ESG report overall, carried out by a CPA firm and non-CPA firm, respectively. A small portion of companies claim to have assured their ESG report content internally, but no further explanation on the assurance level, scope and processes were provided. Meanwhile, HSI companies looked to CPAs to provide assurance in 56% of the cases where assurance was obtained.




*CPA vs. non-CPA assurers*

In the past, financial reporting and ESG reporting have been seen as two separate streams as if "never the twain shall meet", with two distinct and separate teams being responsible for them. Dealing with financial and sustainability issues in silos is now seen as increasingly untenable, particularly with the emergence on the scene of reporting benchmarks such as the TCFD recommendations. Investors nowadays need to be able to understand the financial implications of ESG-related issues and decisions. They do not see ESG risks and opportunities as a discrete area but an integral part the overall strategic and operational risks and opportunities facing companies. The situation is similar for assurance, in that assurers will need to be able assure information and reporting that will become increasingly integrated and will need to be able to call upon a range of expertise.

CPAs are well placed to conduct ESG assurance:

- Most CPAs will have extensive experience and expertise in financial reporting and auditing. This background can be valuable when assessing ESG disclosures that have a financial impact or require financial analysis, such as when assessing the financial risks and opportunities associated with ESG initiatives.

- They have a very-well-established presence in the market and are well-known and trusted in the business and financial communities. Engaging a reputable CPA firm for ESG assurance can

## *7. Who are the assurers of ESG reports? (cont'd)*

enhance the credibility and perceived reliability of the assurance process and the resulting ESG disclosures. Stakeholders, including investors and regulators, often have a level of knowledge of, familiarity with, and confidence, in the work of CPA firms, and the extensive regulatory framework under which they operate, which may not be the same for all non-CPA assurers.

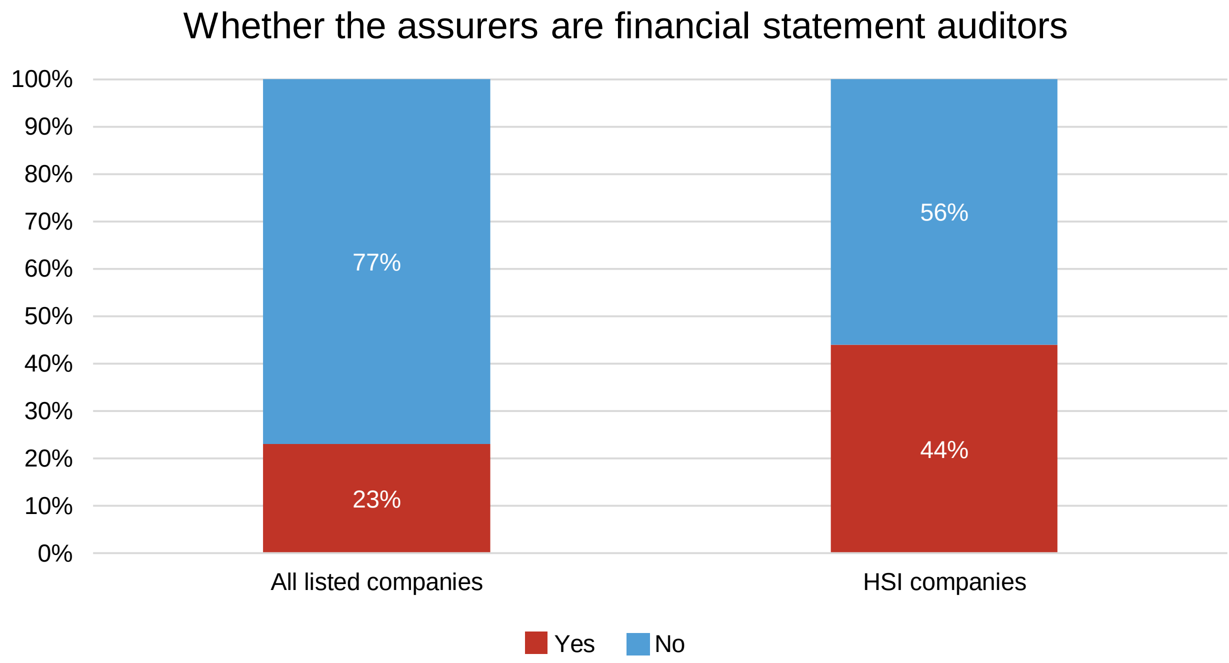
- CPAs are governed by a body of professional and ethical standards that emphasize, among other things, the importance of independence and objectivity. They can leverage on their understanding of financial systems, internal controls and risk management, etc., to provide a holistic approach to ESG assurance, by considering the financials, operational systems and processes, and the compliance aspects of ESG reporting.

- In many jurisdictions, financial statement audits are mandatory for listed companies and regulated entities. Engaging a CPA firm for ESG assurance can help ensure compliance with overall relevant regulatory requirements and provide a more seamless integration of financial and non-financial reporting obligations. As noted elsewhere, increasing integration is the direction of travel and implicit in the new ISSB standards, IFRS S1 and S2.

- Larger CPA firms have significant resources, including specialized teams, technology, and infrastructure, to handle complex assurance engagements. They can bring their established methodologies, tools, and quality control processes to ensure efficient and effective ESG assurance. Most CPAs are use to collaborating with and coordinating the work of other specialists, e.g., valuers, surveyors, and lawyers, in the context of audits and other work. This experience is valuable when it comes to collaborating with, e.g., sustainability and data specialists on ESG reporting and assurance.

## *8. Are the ESG assurers the same as the financial statement auditors?*

Approximately in line with our 2021 study, we found that around 23% of all the companies with ESG assurance engaged their financial statement auditors as assurers. However, for HSI companies, the figure was almost double, at 44%. On the other hand, from another perspective, this means that, in the majority of cases where a CPA was the assurer, the same CPA firm acted as both the financial statement auditor and the assurer for ESG matters (53% for all companies in the study and over 78% for HSI companies). This percentage is derived by dividing the number of ESG assurers who were also financial statement auditors by the total number of ESG assurers that were CPAs in each case.




There may be arguments for either approach:

- Using a CPA firm other than financial statement auditor as ESG assurer may be perceived as adding another layer of independence to the process of ESG assurance, and increasing the overall framework of checks and balances in the system. However, on the other hand, there may be synergies where the financial statement auditors also perform the role of ESG assurers. The auditor will understand the business and the systems and controls that are in place for financial reporting and compliance. With the increasing integration of financial and sustainability information in the future, as we have noted above, the financial statement auditor may well have a head start on any other external ESG assurer when it comes to reviewing a company's data collection, analysis and management processes. The auditor will also be familiar with the management and, for example, understand the extent to which they can rely on management representations.

- Internationally, this is still an open question. In the context of the CSRD, the EU considered whether any restrictions should be placed on the financial statement auditor also taking up responsibility for ESG assurance for the same company, and decided not to impose any particular limitations.

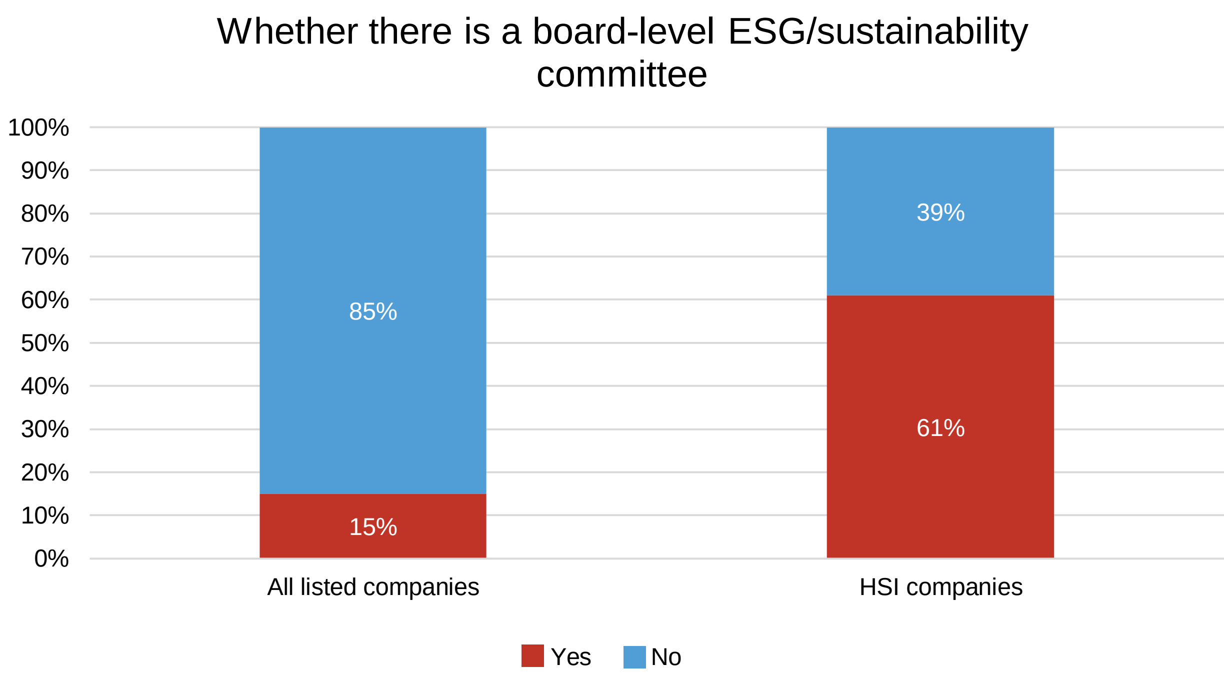
## *9. Is there a board-level ESG/ sustainability committee?*

Over 15% of the listed companies researched (290 out of 1,882) had put in place a board-level sustainability committee. That percentage increased to 61% for HSI companies (69). This contrast may be due to the following reasons:

- The HSI consists of the largest and most-actively-traded companies listed in Hong Kong. These companies typically have more resources than smaller listed companies and may have more advanced governance structures in place, including various board committees serving different functions, due to their size, complexity, and investor expectations.

- Large, more well-recognized companies listed on the HSI face greater scrutiny and higher expectations from institutional investors, analysts, and the public, and more and more institutional investors, particularly international investors, incorporate ESG considerations into their investment decisions. These stakeholders also tend to place greater emphasis on good corporate governance practices, including good ESG governance, and the presence of a board committee with responsibility for this area can be seen as a sign of a clear focus on oversight of ESG matters.

- Many international institutional investors and index providers incorporate ESG considerations into their investment decisions and indices, respectively. These investors look for companies with strong governance structures, such as board committees focused on ESG or sustainability matters. As a result, HSI companies may decide to establish board committees to align with global best practices and attract investment from these institutions. In addition, having such committees operating actively can help to keep the board informed and up to date with important information on, for example, ESG risks and opportunities, as well as emerging ESG-related issues.



## *10. For those listed companies with board-level ESG committees, what is the number of the meetings held during the year?*

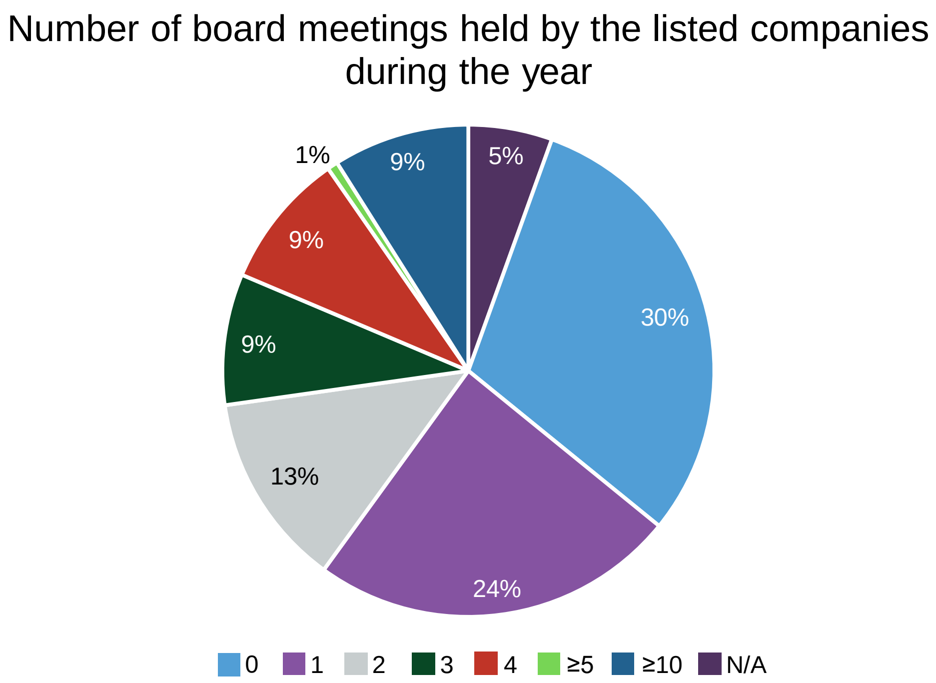
It was found that the majority of the companies (close to 55%) held one to two committee meetings during the year. While there is no optimal number of meetings mandated by the Listing Rules or regulators, the frequency of meetings should, in principle, align with the complexity of the company's operations, the nature of the committee's responsibilities, and the need for timely decision-making. There are a number of factors that may be considered to determine the appropriate the number of meetings that a board-level ESG committee should convene, such as:

- ESG issues span a broad range of topics, including environmental impact, social responsibility, and governance practices. To adequately address these complex issues, board-level ESG committees typically require regular meetings to review ESG strategies, assess performance, monitor risks, and make informed recommendations to the board.

- Regulatory frameworks and guidelines related to ESG reporting and disclosure are evolving locally and globally. Regular committee meetings can help ensure compliance with changing regulations and facilitate consideration and integration of emerging best practices.

- Stakeholder expectations regarding ESG matters are rising, and companies are increasingly expected to engage with stakeholders on these issues. Board-level ESG committees can play a crucial role in overseeing stakeholder engagement strategies and reviewing feedback. Frequent meetings can enhance the committee's ability to respond to stakeholder concerns and incorporate feedback into decision-making processes.

- Regular meetings allow board-level ESG committees to review and monitor the company's progress in achieving ESG goals and targets. This includes evaluating ESG metrics, assessing the effectiveness of sustainability initiatives, and identifying areas for improvement, as well as possible remedial measures where a company is falling short of its targets.



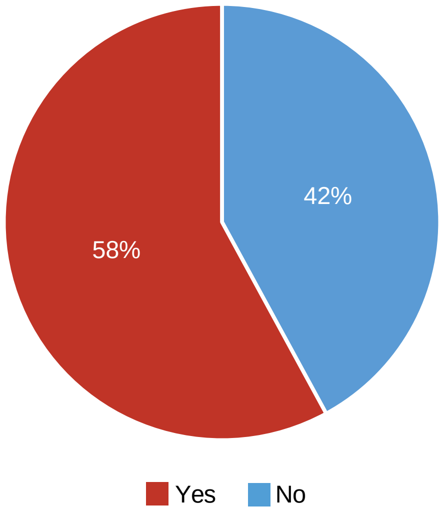
## *10. For those listed companies with board-level ESG committees, what is the number of the meetings held during the year? (cont'd)*

- ESG risks and opportunities can have significant impacts on a company's reputation, operational resilience, and long-term value. Regular committee meetings enable proactive identification, assessment, and management of ESG risks and opportunities, ensuring that they are properly monitored and mitigated, or considered and pursued, as appropriate. This helps to ensure that the board is kept up to date and able to make timely decisions on key areas of ESG risk and /or opportunities.

## *11. For those listed companies with a board-level ESG committee, is there at least one board-level ESG/ sustainability committee member with relevant accounting qualifications*

Among 290 listed companies with board-level ESG committees, over 40% of them had at least one member with relevant accounting qualifications. However, based on the finding in our 2022 study, *Board diversity among listed companies in Hong Kong*, this was most likely to be an independent non-executive director (INED) or a non-executive director (NED). As we noted in that study, a survey on the effectiveness of INEDs, conducted by The Hong Kong Independent Non-Executive Director Association in 2022, found that INEDs do not always get sufficient information from the management to perform their functions effectively.

Listed companies with at least 1 board-level ESG/ sustainability committee member who has relevant accounting qualifications




A "Qualified Accountant (QA)", defined here as a full-time executive director on the board, or, at least, a member of the top senior management, can make a vital contribution in following ways:

- Accounting qualifications provide a strong foundation of financial knowledge and understanding. Without a QA on the ESG committee, the company may lack the necessary expertise to effectively assess and address the financial implications of ESG issues. This can hinder the committee's ability to make informed decisions and recommendations on ESG matters.

- ESG reporting often requires the collection, analysis, and interpretation of relevant data, including financial data. A QA can help ensure the accuracy, reliability, and integrity of ESG data, particularly when it intersects with financial management and reporting. Without such expertise, a company may struggle to effectively measure, analyze and disclose relevant ESG-related information, potentially undermining the credibility of its ESG reporting efforts.

- ESG issues can pose financial risks to companies, such as risks relating to regulatory non-compliance, reputational damage, or operational disruptions. A QA can contribute to the identification, evaluation, and management of these financial risks within the purview of the ESG committee. Their expertise can help assess the financial implications of ESG risks and opportunities, and their potential impact on the company's overall financial performance.

## *11. For those listed companies with a board-level ESG committee, is there at least one board-level ESG/ sustainability committee member with relevant accounting qualifications (cont'd)*

- Looking ahead, companies will need to further integrate their business, financial and ESG strategies to ensure alignment and maximize long-term value creation. A QA can facilitate the integration of financial and ESG considerations by providing insights into the financial implications of ESG initiatives, identifying opportunities for value creation, and assessing the financial viability of sustainability initiatives.

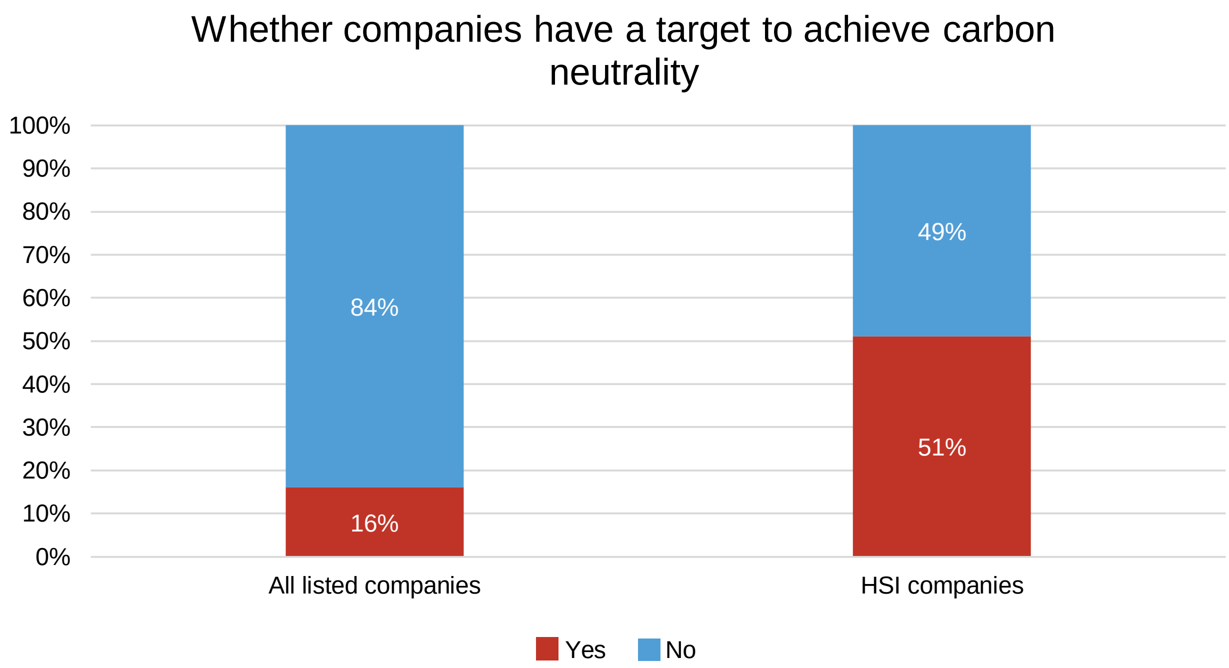
- Regulatory frameworks and reporting requirements relating to ESG are evolving rapidly. Companies need to navigate complex reporting obligations, which, in future, are likely to include applying ISS or their local equivalent. The HKICPA will be the local standard setter for sustainability reporting standards and we are committed to ensuring that our members have the capacity to understand and appropriately apply these standards. A QA who is also an HKICPA member will give companies more confidence in their ability to discharge their evolving ESG reporting obligations.

## *12. Whether the listed companies have any target to achieve carbon neutrality by a certain date (e.g. by 2050)*

If Hong Kong and the Mainland are to achieve their stated aims of carbon neutrality by 2050 and 2060, respectively, and meet interim targets along the way, it is essential for many major companies with operations in Hong Kong and the Mainland to establish their own target date to achieve carbon neutrality, and to set out interim steps and milestones. Setting a carbon neutrality target demonstrates a company's commitment to addressing climate change and reducing its greenhouse gas emissions, which is among the most urgent, if not the most urgent, ESG issue facing humanity. By setting a clear goal to achieve carbon neutrality, companies will be contributing to local, regional and global efforts to mitigate climate change and transition to a low-carbon economy.

Overall, only around 16% (i.e. 309/1,882 * 100) of all the listed companies researched disclosed an objective to achieve carbon neutrality by a specific date, but this percentage increased substantially, to around 50% (i.e. 35/69 * 100) among HSI companies. This is probably due to HSI companies' size and impact and the fact that they have a higher profile and face greater investor and stakeholder pressure to demonstrate their commitment to sustainability and good ESG practices; hence, they may disclose reasonably ambitious targets, to set an example and maintain their reputation as industry leaders. As more institutional investors, asset managers, and other stakeholders take ESG considerations into account in their investment and other decisions, so HSI companies are more likely to be influenced to respond by setting carbon neutrality targets, to fall in line with investor expectations and enhance their stakeholder relations.

However, we also found that the extent of companies' commitment to carbon neutrality sometimes lacked clarity, in terms of, for example, whether it applied at the group/ company level and whether it also encompassed the entire supply chain.

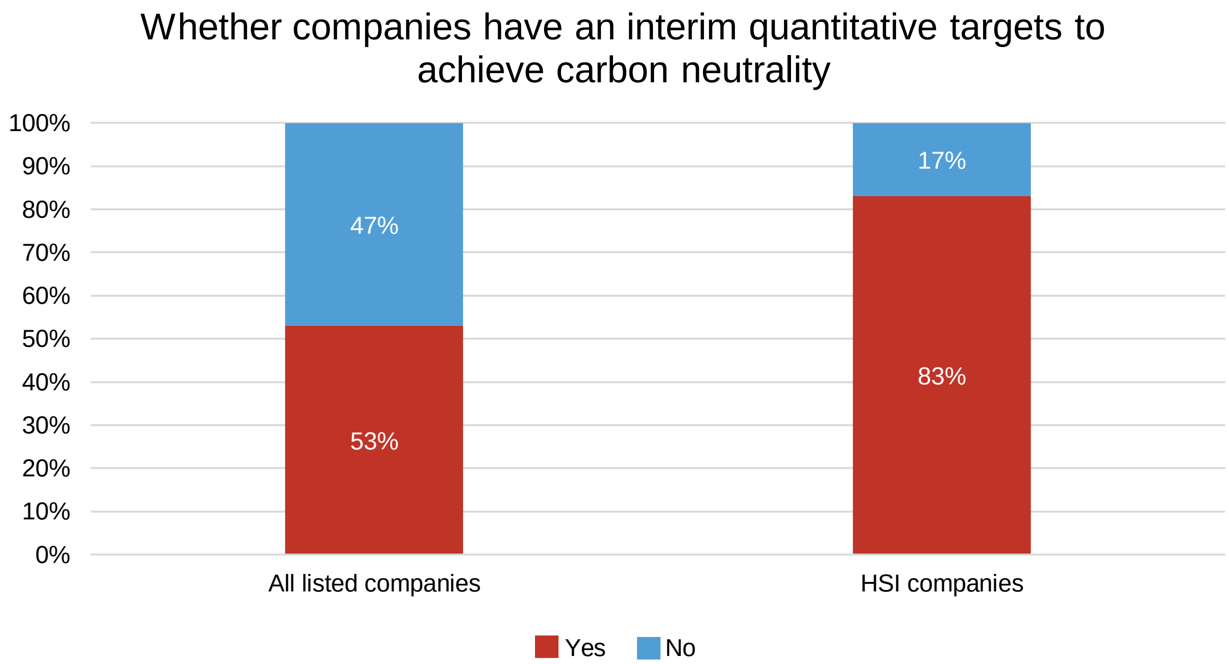


## *13. For those companies that have carbon neutrality targets, how many have corresponding interim targets in place?*

Among the 309 listed companies that had committed to carbon neutrality by a specific date, a little over 50% had interim targets in place. This is a somewhat disappointing finding. The setting of, and reporting against, interim targets and milestones plays an essential role in achieving long-term targets, as the former provide a structured roadmap for companies to track their progress towards the end goals and to make any adjustments that may be necessary along the way due to changing circumstances.

In contrast, the HSI companies demonstrated a more positive result, with over 80% of them incorporating interim targets. HSI companies face greater investor scrutiny and pressure to demonstrate their commitment to sustainability goals. As noted elsewhere in this report, institutional investors and asset managers increasingly consider ESG factors when making investment decisions. HSI companies may be more responsive to these expectations and be motivated to set interim targets, so as to provide clear milestones that align with investor expectations for transparency and their wish to be able to monitor companies' progress.

Breaking down a long-term target into interim, achievable milestones allows for better planning, implementation, and monitoring of sustainability actions. It helps companies stay on track and assess whether they are making sufficient progress over time. Without disclosure of meaningful and practical interim targets, questions may be raised as to whether disclosure of a long-term target reflects a genuine commitment or is just a form of window dressing or greenwashing.



## *Summary: Findings, observations and recommendations*

Findings

While certain observations have been made under the relevant areas above, we recap and consolidate our main findings and observations below.

### A. ESG assurance

1. 141 out of 1,882 (7.5%) December 2022-year-end listed companies obtained ESG assurance compared with only 85 companies in our 2021 study (4.5%). Although, in absolute terms, the increase is modest, in percentage terms, it is more significant, at around 67%, albeit starting from a low base. Nevertheless, in general, it seems that the majority of local listed companies still have yet to see the benefits of obtaining assurance, despite the increasing importance of taking on board ESG/ sustainability considerations in the global business and investment environment.

   There may be number of factors at play here:

   - As assurance is not mandatory, they may see this as an additional burden, which they are not yet ready to take on, which, in turn, may indicate that the bulk of companies are still doubtful about the business case, i.e., the costs versus the benefits of assurance, so they are adopting a "wait and see" approach;

   - At this stage, they may not have the full confidence in their own ESG data analysis, collection and management processes to have the information assured. In more extreme cases, it may raise questions about possible greenwashing.

   - It could also indicate that many companies are publishing ESG reports primarily to fulfil the disclosure requirements of the ESG Guide, and for image reasons, in order to, at least, meet the minimum expectations of the market

   Looking at the different size categories, the number of listed companies found to have ESG assurance in our 2023 study, compared with the 2021 study, in the medium-cap category showed an incremental increase (14.6% vs. 11.6%, i.e., 25.8% growth), while we found a larger rate of growth, although from a very low base figure, in the small-cap categories (2.5% vs. 1.4%, i.e., 78.5% growth).

   However, in large-cap companies (≥HK$38 billion), the research found a much more substantial jump, from 20.1% of companies in 2021 to 41.6% in 2023, i.e., more than double the percentage in the previous study. This clearly indicates that larger companies are responding more rapidly to the fast-moving ESG environment, and the expectations and needs of investors and other stakeholders. This is what we would have predicted, given, in general, their more international investor base and greater level of resources.

2. As to the nature and scope of assurance obtained, the majority of the relevant companies tended to obtain <u>limited assurance</u> covering selected ESG information and statistics. Amongst other reasons, this can be explained by the lower time and resources commitment required to obtain a limited level of assurance than to obtain a more extensive <u>reasonable level</u> of assurance. This adoption of a more limited scope of

assurance may, at one and the same time, be seen as a reflection of (i) the main areas of interest or concern of the companies' stakeholders and (ii) the extent to which companies themselves have sufficient confidence in their data gathering and processing methodologies across a broader range of data. It may also be indicative the willingness and confidence of the assurers themselves to give assurance on a more extensive body of information and data. The last point may be more likely to be a factor when the assurers are CPAs, as their work is governed by more rigorous framework of standards and regulation than may be the case for other assurers.

3. Regarding the assurance standards and benchmarks referenced by assurers, ISAE 3000 (Revised) issued by the IAASB, continued to be the most commonly adopted assurance standard, with 63% of assurance reports in the study referring to it, and another 4% referring to the local equivalent, HKAE 3000 (Revised), issued by the Institute. ISAE/ HKSAE 3000 (Revised) is a general standard on Assurance Engagements Other than Audits or Reviews of Historical Financial Information. The Institute also issued Technical Bulletin AATB 5 (Revised) *Environmental, Social and Governance (ESG) Assurance Reporting*, which was updated in May 2022, to provide practitioners with practical non-authoritative guidance when performing assurance engagements on ESG information. In future, the situation is expected to change as the IAASB is currently consulting on a proposed, more specific international ESG assurance standard, Exposure Draft Proposed International Standard on Sustainability Assurance (ISSA) 5000, *General Requirements for Sustainability Assurance Engagements*.

4. The assurers were CPA firms in 43% of cases for all the companies in the study with ESG assurance, while 56% were conducted by non-CPA firms. In the case of HSI companies, the figure for CPA firms increased to 55% while non-CPAs accounted for 36% and another 5% stated that they were internally assured.

5. For listed companies, generally, 77% of the companies with ESG assurance did not engage their financial statement auditor as their ESG assurer and 23% did do so. However, for HSI companies, in 44% of cases, their auditor firm doubled up as their ESG assurer. From another perspective, in the majority of cases where a CPA was the assurer, the same firm acted as both the financial statement auditor and the assurer for ESG matters (53% for all companies in the study and over 78% for HSI companies).

**B. ESG governance and reporting**

1. As Hong Kong listed companies, the companies in the study should all have prepared their ESG reports in accordance with the Appendix 27 of the MBLR or Appendix 20 of the GEMLR (i.e., the ESG Guide). On top of this mandatory requirement, most of them followed or made reference to other external, non-local standards. The standards issued by GRI were the second-most-widely-referenced framework referred to by companies, which is line with the findings of our 2021 study. Looking ahead, the situation is expected change over time, with the recent publication by the ISSB of the first two, investor-focused ISS, namely IFRS S1 and IFRS S2, covering the disclosure of general ESG-related financial information and climate-related information. However, it is expected that a significant amount of capacity building will be required before these new standards can

be adopted and applied by the bulk of listed companies. In addition, another factor will be the implementation of the EU Directive, the CSRD, applicable to some companies with financial years commencing on or after 1 January 2024, which mandates the use of European Sustainability Reporting Standards. Overall, the adoption of more generally-accepted sustainability reporting standards should help to bring about more consistency in assurance.

2. Turning to the question of board-level ESG committees, only around 15% of the companies studied had set up a board-level ESG committee. This percentage increased to 61% for HSI companies.

   The majority of the companies with a board-level ESG committee tended to hold one to two committee meetings during the year. While there is no optimal number of meetings mandated by the regulator, the frequency of meetings should, in principle, align with the complexity of the company's operations, the nature of the committee's responsibilities, and the need for timely decision-making.

   Among the 290 listed companies with a board-level ESG committee, over 40% had a director with relevant accounting qualifications. However, based on the finding in our 2022 study, *Board diversity among listed companies in Hong Kong*, this was most likely to be an INED/ NED rather than a QA, i.e., a full-time executive director on the board, or, at least, a member of the top senior management, with relevant accounting qualifications.

3. A little over 16% (i.e. 309/1,882 * 100) of the listed companies researched aimed to achieve carbon neutrality by a specific target date. This percentage increased to just over 50% (i.e. 35/69 * 100) among HSI companies.

4. Some companies stated an intention to achieve a carbon peak by a specific year without providing further explanations. This means that they aim to reach the point where their carbon emissions will reach their highest level and then start to decline. This commitment signifies a recognition of the need to address and reduce greenhouse gas emissions to mitigate climate change. However, the absence of additional explanations may be a cause for concern. Stakeholders may find it difficult to fully comprehend the company's approach and the steps they plan to take to achieve their carbon peak target.

5. Some companies expressed their support for China's 3060 goal, which refers to the country's commitment to reach peak carbon emissions by 2030 and achieve carbon neutrality by 2060. However, many of these companies did not incorporate any specific quantitative targets for themselves to align with or contribute to attaining this national goal. While expressing support for the broader national objective can generally be regarded as a positive step, the lack of self-initiated, quantitative interim and longer-term targets raises questions about the concrete actions these companies are taking in terms of carbon reduction efforts. This, in turn, makes it challenging for stakeholders to assess the company's commitment to the national 3060 goal.

6. In addition, the extent of the commitment to carbon neutrality sometimes lacked clarity, in terms of, for example, whether it applied at the group/ company level and whether it encompassed the entire supply chain.

## *Summary: Findings, observations and recommendations (cont'd)*

Recommendations

**A. ESG assurance**

1. The board of companies that do not currently seek assurance on their ESG reporting should consider the benefits of doing so, at least annually. By obtaining independent verification of their ESG performance, companies can build trust and credibility with stakeholders, including investors, who, increasingly, take ESG factors into account in their decision-making process.

2. When considering whether they should obtain third-party assurance, the views and perceptions of investors and other key stakeholders are important. However, on top of this, companies should also take into account that committing to having ESG data and information assured could help them to enhance the self-discipline, rigour and objectivity of the process of data gathering, processing and management, strengthen their risk management and internal controls and, more generally, help to validate the work that they are doing in sustainability and the contribution that they are making to broader societal, regional and national goals.

3. When considering the nature and scope of any assurance, companies should, initially at least, focus on the information that is relevant for their key stakeholders and the company itself. This will not be the same for all companies. As with sustainability reporting generally, materiality is an important criterion when determining where to start. It is reasonable to take step-by-step approach to expanding the scope of ESG assurance.

4. The field of ESG assurance is still developing, just like the field of ESG reporting. Not all assurance is the same and companies should understand and ask questions about what they are getting for their money. For example, ESG assurance may carry more weight, where companies use a reputable assurer that adopts recognized international benchmarks for their assurance work and, ideally, are subject to an accountability or regulatory framework for the work they perform.

5. CPA firms with experience in this area are among the most suitable professionals to undertake ESG assurance. By virtue of their training and experience and the extensive framework of ethical and professional standards, and the regulatory regime that they operate under, CPAs are well placed to offer this service. Their expertise in financial reporting and auditing, as well as their general grounding in risk management and internal control, and the obligation to keep themselves up to date with technical and professional developments, are all valuable assets when it comes to reviewing ESG disclosures that have financial impact or which require financial expertise, such as assessing the financial risks and opportunities associated with sustainability initiatives. Once the IAASB's ESG assurance standard, ISSA 5000 has been finalized and published, for CPAs, this will become part of the body of professional standards that they will need to adhere to and they will be regulated in terms of their compliance with it.

   The involvement of CPAs in ESG assurance can help bridge the gap between the financial and non-financial aspects of corporate reporting, facilitating more effective communication and decision-making for stakeholders. This will be essential going forward with the expected wider adoption of the ISSB's investor-focused sustainability standards. Through their financial reporting and auditing related work and training, CPAs are well versed in applying systematic and rigorous, evidence-based processes and methodologies. They can bring these skills to ESG-related reporting and assurance work, where necessary testing the processes, controls, and data management systems used, in order to enhance the credibility and accuracy of companies' ESG reporting.

They also bring independence and objectivity to their work, which is crucial in providing credible and reliable ESG assurance. Where specialized knowledge may be required, e.g., in areas like environmental impact assessment, social impact analysis, CPAs are used to collaborating with and coordinating subject matter experts to enhance the quality and depth of assurance engagements. This is how auditors work together with valuers, surveyors, specialist tax practitioners, forensic experts, etc. on company audits and other services.

**B. ESG governance and reporting**

1. To support the board on ESG matters, wherever possible, a board-level ESG committee should be established. It ensures that ESG issues are given strategic attention and integrated into the company's overall business strategy. Increasingly, ESG factors will have a significant impact on companies' reputation, risk profile, opportunities and, ultimately, their long-term success,. By establishing a dedicated committee, the board can give appropriate priority to ESG considerations and ensure that these considerations are aligned with the company's values, strategies and operations, as well as stakeholders' expectations. A board-level ESG committee can also engage directly with the board and senior leadership to shape the company's ESG agenda. It can advise on ESG-related risks, opportunities and emerging issues, and ensure that ESG factors are integrated into the company's overall governance framework. Meanwhile, a management-level ESG committee can work within the operational teams to implement the strategies, initiatives, and targets set by the board-level committee.

2. ESG risks and opportunities can have a significant impact on a company's reputation, operational resilience, and long-term value. Regular ESG committee meetings enable proactive identification, assessment, and management of ESG risks and opportunities, ensuring that they are properly monitored and mitigated, in the case of risks, or considered and pursued, in the case of opportunities, as appropriate.

3. Where there is a board-level ESG committee, ideally, it should include at least one full-time director/ member of the top senior management with relevant accounting qualifications. This background will be valuable when assessing the financial impacts of ESG initiatives, risks and opportunities. In future, as indicated above, this will also be important in helping the board to understand the proper application of international sustainability reporting and disclosure standards.

4. For smaller companies with more limited resources and expertise, where a dedicated board committee may not be practicable, the relevant responsibilities could be taken up by another committee, or, at the very least, the board should ensure that ESG issues

are included on the agenda annually or more frequently. Outside expertise could be brought in to advise the board or committee, where necessary.

5. Companies should provide clear and explicit information regarding any board-level committee responsible for ESG oversight, including its authority, terms of reference, etc. Where there is no committee with responsibility for ESG, meaningful information regarding the board's consideration of ESG matters should be disclosed, including how often ESG issues are included on the agenda and what matters are discussed. This is a basic part of good corporate governance, and transparency and accountability to stakeholders.

6. Companies should go beyond expressing general support for regional/ national carbon-neutrality goals, and set a target date to achieve carbon neutrality themselves, which should, in principle, align with, or be in advance of, any relevant regional/ national goal. They should also set practical and achievable interim targets and milestones, as part of a structured roadmap to track their progress towards the long-term goal. This helps give companies direction and impetus, and enables them and their stakeholders to assess whether they are making sufficient progress over time, and to make any adjustments that may prove be necessary. Without disclosure of concrete interim targets, questions could be raised as to whether disclosure of a long-term target reflects genuine commitment or is just a form of window dressing or greenwashing.

7. Companies should outline the specific strategies and action plans they will employ to achieve their target. This can involve, e.g., implementing energy-efficient practices, adopting renewable energy sources, optimizing supply chains, investing in low-carbon technologies, and, possibly, engaging in verifiable carbon offsetting initiatives. It is crucial for companies to establish clear timelines and milestones for their carbon reduction journey.

8. To provide clarity, companies should explicitly define the scope of their carbon-neutrality commitment. This includes specifying whether it encompasses all of Scope 1, Scope 2 and Scope 3 emissions. Ultimately, to be effective, companies' commitment needs to cover Scopes 1 - 3, although, at this stage, it is understood that Scope 3 emissions, in particular, are more challenging to measure and manage.

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