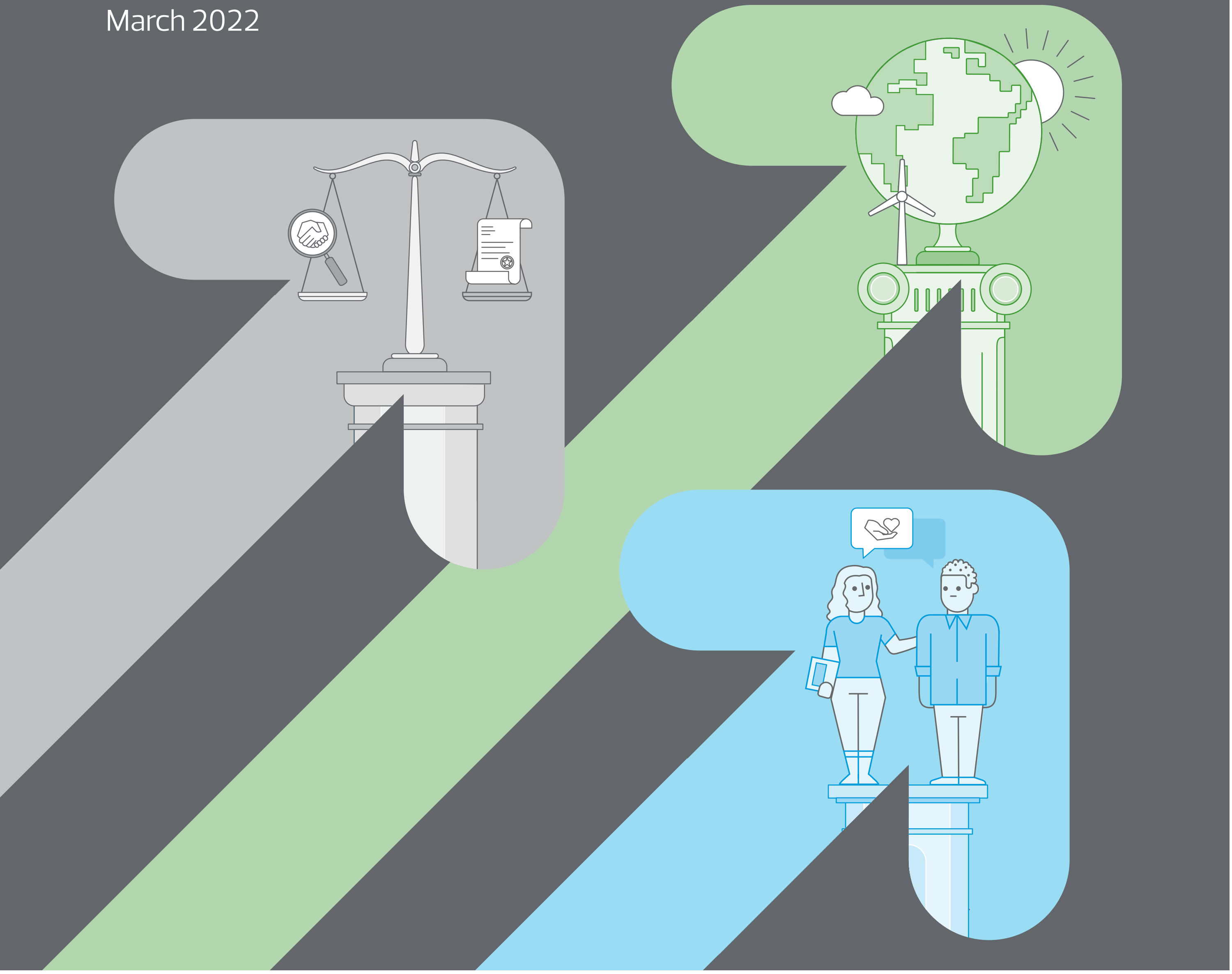
What does ESG mean for the charities sector?

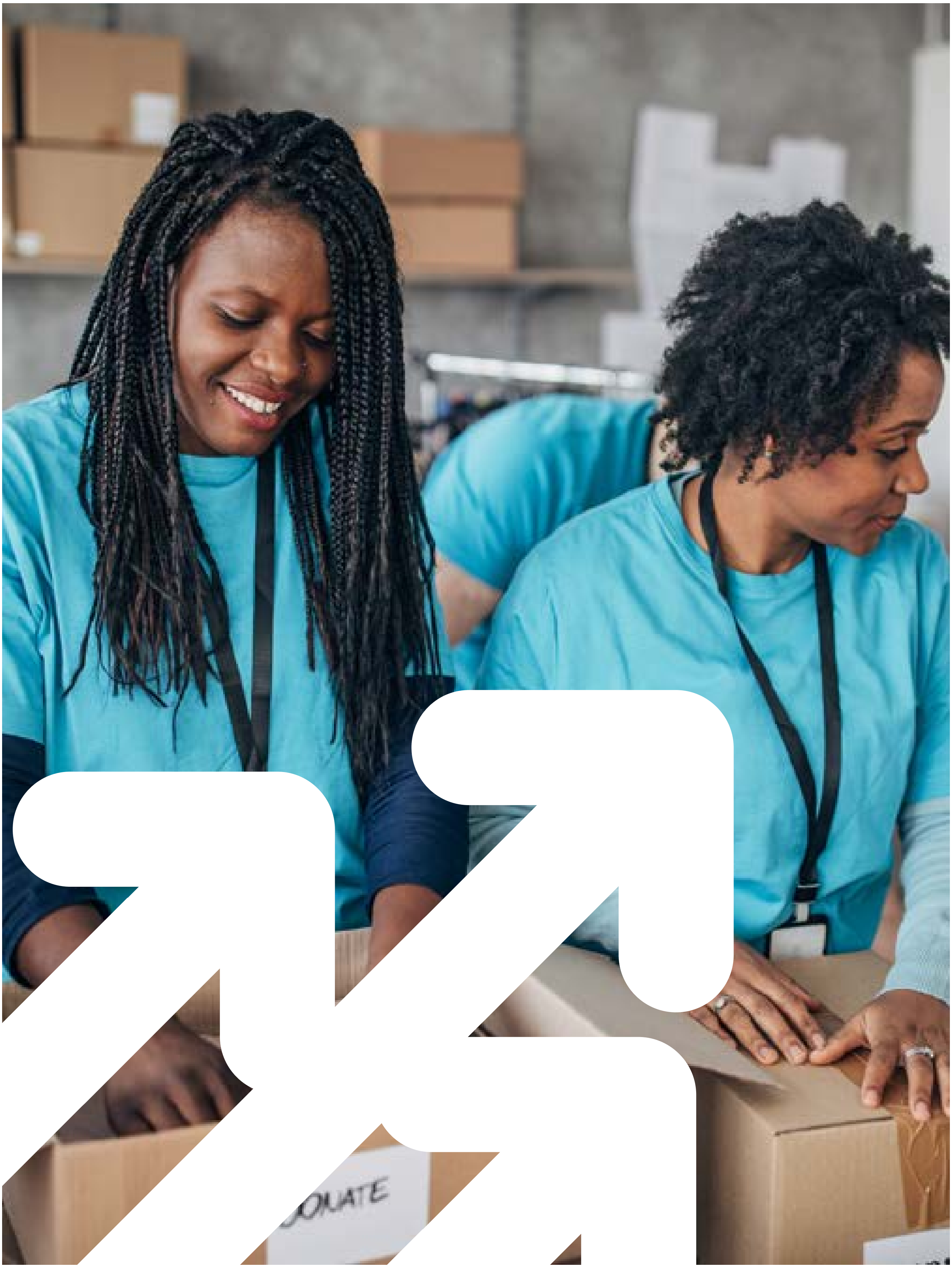
March 2022



THE RISE OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE

THE POWER OF BEING UNDERSTOOD
AUDIT | TAX | CONSULTING

RSM



CONTENTS

Executive summary

The volume of environmental, social and governance (ESG) reporting has increased significantly in the private sector over the past few years, and the same expectation is now extending to charities. Charities are built on the principle of providing a public benefit — should this extend as far as ESG reporting?

ESG is made up of three pillars:

Environmental

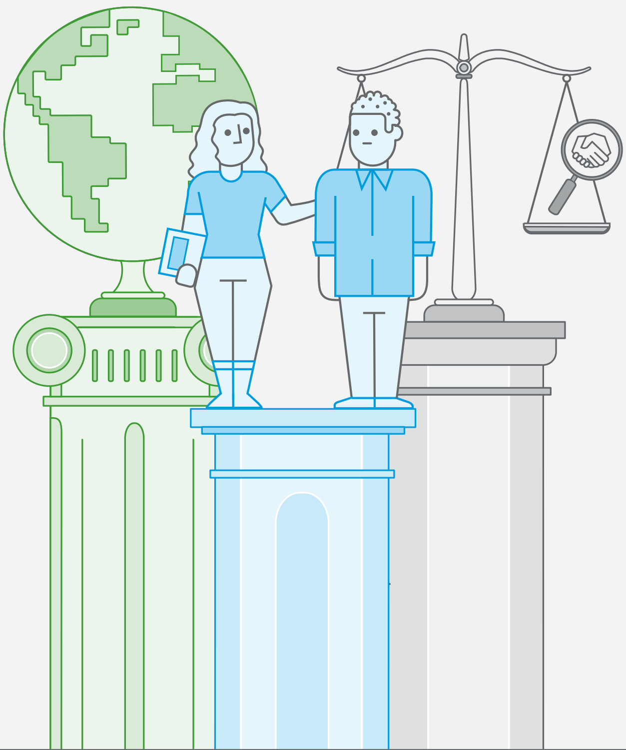
How an organisation interacts with and impacts its surrounding environment

Social

How it interacts with society

Governance

How it manages its governance

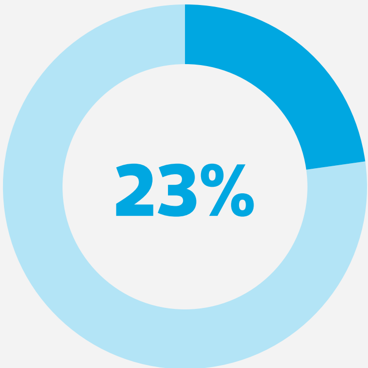


ESG requires organisations to report their activity against these three pillars for the information and benefit of various stakeholders.

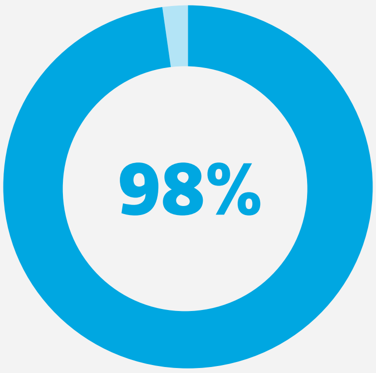
To help understand how charities are currently reporting on their ESG performance, we have examined areas of ESG that are commonly disclosed in the annual reports and websites of 114 charities across England, Wales, Scotland and Northern Ireland.

Key findings

1. Of the charities we analysed, none included a section specifically labelled ESG in either their website or annual report. 23 per cent of charities did include a section referencing activity that falls under the ESG umbrella. These sections covered a range of topics demonstrating the breadth of opportunity for charities to engage with ESG.

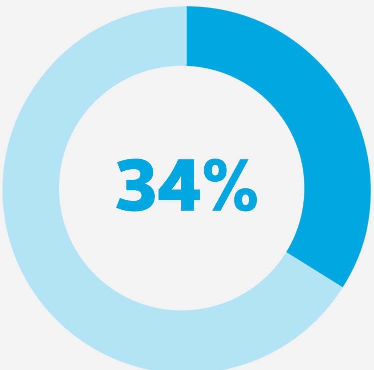


2. In England and Wales 98 per cent of charities stated in their annual report that their organisation met public benefit requirements. There are two aspects of public benefit: the 'public aspect' and the 'benefit aspect'. Recognition of 'doing no harm' fits firmly under the 'public aspect' and is directly linked to ESG considerations.



3. Just over a third of charities referenced a charity code. This indicates the emerging best practice, particularly for medium and larger sized charities.

   The Charity Governance Code is one example of codes/mechanisms that indirectly encourages charities to think about their approach to ESG.



Introduction

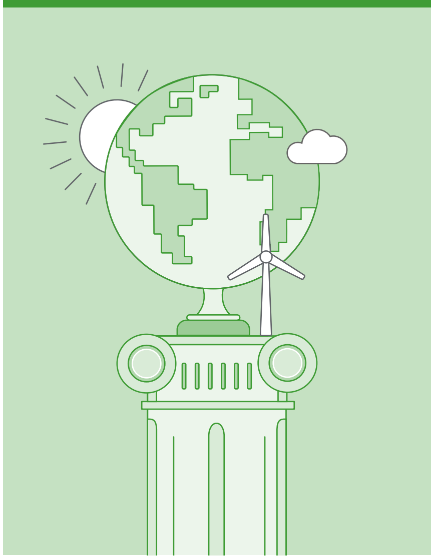
It is now more critical than ever that organisations take responsibility for their surrounding environment and society — and charities are no exception.

The aim of this report is to look at how charities are communicating their engagement with ESG matters. This report can be used as a benchmarking tool to assess where your charity sits in terms of ESG reporting compared to others in the sector.

Larger charities may be familiar with ESG terminology having come across it when they invested funds into 'responsible' assets. But for many, ESG will be a new — and possibly daunting — concept. However, when exploring ESG principles, some will find their charities more progressed than anticipated as some ESG activity will already exist in their operations and strategic planning, but are simply not identified.

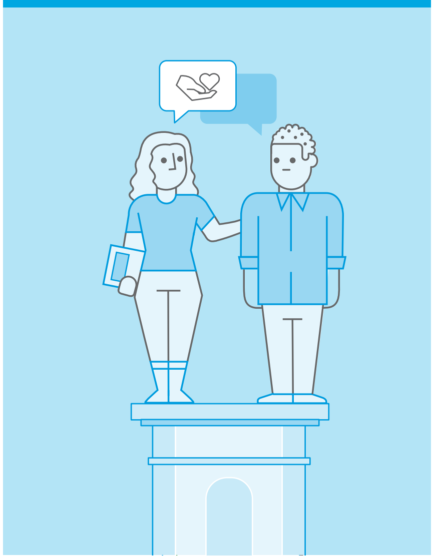
Charities have a head start when it comes to ESG. The fundamental purpose of a charity is to offer a public benefit and cause no harm to the environment. Both these principles sit at the heart of ESG.

Environmental



The environment and sustainability are increasingly on the Board agenda.

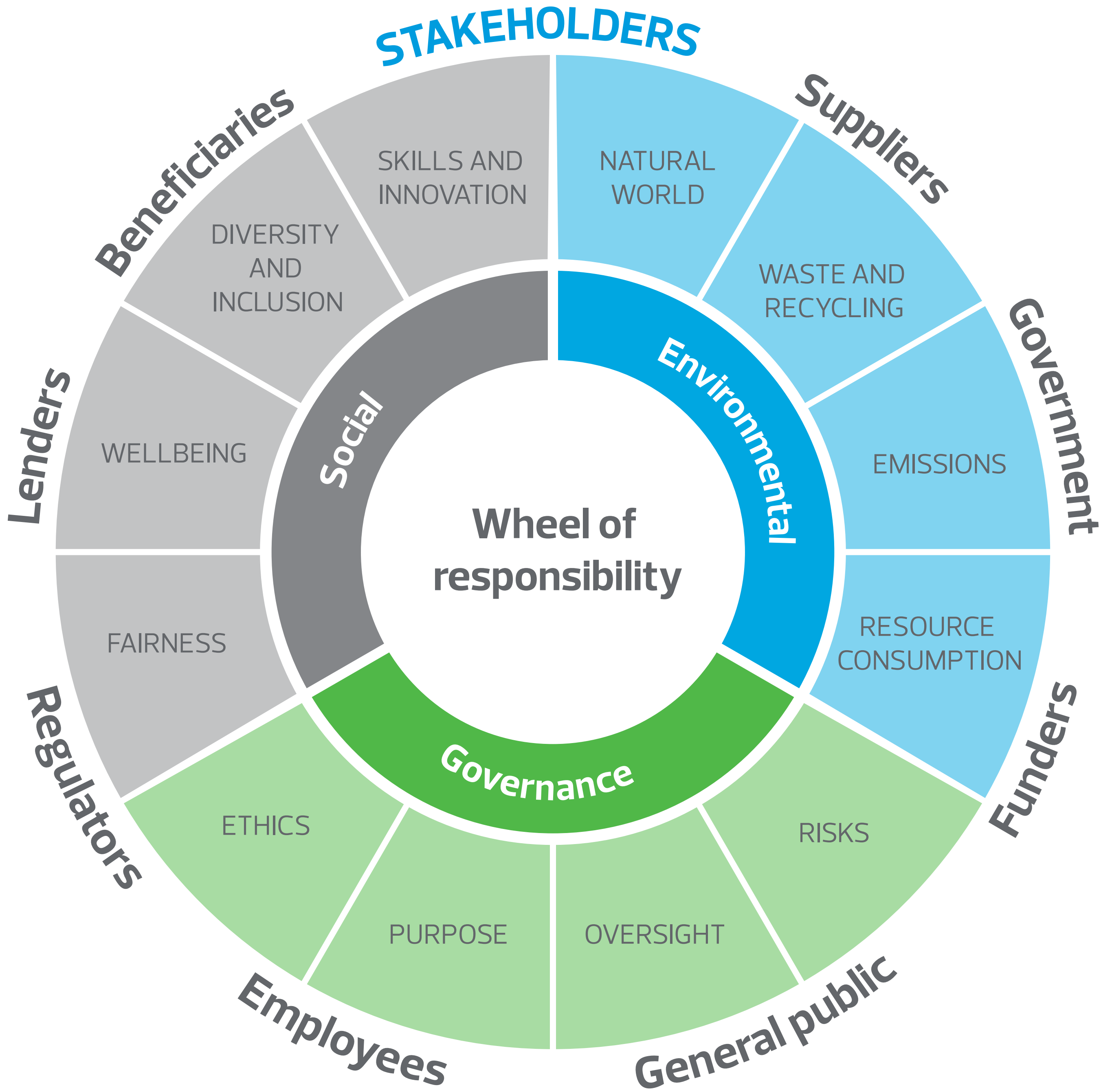
Social



The social impact of organisations both in communities and on employees must be proactively managed.

Governance

Effective governance is critical for a well run charity.


STAKEHOLDERS
Wheel of responsibility
Social
Environmental
Governance
SKILLS AND INNOVATION
DIVERSITY AND INCLUSION
WELLBEING
FAIRNESS
NATURAL WORLD
WASTE AND RECYCLING
EMISSIONS
RESOURCE CONSUMPTION
ETHICS
PURPOSE
OVERSIGHT
RISKS
Beneficiaries
Lenders
Regulators
Employees
General public
Funders
Government
Suppliers

What are the benefits for engaging in ESG?

With awareness of the climate crisis and societal shortfalls at an all-time high, engaging in ESG now could help you in the long term by:

- Demonstrating value and responsibility to funders
- Contributing to requirements for bid proposals
- Helping attract the best talent and retention of staff
- Providing partnership opportunities with corporates who want to engage with sustainable and responsible charities
- Driving improvements in operational efficiencies
- Building understanding of wider stakeholder needs

A beneficial side effect of implementing ESG initiatives are the substantial cost-efficiencies. For example, resource efficiencies, such as re-using and recycling initiatives, energy efficiency and accessing government schemes to promote ESG factors and adopting new energy sources.

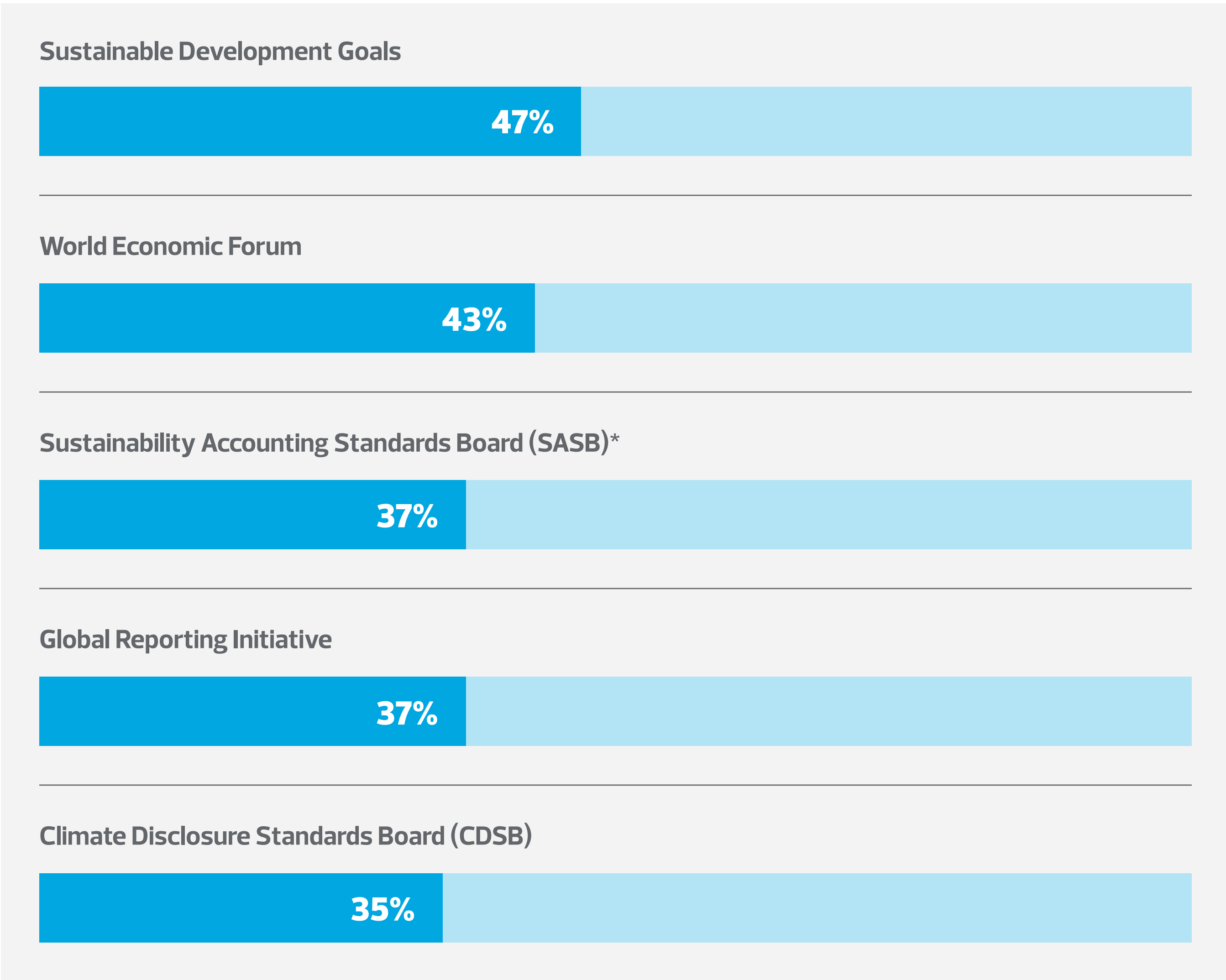
Organisations globally are also under heavier scrutiny than ever before. Anyone with access to a computer or a phone can research the charities they interact with. If practices that fall below society's expectations, including but not limited to improper waste disposal, poor engagement with diversity and inclusion or overly inflated remuneration, are discovered people can and will readily move on – and also potentially share damaging performance information on social media channels which can expose the charity to reputational damage. So, it is more important than ever before to start including a separate section devoted to ESG within annual reports – it is direct communication to stakeholders which helps keep them updated.

RSM's The Real Economy survey of over 400 middle market businesses leaders in 2021, found that 84 per cent of organisations that had an ESG policy felt that it contributed to their future sustainability. Reasons given for this include cost reductions, energy efficiency, and attraction and retention of clients and investors, all of which are considered key.

ESG reporting

Resources are available to help organisations start to communicate their ESG performance and demonstrate their commitment to sustainable practices. ESG frameworks include metrics and suggested methodologies to help with calculations.

There are over 22 ESG reporting standards available. In our 2021 survey, [The Real Economy found that middle market businesses were using a wide spread of standards](), with many businesses using more than one metric. The most popular were:



*The International Sustainability Standard Board (ISSB) is being created combining SASB and CDSB, which may be a step towards a less fragmented reporting landscape.

Source: United Nations

Overview of our research

We analysed ESG reporting in 114 charities and reviewed their annual reports and websites for the following themes:

- ESG within annual reports
- 'E' – Environmental considerations (eg carbon reporting)
- 'S' – Social activity (eg Charity Commission Public Benefit)
- 'G' – Governance (eg Charity Governance Code)

The 114 charities are divided into the following:

Income tier	No. of charities	% of charities
Under £5m	23	20%
£5m–£25m	69	61%
Over £25m	22	19%

Focus	No. of charities	% of charities
General focus*	82	72%
Environmental	19	17%
International	13	11%

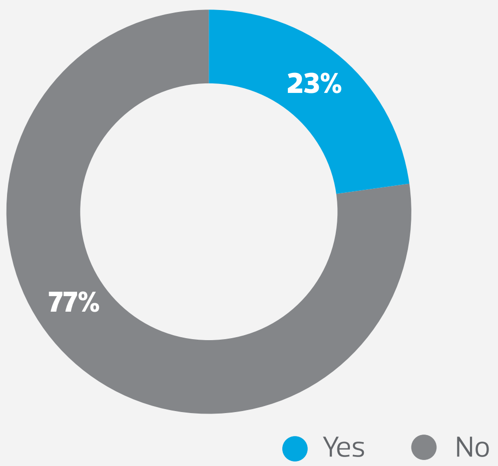
UK location	No. of charities	% of charities
England & Wales	91	80%
Northern Ireland	3	3%
Scotland	20	17%

*A general focus includes charitable areas such as animals, community, culture, disability, education, healthcare, heritage, housing, palliative care, religion, research, and welfare.

ESG within annual reports

Unlike most corporate organisations, charities are not generally including a section within their annual report specifically titled 'Environmental, Social and Governance'. This may be because a charities purpose is intertwined with having a social/public benefit, it may not be totally clear why including a section dedicated to ESG is necessary.

Does the annual report include reference to activity that falls under the ESG umbrella?



However, 23 per cent of charities included a section that included reference to activity that falls under the ESG umbrella, including:

- Diversity and inclusion
- Environment
- Sustainability
- Ethical investment policy
- Anti-racism
- Gender pay gap

Key findings

Charities with an income over £25m are more likely to have a separate ESG section (59 per cent) than those with a smaller income. The number falls to 9 per cent when looking at charities with income of less than £5m. Overall, 23 per cent had a dedicated ESG section, meaning that around only one in four charities are taking advantage of the benefits of promoting and reporting on their ESG activity.

Across all of the areas of focus, environmental charities were less likely to have a separate section on ESG.

Of the 23 per cent that did have a dedicated ESG section, there was a general focus towards environmental sustainability, rather than ESG holistically. As a charitable body, social impact is interweaved throughout annual reports, and as a result, may not have warranted a separate section.

It therefore seems that, although a charity's purpose sits closely with the purpose of ESG, charities need to develop their ESG reporting capabilities.

With this in mind the fact that there are only 23 per cent of the charities analysed that have included reference to activity that falls under the ESG umbrella is surprising, we would have expected a lot more charities adopting a specific section.

Equality, Diversity, and Inclusion (EDI)

How charities engage and address EDI is key to helping deliver public benefit.

It is Principle 6 within the Charity Governance Code and by addressing EDI it helps boards make better decisions as well as staying closer to those it serves. Charities with a strong culture and EDI principles help create a people-first employee experience culture, adding to their total value.

From an ESG perspective, there is a continued focus on how charities are transparent and communicate with their workforce. In addition, employees are an important stakeholder group.

If you have transparency on processes, policies and pay it extends the benefits to other protected characteristics like ethnicity.

Gender Pay Gap (GDP)

From 2017, any employer who has a headcount of 250 or more on their 'snapshot date' must comply with regulations on gender pay gap reporting. This requires employers to report and publish specific figures about their gender pay gap each year. There are two sets of regulations, one covering most public authorities and the other covering private, voluntary and all other public authority employers.

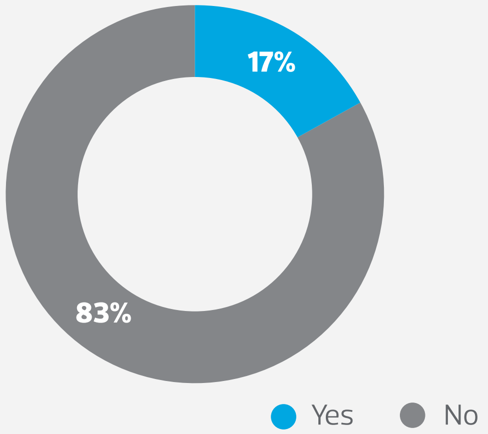
Moving forward, there may be increased requirements for wider diversity pay gap reporting. Gender pay gap reporting | RSM UK.

Checklist to help with your ESG journey:

- Identify if you already have activities that fit under the ESG umbrella – the chances are you do.
- Find out what matters to your beneficiaries, funders, employees, volunteers and other stakeholders.
- Communicate the above and any further commitments more widely and get people on board with your ESG journey.

‘E’ Environmental

Does the financial report contain Streamlined Energy and Carbon Reporting?



Key findings

Its pleasing to note that there is a high take up of charities (all but one) with an income of more than £36m including carbon reporting in their annual report.

Of the charities with under £36m in income, only 10 per cent contained SECR. Of that 10 per cent the majority had balance sheet assets over £18m, and some had more than 250 employees, meaning they met the other two criteria required for reporting SECR.

The purpose of Streamlined Energy & Carbon Reporting (SECR) is to bring the benefits of carbon and energy reporting to more companies, including incorporated charities. The reporting framework, devised by the Department for Business, Energy & Industrial Strategy, is intended to encourage the implementation of energy efficiency measures, with both economic and environmental benefits. It is a legal requirement for organisations defined as ‘large’.

SECR is required of a company, LLP or group that exceed at least two of the following three thresholds in the preceding financial year:

- £36m annual turnover
- £18m balance sheet total
- 250 employees

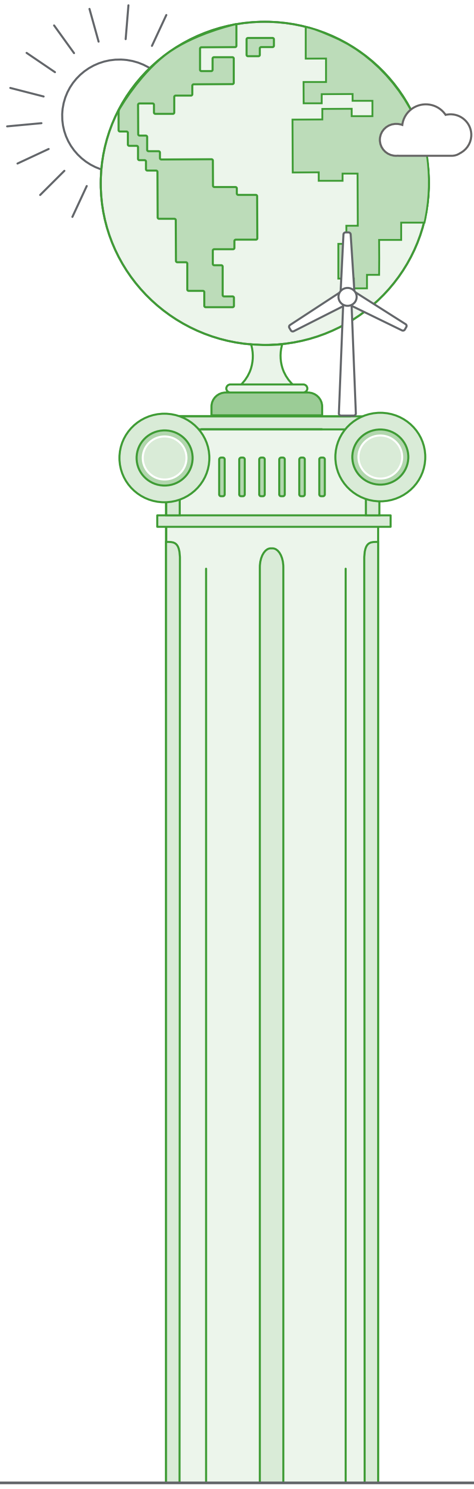
A statutory de minimis exemption exists for quoted or large unquoted companies and LLPs that can confirm their energy use is low — 40MWh or less over the reporting period. These companies will still need to include a statement in their report confirming that they are a low energy user.

The disclosure should be made within the Trustees' Report for charitable companies.

Checklist to help with your ESG journey:

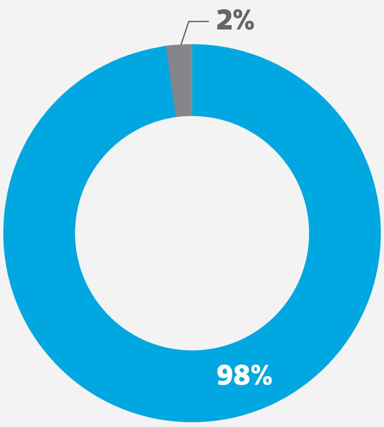
Even if you are not legally required to comply with SECR, knowing how much energy your organisation uses can help inform your energy efficiency activities – particularly as flexible working is adopted more widely. So, consider:

- Which activities release greenhouse gas emissions? This list could include electricity use, gas use, waste disposal, business travel, commuting and employee owned vehicles.
- Access and compile the data from the sources available to you. For example, the total kilowatt hours used from your electricity bills over a 12-month period.
- Make use of The Department for Environment, Food and Rural Affairs', (DEFRA) greenhouse gas conversion factor to calculate your organisations greenhouse gas emissions.
- Once you have compiled your charity's information, look for opportunities to reduce your emissions even further.



'S' Social

Does the charity comment on the public benefit requirements?



England and Wales only

Due to the difference in legal requirements between the devolved nations we have split out the data by country.

Key findings

In **England and Wales** 98 per cent of charities stated that their organisation met public benefit requirements within their annual report.

In **Scotland**, the legal requirements differ from those in England and Wales. A charity in Scotland must demonstrate a public benefit through their objectives, but they do not have to declare it in the same way. Whilst charities in England and Wales have to state that they meet public benefit requirements, in Scotland it can be inferred from a charity's activities.

Of the Scottish charities we looked at, only 65 per cent comment on the public benefit of their organisation.

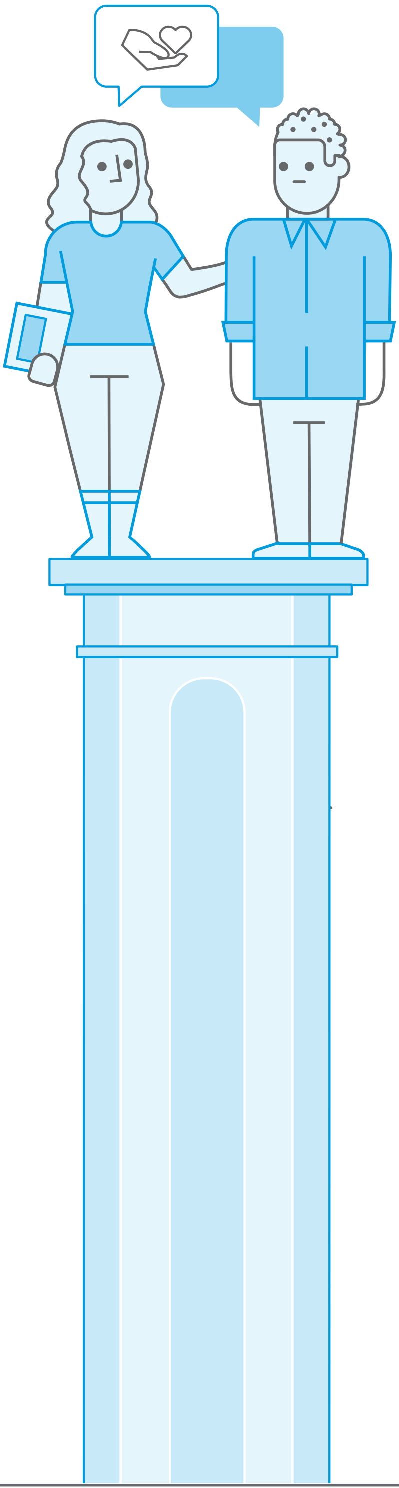
It is important that you understand the 'public benefit' requirements asked of your charity. Public Benefit is defined in the Charities Act 2011 as:

1. A charity is defined as an institution established for "charitable purposes" and subject to the control of the High Court's charity law jurisdiction.

2. "Charitable purposes" means that the institution must fall within the descriptions of purposes in the Charities Act 2011 and be for the public benefit.

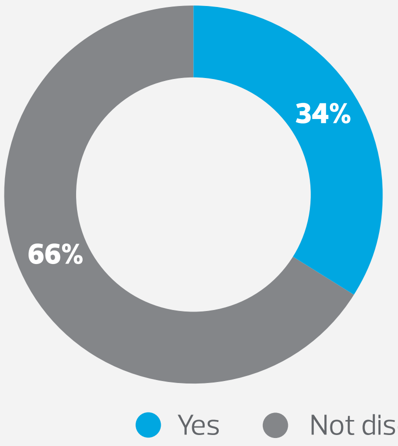
3. There are two aspects of public benefit: the 'public aspect' and the 'benefit aspect'. The 'public aspect' of public benefit is about who the purpose benefits and it must benefit the public in general, or a sufficient section of the public and not give rise to more than incidental personal benefit. The 'benefit aspect' of public benefit is about whether the purpose is beneficial and any detriment or harm that results from the purpose must not outweigh the benefit.

4. The 'public' benefit through charities tackling climate change is, for example, that homes will not be under water and crops will not be decimated. The 'benefit' is that failing to do so will otherwise threaten life on earth.



'G' Governance

Does the charity follow the Charity Governance Code or other code?



Examples of other codes that could be followed:

- National Housing Federation (NHF) Code of Governance
- Institute of Fundraising Code of Practice
- UK Corporate Governance Code
- CBI Better Payment Practice code
- The Code of Sports Governance

The Charity Governance Code is not a legal or regulatory requirement, but it does set principles and recommended practice for good governance and is deliberately set to be aspirational. The Charity Commission endorses the Code but has no power to enforce compliance: rather it is adopted on a comply or explain basis.

In 2019, we conducted research* and analysed the annual reports of 85 charities. Approximately 44 per cent acknowledged the Code. 31 per cent of charities, by our scoring methodology, demonstrated excellent Governance. Now, 34 per cent of charities referencing a code, awareness and recognition of the codes has clearly increased, even if only marginally.

The Charity Governance Code can complement ESG initiatives within the charity through the following:

- areas of the Code that may need greater emphasis or clarity, such as the diversity principle;
- changes in the sector since the Code was published in 2017, such as the publication of ethical principles for the sector in response to the safeguarding incidents; and
- learning from Governance developments in other sectors.

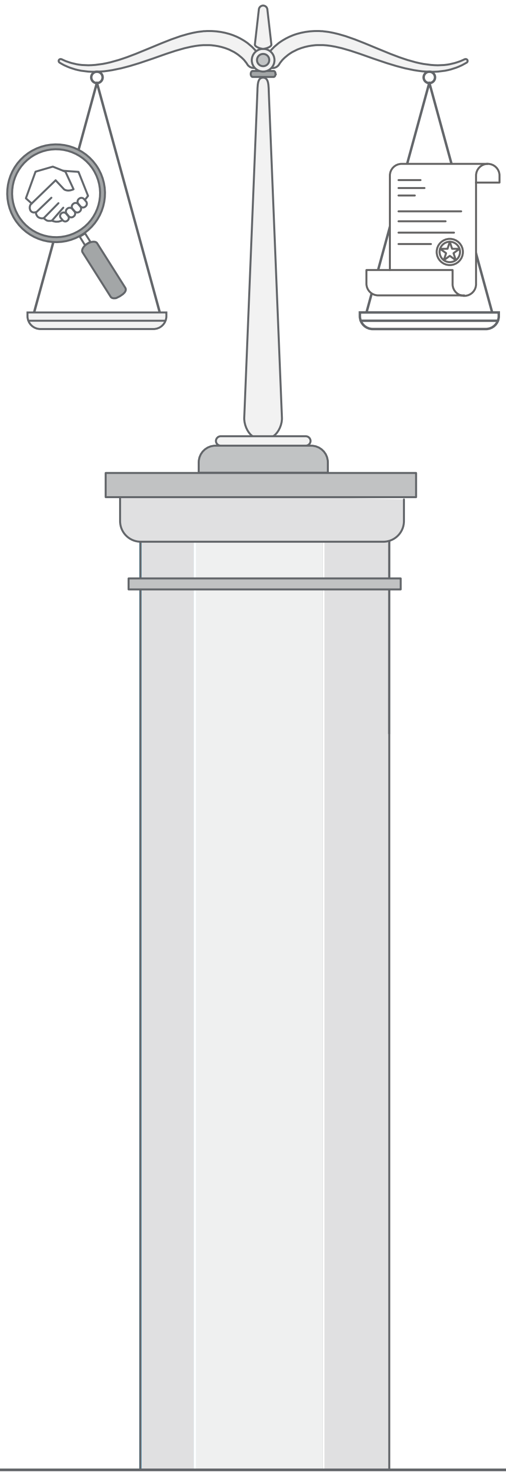
*It should be noted that the research conducted in 2019 was analysing 85 charities of various sizes and activity areas.

Checklist to help with your ESG journey:

- By aligning with the Charity Governance Code Principle 6 consider your charity's culture as you establish equality, diversity and inclusion approach and other related practices.

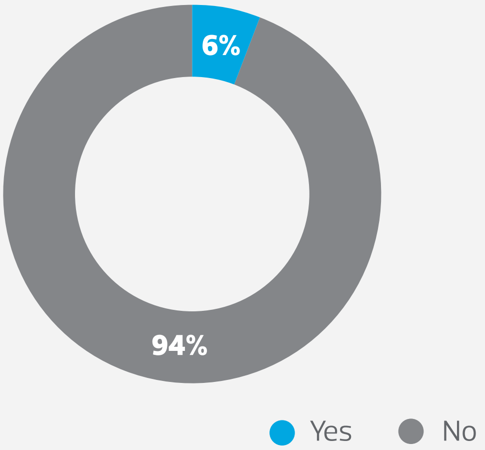
- Consider your approach to equality and diversity in your board and committee structures.

- When considering social responsibility of a charity, be aware of the wellbeing of employees and implement programmes and related activities to support their needs.

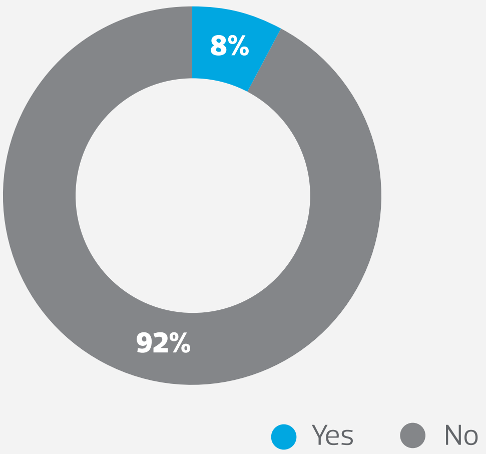


Management of ESG

Is there a Governance Manager mentioned in the annual report or on the website?



Is there a director of ESG/Sustainability mentioned in the annual report or on the website?



Whilst there are few examples of a dedicated employee having ESG as their primary role, it is clear that ESG does form a part of several peoples' roles rather than being a specific set of responsibilities for one person.

There is merit in identifying a lead or figure head (even if it forms part of several peoples' roles) as it does focus activity around ESG and the importance within the charities culture.

An alternative could be having an ESG or sustainability working group with Board sponsorship and splitting core responsibilities across all members of the group.

Checklist to help with your ESG journey:

- Find out what kind of ESG activity really matters to your employees and engage them in the wider discussion around your organisations ESG activities.
- Clearly define and assign your ESG reporting and strategy responsibilities.
- Get your leadership teams on board and let them lead by example.

Case study:

The Children's Trust is a top 250 children's charity and is an excellent benchmark for best practice ESG reporting. The trust has a Sustainability Lead and have developed a 'Responsible Organisation Strategy for 2021 – 2025'.

The Children's Trust
For children with brain injury

WHAT IS THE STRATEGY?

The Children's Trust strategy identifies where responsibility sits in their organisation on a number of themes and the reporting mechanism for each theme, including:

Their programme will report into a 'Building Excellence Board', through to the Senior Leadership Team and then the Board of Trustees. The information generated is available in an easily accessible ESG strategy document.

HOW HAS THE STRATEGY DEVELOPED?

In 2018 when The Children's Trust developed their strategy, the appetite within the Trust was so large that their environmental reporting became part of the health and safety team's responsibility.

They also developed an enhanced strategy, including committing to six of the United Nation's sustainability and development goals.

In 2020 they appointed a sustainability lead and an Equity, Diversity and Inclusion officer, illustrating how charities can be inclusive and sustainable organisations. They also signed up to the Association of Chief Executives of Voluntary Organisations (ACEVO) principles to address diversity at leadership level in the charity sector.

LEADERSHIP AT EVERY LEVEL

One clear benefit of The Children's Trust's strategy is their 'leadership at every level' focus. Everyone across the charity is empowered to take action. So, whether it is a youth worker, a teacher or the Chief Executive they can all make a difference to how the charity engages with ESG.

PROGRESS

They have committed to reporting on their progress in their annual report and accounts, as well as annually in a Responsible Organisation Strategy update. This helps keep all stakeholders up to date and shows the focus that ESG has within the charity.

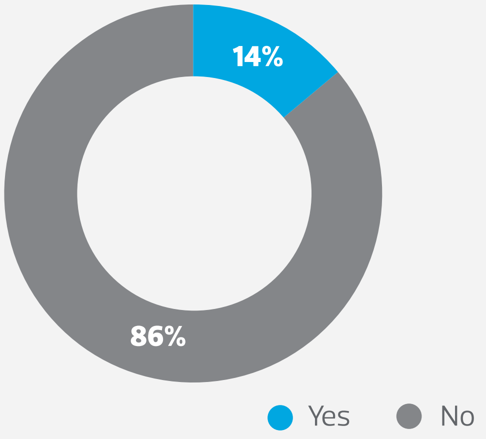
"We know we provide great services for children, young people and families across rehabilitation, education, care and in the community. By implementing robust impact reporting, we wish to further measure and evidence the difference we make to their lives, and to their families. We want to demonstrate this to our key stakeholders, connecting them with our work, and in creating assurance and building confidence that their support is helping to deliver the best possible impact on the lives of the children we support, and our work as a charity."

THE CHILDREN'S TRUST

For more information on The Children's Trust please visit: www.thechildrenstrust.org.uk

ESG website presence

Is there a separate page on the website for ESG?



Examples of ESG areas on websites include:

- Responsible organisation
- Green screen
- Corporate responsibility
- Green initiatives
- Environmental policy
- Sustainability

In many respects, a charity's website connects it to those outside of its organisation. It acts as a charity's 'public face' and source of knowledge for external stakeholders. There is therefore real value in clearly articulating how and why responsibility matters to your organisation and the commitments and progress your charity is making with ESG.

Whilst we know that only some charities have included a separate section on ESG within their annual report, we anticipate this practice will become more commonplace.

Checklist to help with your external communications:

- Consider which stakeholders would be interested in ESG within your charity. For example, funders, banks, procurement teams, D&I initiatives, employee representative groups.
- Start small – focus on key information.
- Build a story – this is where you explain how the organisation goes further with public benefit.

Q&A WITH THE SOIL ASSOCIATION

Q: As a charity working across the spectrum of human health, the environment and animal welfare, how have you embedded ESG within your wider operations?

A: 'Our charity has recognised we are led by the impact we make. This is enabled by the support we receive, our operational health and our financial resilience. We have captured these elements in a balanced scorecard, with defined measures that we follow and report on. Our impact for beneficiaries is centred in environmental outcomes & societal health outcomes, so ESG becomes a natural everyday agenda. Our employee and supporter health is a natural sustainability question along with the openness of reporting restricted and unrestricted funding health. Underpinning our operation are our organic principles of fairness, care, health and ecology, which chime with the heart of ESG thinking. Our values are built into our performance management approach.'

Q: Have you had any wider benefits from being a sustainable charity?

A: 'As a charity we face big issues with limited resources, we join forces for positive change to make a noticeable impact in the world. Being a sustainable charity speaks to the agenda of many other organisations and so we can achieve greater impact from lower cost through alliances and partnerships with NGOs and funders.'

Q: How do you evidence meeting your public benefit requirement in relation to your environmental objectives?

A: 'Hard metrics on environmental outcomes are limited and certainly not regulated. We are building a suite of metrics to address this. In the meantime, we evidence the impact of individual initiatives, share our progress with funders and supporters and re-cycle this evidence to a wider public through storytelling to inspire more change. We publish an annual progress report to assess change within the UK on the issues we are seeking to address. We consider our annual report and accounts a perfect opportunity to explain our wider impact performance.'

The Soil Association is the charity joining forces with people and nature to transform our future from the ground up. For more information please visit www.soilassociation.org.

Additional considerations

Expectations around ESG in the wider market

RSM's The Real Economy found that 86 per cent of businesses who were familiar with ESG, were using measures to evaluate their own business's performance. Perhaps more importantly, 75 per cent of businesses familiar with ESG were using measures to evaluate other business's performance. There is a growing expectation that organisations provide information on their ESG activity. Charities need to stay abreast of these expectations and start comprehensively reporting on ESG metrics.

Partnerships for societal change

The final Goal of the United Nations Sustainable Development Goals is to strengthen the means of implementation and revitalise the global partnership for sustainable development. It aims to support partnerships to achieve the 16 other ambitious goals that are to be met by 2030. These partnerships could be with national governments, private sector or charities.

For companies seeking to introduce sustainability into their business models, maintaining alliances and partnerships to help support progress is key. Alliances help to make an impact by using their more substantial resource to build on a charity's purpose and knowledge This goes beyond just donations to charity but also leveraging corporate skills and assets in partnership with NGO's.

Attracting the right corporate partners

The impact of the coronavirus pandemic over the last two years have certainly been tough for the charity sector, especially when seeking new corporate partners to help with funding, volunteers and support.

Involvement with charities and local communities is a pivotal part of many corporate ESG strategies and charities must ensure they partner with a corporate that is the right strategic fit for the individual charity's purpose.

For example, a charity aimed at supporting environmental causes like rewilding or stopping deforestation. There could be a real disconnect between the charity's aim and the aim of its wider supply chain/corporate partners, putting the overall impact of the charity at risk.

So, when seeking a new corporate partner, it is worthwhile reviewing their ESG strategy and how it aligns with your charity.

Conclusion

Where is the charity sector on its ESG journey?

The charity sector has had an encouraging start to its ESG journey. 34 per cent of the charities we looked at have adopted a governance code, meaning their governance reporting in particular is well progressed.

Charities now need to consider how to define and communicate their impact on their people and the planet more clearly within their annual reports. We have seen positive steps within our research with a significant proportion of our sample explicitly complying with regulatory mechanisms such as SECR and gender pay gap reporting, but there is more to be done.

The Environmental pillar of ESG is where the charities sector is behind corporate reporting. Many may assume that because a charity's entire purpose is to make positive change that they do not need to consider their sustainability. Charities must inherently be for the public benefit but this also means that they should do no harm, and that can apply to our planet. It is important that environmental considerations are given time and consideration, and that any targets or readily available information is made available to stakeholders.

Pulling all the different elements of ESG into a cohesive strategy and communicating the agreed strategy to the right stakeholders will be the next step forward for many charities.

“

From our research I can conclude that it's a promising start for the charity sector when it comes to ESG reporting. If we break down the 'E' 'S' and the 'G':

- **Environmental:** perhaps the most challenging element of ESG for charities, except for those that are already aligned to focus on the environment by virtue of their purpose. For other charities, it is important that they do not cause harm and this extends to the environment. Even if you are not legally required to comply with SECR, knowing how much energy your organisation uses can help inform your energy efficiency activities – particularly as flexible working is adopted more widely.

- **Social:** given the focus on public benefit in other areas such as the Charities Act 2011, this element is inherently strong for charities.

- **Governance:** again, this element is well adopted for charities particularly with the Charities Governance Code. As a sector we could challenge corporates – how many non-listed companies follow a governance code?

The charity sector should be proud of the efforts they have made to date reporting on ESG, however we shouldn't be complacent. ESG is evolving rapidly so it's vital to stay up to date and abreast of any new regulations.”

Nick Sladden
HEAD OF CHARITIES, RSM

ESG appetite

We all have a responsibility to protect our planet and the communities we operate in. We are seeing regulators take a much deeper interest in ESG matters than ever before. Whilst organisations are likely to be talking about ESG, and perhaps developing strategies, plans, commitments, and setting targets, we are clearly all on a long journey.

RSM has an audit approach which is designed to look at your external commitment and communication in relation to ESG matters and compares it to the views held by senior management and an organisations largest stakeholder group – its employees.

The organisation's external content

Our ESG appetite review includes a desktop review of the 'public face' of the organisation. This focuses on the information it has published regarding its ESG commitments, targets, plans, priorities and achievements.

With our subject matter experts, we will also consider whether you are meeting minimum reporting expectations; and will provide feedback on any missed reporting.

Stakeholder survey

Surveying the stakeholder groups; senior management / the board and employees.

A short survey will be issued, with the responses being collated and analysed principally to provide insights into organisational culture and strategy. (The survey will be completed anonymously.)

We utilise RSM's 4questionnaires, part of the Insight4GRC suite, to gather stakeholder views.

FURTHER INFORMATION

Nick Sladden
Head of Charities
E: nick.sladden@rsmuk.com

Carys Tetlaw
Senior Consultant
E: carys.tetlaw@rsmuk.com

Shauna Mallinson
Risk Assurance Director
E: shauna.mallinson@rsmuk.com

Emma Griffiths
Managing Consultant
E: emma.griffiths@rsmuk.com