Ethical reporting of ESG in company financial statements – a South African interpretation

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Abstract: MSCI in the USA has been implementing environmental, social and (corporate) governance (ESG) for the past 45 years (MSCI ESG Metrics, 2020). ESG identifies eight risks which incorporate 56 factors in total. These factors can be phrased as questions requiring either yes or no answers in order to identify whether the business activities and/or company practices of any company will be sustainable or not in the future. In this article, ESG is discussed with reference to MSCI, King IV and why companies (including fund managers and pension funds in South Africa) should be reporting on ESG in their financial statements as part of ethical reporting practices. The research presented in this article is neither quantitative nor qualitative data were collected, for example group discussions/interviews.

Keywords: ESG metrics; ethics; ethical reporting; King IV; fund manager; pension fund; corporate governance.

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1 Introduction

Reporting on environmental, social and (corporate) governance (ESG) has been included in financial statements since the early 1970s as a direct result of the actions of MSCI – to analyse ESG relevant to companies (MSCI ESG Metrics, 2020; Lokuwaduge and de Silva, 2020; Sandberg, 2007).[1] Consequently, for investment purposes, company investors are now considering how well a company manages its ESG (Fisher-Vanden and Thorburn, 2011; Ivanova, 2017; Kraik, 2020). If a company discloses poor ESG results, investors will most likely not invest in that particular company, even if the company is financially sound (Dowell et al., 2000; Kaptein, 2019, 2017). It appears that investors currently consider long-term company sustainability to be more important than financial soundness (Tarmuji et al., 2016). Obviously, long-term financial results are uncertain, but an investor can assume that good ESG reporting in the present may produce better and more sustainable future financial results in the future (Cadbury Report, 1992; Camilleri, 2015; Neel and Voorhis, 2020). Although social relations is only one of the eight ESG risk factors, the ESG relevant to social relations consists of the following factors: social perceptions of the company relating to climate change, social perceptions relating to fragile ecosystems, social perceptions relating to pollution, social perceptions relating to making use of energy-efficient products, social perceptions relating to a healthy working environment for employees, social perceptions relating to corruption on the part of employees or the board of directors, social perceptions relating to corporate behaviour and the like, and the same applies to the other seven risk factors (Collier and Esteban, 2007; Ivanova, 2017; Lokuwaduge and de Silva, 2020; MSCI ESG Metrics, 2020). The social reporting leg of ESG, for example, explains or reports to investors on what the board of directors considers important information relevant to their business activities, for example the board considers energy-efficient products more important than short-term financial results (Camilleri, 2015; Tarmuji et al., 2016). The problem in this paper is therefore to understand whether non-ESG reporting constitutes unethical reporting.

2 ESG metrics and reporting purposes

Boards of directors may interpret the 56 ESG factors developed by MSCI over 45 years differently; in other words, subjectively instead of objectively (Khan and Bonnet, 2020; Lokuwaduge and de Silva, 2020; Monsma, 2006). For this reason, it is suggested that an external service provider be appointed to promote objective ESG reporting, for example an auditor could be authorised to report on the biological environment and how the board of directors protects that environment (Limkriangkrai et al., 2017). To (some) investors, poor ESG reporting indicates future financial unsustainability (Neel and Voorhis, 2020). For this reason an investor would (most likely) not invest in such companies (MSCI ESG Metrics, 2020; Puaschunder, 2019). As it is not practical to list all 56 factors in this article, we will focus on one risk factor, good corporate behaviour, which overlaps to a certain extent with social relations (Fisher-Vanden and Thorburn, 2011).

3 Good corporate behaviour

An example of an external service provider (who is not an auditor) that continuously develops all 56 factors is an American company called MSCI (MSCI ESG Metrics, 2020). MSCI has developed the eight risks and 56 factors over a period of 45 years and continuously conducts research on companies' ESG reporting (MSCI ESG Metrics, 2020). For example, MSCI evaluates the 56 factors by reading the financial statements of different companies and thus assess whether these companies are ESG compliant or not. For example, MSCI may use a tick-box questionnaire relevant to corporate behaviour that may be answered with either a yes (1) or a no (0) to understand the future sustainability of the company (Bernardi and Stark, 2018; Rua et al., 2017). An example of such an ESG questionnaire is in Table 1 (MSCI ESG Metrics, 2020).

Table 1 Example of an ESG metrics – as a heading/caption?

The company has an internal policy to avoid bribery and corruption.	Yes (1)/no (0)
The directors are always acting with the necessary ethics.	Yes (1)/no (1)
The company has paid its corporate taxes and is up to date.	Yes (1)/no (0)
Total score	Number of ones, for example, indicates sustainable business practices or not.

By completing the above tick box a clear picture is presented of how this particular company complies with ESG reporting (Neel and Voorhis, 2020; Limkriangkrai et al., 2017; Rua et al., 2017). However, although the above questions are very simple, sometimes an external service provider, for example an auditor (or even MSCI) must carry out additional investigations to understand the state of corporate behaviour in a particular company. This will be discussed in the next section.

4 Ethical ESG reporting

Ethics is a complex phenomenon. Various definitions of ethics may be obtained in relevant dictionaries or King IV's definition may be used instead. King IV (2016, p.12) is South Africa's corporate governance code and defines ethics as follows:

> "Considering what is good and right for the self and the other and can be expressed in terms of the golden rule, namely, to treat others as you would like to be treated yourself. In the context of an organisation, ethics refers to ethical values applied to decision making, conduct, and the relationship between the organization, its stakeholders and the broader society."

This definition focuses briefly on good or bad corporate behaviour (Sandberg, 2007; Dowell et al., 2000). In practice, it is not always easy to understand what amounts to good or right corporate behaviour. If a company merges with another company and the purpose of the merger is to gain greater market share instead of increased profitability, it is very difficult to label the transaction as either good or bad or unethical (Susko, 2018). Where the main purpose of a merger decision was to acquire greater market share irrespective the financial end result, the merger could also be deemed to be an acceptable business strategy (at the cost of profitability). To understand whether a transaction is unethical the following example briefly illustrates the difficulty in understanding or identifying good corporate behaviour.

In Anderson Insurance Underwriting Managers v Constantia (2017), a newly appointed chief executive officer at a South African insurance company (Constantia) rejected previous negotiations between Constantia and Anderson. Prior to the new chief executive officer's appointment, Constantia agreed to merge with Anderson, and to make Anderson a division of Constantia. Anderson had approximately 116 short-term insurance brokers and its annual insurance premium was R144,000,000. In terms of the above definition of ethics, one could argue that the merger was good or right. However, the newly appointed CEO did not continue with the merger and rejected all the signed agreements. The main reason for this was because Anderson had suffered financial losses of approximately R13,000,000 over a two-year period. When one considers R13,000,000 over R144,000,000 or an increase in market share of approximately R144,000,000 policyholders for Constantia, the fact that the CEO rejected the merger simply does not make sense (Collier and Esteban, 2007). What is very strange about this case is that although financial losses of R13,000,000 were incurred over two years, Constantia kept the policyholders after rejecting the merger. For this reason Anderson approached the High Court of South Africa to argue that the merger should continue to be implemented. In this case, it is difficult to decide which of the business decisions (to accept or to reject a merger) is more ethically correct (Aquila et al., 2020).

ESG, in principle, does not require any reporting on litigation or future litigation as part of the 56 factors (or part of good corporate behaviour) (MSCI ESG Metrics, 2020). To this end, to report on Constantia's good corporate behaviour an external service provider would have to actually read the case in order to understand the different business decisions relevant to the merger. The external services provider should also in addition understand, that Constantia is primarily owned by a JSE-listed company, Conduit Capital. A recent stock exchange announcement by JSE Stock Exchange News Services (SENS), in 2020, indicated that Constantia Insurance had made a financial loss after tax of approximately R582,000,000 (Thompson, 2020). Another listed JSE company, TRUSTCO, would have exchanged a number of its shares with Conduit Capital to acquire Constantia. However, the CEO of Conduit announced that such a transaction between TRUSTCO and Conduit benefited the shareholders of both companies. Consequently, we have to ask the question, how do they (shareholders) benefit? The reason is probably an increased market share for TRUSTCO in the financial services industry, despite Constantia's extreme financial losses. In considering the above and comparing the two losses of R582,000,000 and R13,000,000, the rejection of the Anderson merger would appear irrational and probably an unethical business decision. In Constantia's 2018 financial statements (financial statements June 2017–June 2018), there is no explanation of the Anderson litigation (Constantia, 2018). This is despite the fact that King IV supports the principle of integrated reporting; in other words, it supports the incorporation of information on litigation or SENS announcements in companies' financial statements (King IV, 2016). By not reporting on these matters, we can assume that unethical reporting had occurred. It would be extremely difficult for an external service provider, attempting to understand whether Constantia complies with ESG, to find the above case and/or SENS announcement and to link the two as ESG data. In addition, investors would consider the above information (SENS and Anderson) very important for making an informed decision on whether to invest in Constantia in future.

5 Good corporate behaviour reporting

Even if an investor is unable to access Constantia's financial statements in order to understand the effect of the Anderson litigation or TRUSTCO's proposed transaction to acquire Constantia, it is impossible to label these transactions as either good or bad unless an external service provider can compare the two transactions to present appropriate reporting in the financial statements of, for example, Constantia (Li et al., 2018). If one reads about TRUSTCO's business activities, it becomes evident that it is (was) in the process to building a new oasis city close to Windhoek, Namibia. Some city planning experts have said that it is impossible to build a new city in Namibia, particularly due to water scarcity. It is possible to make use of ESG reporting to understand the sustainability of the new proposed city, based on an external service provider's objective opinion on the Namibian environment and the future role of Constantia to this development. All the above, Anderson, Constantia and TRUSTCO, are party to ESG and consequently questions may be raised as to why Conduit Capital would transact with TRUSTCO when considering the fragile Namibian environment (Camilleri, 2015; Limkriangkrai et al., 2017). It also raises questions as to why a merger was rejected between Anderson and Constantia.

When financial statements fail to disclose any information relevant to previously failed transactions or proposed new business transactions, it is very difficult for any investor to understand, for example, TRUSTCO's corporate behaviour and how it relates to future financial sustainability. In general, an investor will only invest in companies if those companies are sustainable in the long-term (Lokuwaduge and de Silva, 2020; Rusu, 2020). In this regard, shareholders or stakeholders who rely on ESG reports may refuse to invest in these companies (Li et al., 2018). On the other hand, it can happen that an uninformed investor may still invest in the above companies. For this reason, most investors will only invest in companies that implement the risk factors as identified by MSCI in their financial statements. MSCI reports on approximately 8,500 companies, as an external service provider, and it is unclear how many South African companies form part of the MSCI project, which classifies companies as either high risk or low risk investments (MSCI ESG Metrics, 2020). One could assume that ESG is not particularly important to South African investors because there is no clear understanding (of the importance) of what exactly unethical reporting is (Neel and Voorhis, 2020).

In view of the definition of ethics in King IV, discussed earlier, and the difficulty involved when an external service provider seeks to report on good corporate behaviour, one would have expected that Conduit Capital would be part of ethical reporting – reporting voluntarily on the proposed transactions with TRUSTCO and the like. In the Conduit Capital financial statements from June 2019 to June 2020, there is no mention of TRUSTCO or Constantia (Conduit Capital, 2019, 2020). We were unable to find TRUSTCO's financial statements. In this regard, we believe that the above information must be disclosed in relevant financial statements to allow South African investors an opportunity to understand the financial sustainability of these companies, and their approach to good corporate behaviour.

6 Possible consequences of poor corporate reporting, if any

Although there is no reason why a single investor cannot invest in a company, irrespective of unethical reporting, the onus rests on fund managers to invest only in companies that are ESG complaint (Dowell et al., 2000). Generally, a written agreement or contract exists between the pension fund (who represents the employer) and the fund manager on how the fund manager should invest the pension contributions received. If the written agreement does not specifically require investments in ESG-compliant JSE-listed companies, it could be an indication of unsustainable investments. The whole purpose of ESG is to indicate whether a listed company is sustainable in the long run; in other words, there is the great possibility that sustainable investments will generate better financial results in future (Fisher-Vanden and Thorburn, 2011). In Clacher v Mercedes Benz South Africa Pension Fund (2020), the complainant contributed to the pension fund

[Mercedes Benz South Africa Pension Fund (hereafter Mercedes Benz Pension Fund)]. Although this adjudication/case does not deal with a written contract between Mercedes Benz Pension Fund and the fund manager, it is still relevant to our discussion, since the employee/complainant (Mr. Clacher) argued that he should have been able to choose his own investments and not the fund manager or the pension fund. In other words, strictly speaking, he maintained that the Mercedes Benz Pension Fund represented the employees and therefore the employees should choose which investments were to be made. In this regard, clear communication should have existed between the Mercedes Benz Pension Fund and the employer (representing the employees) as well as between the fund manager and Mercedes Benz Pension Fund. The fund manager cannot therefore, as was argued by Clacher, reject the employees' investment choices. In the Clacher case, ABSA Consultants and Actuaries (hereafter ABSA) acted as the pension fund administrator or fund manager (for Mercedes Benz Pension Fund) and ABSA argued, in Paragraph 4.5 of the case, that only Mercedes Benz Pension Fund could choose the investments to be made by the fund manager and not the employees. In other words, an employee has no say in how to invest their investments because employees are considered laymen. The same argument could be relevant to the board of directors of Mercedes Benz Pension Fund. The Pension Funds Act 1965 of South Africa in Section 7D(e) [but Section 7C(2)(g) may require academic qualifications for board directors/members if so regulated in the rules of the pension fund] does not require that the board must be investment experts, only that the board must consider investments in good faith, with care and with diligence.

In Paragraph 4.7 of the Clacher case, Mercedes Benz Pension Fund chose investments without consulting the employer (or its employees) and, as a result, ABSA followed and implemented the investment choices of Mercedes Benz Pension Fund. Therefore, although the Mercedes Benz Pension Fund board was not investment experts, generally the fund manager could influence the board's investment choices as to which investments were good or bad. In the Clacher case, the adjudicator never focused on any evidence why ABSA convinced Mercedes Benz Pension Fund to alter its investment strategy, for example no evidence was presented as to why certain listed companies were preferred over other listed companies. Therefore, even if a written contract did exist between Mercedes Benz Pension Fund and ABSA, ABSA was considered the investment expert and could convince why an investment strategy should be changed in future. However, Section 7D(c) of the Pension Funds Act of South Africa 1965 requires adequate and appropriate investment communication between any pension fund and its members (in other words employers and their employees). In the Clacher case (in Paragraph 5.3), Mercedes Benz Pension Fund never communicated any relevant information to its members as to why the investment strategy was changed. By failing to communicate or failing to call relevant meetings with relevant employers, the Mercedes Benz Pension Fund had not acted in good faith – irrespective whether the changed investment strategy sought to benefit all its members (Collier and Esteban, 2007; Nelson, 2015).

However, in Paragraph 5.9 the pension fund adjudicator emphasised the fact that a member or members of a pension fund can make investment choices if such a provision exists in the rules/constitution of that particular pension fund. In other words, it is possible for the fund manager or ABSA to invest according to the employees' investment choices – irrespective whether those choices are poor from an investment perspective. The pension fund adjudicator therefore held that the pension fund rules in the present case did not allow employees to make any investment choices, and consequently

Mercedes Benz Pension Fund acted in good faith to agree to a changed investment strategy. In this regard, it seems that ABSA or Mercedes Benz Pension Fund could invest in sustainable companies that are ESG compliant, unless the rules of the pension fund allow employees/members to make their own investment choices which may not include ESG complaint companies. It is not clear whether an employee/employer should receive training to understand the advantages of ESG investments from a South African perspective.

In addition, it is possible that the South African Registrar of Pension Funds (currently known as the Prudential Authority) will only register future pension fund rules that make specific provision for ESG investments only; irrespective of whether an employee, pension fund or the fund manager is allowed to choose the investments. In this regard, employees, pension fund or the fund, manager depending on the circumstances, must invest in companies that are ESG compliant, thus preventing investment in non-ESG compliant companies (Dowell et al., 2000; Nelson, 2015). The essence of ESG is to support social relationships. In this regard, pension funds (in general) can promote social relationships between the fund and its members by drafting a simple tick-box questionnaire based on the South African Pension Funds Act 1965 and the rules of the pension fund in order to monitor effective communication between the parties (Table 2).

Table 2 An example how ESG metrics can promote social relationships

The rules of the pension fund allow for members to choose their investments.	Yes/no
If a member chooses a particular investment, clear communication exists between the pension fund and the fund manager to invest according to the members' instructions.	Yes/no
Clear communication of the rules of the fund or the legal effect of the fund rules exists between the pension fund and its members.	Yes/no
The written investment instructions between the pension fund and the fund manager are not contrary to the rules of the pension fund.	Yes/no

The nature of these questions may differ from one pension fund to another; nevertheless ESG illustrates the most important perspectives and factors to consider when assessing the future sustainability of investments, for example to identify and to report on effective communication between a pension fund and its members. In addition to the above tick-box questionnaire, it is also possible to draft a questionnaire that focuses solely on the board of a pension fund, for example ESG requires the reporting in Table 3 (MSCI ESG Metrics, 2020).

Table 3 An example how ESG metrics can focus on the pension board

The pension fund investment activities are injury-prone or harmful.	Yes/no
The pension fund relies on a highly skilled board.	Yes/no

While the above two example questions from an ESG perspective sound different from the earlier explanation of ethics, the two questions should be answered by keeping in mind that the Pension Funds Act does not require board members to be highly skilled. In addition to the above questionnaire example, harmful actions could be interpreted as poor or ineffective communication between the pension fund board and its members. For this reason an external service provider must not only understand the provisions of the Pension Funds Act but also the 56 factors that have to be responded to and reported on in financial statements. In this regard, the ESG tick-box questions posed above should be viewed from a South African perspective in order to understand why a highly skilled pension fund board is not a requirement to contribute to ethical reporting (Jeffers et al., 2018).

6.1 The fund manager

Should a pension fund also consider ESG relevant to the decisions made by fund managers? Or, to put it differently, should Mercedes Benz Pension Fund have considered whether ABSA was ESG compliant in promoting future sustainable investment decisions. To answer this question, the following background information is important. In 2018, it was announced that Sanlam had acquired ABSA Consultants and Actuaries. ABSA's financial standing was explained as the sole reason why the acquisition was an important investment decision for Sanlam; for example ABSA managed approximately 119 individual pension funds with 339,000 members/contributors in total (Sanlam, 2018c). There is no indication whether any ABSA employees at the time are still working for Sanlam or whether Sanlam retrenched ABSA employees immediately after the 2018 acquisition. We were also unable to find relevant financial statements explaining ABSA's social relationships during the acquisition; however, the online annual financial statements of the Sanlam Group 2018 explain its own fund managers' financial performance in great detail (Sanlam, 2018b, 2018a). ESG has a different point of view – it is not all about financial results or the financial growth rate (Lokuwaduge and de Silva, 2020). ESG views the way in which a company improves its social relationships, contributes to good corporate behaviour and the like, and discloses its ESG compliance in any relevant financial statements (Neel and Voorhis, 2020). Although the bottom line is an important factor in the financial world, since it indicates financial strength, social relations are equally important from an ESG perspective. If ABSA employees left Sanlam after the acquisition, according to ESG it shows that Sanlam's social relations are unsustainable in future (Dowell et al., 2000). If Sanlam invests in listed companies that destroy the environment, it sends the message that financial results are far more important than investing in companies that protect the environment (Collier and Esteban, 2007). The mere fact that there is also no reference to ABSA in the online Sanlam Group 2019 financial statements allows for the conclusion to be made that financial results are more important than ESG reporting (Li et al., 2018).

Based on the above explanation, the possibility exists that a pension fund may refuse to sign an investment contract where Sanlam acts as the fund manager. In the long-term, ESG means it is important for investors to understand the future sustainable practices of companies, than investing in companies that do not care about ESG (Dowell et al., 2000; Sanlam, 2019b, 2019a: only two pages long on the internet). In this regard, non-disclosure of any ESG factor in financial statements amounts to unethical reporting (Puaschunder, 2019; Rua et al., 2017).

On the other hand, large companies struggle to interpret data successfully due to their large-scale business activities and the inability of their IT departments to interpret relevant data successfully. If a brilliant IT employee interprets data more effectively, even though such interpretation is part of social relations and good corporate behaviour, the company will most likely not report/disclose its ability to interpret data successfully in its financial statements. The reason is simply to protect the company's social relations, as a competitor may approach such IT employees with lucrative salaries. In this regard, failure to report on IT social relations should not be interpreted as unethical reporting (Dell EMC, 2018).

6.2 Pension funds

In South Africa, pension fund investments are regulated by specific legislation. Regulation 28 of the Pension Funds Act 1965 specifies the maximum percentages for distributing fund investments, for example cash deposits must not exceed 25% of the aggregate value of a fund's investment. Other examples include the following: cash held by a foreign bank must not exceed 5% of the aggregate value of the pension fund, investments in immovable property must not exceed 25%, commodities (gold Kruger rands) 10% and hedge funds 15%. It is possible to invest in other assets, but no clear definition exists for explaining the true meaning of other assets. In this regard, other assets could imply crypto currencies, for which a maximum percentage of 2.5% is allowed by Regulation 28 (Government Gazette, 2011). From a South African perspective these pension fund distributions in various investments are unique. In its report, the OECD (2019a) compared various pension fund investments in different jurisdictions and it is clear that there is no golden rule as to how pension funds should be investing their funds. For example, in Australia no maximum percentages for investments are given, but funds must at least be invested in various categories of investments, for example equities, bonds and cash deposits (OECD, 2018, 2019a, 2019b). In Australia, the rate of return on investments is very high at 5.6%. However, of 50 countries surveyed, only 19 have had positive annual returns for the last 15 years (OECD, 2019b).

Owing to the poor return on investments, states are increasingly changing their pension fund investment regulations and legislation to create a platform for improving the rate of return on such investments (OECD, 2018). In South Africa, the state is proposing changes to Regulation 28 to allow pension funds to invest in state infrastructure, for example building roads, bridges and the like. Although the aggregate value of South African pension funds is comparable in value to most European countries, South Africa has been downgraded by Moody's Investor Service to a Ba2. Moreover, Moody's remains very negative about the future of the South African economy as a direct result of the poor state governance practices over the last 24 years (Bloomberg, 2021). Consequently, South Africa is not an attractive destination for direct foreign investment.

One of the main reasons why the South African government is proposing changes to Regulation 28 is because immovable investments have a 0% return on investment, with tenants currently vacating office buildings as a result of the recent COVID-19 pandemic. The South African Government states that investments in infrastructure would at least contribute to a higher rate of return than immovable property. In addition, pension funds can invest up to a maximum of 45% of the fund's value in infrastructure. In South Africa, there are currently only a few companies that can build roads or highways on the same level as its international peers (Simiyu, 2020). In this regard, it would not be difficult for these companies to adopt ESG in their financial statements, for example disclosure of the level of certificated competence to build roads. However, the South African state must give an instruction (or tender) to a road construction company to build roads. However, it is also possible that the state could give an instruction to a newly registered company or a state company to build roads or highways in South Africa instead.

The question therefore is simple – would a pension fund invest in a newly registered company with no track record of building roads successfully (or a state company with a track record of building poor quality roads) in South Africa? In Nucon Roads and Civils Pty (Ltd) v The MEC for Department of Public Works and Others (2014), Nucon Roads and Civils requested the court to set aside an instruction from the Office of the Department of Public Works of South Africa in terms of which the state department awarded a tender to Roads and Transport: NW Province. The former company indicated that the cost of building a new road would amount to R104,980,168 while Roads and Transport: NW Province had submitted a tender for R133,845,273. The department gave the instruction to the less experienced and more expensive road building organisation (Wasserman, 2020). Nucon Roads and Civils also had a higher compliance certificate to build roads (eight CEPE complaints) than roads and transport, which only had a seven CEPE certificates. In summary, in terms of building roads, Roads and Transport was not only more expensive but, based on its certificate of compliance, it was also less capable of building good quality roads. This serves to illustrate that, where a civil company or a state company obtains a tender to build roads, but the principles of due diligence when awarding tenders are not followed by the state, pension funds will most likely not invest in such companies. Under such circumstances and in view of Moody's investment rating for South Africa, a foreign direct investment company would also be unlikely to invest in such companies. In this regard, even if the state were to amend Regulation 28, the market (and not the state) must be able to decide which company should be building roads in South Africa in order to protect the aggregate value of its investments and to ensure that the rate of return on its investments remains good (Sandberg, 2007).

7 ESG metrics and King IV

King IV also acknowledges the eight ESG risk factors to some extent. The ESG metrics list these risk factors as follows: climate change, natural capital, pollution, environment, human capital, product liability, stakeholder opposition and corporate behaviour (Bernardi and Stark, 2018; Tarmuji et al., 2016). King IV (2016), however, lists only six risk factors, including financial capital, manufacturing capital, human capital, intellectual capital, natural capital, and social and relationship capital. Although, in the foreword to King IV, these risks are summarised as economy, society and the environment (ESE). By contrast, ESG focuses on the environment, social relations and governance. Although the economy, or the bottom line, is important, the future sustainability of the company is far more important and has a direct bearing on effective company management or, in other words, good corporate behaviour. However, King IV (2016, p.4) does recognise the importance of good corporate behaviour, as stated by Mervyn E. King, as follows:

> "In the context of all above, governing bodies have the challenge of steering their organizations to create value in a sustainable manner, making more but with less to meet the needs of a growing population and the reality of dwindling resources … Consequently, a business judgment call that does not take account of the impacts of an organisation's business model on the triple context [economy, society and environment] could lead to a decrease in the organization's value."

What is important is the fact that although King IV defines ethical leadership, and ethical leadership includes ESE, its emphasis lies on how the board of directors should be using the 'triple context' (ESE) to produce sustainable business activities in future (King IV, 2016). To this end, King IV overlaps with ESG; both are concerned with future sustainable business practices. In other words, King IV focuses on the fact that every company must have a purpose/business purpose for implementing ESE in practice, for example the company board contributes to employee development as a way of reducing the employee turnover rate or introduces new methods to reduce the company's carbon footprint (King IV, 2016; Cath, 2020). King IV also suggests ways in which companies should be reporting on ESE in their financial statements such that an investor will be able understand the company's future sustainability practices (King IV, 2016; Ojala, 2019). King IV also recommends continuous monitoring of ESE as well as considering how additional industry codes, legislation and/or global developments should influence ESE reporting in company financial statements. This reporting in financial statements also contributes to ethical reporting as it helps an investor make informed investment decisions (Nelson, 2015; Susko, 2018). If no disclosures/reports exist in the financial statements, the following question is important from a practical perspective: are there any other methods for observing ESE or ESG compliance?

8 Other methods for observing ethical reporting

King IV defines certain key terms, among them being sustainable development and assurance. Assurance is briefly defined as "[t]he diligent application of mind to evidence, resulting in a statement or declaration concerning an identified subject matter … and that is made for the purpose of enhancing confidence in that subject matter or subject matter information." This brief definition contains a very important word, namely, purpose (King IV, 2016). In this regard, external service providers (in the event they are unable to convince a company to report in full on ESE or ESG matters in their financial statements) should advise companies to join an industry association which requires its members to comply with its rules or codes. By enrolling as a member, the member subscribes to these rules or codes, thus clearly indicating that it has made a commitment to sustainable business practices. One example of such an association is the Marine Stewardship Council (2020). This council was established in 1996 as a method to 'advertise' its members' commitment (or business purpose) to sustainable fishing practices. Therefore, there is no need to give a full explanation by external service providers in the relevant financial statements of how the companies comply with ESG, because membership to the Marine Steward Council implies automatic ESG compliances. An investor would therefore search for companies that are council members for investment purposes (Marine Stewardship Council, 2020). It is also possible to establish similar councils in South Africa, where their membership could 'advertise' sustainable business practices or South African companies could approach (apply for membership) the MSCI for review of their financial statements.

9 Conclusions

ESG of MSCI consists of eight risk factors with approximately 56 factors in total, which could play a very important role in the South African ethical reporting landscape (GAO Reports, 2020). Although an auditor (or any other external service provider, for example MSCI) is not required to explain or to monitor or to audit these eight risk factors, a company that is willing to report on all 56 factors clearly contributes to ethical reporting, for example in its financial statements. Currently, MSCI specialises in ESG reporting to assist investors in making better informed investment decisions. MSCI monitors approximately 8,500 companies around the world, and a possibility exists to duplicate these ethical reporting standards in South Africa. For example, a pension fund may request fund managers to report on the 56 factors of ESG in their financial statements or can apply ESG' tools to any fund manager in order to understand the fund manager's commitment to sustainable business practices. In addition, it will also not be very difficult to apply either ESG or ESE since a clear overlap is evident in reporting on financial sustainable business practices relating to the environment, social relations and governance (or good corporate behaviour) (Buniamin and Ahmad, 2018).

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Notes

1 This article is written solely on the basis for academic discussion. Companies discussed in the article are not intended to serve as endorsements of effective or ineffective corporate governance management. Financial statements referred to in the article have reference to their online publications.