Summary

Mismanaging water-related risks can seriously damage an organisation's operations but also its reputation, legal, and financial performance. Therefore, water related-risks should be considered in financial statements and performance outlook of companies. This Tool introduces the basics of water-related financial disclosures in the context of sustainability reporting standards, discusses the importance of these disclosures for corporate water investments, provides an overview of the water-related financial disclosures guidance and frameworks, and explores challenges related to its application.

Water-Related Financial Disclosures in the Context of Sustainability Reporting and Materiality

Water-related financial disclosures fall within the broader concept of sustainability reporting, which is the disclosure and communication of environmental, social, and governance (ESG) goals—as well as a company's progress towards them. The aim of reporting ESG is to help companies to better measure and manage their exposures to ESG-related risks and to become better corporate citizens by measuring, disclosing, and managing the environmental and social impacts they create (EY - Oxford Analytica, 2021).

Sustainability reporting is based on the concept of materiality. A material sustainability issue is an economic, environmental, or social issue on which a company has an impact or may be impacted by (NYU-Stern, 2019). Materiality analysis is the process through which a company systematically identifies, selects, prioritises, and reviews what is material to the company and its stakeholders, and thus merits inclusion in sustainability reports (Calabrese et al, 2019).

The issue of water scarcity is generally considered to be a material issue for major beverage and food companies (e.g., PepsiCo, Coca-Cola, Heineken, Danone, etc.). These companies rely on water to produce its products, and without a consistent supply of inexpensive water, would likely face significant business challenges. Because other people rely on the same water resources, the companies may face pressure from stakeholder groups who object to its sourcing of water from communities in water-stressed regions. Thus, water-related risks become a material issue for corporate players (Tool C5.05) creating an incentive to disclose water-related financial information.

Water-related financial disclosures are especially beneficial to companies in sectors that have high exposure to water-related risks. These are generally but not exclusively water-intensive industries businesses (Figure 1). Companies that use little water can also have a high exposure to water risks (e.g. for instance technology companies that use water in only some key aspects of their operations). Sector-specific risks vary however based on the basin in which these industries operate (Figure 1). Those in the red and orange categories in Figure 1 will find sustainability reporting for water most beneficial.

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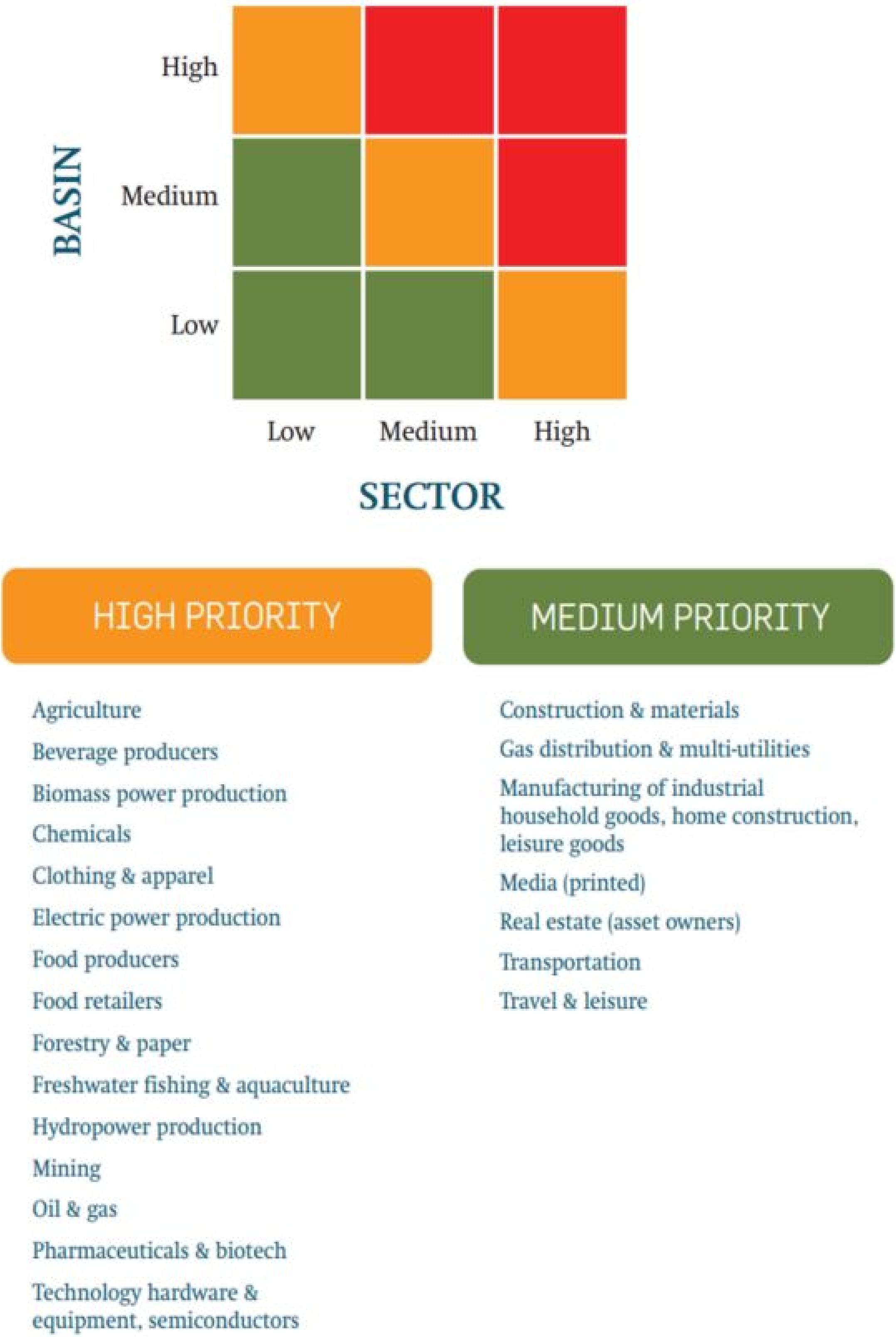

Figure 1. Measures of Exposure to Water-Related Risks. Source: CEO Water Mandate (2014).

Water Disclosures as an Incentive for Corporate Water Investments

Water-related financial disclosures can be used to incentivise companies to increase their investments in improving water management. The identification of water-related risks and the estimation of their associated financial costs can indeed provide a strong economic rationale for companies to start investing in water management. In fact, companies are likely to be persuaded to invest in water action, especially if that cost to manage the risks is low in comparison to the potential financial loss due to a water problem.

To provide a simple example of this, consider the following situation. A beverage company has been operating in a basin where water resources have become slowly but increasingly scarce. Yet, this company has never had any problems in accessing the quantities it needed and therefore never saw the need to invest in water efficient systems or financially contribute to watershed conservation programmes. One year, a drought hits and the government imposes a quota system guaranteeing water for the environment and households, through which the company only gets 50% of the amount of water it requires. The consultants hired by the company to analyse the financial impact of the drought and solutions to minimise losses, decide to apply the water-related financial disclosure methodology, which takes into consideration all water-related risks instead of focusing solely on the possibility of a drought. The study reveals that the company is seriously exposed to water-related risk and that a variety of water issues could easily bring it to bankruptcy. Such realisation provides an extremely convincing reason for the company to start investing in improving its water management practices and also those in the watershed, e.g., by installing water reuse systems and/or investing in water conservation projects in the basin. As such, water-related financial disclosures can prove to be an extremely powerful tool in building an investment rationale for corporations to increase their spending towards improving water management practices.

Another way in which water-related disclosures can help raise corporate water investments comes from the fact that many development banks and investors favor companies that take these risks into consideration. Take the previous example from the perspective of an investor who offers a limited amount of concessional loans. The beverage company presented earlier (Company "X") has a competitor (Company "Y"), and both are now looking for funds so that they can expand. On paper, the two companies look very similar in terms of annual income but X makes slightly less profits than Y. That said, X made a number of investments to increase its water supply and demand efficiency and carries out a water-related financial disclosure assessment every year. Company Y, on the opposite, hasn't looked much into any of those issues thinking the drought was a one-off event. At first sight, the investor would have been probably keener to lend to Company Y due to its higher returns, thus offering a more secure repayment. That said, when presenting its business to the investor, Company X shares how they have been managing water-related risks and integrating water-related financial disclosures as part of their in their strategy and workplans. Taking the risk exposure of each company into account, the investor would then likely favor company X.

While this is a hypothetical scenario, many development banks have now started to request companies applying for funding to disclose their climate- and water-related financial risks (IDB, 2021). Companies that want to attract funding, therefore, have an imperative to not only carry out water-risk financial disclosures but also show that they are taking action to mitigate risk, all of which creates a stronger investment rationale in improving water management.

Roadmap and Checklist for Water-Related Financial Disclosure

Based on the climate-related financial disclosures (TCFD, 2021), a checklist of six requirements to guide organisations in the process of preparing their water-related disclosures was compiled. Based on the principle that disclosures are voluntary, these requirements are by no means mandatory (CDSB, 2021):

- **Requirement 1 – Governance:** identifying person(s) responsible for water policies as well as explaining whether the governance mechanisms for water policies, strategies and disclosure differ from other material concerns.
- **Requirement 2 – Management's environmental policies, strategy, and targets:** explaining the material water-related dependencies and impacts of the organisation, summarising water policies and strategies and setting science-based targets for delivery of water policy.
- **Requirement 3 – Risks and opportunities:** identifying material water-related risks and their implications on value chains.
- **Requirement 4 – Sources of environmental impact:** providing, explaining, and categorising

metrics and indicators for sources of material water impacts (at least withdrawals, consumption, and discharge).
- **Requirement 5 – Performance and comparative analysis:** providing appropriate historical data to the results reported from the metrics and indicators above for material water impacts to allow for useful comparison and explanation of trends.
- **Requirement 6 – Outlook:** explaining the likely effect of future water-related impacts, risks, and opportunities as well as of water strategy on company performance and resilience.

Key Reporting Frameworks

There are a number of frameworks that can help companies to know what specific types of information should be included in their corporate water disclosures and how to structure this content (e.g., Natural Capital Protocol, Australian Water Accounting Standard, GRI Water Effluent Standards). Three of the most commonly used international water-related water disclosures frameworks include:

- **CDP Water Questionnaire:** is divided into 11 modules: W0 Introduction; W1 Current state; W2 Business impacts; W3 Procedures; W4 Risks and opportunities; W5 Facility-level; W6 Governance; W7 Business strategy accounting; W8 Targets; W9 Verification; 10 Signoff (CDP, 2021). The questionnaire is available in two formats; minimum with core questions; and advanced which has a total of 71 questions (N.B. the minimum version is only available for companies with less than 250M Euro/USD in annual revenue). In addition to the Water Questionnaire, the CDP developed two other surveys which companies can use to disclose information on 1-climate change and 2-forests.
- **CEO Water Mandate's Corporate Water Disclosure Guidelines:** is built on three pillars further divided into 11 areas of information and to track and include for corporate disclosures (Figure 2). Before going into the detailed disclosure, businesses are required to assess their company water profiles and their exposure and significance of the water risks, which then guides whether a company should be taking the "basic" or "advanced" reporting process. Each block has a two-track metric system depending on the level of reporting that the company decides to pursue.

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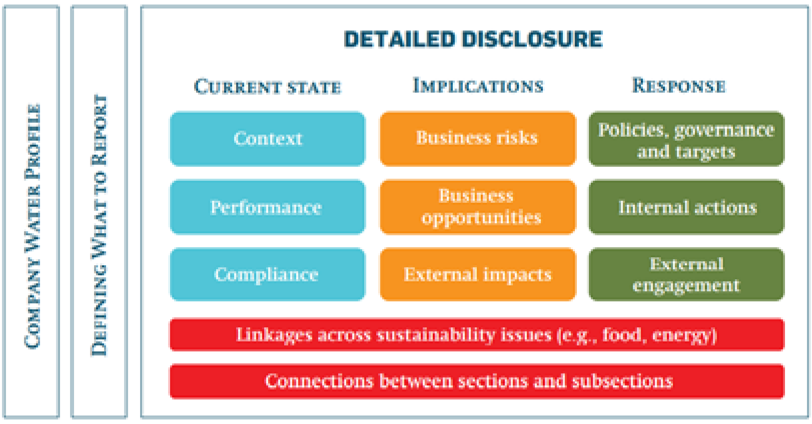

Figure 2. CEO Water Mandate's Corporate Water Disclosure Framework. Source: CEO Water Mandate (2014).

- AWS International Water Stewardship Standard: is developed around a 5-step process: (1) gather and understand; (2) commit and plan; (3) implement; (4) evaluate; (5) communicate and disclose. Each step is composed of several criteria which are categorized as "core" and "advanced". Each criterion is related to one of the five main outcomes defined in the AWS Standard: good water governance; sustainable water balance; good water quality status; important water-related areas; safe water, sanitation and hygiene for all (WASH). Points are awarded for each criterion and the company receives an AWS certification (core, gold, or platinum) depending on the total number of points achieved. Unlike other frameworks which mostly work on self-assessment reporting basis, AWS is a standard that can be independently verified and audited.

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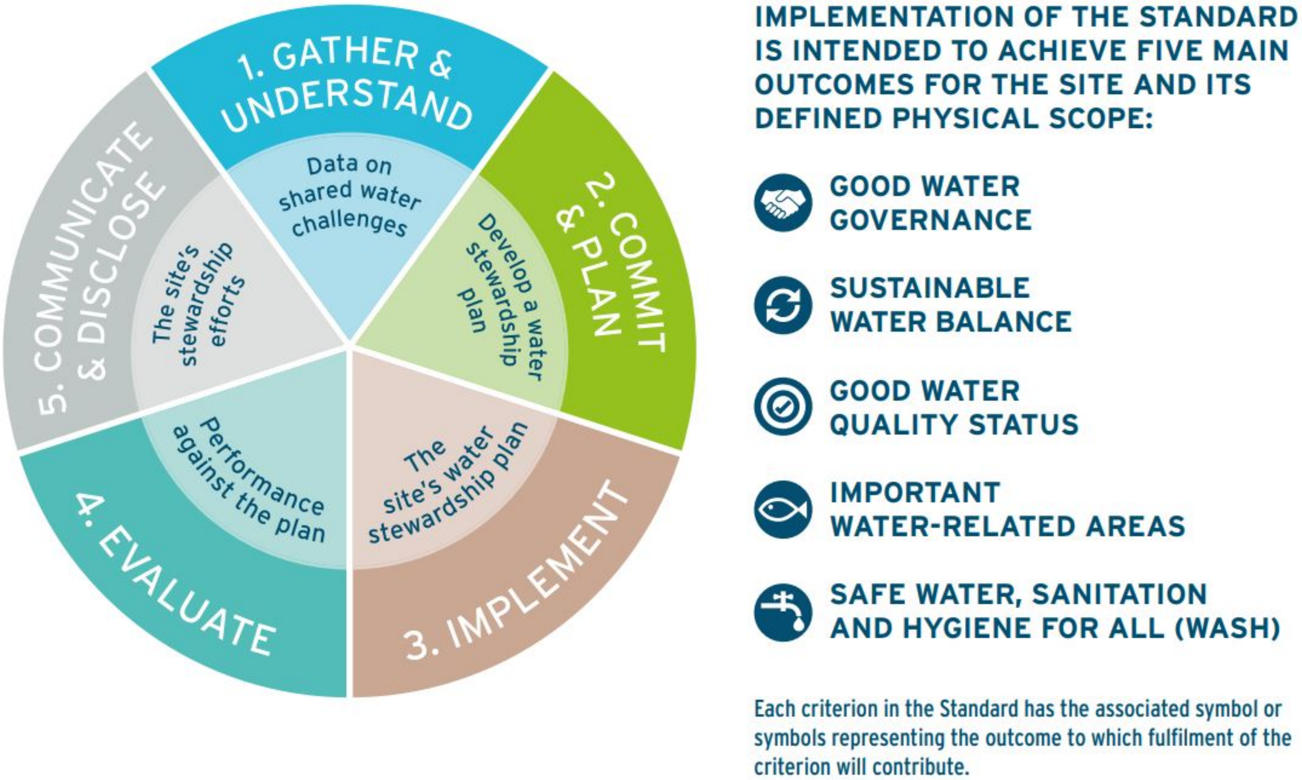

Figure 3. Structure of the AWS Standard Framework. Source: AWS (2019).

Practical Challenges in Implementing Water-Related Disclosures

With these benefits in mind, there are nonetheless a number of practical challenges for companies to disclose water-related risks. First, implementing robust sustainability reporting frameworks is costly. It requires capital, human resources, and long-term efforts, which means that only the biggest corporations (multinationals) or public owned companies (oil and gas, utilities), with exposure to international financial markets, might undertake such initiatives. That is one of the reasons why there is strong opposition to mandatory systems, in particular in developing countries. Second, there is a growing demand on sustainability reporting standards that vary by location, when companies look for financing in international financial markets (e.g., from financial regulators and stock exchanges), which in turn deters quality of disclosures due to strained internal resource capacities. Likewise, companies must also respond to varying requests for voluntary disclosures and assessment processes set by ratings providers as the broader investment community and shareholders are calling on companies to provide greater transparency around sustainability risks (EY - Oxford Analytica, 2021).

Thematic Tagging
Private Sector

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