The future of sustainability reporting standards

The policy evolution and the actions companies can take today

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EY
Building a better working world

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Contents

Foreword

The shared global experience of the past year has illustrated the interconnectedness of our world, our vulnerability to the environment and the impact of global action.

Public health, climate change, social inequality, diversity and inclusiveness are challenges that need global attention and innovative, collaborative solutions. We also need a common language to measure and report on society's progress and for the global economy to price externalities such as greenhouse gas emissions and environmental damage, allocate capital and make better decisions

Over the last 18 months, significant progress has been made toward establishing global sustainability reporting standards. *The future of sustainability reporting standards* analyzes this progress across both developed and developing markets and recommends actions companies can take now to navigate and prepare for emerging sustainability reporting mandates.

The most promising development is the expected launch of the International Financial Reporting Standards (IFRS) Foundation's International Sustainability Standard Board (ISSB) at COP26 in November. As the body that sets accounting standards in much of the world, the IFRS Foundation is well positioned to introduce the discipline that exists in financial reporting into sustainability reporting, building on the linkage between the various standards while respecting their different perspectives.

We strongly support the IFRS Foundation's proposed creation of the ISSB and the development of robust, globally consistent sustainability reporting standards. At the same time, we support efforts within the European Union, United States and other jurisdictions to develop regional standards that respond to local stakeholder needs and expectations. Like the IFRS Foundation, we recognize the need to instill regional flexibility alongside a global standard.

The next 12–18 months are an opportunity for action and will likely result in developments that represent one of the most significant innovations in corporate accounting and reporting in decades.

Many businesses are preparing for future sustainability disclosures and committing to transparency and accountability before they are mandated. Now is the time for companies and their leaders to work together with regulators and civil society to achieve consistent, global standards and contribute to this critical process that will help define corporate reporting and accountability for the next generation.

Carmine Di Sibio
EY Global Chairman and CEO

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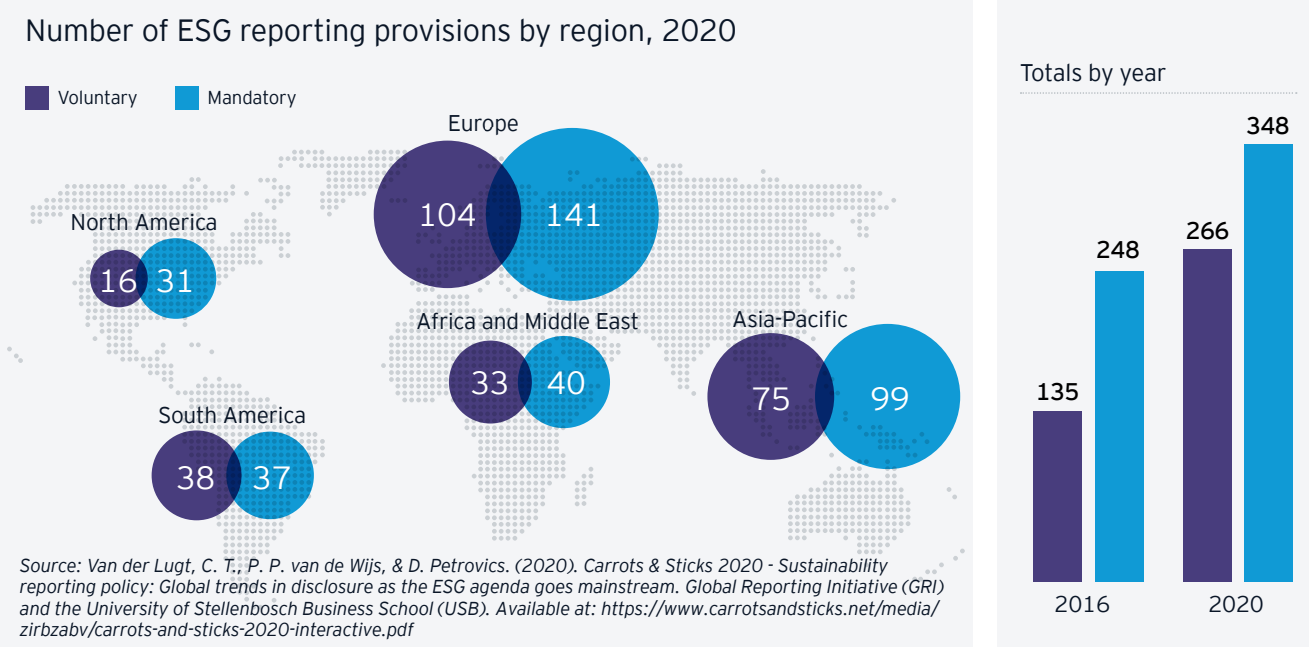
Introduction

The number of environmental, social and corporate governance (ESG) regulations and standards globally has nearly doubled in the last five years. Accompanying this rise are various reporting frameworks led by the “Group of Five” standard setting organizations.[1] In addition, there are currently over 600 ESG reporting provisions globally, with many having differing interpretations of sustainability.

The high number of guidelines about what ESG information is required or recommended to be disclosed means companies face barriers and strained resource capacities to focus on quality ESG disclosures. For instance, publicly listed companies have to abide by mandatory financial and nonfinancial[2] disclosure requirements issued by regulators and stock exchanges. 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.

As a result of these different processes and requirements, there are often significant variations in the information disclosed about a company's ESG performance. It is thus not surprising that there is a disconnect between the increased focus on evaluating ESG performance from investors and the availability and efficacy of standardized nonfinancial data provided by companies.

Figure 1: Voluntary and mandatory ESG reporting provisions



Source: Van der Lugt, C. T., P. P. van de Wijs, & D. Petrovics. (2020). Carrots & Sticks 2020 - Sustainability reporting policy: Global trends in disclosure as the ESG agenda goes mainstream. Global Reporting Initiative (GRI) and the University of Stellenbosch Business School (USB). Available at: https://www.carrotsandsticks.net/media/zirbzabv/carrots-and-sticks-2020-interactive.pdf

ESG areas of scope

ESG standards generally encompass the following:

Environmental, e.g., waste management, emissions impact, energy efficiency, air and water pollution, environmental protection, and biodiversity loss and restoration

Social, e.g., human rights, labor rights, working conditions, health and safety, employee relations, employment equity, gender diversity and pay gaps, anti-corruption, and impact on local communities

Governance, e.g., ownership and structural transparency, shareholder rights, board of directors' independence and oversight, diversity, data transparency, business ethics, and executive compensation fairness.

The aim is that these standards 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.

Growing momentum

Given the lack of consensus over what reporting information is required and the need for comparability across and within jurisdictions, there has been a growing momentum towards a global harmonization of sustainability-related financial reporting standards in the last 18 months. The most promising development is the IFRS Foundation's ISSB, set to launch at COP26 in November 2021. Building on existing frameworks and endorsed by the Group of Five, the World Economic Forum International Business Council (WEF IBC) and the International Organization of Securities Commissions (IOSCO), the ISSB will be tasked with developing and maintaining global sustainability-related financial reporting standards that are relevant to enterprise value. The IFRS Foundation's extensive consultation with stakeholders has concluded that there is an urgent need to accelerate the establishment of a high-quality, global, sustainability-related financial reporting framework.[3] In their 5 June communique, the G7 Finance Ministers and Central Bank Governors expressed support for the ISSB and called for mandatory climate-related financial disclosures based on the Task Force on Climate-related Financial Disclosures (TCFD) framework.

The bigger picture

Initiatives by institutional bodies such as the IFRS Foundation to harmonize disclosure will have to confront a host of political and regulatory issues arising from national and regional divergences, influenced by an ecosystem of stakeholders with different interests. This report explores this broader political context, which encompasses a diverse set of actors — ranging from individuals to public and private institutions — who play a salient role in shaping the sustainability reporting debate. Actors embedded in this ecosystem approach the conversation with varying degrees of influence and often different objectives. Furthermore, each actor is operating in a political context that will ultimately affect the future direction of the global sustainability reporting discourse. The report concludes by outlining recommendations for how companies can navigate this dynamic and evolving terrain.

The IFRS Foundation has concluded that there is an urgent need to establish a global sustainability reporting framework.

State of play: sources of influence

The sustainability reporting movement originated out of civil society and gained prominence among a small number of socially responsible, activist investors who aspired for companies to disclose their impact on broader stakeholders.

In the past several years, the dynamics of the sustainability debate has dramatically shifted, with mainstream investors noting that sustainability issues impact risk, return and value of companies over the long term. This has resulted in mainstream investors wanting comparable, consistent and reliable information about a company's sustainability performance. This change is influencing securities regulators to become involved and, likewise, corporate boards to seriously think about and react to sustainability issues. The IFRS Foundation's ISSB proposal would not have come to fruition if mainstream investors had not demanded sustainability information.

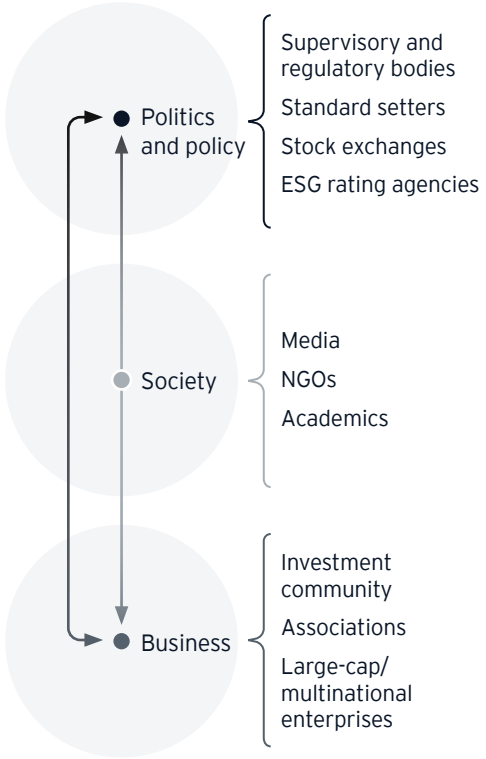
Pressures to produce higher-quality sustainability reporting can be understood from both below and above. From a bottom-up perspective, members of society are pressuring political/policy and business actors to implement progressive changes in the E, S and G spheres. There are also top-down pressures from regulatory and standard setting actors that are promoting compliance and/or behavioral shifts through policy and best practices guidelines. Meanwhile, investors are directly influencing companies to improve their ESG disclosures through ownership stakes and capital allocation.[4]

The various players in this sustainability reporting ecosystem can be broadly defined into three primary categories of stakeholder influence, with each possessing different aims and objectives (see Figure 2: Sources of influence).[5]

Political and policy influencers interact closely with business influencers in a two-way fashion, whereas societal actors have engaged with political/policy and business influencers in a one-way stream.[6] Within each of the three primary sources of influence, the subcategory influencers interact closely with each other. For instance, within politics and policy, regulatory bodies and standard setters may influence one another. Furthermore, within each subcategory, the relevant actors can likewise influence their own stakeholders and/or supply chain partners (e.g., Apple's supplier responsibility code).[7]

Figure 2: Sources of influence

The global sustainability reporting ecosystem



Source: Oxford Analytica research

While the degree of closeness between political/policy and business influencers can vary by jurisdiction, in most Western jurisdictions there is a clear delineation between political/policy on the one hand and business influencers on the other. This is reflected in the different roles played by national regulators and business associations.

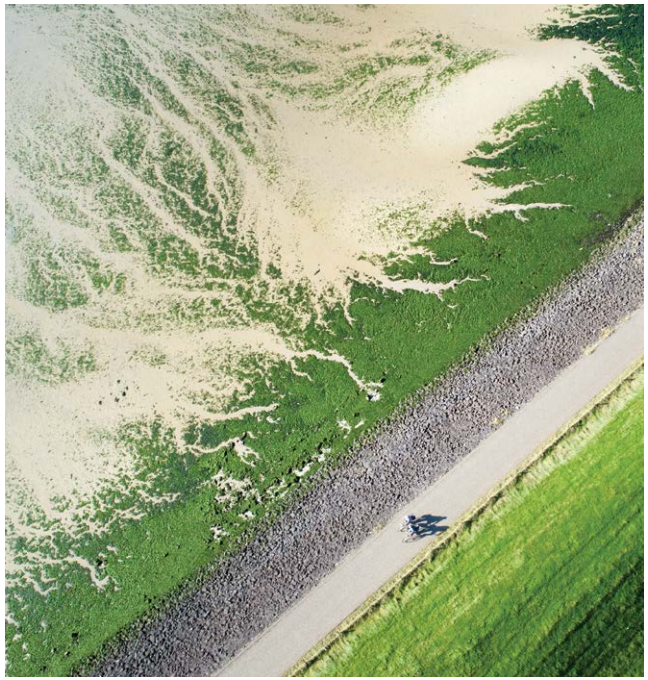
Looking ahead, ESG reporting will continue to be heavily influenced by the sustained efforts of societal actors who advocate for, and shape, best reporting practices. A good example of this is the history of the climate change and environmental protection movement in the 2000s.[8] The expectation is that, in the long term, societal actors will continue to play this pivotal role.

Over the last two decades, influencers in E, S and G have employed different mechanisms and strategies for advancing the sustainability discourse. For example, influencers in the E and S space have traditionally used tactics such as naming and shaming,[9] direct lobbying and petitions,[10] shareholder/investor activism,[11] and developing reputational authority in order to better influence the debate and motivate government, corporate and broader societal action.[12] Influencers in the G space, in principle, have used these tactics as well but also rely on their own peer individual networks[13] as a major source of influence for change. Current and future strategies for influencing a global sustainability standard will be a subset of these mechanisms.

Partially underpinning these tactics of influence is a philosophy of stakeholder capitalism.[14] From this perspective, a company's purpose is to create and maximize long-term shareholder value and consider its impact on all stakeholders,[15] including employees, customers, suppliers and local communities. Some high-profile executives, stock exchanges[16] and sovereign wealth funds[17] have actively taken on the responsibility to embrace this philosophy and aim to influence the debate on global sustainability.

> "To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate.
>
> **Larry Fink**
> Chairman and Chief Executive Officer, BlackRock
> 2018 Letter to CEOs

Global variations in managing sustainability-related disclosures



Jurisdictions are taking different approaches to sustainability reporting. This is demonstrable in terms of how they define materiality, as well as how different jurisdictions approach E, S and G separately in their frameworks.

Materiality, a long-established financial accounting concept, has been a bedrock feature of securities law and regulation. The US Supreme Court defined it as information that, if disclosed, "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[18]

The definition of materiality used in the United States is a flexible concept capable of evolving along with investors' needs. Other key global actors, most notably the European Union (EU) and the WEF, are using alternative definitions and applications of materiality to nonfinancial considerations and introduced concepts such as "double materiality" and "dynamic materiality."

Understand your audience: different ESG disclosures may be relevant to different stakeholder groups

The concept of double materiality, first introduced by the European Commission,[19] is based on a view that a company should report on two aspects:

- **Influencing enterprise value:** sustainability topics that influence enterprise value. The main audiences for impact inwards are investors, lenders or other creditors. This is the traditional understanding of the term "materiality."
- **Influencing people, the environment and the economy:** sustainability topics with broader influence on the economy, the environment and people (including human rights according to the GRI definition).[20] The main audiences for impact outwards are governments, consumers, business partners, employees, civil society organizations and local communities.

Dynamic materiality, as described by the WEF,[21] is about anticipating how present and future issues can become financially material across industry or for a specific company. That is, what is financially immaterial to a company or industry today can become material tomorrow.

The Group of Five has introduced the related concept of nested materiality to explain three reporting lenses, from broad to narrow, which sustainability matters can move between over time: (1) a company's impact on all sustainability matters (the economy, the environment and people); (2) sustainability matters that impact enterprise value; and (3) core financial information.[22]

Two views of sustainability disclosure requirements and priorities: the United States and the EU

The United States and the EU are taking different paths toward sustainability reporting. This is largely the result of differences in governance, legal traditions and the balancing of domestic interests. Up to now, the United States has relied on a principles-based approach, tied to the concept of materiality, with respect to mandatory sustainability disclosures. In addition, voluntary sustainability reporting is being driven by market demand. On the other hand, the EU generally emphasizes regulatory measures to enforce materiality considerations, which is consistent with its stated institutional priorities and past jurisprudence.[23]

In the United States, the US Securities and Exchange Commission (SEC) currently requires public companies to disclose certain ESG information, such as a description of human capital resources and any measures or objectives on which management focuses, if it is material to an understanding of the business. In addition, the SEC issued guidance in 2010 regarding how the US securities laws and regulations may require disclosures of climate-related information, depending on a company's circumstances. The SEC is also actively considering new regulatory initiatives. However, there is general agreement that the level of information that companies are compelled to disclose under the existing regulatory framework is significantly lower than in a number of other developed markets. The SEC recently has taken several actions relating to climate and ESG reporting, including a public request for information regarding potential new climate disclosures and a review of climate-related disclosures.[24]

The EU adopted a proposal in April 2021 that will replace reporting requirements under the Non-Financial Reporting Directive (NFRD), which currently require large public-interest companies with more than 500 employees to disclose environmental, social and employee-related matters, such as anti-bribery, corruption and human rights performance.[25] The proposed Corporate Sustainability Reporting Directive (CSRD)[26] will extend the scope to include large companies[27] and all companies listed on EU-regulated markets in the EU (except listed micro-enterprises). The CSRD brings sustainability reporting closer to financial reporting by requiring "limited assurance" of sustainability information by a company's auditor or an independent assurance services provider. Later, there will be the option of moving forward to "reasonable assurance"— the standard of assurance provided for financial information. Companies within the scope of the CSRD will have to comply from financial years starting on or after 1 January 2023.

Of further note is that the EU is developing a very specific taxonomy[28] and action plan[29] for sustainable finance. The classification system will have a large impact on what economic activities are able to attract funding under the EU Green Deal.[30]

Most large companies based in the EU and EU subsidiaries of foreign companies will fall within the scope of the CSRD

50,000

estimated number of companies in scope

January 2023

effective from financial years starting on or after 1 January 2023

Different legal approaches to mandatory disclosures

Jurisdictions have varying legal constructs governing corporate disclosure, as well as different legal liability profiles. For example, the United States has the most litigation risk related to corporate disclosures.[31] Both the legal framework and the level of litigation risk in different markets have an influence on the nature and acceptance of both voluntary and mandatory disclosures.

The US framework is built around the framework of investor protection, capital formation, and fair and orderly markets. In contrast, the EU framework is built around mandating multi-stakeholder disclosure. There is no concept of mandatory multi-stakeholder disclosure in US securities law.

Another factor to consider is that the EU is more oriented towards an approach of prescribing specific metrics that will be reported by all companies. In contrast, the United States is more oriented to a concept where a company decides what information is material to investors, unless the SEC prescribes something specifically.

Mandatory ESG disclosures in select jurisdictions

In the United Kingdom, listed companies are mandated to provide a report disclosing annual greenhouse gas emissions and diversity under the Companies Act 2006.[32] Companies with a "premium listing" of equity shares are required to report on how they apply the main principles of the Corporate Governance Code 2012.[33] The UK government has also confirmed that, by 2025, it will make compliance with the TCFD mandatory.

In Canada, all publicly listed, federally incorporated companies — specifically those governed by the Business Corporations Act[34] — are required to provide, as part of their annual shareholders meeting materials, disclosures about the company's diversity policies relating to its board of directors and senior management team. Moreover, at a minimum, companies are required to disclose information on the composition of the four federally designated, underrepresented groups (women, indigenous, visible ethnic minorities and persons with disabilities). There are currently no mandatory environmental or social disclosure requirements. However, Ontario's Capital Markets Modernization Taskforce 2021 final report recommends mandating disclosure of material ESG information in regulatory filings, especially pertaining to climate change-related disclosure compliant with the TCFD recommendations.[35]

In mainland China, the Securities Regulatory Commission (CSRC), in collaboration with the Ministry of Environmental Protection, will be introducing requirements for all listed companies to disclose ESG risks to enterprise value associated with their operations.[36] The Shanghai and Shenzhen stock exchanges have already issued guidance that demands better disclosure on ESG reporting by listed companies (requiring listed companies to disclose social responsibility, including measures for environmental protection) and offer ESG-related training. Furthermore, Shanghai's IPO requirements state that companies must provide an annual sustainability report.

In Hong Kong, the ESG reporting obligation is mandatory as a listing rule, more aptly described as "comply or explain."[37] That is, if the company does not report on one or more of the required ESG provisions, it must provide bona fide reasons for its failure to do so in its ESG disclosure report.

Understanding China's ESG disclosure behavior

The drivers behind mainland China's surge in ESG disclosures, as measured by an increase in the number of Chinese signatories to the UN-supported Principles of Responsible Investment,[38] can be understood in two ways.

First, it suggests that China's (re-)centralized structure under President Xi Jinping provides a mechanism to rapidly incorporate ESG performance considerations across decision-making in the public and private sectors. Due to this governance structure,[39] the expectation is that China will quickly incorporate sustainability standards via top-down pressures.

Second, as China reduces some legislative constraints to foreign direct investment (e.g., the 2020 Foreign Investment Law),[40] increased ESG disclosures broaden foreign access to its financial markets[41] and better protect the rights and interests of foreign investors. As such, ESG considerations will become more pronounced due to the entry, and increasing activities, of foreign companies that seek investment options in Chinese markets.

Within the Asia-Pacific region, regulators and stock exchanges have adopted varying approaches to reporting ESG information. ESG reporting is voluntary in markets such as Australia and Japan (Japan has also published recommendations for a potential ESG disclosure framework), while in Singapore, the reporting obligation is on a "comply or explain" basis.[42] Across the region, there is a growing trend towards tightening reporting obligations and a gradual acceptance of a mandatory obligation towards ESG disclosures.

Emerging markets: determined to improve ESG reporting standards

Emerging markets are determined to improve ESG reporting standards for several reasons. Foremost, emerging markets are the main manufacturing location for the top global 500 companies,[43] which makes sustainability performance critical. Retaining current and future foreign investors that have an increasing ESG focus will require improvements in disclosure, transparency and risk management. That is, the desire to maintain and attract foreign investment — particularly accessing a larger proportion of the more than USD30 trillion of funds available worldwide for sustainable investing[44] — will mean a greater focus on ESG issues.

The most prominent emerging market player will be China, which leads the international growth in disclosures in the early 2020s for institutional and economic reasons (see above). However, mainland China's current Bloomberg ESG disclosure score[45] is 21.6 (with Hong Kong at 29.9). This is less than half that of France, which holds the top rank score of 46.9, and behind its regional rival, Japan, at 24.1, which suggests that there is still work to be done in China.

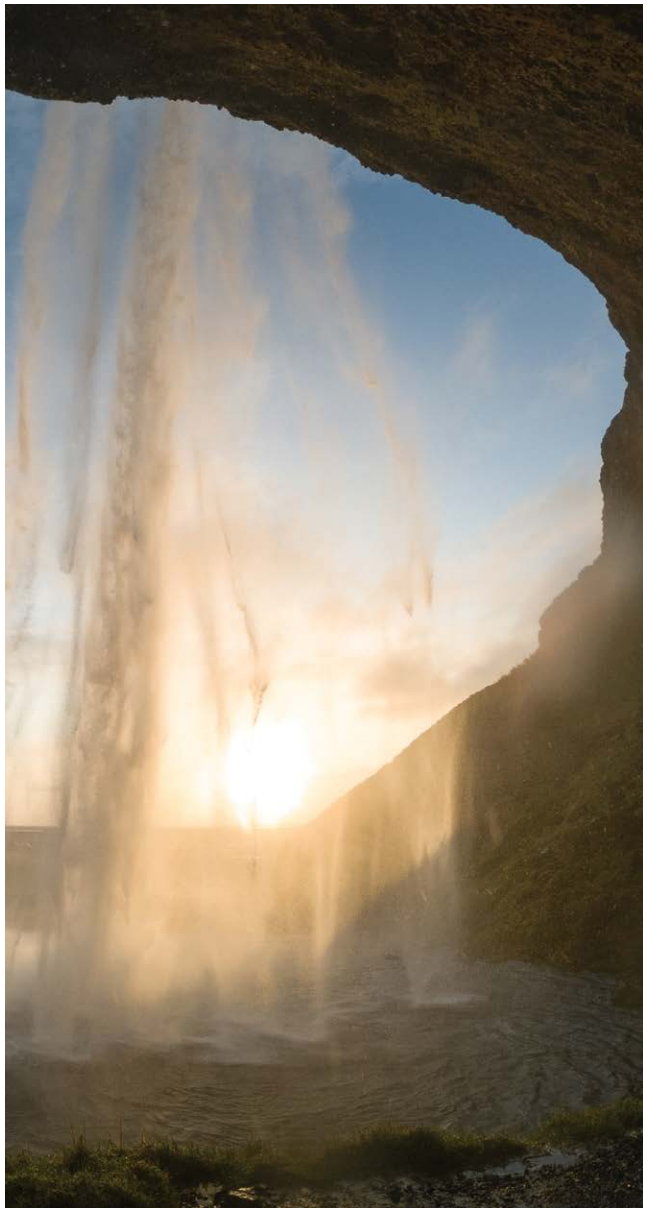
China and the United States now co-chair the G20 Sustainable Finance Working Group.[46] In theory, this has the potential to generate some convergence in disclosure principles, especially in the environmental realm; however, there is an equally strong possibility this may not come to pass. China will simultaneously engage major jurisdictions, such as the EU, through bilateral agreements to align selected, strategic taxonomies (e.g., the EU-China green investment initiative).[47]

Global standards outlook: through a macro lens

The IFRS Foundation spearheads harmonization efforts.

The potential for adopting a global sustainability-related financial reporting standard, with the IFRS Foundation's ISSB at the helm, is strong. The IFRS Foundation is well positioned to lead this effort given its track record in setting global standards.

The ISSB's reporting standard will be enhanced, and gain greater global legitimacy, if jurisdictions adopt ESG disclosures as a mandatory requirement and are subjected to external assurance to avoid market fragmentation. Therefore, understanding the broader political context in which the ISSB will launch is crucial.

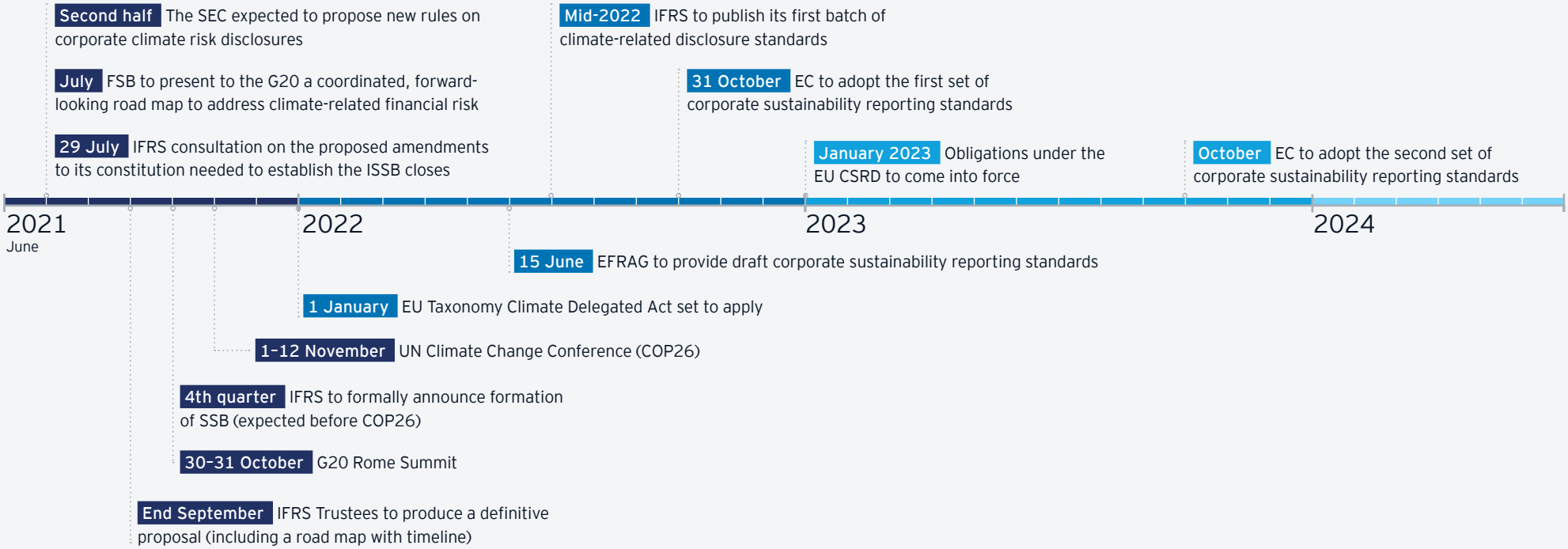


Why is standard setting so important?

One of the most effective mechanisms to achieve comparable, consistent and reliable information is with standards. However, the concept of standards is based on the notion of a target user (e.g., capital markets or society). In developing a standard for disclosure rules, there has to be a clear idea of target users and what their use case for information entails. Moreover, a standard setter must have some mechanism for decision-making, whereby the mechanism involves a clear understanding of the users and their use case. Good standards allow space for meaningful future innovation.

One of the attendant challenges with sustainability-related disclosures is that there has not historically been a clear articulation of user and use case that is consistent to all jurisdictions. This is complicated further by different jurisdictions having different public policy objectives and legal jurisprudence, as discussed in this report.

Figure 3: What to watch



Source: Oxford Analytica research

Engineering baseline support

Foremost, the ISSB will undertake a "building blocks" approach, whereby it will aim to provide a global sustainability reporting baseline that would allow for greater comparability and consistency of application across standards, while also providing flexibility for coordination on additional jurisdictional reporting requirements. This approach is attractive for engineering baseline support.

As of 2018, there were 144 jurisdictions[48] using the IFRS accounting standards, making it likely that many of these jurisdictions will endorse and require companies to use the new ESG standards as a baseline. While it took almost a decade and a half to develop a comprehensive set of IFRS accounting standards,[49] and another decade for major jurisdictions and organizations to fully implement the standards, the pace for many jurisdictions adopting the ISSB standards is likely to be much quicker given the building blocks approach.

Already, major regulators have supported the development of a global ESG reporting framework and the creation of the ISSB. The IFRS Foundation's efforts are reinforced by major actors such as the UN, G20 Finance Ministers, the WEF and IOSCO, which have agreed that there should be a globally consistent and comparable set of high-quality standards for sustainability-related reporting. This is aided by the fact the ISSB approach will build upon existing frameworks and standards by major standard setters such as Sustainability Accounting Standards Board (SASB) and Global Reporting Initiative (GRI).

Further support is provided by some major business associations such as the European Banking Federation and some global investment firms (e.g., BlackRock CEO Larry Fink's letter)[50] that see a single global standard as a mechanism for investors to make more informed decisions about how to achieve durable long-term returns. Other recent private sector-led initiatives such as the Embankment Project for Inclusive Capitalism[51] have been intended to identify metrics to measure and demonstrate long-term value to financial markets. Further, the WEF IBC, together with the accounting community, has developed a common set of core ESG metrics and recommended disclosures,[52] which provide a concrete stepping stone towards a formal global solution while also having a direct impact in terms of shaping the reporting behavior of companies. The IBC's underlying ethos is that "society is best served by corporations that have aligned their goals to the long-term goals of society," with the UN Sustainable Development Goals (SDGs) serving as the road map for that alignment.[53]

The European Union on a different path

The European Commission is on course to issue its own standard setting mandate for the European Financial Reporting Advisory Group (EFRAG) in the area of nonfinancial reporting, with the first set of draft standards expected by 15 June 2022. EFRAG has proposed that the EU participate in global convergence efforts such as the ISSB on a "co-construction" basis, with the attendant goal to foster coherence and consistency between the EU and IFRS Foundation's standards.[54] This suggests that the EU may use ISSB reporting as a supplementary tool but will "top up" where this is in the European public interest.

Another EU initiative, the Carbon Border Adjustment Mechanism (CBAM), is likely to impact ESG reporting. The aim of the mechanism is to protect industry and businesses within the EU from foreign competition that is subject to less stringent greenhouse gas emissions regulations and targets. Although how a CBAM would work has yet to be decided, it will encompass extra-territorial elements insofar as it introduces the possibility of imposing a carbon penalty on imports. To avoid this penalty, companies that seek access to EU markets will have to adopt ESG reporting in line with EU standards.

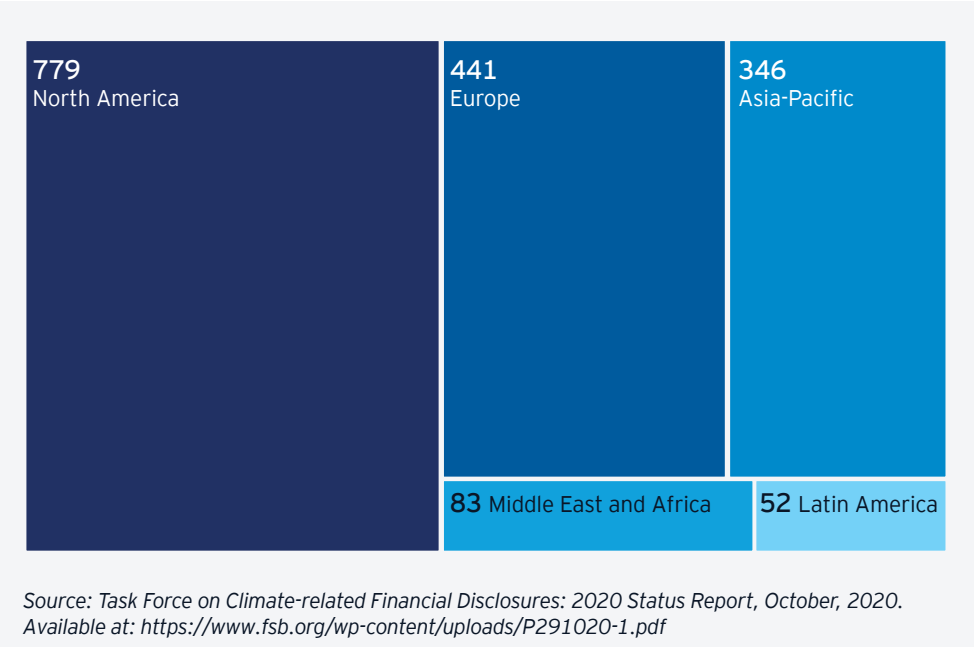
Depending on how CBAM is designed, this could either create pressure for convergence between international and EU standards or accentuate the differences between the two. Divergence is most likely, given the wider set of interests that a global standard will have to satisfy the ambitious climate targets adopted by the EU.

The IFRS Foundation's climate-first approach

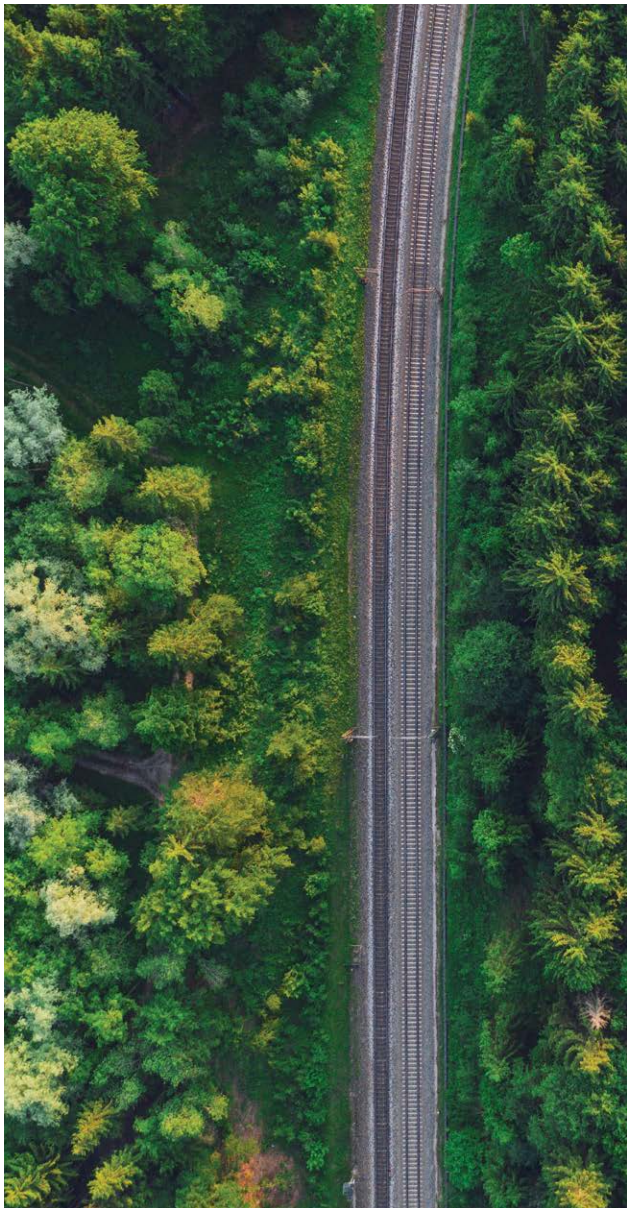
There is broad agreement that the Financial Stability Board's (FSB) TCFD will serve as a reference point for the IFRS's "climate-first approach." Created by the FSB in 2015 to improve and increase reporting of climate-related financial information, the TCFD has become a de facto standard for climate risk disclosure. Its guidelines are used by over 1,700 companies and supported by nearly 60 of the world's 100 largest public companies. Some nations, such as the UK, have also begun mandating TCFD disclosures.

Nevertheless, the extent of TCFD-aligned disclosure varies across regions, both in terms of the number of companies reporting and how they apply TCFD's four pillars of climate risk and opportunity (Governance, Strategy, Risk Management, and Metrics and Targets).[55] For example, in 2019, 60% of European companies undertaking TCFD-aligned disclosure reported the impact of climate-related issues on the company strategy. That figure was only 13% for companies in Latin America.

Figure 4. TCFD disclosure by region (number of companies reporting in 2019)



Source: Task Force on Climate-related Financial Disclosures: 2020 Status Report, October, 2020. Available at: https://www.fsb.org/wp-content/uploads/P291020-1.pdf



Significant variations in E, S and G objectives

The proposed IFRS sustainability reporting standard will be more readily equipped to meet environmental concerns, which by their nature are transnational challenges that do not discriminate across jurisdictions.

Environmental factors

As of March 2021, 191 jurisdictions have committed to the 2016 Paris Agreement[56] and have imposed (or are working towards) stricter regulations to curb greenhouse gas emissions and pollution. This is coupled with actively promoting renewable energy and electric vehicles through state subsidies. Yet, environmental performance information remains insufficient and will require greater environmental risk information statistics and data disclosures to meet the growing demands of investors and civil society actors. The proposed IFRS sustainability-related reporting standards will directly address these concerns, and it is strategically wise that the IFRS Foundation's ISSB will focus on climate-related issues in the first instance — given the global momentum in this area.

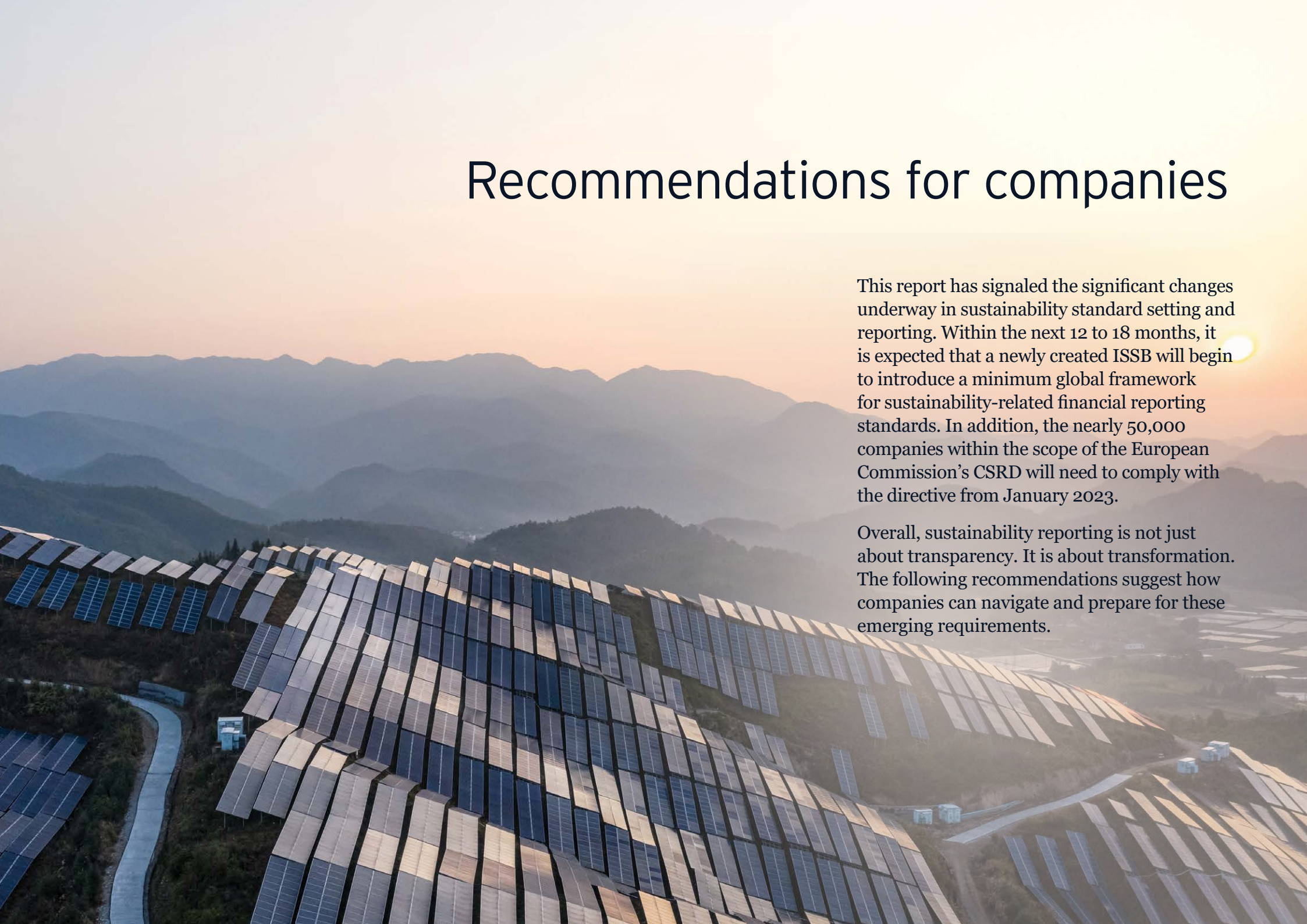
Social factors

Commitments to social factors differ markedly at present across jurisdictions. For example, engaging and measuring human rights standards can be controversial, value laden and easily politicized. There are presently variations between jurisdictions on the ordering of priorities for political and civil rights versus social, economic and cultural rights. While the UN Guiding Principles on Business and Human Rights (UNGPs) and the PRI have been fundamental in advancing human rights considerations in ESG investing, more clarity is needed for a global sustainability standard to be effective.

Corporate governance factors

When it comes to corporate governance factors, many listed companies in emerging markets have an opaque and often confusing ownership structure where investor voting rights have little to no weight. In China, for example, there is a concentrated ownership structure, and potential conflicts of interest between majority/minority shareholders remain a core corporate governance issue. Transparency is another issue.[57] ESG ratings agencies are regularly forced to operate with outdated information on companies. A fully functional global standard will have to embrace various public-private institutional configurations, structures and relationships.

Recommendations for companies



This report has signaled the significant changes underway in sustainability standard setting and reporting. Within the next 12 to 18 months, it is expected that a newly created ISSB will begin to introduce a minimum global framework for sustainability-related financial reporting standards. In addition, the nearly 50,000 companies within the scope of the European Commission's CSRD will need to comply with the directive from January 2023.

Overall, sustainability reporting is not just about transparency. It is about transformation. The following recommendations suggest how companies can navigate and prepare for these emerging requirements.

Don't wait for sustainability reporting to be mandated

The timing with which sustainability reporting is evolving has left companies asking, "Which standards and metrics should we prepare for?" and "Which should we wait for?"

Some companies have chosen to wait on the sidelines until sustainability reporting is mandated in their jurisdiction. This is the wrong approach. As regulators make progress on sustainability reporting standards, companies have a great opportunity to prepare for future disclosures and commit to transparency and accountability today. While the IFRS and other regulatory efforts are expected to take a climate-first approach, it will be important for companies to consider reporting across a range of environmental, social and governance topics.

If companies seize this opportunity, they will be heading in the right direction when new standards are implemented. What's more, they will be able to use the information they gather to inform their strategies, manage their risks and achieve a stronger, more sustainable performance over the long term.

To begin, companies should identify the metrics most relevant to their sector, strategy and stakeholders and develop the capacity to report on those metrics. The Stakeholder Capitalism Metrics, developed by the WEF IBC, are a good starting point for industry- and region-agnostic metrics. They are also signposted from existing standards and metrics and include full implementation of the recommendations of the TCFD.

Put ESG and sustainability reporting on the board's agenda

It is essential for boards to understand how evolving ESG investing and stewardship trends are impacting access to capital and relationships with investors.[58] They should be sufficiently informed to confirm whether the company is effectively capitalizing on these trends to attract long-term investors and secure shareholder support.

Boards need to understand private market and regulatory initiatives, monitor developments from the major jurisdictions as well as within the IFRS Foundation, and know how their company is viewed by ESG data providers. In addition, boards should oversee a materiality assessment and support the integration of ESG within broader strategy and enterprise risk management (ERM).[59]

Seek assurance to build trust in sustainability reporting

As organizations report and disclose more ESG information, they should expect to face more questions around the depth and reliability of their disclosures, risk exposure and resilience, as well as concerns over so-called "greenwashing." To build trust, companies should ensure that their sustainability reporting has robust processes and controls with a supporting audit trail, similar to what exists for financial reporting.

Companies should begin focusing on audit preparedness as a means of building stakeholder confidence and complying with expected regulatory obligations. The European Commission's proposed CSRD will, for example, require large companies to seek limited assurance around their reported sustainability information from either their statutory auditor or an independent assurance services provider.

Integrate the finance function

A company can only deliver value to all its stakeholders when it draws on the skills and input of the entire organization, under the shared vision of leadership. Finance can play a key role in this collective effort by engaging with, understanding and connecting the requirements of stakeholders — particularly investors — and translating those into relevant and material metrics and disclosures.

Reporting must be trusted, credible and relevant to stakeholders and make a clear link between financial and nonfinancial information.[60] CFOs and financial controllers can instill discipline into nonfinancial reporting processes and controls, based on their experience and knowledge of leading practices to support sustainability and ESG reporting. The finance function can help to establish effective governance and obtain independent assurance over nonfinancial processes, controls and data outputs — vital to building trust and transparency with stakeholders.

Contribute to the standard setting process

Many of the world's leading companies have acknowledged that ESG issues are critical to sustainable development and have embedded those issues into their strategy for long-term value creation. These companies see an opportunity to be part of the process, learn from experience and not wait for regulators to mandate disclosures.

Through disclosing, companies can increase their credibility in the standard setting discussions. This is seen through the collective action of almost 80 companies committing to report on the WEF IBC metrics[61] — reducing fragmentation in reporting their contributions to long-term value and the UN SDGs. They are sending a powerful message that the private sector is ready to engage on these issues at the highest levels.

Abbreviations

CBAM: Carbon Border Adjustment Mechanism

CDSB: Climate Disclosure Standards Board

COP26: 2021 United Nations Climate Change Conference

CSRC: China Securities Regulatory Commission

CSRD: Corporate Sustainability Reporting Directive

EFRAG: European Financial Reporting Advisory Group

ESG: Environmental, social and corporate governance

FSB: Financial Stability Board

GRI: Global Reporting Initiative

IOSCO: International Organization of Securities Commissions

NFRD: EU's Non-Financial Reporting Directive

PRI: Principles for Responsible Investment

SASB: Sustainability Accounting Standards Board

ISSB: International Sustainability Standards Board

SEC: US Securities and Exchange Commission

TCFD: Task Force on Climate-related Financial Disclosures

UNGPs: UN Guiding Principles on Business and Human Rights

WBCSD: World Business Council for Sustainable Development

WEF IBC: World Economic Forum International Business Council

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About this report

Oxford Analytica worked in close collaboration with EY teams to produce a report on the future of sustainability reporting standards and how companies can prepare for emerging sustainability reporting requirements. Oxford Analytica's in-house team drew on insights from its worldwide network of experts; interviews with thought leaders across the policymaking, business and civil society sectors; and workshops with EY leaders and subject-matter professionals.

Oxford Analytica, part of FiscalNote, is a geopolitical analysis and advisory firm that draws on a worldwide network of experts to advise its clients on their strategies, operations, policies and investments. Oxford Analytica's trusted insights and seasoned judgements on global issues enable its clients to navigate complex markets where the nexus of politics and economics, business and society is critical to success. Founded in 1975, Oxford Analytica is the pioneer of geopolitical risk analysis, and today works with the world's most influential businesses, governments and international organizations.

Endnotes

1. The "Group of Five" are CDP (formerly, the Carbon Disclosure Project), the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB). SASB and IIRC merged in June 2021 to create the Value Reporting Foundation.
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5. There can also be intragroup competition within the respective category of stakeholder influence, e.g., the investment community could, at times, be at odds with the corporate community.
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