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Environmental Finance

Should non-financial reporting frameworks be harmonised?

08 August 2018

There is a baffling array of sustainability-focused reporting frameworks and standards. Would it be beneficial to bring them into alignment, asks **Elena Johansson**.

Hopes are high that sustainability or non-financial reporting can transform unsustainable business models of companies by disclosing material environmental, social, and governance (ESG) information. When disclosed, ESG data can harm or boost a company's reputation and influence investors in their allocation of capital. But, to date, these reports have been largely supplements to a company’s mainstream financial reporting without managing to be fully integrated or gain equal footing.

John Elkington, a world authority on corporate responsibility and sustainable development who has coined the term “the triple bottom line”, argued that a fundamental reform in company reporting is urgently needed in a recent speech:

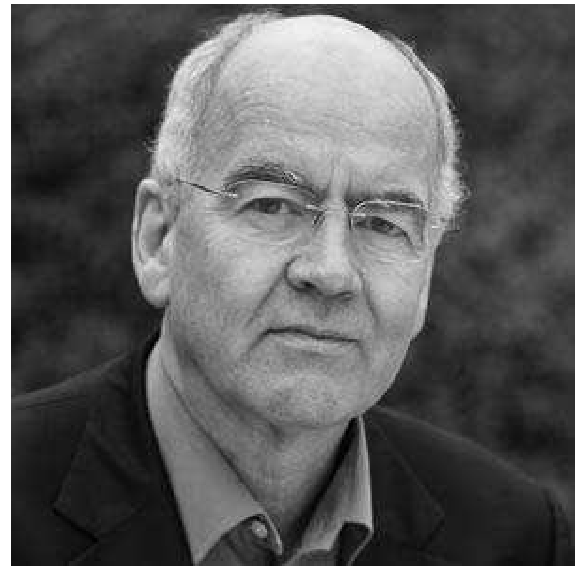
"It's almost as if there was a commercial airliner, and we are headed full speed towards a very big mountain. If you look at the dashboard, if you look at the dials in the cockpit, it's clear that we've got enough fuel; we are going at the right sort of speed; the temperature in the cabin is wonderful; the food is being served—all that sort of stuff—the audio system is working quite nicely, but we are still headed for that mountain.

"And most of the reporting that we do doesn't take that mountain [climate change and a range of other sustainability issues] properly into account."

ESG data complexity

ESG information is being increasingly disclosed by corporates. The Reporting Exchange, an initiative by the World Business Council for Sustainable Development (WBCSD), which represents over 200 leading businesses, wrote in a study on ESG reporting trends: "Regulators are putting an increasing emphasis on disclosure through mainstream and sustainability reports, which may help make ESG risks and opportunities a common factor in decision-making for mainstream investors."

Although not required in mainstream reports, the EU has made disclosure of certain ESG data mandatory for large companies through the Non-Financial Reporting Directive.


John Elkington

There is also a growing drive for climate data specifically. Initiatives like the Task Force on Climate-related Financial Disclosures (TCFD) are seeking to trigger environmentally-related information disclosure from companies to avert financial stability risks.

The various existing frameworks, however, lack common standards or metrics, which hampers their usefulness for investors.

The Reporting Exchange study found that "there are currently over 1,000 reporting requirements for sustainability information, [...], which are accompanied by around 750 reporting and management resources". The expansion of sustainability reporting, it says, "has led to confusion, repetition and multiplicity, making it less effective".

Internationally used frameworks—like Integrated Reporting (IR), Global Reporting Initiative (GRI), CDP (formerly the Carbon Disclosure Project), Climate Disclosure Standards Board (CDSB)—differ in terms of their function, breadth and depth of sustainability reporting.

Jacob Messina, head of sustainability investing research at RobecoSAM, explains that responsible investors face "great challenges and invest significant resources into making good sense of the [ESG] data that is available", an undertaking that mainstream investors would not be willing to take on.

"Mainstream investors", he explains, "are used to comparable data sets that follow rigid standards like the FRS [Financial Reporting Standards] where there is sometimes differentiation, but then there is guidance as to how to convert one into the other, how to adjust for these variations."

Messina, like many investors, calls for an alignment of sustainability frameworks. But one of the barriers, he says, is that standard-setting NGOs have different motivations. They are committed to their methodologies in which they have invested vast resources. They see those methodologies as

intellectual property in need of protection, and have a desire to please their stakeholders, which may hinder their willingness to adapt their frameworks.

An anonymous source went a step further, by telling *Environmental Finance* that another reason for NGOs not aligning their frameworks was that they were defending their work to avoid the risk of becoming obsolete.

CRD harmonisation plans

The Corporate Reporting Dialogue (CRD) was set up in 2014 by the International Integrated Reporting Council (IIRC), the body that established the International Integrated Reporting (IR) Framework. The CRD promotes greater coherence, consistency and comparability between corporate reporting frameworks, standards and related requirements relevant to Integrated Reporting.

Its member organisations are CDP, CDSB, FASB (Financial Accounting Standards Board), GRI, IFRS (International Financial Reporting Standards), IR, ISO (International Organisation for Standardisation), and SASB (Sustainability Accounting Standards Board).

Tony Rooke, technical director global environmental reporting system at CDP, explains that momentum for alignment has built with the release of the TCFD recommendations last year and increasing stakeholder pressure from investors and companies.

Richard Howitt, CEO of IIRC, said: “In the second half of this year, we [the CRD] hope to announce a major three-year project where those frameworks will align on a large number of metrics, starting with the metrics of the TCFD.”

He called it “a big sign to the market” that harmonisation of reporting standards is underway.

Richard Howitt, IIRC

Rooke explains that this will be the first “concerted systemic effort” to align the frameworks, wherever it is sensible and feasible. “Our goal is to try, and wherever possible, over the three-year project, to bring about a state in which the preparers of data can report the same things, the same metrics, in the same way to each of the frameworks,” he says.

Overarching frameworks and principles will help the drive towards harmonisation: the TCFD’s disclosure guidance, the IR’s value creation through multi-capital thinking, and the CRD’s common founding principle of materiality.

To achieve a full harmonisation of frameworks, however, a common understanding needs to be established of which information is material to a company’s business and therefore requires disclosure. Materiality definitions differ depending on: the purpose of the framework, whether their timeframe is short-term or long-term, the geography covered, and the type of stakeholders it serves (e.g. single, multi-stakeholder, or society more broadly).

But Howitt does not believe that materiality definitions can be fully harmonised because sustainability reporting frameworks speak to different audiences.

He says, however, that “each of the [CRD’s member] frameworks has agreed to use that [CRD’s materiality] principle in their next iteration.

“We are going to bring those materiality definitions closer to each other without saying that they can be exactly the same,” he says.

Differences of reporting frameworks

Some argue that a full alignment of reporting frameworks is not needed. As different reporting frameworks have the ability to disclose different types of ESG information, alignment could have detrimental effects on meaningful disclosure.

Tjeerd Krumpelman, head of advisory, reporting & engagement at Dutch bank ABN Amro, doesn’t believe that there is a single framework that can accommodate all business and stakeholder needs.

He suggests an approach that starts with companies using integrated thinking and the materiality definition of the IIRC as a starting point.

“If you start with the overall concept of an integrated report—depending on your stakeholders, audience and business—you can work with different additional frameworks or reports to serve the stakeholder needs,” he argues.

Investors could then push for alignment with a particular sustainability reporting framework within each industry or sector in order to generate comparability of data.

“And if the data is really material, then it would make sense for that company to use a framework that their investors identify with and that can be compared with other companies in a similar sector, and from that it follows [that] it will probably make sense to use [a framework like] SASB or GRI,” he argues.

If, for example, carbon emissions are material for high-carbon industries, investors could drive the alignment to a carbon-specific framework for these industries.

Reporting 3.0

Supporters of another school of thought call, like Elkington, for a more drastic overhaul of sustainability reporting.

Ralph Thurm, managing director at Reporting 3.0, says: “If we are really going to move the needle, if we are really going to drive systemic change, we’ve got to integrate [natural capital] with a different [level of] rigour.”

Reporting 3.0 is a "collaboration space" for stakeholders, and a catalyst for extensive collaborative research and innovation into the next generation of reporting, aiming to spur the emergence of a regenerative and inclusive global economy.

In his opinion, the meaning of sustainable development—as it was defined in the Brundtland report as “intergenerational equity”—has been lost. The 1987 report by the World Commission on Environment and Development (WCED) introduced the concept of sustainable development and described how it could be achieved. It defined sustainable development as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs”.

Thurm continues: “What has happened in these 31 years is that we have degenerated that original concept. What was ‘people, planet and prosperity’, focusing on the wellbeing of humans in a resource-constrained world, has degenerated to ‘people, planet and profit’”.

In his view, concepts like ESG, the Sustainable Development Goals or sustainability rankings of best-in-class companies seek sustainability but, in reality, are lacking fundamental elements to achieve it.

Company performance has to be put into context of thresholds and allocations, and has to be measured with tools, such as the science-based targets, he argues.

As an example Thurm takes a company with a site in a watershed. To be truly sustainable, he says, the company needs to stay within its allocation of the set threshold and fulfil its duties and obligations to its ‘rightsholders’, defined as those who have a ‘right to know’: “The threshold is calculated based on the amount of water that the watershed can replenish per year, and the allocation is the fair share the company can use in relation to the yearly water replenishment, taking into account all other ‘rightsholders’ in the same watershed”.

As long as such thresholds and allocations are ignored, the financial sector is acting more “as part of the problem” than “as part of the solution”, Thurm argues.

Initiatives to create such targets already exist. CDP is already working on a “context-based water target”.

“There is a growing momentum to look at whether we could have similar targets, like the science-based target, for other parts of ESG as well,” Rooke says.

The scope of standards or frameworks through the lens of <IR>

Initiative	Financial capital	Manufactured capital	Intellectual capital	Human capital	Social and relationship capital	Natural capital
CDP						●
CDSB						●
FASB Accounting Standards	●	◖	◖	◖		◖
GRI Sustainability Reporting Standards				●	●	●

The scope of standards or frameworks through the lens of <IR>

Initiative	Financial capital	Manufactured capital	Intellectual capital	Human capital	Social and relationship capital	Natural capital
International Financial Reporting Standards	●	◖	◖	◖		◖
ISO 26000 - Social responsibility			◖	●	●	●
SASB				●	●	●

● Full coverage. ◖ Partial coverage

Source: Corporate Reporting Dialogue, Navigating the corporate reporting landscape, accessed 07 August 2018

An overview of the main sustainability reporting frameworks and standards

CDP (formerly the Carbon Disclosure Project)*

- **Purpose**
  - Use the power of information disclosure to drive organisations to measure, manage and reduce their impact on the environment and build resilience, while providing high quality information to the market.
- **Desired outcome**
  - Capital is efficiently allocated to create long-term prosperity, rather than short-term gain at the expense of the environment. Dangerous climate change is prevented and natural resources are protected.
- **Recent updates**
  - Inclusion of TCFD recommendations, including scenario analysis
  - Increased emphasis on forward looking metrics
  - Sector-based disclosure to align with other frameworks

CDSB (Climate Disclosure Standards Board)*

- **Purpose**
  - Help organisations prepare and present environmental information in mainstream reports to provide consistent, comparable, clear and decision-useful information for

investors

- **Desired outcome**
    - Build the trust and transparency needed to foster resilient capital markets. Create sustainable economic, social and environmental systems
- **Recent updates**
    - Aligned with the recommendations of the TCFD and 20 other mainstream reporting provisions

FASB (Financial Accounting Standards Board)*

- **Purpose**
    - Establish and improve standards of financial accounting and reporting that foster financial reporting by non-governmental entities to provide decision-useful information to investors and other users of financial reports
- **Desired outcome**
    - Promoting financial reporting that accurately and neutrally reflects economic activity and promotes the efficiency of capital markets. Establish a reference point and benchmark by which other standard setters may judge the quality of their own work.
- **Recent updates**
    - FASB met with the International Accounting Standards Board (IASB) in London in June 2018, which is the first first joint meeting since 2016 to discuss topics of mutual interest

GRI (Global Reporting Initiative)*

- **Purpose**
    - Enabling all organisations – regardless of size, sector or location – to report the sustainability information that matters
- **Desired outcome**
    - A sustainable global economy that combines long-term profitability with ethical behaviour, social justice and environmental care
- **Recent updates**
    - G4 guidelines transitioned to the Sustainability Reporting Standards (GRI Standards) in July 2018

IFRS (International Financial Reporting Standards)

- **Purpose**
    - Provide high quality, transparent and comparable information for investors, provide capital markets with a common language for financial reporting, promote capital market stability through transparent financial reporting and promote consistent application of standards
- **Desired outcome**
    - To develop IFRS Standards that bring transparency, accountability and efficiency to financial markets around the world. Serve the public interest by fostering trust, growth and long-term financial stability in the global economy
- **Recent updates**
    - The process of updating the IFRS Practice Statement 1 Management Commentary has begun. It considers how broader financial reporting could complement and support IFRS financial statements, including insights into a company's strategy for creating

shareholder value over time by, for example, forward-looking financial statements and non-financial information

IIRC (International Integrated Reporting Council)*

- **Purpose**
  - Help organisations explain to providers of financial capital how they create value over time
- **Desired outcome**
  - Efficient and productive capital allocation and financial stability and sustainability
- **Recent updates**
  - IIRC and Reporting 3.0 announced a collaboration on a new 'White Paper' on multi-capitalism

ISO 26000 – Social responsibility (International Organisation for Standardisation)*

- **Purpose**
  - Provide guidance on how businesses and organisations can operate in a socially responsible way
- **Desired outcome**
  - To support innovation and provide solutions to global challenges by gathering experts to share knowledge and develop voluntary, consensus-based, market-relevant International Standards. Ensure quality, safety and efficiency through International Standards giving specifications for products, services and systems and facilitate international trade
- **Recent updates**
  - n/a

PRI (Principles for Responsible Investment)

- **Purpose**
  - The PRI's goals are to understand the investment implications of environmental, social and governance issues and to support signatories in integrating these issues into investment and ownership decisions
- **Desired outcome**
  - By encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation, the PRI will work to achieve a sustainable global financial system and benefit the environment and society as a whole
- **Recent updates**
  - PRI has committed to align its reporting framework with the TCFD recommendations over several reporting cycles

SASB (Sustainability Accounting Standards Board)*

- **Purpose**
  - Help public corporations disclose material sustainability information in mandatory SEC filings, such as the Form 10-K and 20-F
- **Desired outcome**

    - Decisions that increase long-term value and improve sustainability outcomes. More useful information for investors and improved corporate performance on those environmental, social and governance issues most likely to affect value
- **Recent updates**
    - It is in the process of updating its standards. Codification of its framework planned for the coming months

**part of the planned harmonisation project of the Corporate Reporting Dialogue*

Sources:

The Association of Chartered Certified Accountants (2016), Mapping the sustainability reporting landscape, accessed 07 August 2018;

Corporate Reporting Dialogue, Navigating the corporate reporting landscape, accessed 07 August 2018

Some of the information has been gathered from organisations' websites.