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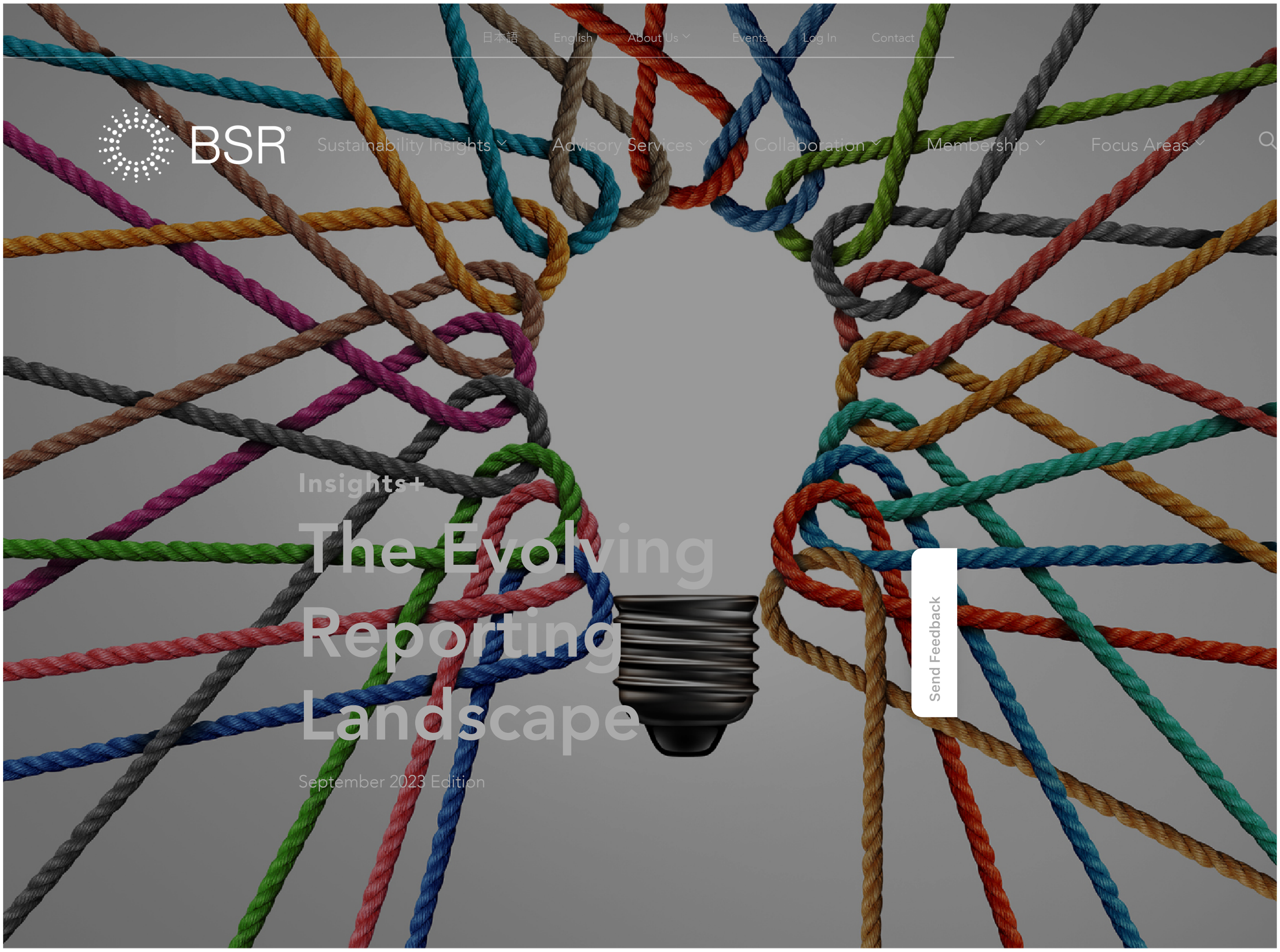

Insights+

The Evolving Reporting Landscape

September 2023 Edition

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Insights+ provides insights and foresight that empower the CSO to be a strategic C-Suite advisor by crystallizing emerging and cross-cutting sustainability issues, enabling companies to elevate their strategic ambition and achieve tangible progress toward a more just and sustainable world.

In this fourth edition of the Insights+, the Future of Reporting team highlights the latest developments in sustainability reporting, explores the implications of these developments across specific business functions, and hints at what might be around the corner.

What Business Leaders Need to Know

Executive Summary

Sustainability reporting has been a necessary but insufficient feature of just and sustainable business for over thirty years. Necessary, because stakeholders should be able to make informed decisions based on a company's sustainability practices. Insufficient, because reporting is not performance improvement.

BSR has always held the view that effective sustainability reporting will contribute to performance improvement across all areas of just and sustainable business. Time and again, we have witnessed firsthand how the prioritization, goal setting, and scrutiny that accompanies sustainability reporting helps drive transformation in companies, industries, and whole value chains.

For the past 30 years, this belief has been accompanied by an era of experimentation, proliferation, and fragmentation in reporting. This innovation has been a good thing, and many reporting standards that we take for granted today would not exist without it.

However, we are entering an important new era of alignment, harmonization, and regulation of reporting.

Alignment, because the various voluntary reporting initiatives and mandatory disclosure regulations are developing truly interoperable standards. Harmonization, because the various "hard law" efforts are directly referencing well-established "soft law" standards, such as the OECD Guidelines on Multinational Enterprises, UN Guiding Principles on Business and Human Rights, and Taskforce on Climate-related Financial Disclosures recommendations. Regulation, because so many disclosures that used to be pursued as a voluntary concern must now be pursued as a mandatory concern.

But this shift from the era of "experimentation, proliferation, and growth" into an era of "alignment, harmonization, and regulation" does not mean the end of innovation in reporting. On the contrary, it simply means moving from one era of innovation into a new one.

What we need now is innovation inside companies to turn these reporting standards into reporting practices that inform better decisions by all stakeholders and improved sustainability performance across all companies. This requires a conscious effort, significant investment, and new ways of doing business.

Our work isn't done because reporting is becoming mandatory; our work is simply entering an exciting new phase.

In this issue of BSR Insights+, we set out the latest developments in reporting, describe what this means for business, and hint at what might be next around the corner. We emphasize the role that many different functions inside companies will need to play in this new era and underscore the importance of reporting as a necessary feature across the whole agenda of just and sustainable business.

Chief Sustainability Officers and their teams have a once-in-a-generation opportunity to harness reporting as a positive, energizing, and meaningful vehicle for change. We look forward to working with many of you to seize this moment.

Latest Developments

A new wave of disclosure rules calls for reporting on a broader range of issues and regulations, which will align previously disparate yet complementary voluntary standards. The most recent European Sustainability Reporting Standards (ESRS), the International Financial Reporting Standards (IFRS) Foundation's inaugural sustainability disclosure standards, and pending rules from the US Securities and Exchange Commission (SEC) build on foundations set by the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), and the Task Force on Climate-Related Financial Disclosures (TCFD). The SEC's pending climate disclosure rule and similar mandates by other jurisdictions utilize the TCFD's recommendations and are also likely to align with the IFRS standards. These regulations and standards are not identical (which is unrealistic to expect), but they also do not appear to conflict with each other.

While some of these new rules are aimed at enabling investors to assess companies' exposure to—and management of—sustainability risks and opportunities, there also is increased recognition that the ways in which company activities impact the environment and society will eventually affect business. Even a company that is motivated only by minimum compliance with new regulations on mandatory climate disclosure (i.e., the SEC and other countries) will face increased pressure to closely monitor and report on their broader sustainability performance.

Across these developments, BSR has observed several key themes:

- **A Common Architecture Building on Voluntary Frameworks**: The ESRS and IFRS Standards share a common foundation; each draws on the four TCFD pillars. As such, they add accountability of governance and management to material issues, as well as strategy, risk management, and target-setting. They each feature a set of general requirements followed by topic-specific elements. The IFRS Standards reference the SASB, which acknowledges sector-specific considerations. European authorities (the European Financial Reporting Advisory Group, or EFRAG) are also developing sector-specific standards and standards for the 10,000+ non-EU companies that fall in scope of the Corporate Sustainability Reporting Directive (CSRD). The ESRS structure on general requirements, sector standards, and topical standards appears to match the GRI following their recent history of close cooperation.

- **Alignment of Materiality**: GRI focuses on impact materiality (a company's outward impacts on the world), while SASB and the IFRS Foundation focus on financial materiality (issues that impact business value). Recently, EFRAG formalized the concept of double materiality, and in doing so, has also embedded and directly referenced key human rights frameworks and OECD guidance for international companies. The definition of financial materiality continues to vary between regulations. However, the SEC's definition of materiality has never been the same as that of the IFRS Foundation (whose financial reporting standards are followed by 140+ jurisdictions).

- **Due Diligence to Understand Value Chain Impacts**: The materiality assessment of a negative impact is informed by the due diligence process defined in the international instruments of the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises. The ESRS, IFRS Standards, and draft SEC climate disclosure rule require reporting on impacts across the full value chain, both upstream in supply chains and downstream via product use. Disclosure extends beyond the limits of a company's financial boundaries. These reporting expectations align with actions required by the Corporate Sustainability Due Diligence Directive (CSDDD). They imply deeper supplier engagement (and engaging beyond Tier 1 suppliers) as well as significant new efforts and resources to better understand how business relationships affect society and the environment.

- **Coordinated Report Location and Timing**: The IFRS Foundation expects disclosure as part of general-purpose financial reporting but does not stipulate a specific location to avoid contradictory jurisdictional requirements. EU rules do not explicitly require that US companies report in the 10-K, but they mandate that sustainability statements are featured in a company's "management report" and that the statements are third party-assured. Most pending disclosure regulations expect that sustainability reporting is published with financials, which means parallel or joined-up drafting, audit, and approval timelines for sustainability and financial information.

- **Climate-First, Not Climate-Only**: Some companies may be focusing on climate data assurance as they await the US SEC rule which, once final, will build on and deepen guidance dating from 2010. But other SEC rules on cybersecurity and human capital are in the pipeline. Similarly, the IFRS Foundation is now setting its workplan for continued standards development on human rights, human capital, biodiversity, and ecosystem services. While the ESRS subjects all topical standards to the double materiality test, they are the most far-reaching at this point and span environmental, social, human rights, and governance. A partial exception is made for climate in the EU sustainability reporting standards, where companies that claim climate change is immaterial must publish a detailed statement that describes how they arrived at this conclusion.

- **Elevate Social Discourse**: BSR has noticed a shift in the language used in reporting regulations. The ESRS refers to an "adequate wage" for value chain workers as well as "fair remuneration" and "living wage" for a company's "own workforce." We can expect a description of the diversity policy as well. The ESRS also includes "just transition" impacts and increasingly seeks to bridge environmental and social disclosure topics. The ESRS, IFRS Standards, and draft SEC rule all emphasize the use of scenario analysis for assessing risks and opportunities. When considering financial materiality, the timeframe marks a departure from the shorter-term forecasts seen in a company's financial statements, which accounts for the extra time taken to assess impacts, risks, and opportunities prior to disclosure.

Business leaders would be wise to assess each dimension of impact (their outward impacts on the world stemming from operations and business relationships and how sustainability topics stand to affect business performance). The EU's double materiality approach requires disclosure on both.

Regardless of materiality dimension, topic, or even jurisdiction, the evolving reporting landscape will force closer coordination across functions within companies, a deeper understanding of sustainability impacts, and their relationship to the core business—whether financial or on society and the environment—with the same level of rigor, transparency, and management accountability as stakeholders have come to expect of financial reporting.

What Does This Mean for Business?

These developments carry considerable implications for specific business functions. The legal and finance teams, who were previously less involved in voluntary sustainability reporting, will need to help ensure compliance with the letter of the law. Sustainability teams will have to upskill their peers across departments, drive disclosure in line with the spirit of the law, and meet heightened expectations from key stakeholders, including customers, employees, investors, suppliers, and regulators.

The evolving regulations landscape will affect several key business functions:

- **Sustainability**: Now more than ever, sustainability teams are a central body that convenes with other key leadership functions, including Finance, Risk, Accounting, General Counsel, and Corporate Affairs. They play a critical role in driving an organization's ESG agenda, upskilling staff, and ensuring that efforts meet new regulatory requirements. Additionally, they will be expected to update materiality assessments in line with a "double" materiality methodology, lead or coordinate reporting gap analyses for compliance with the new standards, and foster cross-functional collaboration. This may involve conducting governance reviews and strengthening internal controls on ESG data.

- **Finance**: ESG data is now on par with financial data, complete with verification and approval from management. Finance teams (including internal audit and risk) should assess at a functional level how subject matter experts collect and validate datapoints, establish controls for these processes, enhance consistency and robustness as necessary, and consider how to align sustainability reporting timelines with financial reporting. The surge in assurance demand also risks exacerbating a skills gap in terms of internal audit capabilities and third-party validation alike; forward-looking CFOs would be wise to hire qualified talent or train existing audit staff as soon as possible.

- **Legal**: While regulators have historically received sustainability reporting, legal teams must now understand whether the company (or which entities) are in scope, when compliance obligations come into effect, and how they affect the language and location of disclosures. Legal teams should also seek to understand how sustainability vocabulary aligns with or diverges from other types of disclosure regulations (i.e., "materiality" definitions in US securities law versus EU requirements). It is critical to partner with the Finance team to understand the scope of audit and assurance. Similarly, it is vital to engage the Corporate Secretary to the Board to understand new board accountabilities on sustainability matters.

- **Procurement**: The push to disclose impacts across the value chain requires, at the very least, greater transparency among vendors and direct engagement with suppliers. Procurement teams will also need to collaborate with other departments and suppliers alike on due diligence processes to meet other pending regulations, such as the EU Corporate Sustainability Due Diligence Directive (CSDDD).

- **Board and C-Suite**: The incoming disclosure regulations imply changes to sustainability governance and oversight at board level. Boards and executives will need to expand their skills, establish accountability measures, and involve leadership in sustainability impact, risk, and opportunity identification, including assessment of potential future impacts through scenario planning and stakeholder engagement. Additionally, business leaders can review compensation practices to ensure that sustainability performance is incentivized from the top while staying in line with company strategy and business models.

- **IT**: As connectivity between sustainability and financial information increases, so should the systems that collate data and disclosures. To mitigate potential compliance burdens, businesses can align ESG management tools, reporting platforms (whether financial or sustainability), and core business systems.

- **Human Resources**: Understanding the scope and expectations of regional and national requirements is key, especially with respect to employee data, where collection expectations, abilities and sensitivities vary (e.g., diversity data in the EU, sexual orientation in regions where disclosing LGBTIQ+ status presents risks to employees). Adapting global approaches with national or regional norms and compliance regimes is imperative. Conducting pay equity assessments and preparing for additional transparency on internal practices will likewise be necessary for baseline compliance.

- **Marketing and Communications**: The regulations imply making disclosures in a management report. For US companies, this means increased alignment of corporate narrative with the 10-K, and potentially reduced storytelling, imagery, and case study callouts, which may be shifted elsewhere (i.e., to the website or other voluntary reports). How can companies complement "core" disclosures with "more" information that meets specific target audiences' information needs?

In light of all of this, business leaders would be well advised to establish cross-functional working groups and steering committees to guide both governance and management of sustainability (the two are not synonymous). Board level oversight and tone from the top are key. Business leaders also will need to designate clear roles and responsibilities at the working level and within business units to ensure collective management of material issues and uniform ways of work (e.g., metrics' calculation or estimation). BSR expects to see an increase in multi-vendor arrangements whereby law firms, audit firms, boutique consultancies and nonprofits collaborate to enable compliance within the evolving regulatory space.

Companies that already disclose against voluntary reporting standards are grappling with a lingering preparatory question: What should they do to with their current tables, indices, and processes? Those that report against GRI, SASB and the TCFD are best positioned for future regulations, as the TCFD provides a foundational architecture, while SASB/the IFRS Foundation and GRI each collaborated with EFRAG as they drafted the ESRS. Continuing to report—and deepen disclosure—against voluntary standards will smooth the transition toward a mandatory reporting environment.

Reporting regulations also raise questions on how companies can achieve both compliance and ambition at the same time. New requirements build on voluntary standards and help make the case for increased resources; however, it will be important for resources to fund compliance activities that advance sustainable business and capture the increased involvement of non-sustainability functions to enhance impact.

Given increased reporting rigor and liability concerns, some teams may need to make difficult trade-offs, such as how to allocate time and resources between reporting and performance improvement. It will be important to keep ambitions, goals, and targets for just and sustainable business as a central focus when investing in enhanced disclosure, and ask how reporting can be harnessed to support performance.

Voluntary disclosure today does not guarantee compliance tomorrow, and companies will need to address key strategic questions on when, where, and how to report. For example, a global US-headquartered company with EU subsidiaries in scope of the CSRD is faced with a quandary: Does the company disaggregate EU entities' data for the ESRS, report that first, and wait for the potentially less onerous standards for third-country undertakings that will apply to their global operations later? Or does the company report against the current ESRS early on a consolidated basis to mitigate having to tease out the EU entities' data? These questions carry direct implications for sustainability practitioners but can only be addressed through engagement and cooperation with a wider array of stakeholders

Emerging Issues

Compliance Burden Excludes Small- and Medium-Sized Enterprises from Supply Chains

- The President of Indonesia criticized the EU's landmark deforestation law, characterizing it as "discriminatory." This criticism centered on the challenges that smallholders encounter in complying with the reporting requirements, which restrict the importation of forest products.
- Buyers may gravitate toward bigger players who can check the compliance box but who may be less well placed to drive positive impacts within communities and ecosystems.
- Regulations intended to prevent harm place an unjust burden on the

global South, resulting in less diverse and resilient supply chains.

Greater Role for AI in Compliance and Assurance

- The resource and capability gaps created by an increased compliance burden are increasingly filled by AI applications, following uptake by legal services and management consultancies.
- Safeguards are lacking to ensure AI-based services, such as reviewing and verifying data against standards, have the capabilities required.

Coming Soon from BSR

The Human Rights team assesses the impact of AI in the healthcare industry.

Join BSR's Global Event Series: Beyond Growth: Reconciling Business and Earth System Boundaries.

A deep dive into the key issues on the agenda at COP28.

Our Experts

Our team consists of global experts across multiple focus areas, bringing a depth of experience and knowledge around upcoming regulatory requirements.

Adam Fishman

Sean McClellan

Nine Weijenborg

Christine Diamente

Associate Director, Transformation
New York

Associate, Technology Sectors
San Francisco

Manager, Transformation
Paris

Managing Director, Transformation
London

Let's talk about how BSR can help you to transform your business and achieve your sustainability goals.

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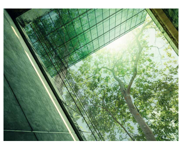

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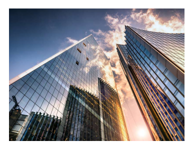
China's New Drive for Sustainable Consumption



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"And" May Be the Most Important Word

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Applying an ESG Lens to Crypto

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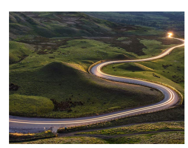
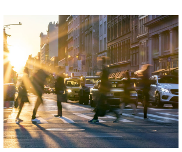


CASE STUDIES

Phoenix's Human Rights Journey: Designing a Human Rights Roadmap



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