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# THE DEVELOPMENT OF ESG REPORTING STANDARDS

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**Abstract:** The need for non-financial information from corporations has led to the development of many sustainability accounting frameworks, which aim to enhance the standardisation of environmental, social, and governance (ESG) information disclosure. With the use of these frameworks, investors may now evaluate the sustainability effect of capital allocation decisions with more consistency, accessibility, and ease of interpretation. Simple to gather and share data is, however, significantly less useful than information that has to be discovered through laborious procedures, thorough due diligence, working with subject-matter experts, and coincidental discoveries. Thus, ESG frameworks must make a challenging trade-off between standardised data, which is in high demand and can be obtained at a low cost, and the complex and esoteric data needed to serve as the foundation for strategies that can beat the market.

**Keywords:** ESG reporting, Triple bottom line (TBL), Carbon disclosure · Corporate sustainability strategy

## Introduction

A wide range of stakeholders, including investors, are advocating for more disclosure of non-financial information than what is presently included in financial statements. The UN Principles for Responsible Investment, which integrate environmental, social, and governance (ESG) factors into financial decision-making, are widely accepted by investors as having significant social and private value. Some, on the other hand, are more focused on achieving financial outperformance by pursuing ESG alpha. Furthermore, investor interest in more transparency on the effects of global climate change trends on business assets and supply networks has increased due to mild pressure from certain regulatory bodies to examine the risks of climate change and extreme weather on corporate balance sheets. Thus, there is a lot of interest in updating disclosure and accounting standards to track metrics of non-financial

performance and include an examination of the opportunities and hazards associated with climate change (Winchester, 2003).

Over the last 25 years, a variety of sustainability accounting frameworks have developed in order to organise and make consistent the range of non-financial information that may be provided. In order to assess how capital allocation decisions affect the natural and social environment, investors must have access to reliable, simply understood, and consistent ESG measures. To accomplish this objective, the creation of sustainable accounting systems that provide accuracy and interoperability is essential. Even the most basic steps in this approach have made it easier for money to go to funds associated with sustainable development and low-carbon ventures (Tett, 2020). However, information that is widely or easily known is frequently far less valuable than information that must be gleaned through laborious procedures, extensive due diligence, collaborations with subject-matter experts, and coincidental insights when asset managers incorporate deeper sustainability-related knowledge into their pursuit of outperformance. It might be asking too much to anticipate that openly accessible and transparent frameworks can supply the complex and esoteric data needed to serve as the foundation for long-term alpha isolation tactics. It is appropriate for investors to look for this kind of information, but they must look outside of the frameworks and standardised data sources (Bose & Simpson, 2019).

## Non-Financial Reporting Frameworks

A wide variety of frameworks include various typologies and classifications of sustainability-related elements. Upon reviewing the primary frameworks accessible to investors, it is evident that there is a great deal of cooperation among them, with minimal instances of duplication or inconsistency. They are often capable of being used in combination. All of them rely on the Triple Bottom Line as the fundamental conceptual framework that enables the inclusion of non-financial performance measurements in the assessment of business operations. This idea was first put forth by John Elkington, the world's foremost expert on sustainable development and corporate responsibility. Elkington claimed that businesses should gauge their success by looking at three "bottom lines": the financial "profit and loss" account, the social "people" account, and the environmental "planet" account. It's possible that the Triple Bottom Line is the most commonly acknowledged basis (Yates & Murphy, 2019).

The Global Reporting Initiative (GRI), established in 1997 by the UN Environment Programme, the Tellus Institute, and the Coalition for Environmentally Responsible Economies, is the most widely used example of a Triple Bottom Line framework for corporate reporting. Based on its fourth iteration of reporting rules, which were released in 2013, GRI introduced its sustainability reporting standards in 2016. The purpose of GRI standards is to provide guidance for the voluntary creation of sustainability reports, which are often released independently of regulatory filings. The GRI standards are frequently used for certain disclosures and do not conflict with any of the other frameworks on this list.

The "three P's" of the triple bottom line are profit, people, and the planet. These categories can help businesses understand their environmental responsibilities and identify any detrimental social effects they may be causing (Surowiecki, 2004).

**Triple Bottom Line framework**

From there, businesses may include sustainable practises into many facets of their operations, such as supply chains, business partners, and the use of renewable energy, to benefit the environment and society while still making a profit.

Profit- A company's ability to succeed in a capitalist economy mostly rests on how well it does financially, or how much profit it makes for its owners. Important corporate choices and strategic planning projects are often thoughtfully crafted to optimise earnings while lowering expenses and minimising risk. The only objectives of many businesses in the past have been expansion and economic effect. Purpose-driven executives are now realising that they can utilise their companies to change the world for the better without sacrificing profits. Adopting sustainable initiatives has been shown to be a key factor in corporate performance in several instances.

People- The influence a company has on society or its dedication to people is highlighted by the second part of the triple bottom line. Differentiating between a company's stakeholders and shareholders is crucial. Businesses have always valued shareholder value as a measure of their performance, which means they work to create value for the people who own their company's shares. Businesses are putting more of an emphasis on producing value for all parties affected by their actions, such as consumers, workers, and community members, as they embrace sustainability more and more. A few easy ways businesses can help people and future generations are by promoting volunteerism in the workplace and making sure that hiring practises are fair. To bring about change on a bigger scale, they might also turn their gaze outside. For example, several businesses have established fruitful strategic alliances includes charitable groups that are united by a same mission.

Planet- Having a beneficial influence on the environment is the third and last pillar of the triple bottom line. Climate change and environmental issues have been largely caused by the enormous pollution that huge firms have contributed to the environment since the beginning of the Industrial Revolution. According to an International Energy Agency assessment, 135 million tonnes of methane were emitted into the atmosphere by the worldwide energy sector in 2022. Businesses have traditionally been the main causes of climate change, but they also have the power to accelerate progress in this direction. A growing number of company executives are realising that this is their social duty. The biggest companies in the world aren't the only ones making this effort; almost any company can alter their operations to leave a smaller carbon imprint. Making changes like reducing energy use, using resources from ethical sources, and optimising shipping procedures are positive steps towards long-term sustainability.

**Importance of Triple Bottom Line approach**

Adopting a strategy that prioritises profit above mission, such as the triple bottom line, may sound utopian to others. On the other hand, creative businesses have consistently demonstrated that it is feasible to succeed while doing good. Impact on society and the environment is not intrinsically valued by the triple bottom line over financial prosperity. Instead, by committing to sustainable business practises, several companies have seen financial gains.

"There are many circumstances in which doing the right thing and making money at the same time is possible," explains Rebecca Henderson, a professor at Harvard Business School, in Sustainable Business Strategy. "There is, in fact, reason to believe that there are economic opportunities worth trillions of dollars in resolving the world's problems."

As an example, consider this: 50% of customers are ready to pay more for sustainable items, according to an IBM consumer research. Furthermore, at 44% of the market, purpose-driven consumers—those who select brands and goods based on how well they connect with their values—represent the largest sector.

In addition to assisting businesses in taking advantage of the expanding market for sustainable products, adopting sustainable business practises may draw in a lot of investment. Environmental, social, and governance (ESG) metrics are a third-party assessment of the triple bottom line that organisations employ internally. They hold them publically responsible for concentrating on more sustainable practises in addition to financial profit.
Evidence has proved over and again, according to Sustainable Business Strategy, that companies with promising ESG measures typically generate higher financial returns. Consequently, an increasing number of investors are now centering their investing decisions around ESG measures (Bose et al., 2019).

**Environment-Related Frameworks**

The Climate Disclosure Standards Board (CDSB), the Carbon Disclosure Protocol (CDP), and the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) are a few frameworks for climate-related indicators. It's important to distinguish between initiatives like the early Carbon Disclosure Protocol that measure the environmental impact of corporate activity and initiatives like the Task Force on Climaterelated Financial Disclosures that measure the impact of environmental and climatic changes on corporate financial performance and balance sheets. The former assesses how economic activity affects ecosystems as a whole, whereas the latter assesses how shifting ecosystems affect firms' financial prospects.
A group of 35 institutional investors came together to form the Carbon Disclosure Protocol (previously called the Carbon Disclosure Project), a non-profit organisation with headquarters in the United Kingdom that was established in 2000 with the goal of utilising corporate carbon

emissions data in the process of building portfolios.

The top publicly listed firms are sent questionnaires by the Carbon Disclosure Protocol (CDP) on carbon emissions from their supplier chains and activities. The replies are then compiled into a database that is accessible to subscribers and the general public. The longest-running series of business climate change disclosures is represented by this repository. Since 2002, it has made an effort to gather information on carbon emissions for every Financial Times Global 500 company and every S&P 500 company since 2006 (Mohin & Rogers, 2017).

With about $100 trillion in assets under management, 515 institutional investors made up the CDP's investor membership as of May 2020. It is quite probable that corporations who get questionnaires will reply given the amount of investor representation. Responses to a common questionnaire make up the majority of disclosures, hence response consistency is rather high. Because of this, academic research on the connection between environmental disclosure and financial success frequently uses CDP data. Since 2003, Matisoff et al. claim that the adoption of CDP reporting has greatly enhanced transparency for both Scope 1 emissions—which originate from an organization's direct activities—and Scope 2 emissions—which are the result of indirect emissions from the usage of power. The research did discover, however, that there is still a deficiency in openness with regard to Scope 3 emissions, which originate from product lifecycles, supply networks, and other indirect sources. Additionally, there is some indication that the carbon emissions disclosed by corporations in CDP surveys are more precise and comprehensive than those seen in traditional corporate sustainability reports.

**A Sustainability Reporting Framework Based on the Sustainable Development Goals**

The United Nations has followed a process of broadening the quantitative measurements of social and environmental performance, which culminated in the formulation of the Sustainable formulation Goals (SDGs) in 2015. This effort has occurred in tandem with investor ambitions to broaden performance metrics of firms. The 2015 Goals push for economic growth that strikes a balance between social and economic development and environmental sustainability, encouraging governments and commercial players to consider the triple bottom line of people, profit, and planet. Compared to the previous Millennium Development objectives (MDGs), the business sector was much more involved in the development of the Sustainable Development Goals (SDGs). Many commentators contend that the private sector can contribute innovation, responsiveness, efficiency, and specialised skills to the objectives' accomplishment, (Wiederhold, 2014).

Investors may have a major positive influence if they encourage corporations to work towards reaching SDG objectives. Theoretically, investor-driven capital allocation might assume greater responsibility for advancing global sustainable development in addition to generating

jobs and economic progress. In order to achieve this, the World Business Council for Sustainable Development, the UN Global Compact, and the Global Reporting Initiative (GRI) created the SDG Compass, which offers a five-step process for matching business strategies with the SDGs: (1) comprehending the SDGs; (2) defining priorities; (3) establishing goals; (4) integrating; and (5) reporting and communicating.

A list of 231 official indicators is kept up to date by the Statistics Division of the UN Department of Economic and Social Affairs, which tracks advancement towards the SDGs. Furthermore, the Compass has a list of indicators created by other institutions like the World Bank and GRI that correspond with particular SDGs. While the primary target market for SDG indicator information is not investors, the inclusion of the SDGs in financial products has proven to be popular. SDG-aligned investment vehicles and a number of SDG-linked bonds have been introduced.

**Some Distinctive Features of Frameworks**

The Sustainable Accounting Standards Board (SASB) and the Global Reporting Initiative (GRI) vary primarily in that the former prioritises a wide variety of stakeholders while the latter focuses primarily on investors. "Rather than being in competition, GRI and SASB are designed to fulfil different purposes for different audiences," the CEOs of GRI and SASB wrote in a joint essay from 2017. For businesses, it's about selecting the appropriate instrument for thetask (Estival & Pennycook, 2011). The recent release of GRI Standard 206 on Tax and Payments to Governments demonstrates how applicable it is to a wide spectrum of stakeholders. Wiederhold provides a thorough explanation of the various approaches for valuing intellectual property and transferring it to countries with lower tax rates, showing how multinational corporations can lawfully and significantly lower their tax obligations.
The GRI standard mandates that a global company reveal to the public, country by country, the taxes it has paid. Disclosure of this kind might deter aggressive tax evasion and drastically boost openness for taxing nations. Theoretically, tax evasion helps shareholders and certain accountants and tax advisers, but it hurts nearly all other stakeholders by negatively affecting the money available for social welfare and public infrastructure. Due to their substantial share of the externalities that are generated by unstable government funding, non-shareholder stakeholders have a collective interest to reduce the negative consequences of active tax evasion. The fact that no tax transparency requirement has been proposed by the shareholder-focused accounting standards (SASB and IIRRC) to date may not be a coincidence.

In the long run, it is not in the investor's best interest to disregard signs of future pressure against tax-dodging practises, even though the investor may not care in the near term if a corporation actively avoids taxes.Knowledge is what attracts investors. Investors should be aware of information meant for otherstakeholders. For the investor who is concerned with the long-term sustainability of return, then, GRI standard disclosures may be just as pertinent as

more focused SASB disclosures.

**Concept of Materiality**

SASB distinguishes itself apart from previous frameworks by stating that it is working to codify materiality. According to research, business managers' attention to important concerns by industry makes their sustainability investments more valuable. But in a world of disruptive change, classifying certain topics as unimportant and others as crucial by a laborious and sporadic process of standard-setting will lead to an incorrect determination of materiality. For instance, despite a wealth of evidence to the contrary, SASB concluded in its Materiality Map that corporate ethical concerns are unlikely to be substantial for the technology and communications industry (Cho,2017).

Likewise, an asset manager may be blown startled to discover that the SASB does not view client privacy or data security as significant sustainability concerns for the asset management sector. Customer privacy is not a substantial concern for commercial banks according to SASB; data security is. Commercial bank and credit card business Capital One said in 2019 that a hacker had obtained data on 100 million Americans and 6 million Canadians.49 Although it was obvious that there was a data security problem, client privacy was also negatively impacted. When comparing portfolio holdings in Capital One with those of its rivals, an investor would probably want to investigate the company's procedures for safeguarding consumer privacy.

**Analysis of Incrementably Changing Climate Scenarios**

The goal of both SASB and GRI is to provide cross-company comparability for stated key performance metrics. There is less emphasis on cross-issuer comparability in the context of TCFD. Users of climate-related financial disclosures, according to the TCFD, demand that businesses offer more information on the possible financial effect of climate-related challenges on their business prospects (Pavoni,2020). Report preparers are advised by 51 TCFD to do scenario analysis; however, at this time, there is very no consensus on the dimensions and underlying assumptions of these scenarios. There are no "standard scenarios" that include climate change impacts at the local scale, drivers of business performance related to climate change, and parameters of climate change uncertainty related to business planning assumptions, despite the fact that the International Energy Agency (IEA) and the Intergovernmental Panel on Climate Change (IPCC) have developed policy-relevant scenario descriptions.

This drastically limits the value of TCFD-recommended disclosures for investors by making it hard to compare such disclosures across firms. In terms of GRI or SASB standards, the TCFD cannot be regarded as such. Businesses reporting under this framework still find it much too

simple to take into account unique climate risks that investors aren't fully informed about and then determine that their business models can withstand those risks. For instance, all four of the illustrative firm reports that are featured in the most recent status report from TCFD state that their strategies are "robust" or "resilient" to climate threats (McElroy, 2017).

What Happens Next in the Development of Frameworks?

Although issuer-level sustainability indicators can help investors make better capital allocation decisions, they also offer significant success measures and intermediate milestones for a wider group of stakeholders that are committed to universal sustainable development. A wide range of information about our complicated environment may be condensed into information that isdecision-relevant, policy-applicable, and succinct using quantitative measurements of sustainability.Several structural frameworks that restrict and classify the space of metrics have been discussed. In the near future, there is a chance that frameworks may come together, even if the investor-focused and stakeholder-focused strategies have different goals.
It is still improbable that the supply of ESG information would ever be dominated by a single worldwide standard, like the one for screw threads or container sizes.

Today, it is evident that the Sustainability Accounting Standards Board (SASB) is not as frequently used as the Global Reporting Initiative (GRI). The investor-focused approach of SASB will definitely make it more difficult to achieve the kind of widespread credibility that a stakeholder-focused project like GRI can hope to achieve. Furthermore, the U.S.-centric aspect of SASB's strategy may lose its worldwide appeal if the geopolitical tensions between the United States and its allies vs. China and Russia that were seen in the wake of the coronavirus outbreak continue. However, as previously already mentioned, each of the frameworks mentioned has its unique focus (Khan et al.,2016).

The variety of frameworks and indicators may present opportunities or challenges to investors. The value of varied approaches and experimentation to capturing value through security selection is highlighted by the diversity of investor goals and the cloud of incomplete information, despite the lamentation of some regarding the lack of standardisation in frameworks and the ensuing latitude in the measurement of sustainability performance. Since the public's perception of sustainability is always changing, frameworks and composite sustainability indices must be flexible and evolve.
Because investor incentives are so varied, there is still a need for both complex, esoteric, and difficult-to-understand information and for simpler, more standardised frameworks.

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