Sustainability Reporting Standards: Will they nail it or fail it?

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By Mariana López Dávila

Sustainability reporting is a tool for companies to communicate their progress and plans for creating social and environmental value. It also creates accountability vis-a-vis stakeholders such as employees, investors, civil society, regulators, customers, etc.

Over the past decades, sustainability reporting has developed quickly as corporations are increasingly accepting that sustainability-related strategies are necessary to be competitive – from gaining business to attracting capital and employees.

The theory behind sustainability reporting is that if companies measure and publicly report their sustainability performance, it can lead to improved sustainability performance (because what gets measured gets managed), investors favouring companies with strong performance (putting pressure on weak performers), and a more accurate understanding on the impacts companies have on people and the planet (allowing other stakeholders to use this data).

However, sustainability reporting has not brought about the positive change it could. This is because the way companies are measuring and reporting their sustainability performance is nonstandard, incomplete, imprecise, and often misleading.

As a result, information about sustainability performance is not useful to investors, governments, NGOs, and even to the companies themselves. A key solution to this problem is to standardise sustainability reporting to ensure the quality, comparability, accuracy, and verification of sustainability disclosures.

Fortunately, the need for standardizing sustainability reporting has been acknowledged both at the international and European levels.
At the International level, the International Sustainability Standards Board (ISSB), which is part of the International Financial Reporting Standards (IFRS) Foundation, is currently developing new reporting standards that aim to establish a global baseline of sustainability disclosure requirements.

At the EU level, the European Commission mandated the European Financial Reporting Expert Group (EFRAG) to develop European Sustainability Reporting Standards (ESRS) as part of the updated Corporate Sustainability Reporting Directive (CSRD).

This summer, both ISSB and EFRAG published their first set of draft standards to gather input through public consultation. ECOS was actively involved in responding to both consultations. For the EFRAG’s ESRS, we paid special attention to the circular economy standard.

A brief overview: comparing ISSB and EFRAG Sustainability Reporting Standards

There are commonalities among the draft standards recently published by both organizations – the most notorious one being that both sets of standards are closely aligned with the Task Force on Climate-Related Financial Disclosures (TFCD) recommendations.

However, there are significant differences. Chief among them is the greater scope and scale of the EFRAG proposal, which includes a wider coverage of topical disclosures and a double materiality lens.

The concept of double materiality acknowledges that a company should report on both how environmental and social factors impact business value (financial materiality), and how business operations impact people and the planet (impact materiality). This concept emerged as corporations have started to move away from the thinking that their only raison d’être is to make profits, which is the reason why, until now, sustainability reporting only focused on financial materiality.
<table>
<thead>
<tr>
<th>Proposal Name</th>
<th>Sustainability Disclosure Standards</th>
<th>European Sustainability Reporting Standards (ESRS)</th>
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<tbody>
<tr>
<td>Drafting organization</td>
<td>ISSB, which is part of the International Financial Reporting Standards (IFRS) Foundation</td>
<td>EFRAG on behalf of the European Commission</td>
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| Coverage              | ISSB cannot enforce the use of their standards as they are an international organization. However, the ISSB goal is to apply its standards globally by becoming the basis for national legislation. | The ESRS will be mandatory for any company operating in the EU that meets 2 of the following 3 conditions:  
  - 40 million Euros in net annual turnover  
  - 20 million Euros in assets  
  - 250+ employees |
| Materiality           | Single: environmental and social issues that affect the company (financial materiality) | Double: environmental and social issues that affect the company (financial materiality) and impacts of the company on people and the planet (impact materiality) |
| Topics                | • General sustainability  
  • Environmental topics: climate | • General sustainability  
  • Environmental topics: climate, pollution, water, biodiversity, and circular economy  
  • Social topics: workforce, workers in the value chain, affected communities, and consumers  
  • Governance topics: governance, risk management, internal control, and business conduct  
  • 41 sector-specific standards |

Table 1 – Comparison of ISSB and EFRAG Sustainability Reporting Standards
## Our overall assessment

<table>
<thead>
<tr>
<th>ISSB Sustainability Disclosure Standards</th>
<th>EFRAG’s ESRS</th>
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<tbody>
<tr>
<td><strong>Nailing it</strong></td>
<td></td>
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<tr>
<td>✓ Entities have to report on relevant matters across the entire value chain</td>
<td>✓ Focus on double materiality</td>
</tr>
<tr>
<td>✓ High compatibility between ISSB and EFRAG</td>
<td>✓ Combination of cross-cutting, sector agnostic, and sector-specific standards</td>
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<tr>
<td>✓ Climate draft standard requires disclosures on scope 3 emissions</td>
<td>✓ Focus on the entire value chain</td>
</tr>
<tr>
<td>✓ Alignment with TCFD</td>
<td>✓ Business strategy and model linked</td>
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<td></td>
<td>✓ High compatibility between ISSB and EFRAG Climate draft standard – including requiring disclosures on scope 3 emissions</td>
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<td></td>
<td>✓ Alignment with TCFD</td>
</tr>
<tr>
<td><strong>Failing it</strong></td>
<td></td>
</tr>
<tr>
<td>X No clear guidance on third-party verification</td>
<td>X Overly complicated architecture. Draft standards are difficult to read and keep track of</td>
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<tr>
<td>X Single materiality focus</td>
<td>X Insufficient guidance on how to ensure a robust, science-based impact materiality assessment</td>
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<tr>
<td>X Insufficient guidance on how to conduct a robust financial materiality assessment</td>
<td>X Rebuttable presumption allows companies to define what issues are not material to them. There should be non-rebuttable disclosures</td>
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<tr>
<td>X No pre-set indicators for reporting</td>
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<tr>
<td>X Missing requirements for climate mitigation targets and transition plans in line with the 1.5°C goal of the Paris Agreement</td>
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<tr>
<td>X Lack of sustainability disclosures beyond climate</td>
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We have explained the points above in detail, along with specific recommendations, in two joint position papers co-authored with Climate and Company. See our remarks on the ISSB disclosure standards here and on the EFRAG ESRS Exposure Drafts here.

## Our views on the EFRAG Resource Use and Circular Economy Standard

It is important to begin by saying that this standard is the first effort of its kind, as there are no existing comprehensive disclosure standards on circular economy.

Although this effort is important and commendable, the current draft fails to fully and correctly reflect the concept and the most important elements of the circular economy.

The most critical issues of this draft standard are:

- Lack of explicit reference to the elimination of waste and pollution
- No reference to the need to minimise resource use
- Overdue focus on waste management
- Lack of emphasis on design for circularity
- No prioritisation of upstream circular strategies (repair) over downstream ones (recycle)
- Implies that the circular economy is about switching from non-renewable to renewable resources.
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We have described our most critical comments along with our recommendation on a joint position paper and in the form of a mark-up of the Exposure Draft which ECOS co-authored with the Ellen McArthur Foundation, Client Earth, Rethink Plastic alliance, and Dr. Sonja Enser. You can read our position paper here and the mark-up here.

Nailing it or failing it?

The ISSB and EFRAG draft standards represent an important step in the world of sustainability reporting. However, a lot of work needs to be done to ensure the standards nail it and create a harmonised reporting system that produces quality, comparable, accurate and useful sustainability performance data.

The ISSB needs to ensure its standards require companies to report impact data, go beyond climate, and incorporate climate-related disclosures that are sufficiently granular to be meaningful.

EFRAG needs to continue its great work to improve the overall architecture of its standards, expand its guidance to conduct robust and science-based materiality assessments, and accurately reflect the concept of the circular economy to help undertakings embed an understanding of the principles of the circular economy in their strategies.

The next steps

With the input from the public consultation, EFRAG will produce a final set of draft standards to be submitted to the European Commission by the end of September 2022. The Commission is expected to adopt the first set of standards in October 2022. Eligible companies will have to track their 2023 activities according to the ESRS and will be expected to report them in 2024.

In parallel, EFRAG is working on the second set of standards which will include: 41 sector-specific standards, standards for non-EU companies and listed SMEs, voluntary guidance for non-listed SMEs, and amendments to the first set of standards. The second set of standards is planned to be delivered between 2023 and 2025.

ISSB is also working with the input from the stakeholder consultation to deliver the new standards by the end of 2022.

ECOS will continue to follow the developments of these standards very closely to ensure their ambition level remains high and it’s raised where is not high enough.

Related resources:

- Comment letter on ISSB’s proposal on IFRS Sustainability Standards Exposure Drafts IFRS S1 and IFRS S2
- Civil Society Statement on the International Sustainability Standards Board
- Comment letter on the European Sustainability Reporting Standards – co-authored with Climate and Company
- Joint position paper on ESRS Exposure Draft 5: Resource use and circular economy
- ESRS E5 MarkUp by ECOS, EMF, ClientEarth and Dr. Sonja Enser.