Current Trends in European Sustainability Reporting Legislation

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Abstract

An increasing number of non-financial indicators and risks related to the social, environmental and governmental aspects of the activity have a significant impact on the global value of a company in last years. The purpose of this article is to be reviewed European sustainability reporting landscape and to carry out a critical analysis of the legislation of sustainability reporting, and on this basis the main problems and perspectives in its development to ne outlined. Our findings suggest that the creation of two parallel regimes for non-financial reporting will create further confusion among companies as to which standards to be applied.

Keywords: sustainability reporting, CSRD, NFRD, non-financial reporting, ESG reporting, EU legislation

JEL Code: M41, Q56, K20

Introduction

The dynamic business development in the last decade has faced new challenges for companies and imposed new requirements on them regarding the reported information about their activities. An increasing number of non-financial indicators and risks related to the social, environmental and governmental aspects of the activity have a significant impact on the global value of a company. The importance of sustainability reporting issues and increasing demands for rised transparency from investors and other stakeholders have been a driving force behind legislation in recent years. In addition to Europe, these issues have found their normative regulation in many countries around the world, incl. major economies like USA, China, Australia etc.

The purpose of this article is to be reviewed European sustainability reporting landscape and to carry out a critical analysis of the legislation of sustainability reporting, and on this basis the main problems and perspectives in its development to ne outlined.

The scope of the study includes the main legal acts regulating sustainability reporting, with special attention focused on the new Corporate Sustainability Reporting Directive (CSRD) and the sustainability reporting standards developed on its basis.

1. From voluntary to mandatory reporting and the role of Non-Financial Reporting Directive (NFRD).

The reporting of corporate information - financial and non-financial, often becomes a tool that can be considered as part of the overall management strategy of the management of the enterprise to reach a larger number of interested parties in order to announce in an appropriate way the results of the activity and the management of the enterprise. (Atanasov, 2019, p. 320) The need for the disclosure of non-financial (sustainability; ESG) information is increasingly associated with the inability of traditional financial reports to present a complete picture of the business due to the presence of a number of intangible advantages underlying modern business models , thus they cannot provide information about the complete enterprise value. In response to the mentioned shortcomings, the practices of voluntary disclosure of non-financial information by a number of large companies have arisen. This also gives impetus to the emergence and development of a number of frameworks and standards for reporting non-financial information, with the main directions being formed in the field of environment, social and governmental issues (so-called ESG factors). Of course, along with these basic issues in the scope of non-financial reporting are included topics abut the business model of the enterprise, human rights and gender equality, anti-corruption policies, etc., which along with traditional ESG factors today are united under one general term " sustainability reporting" .

The past ten years have seen a kind of invasion of different sustainability reporting practices in different forms, which has made this topic extremely relevant. In this regard, Brown et al. point out that there are more than 30 international frameworks for sustainable non-financial reporting are applicable worldwide. (Brown, 2009) With this variety of reporting and disclosure frameworks relating to non-financial (sustainability) information, very often businesses have difficulty determining which one to use to report the specifics of their operations. These frameworks differ in their purpose and some authors try to classify them according to their characteristics and evaluate them according to the dimension they focus on.

Table 1. Main initiatives for disclosure of sustainability information

Organization	Basic users	Form on provided information	Mainly content
GRI	Wide scope of interested countries	Report for the sustainable development	Construction on sustainable decisions through established standards and global network from interested countries
IIRC	The suppliers on financial capital	Integrated annual report *or* Independent report	Creation on integrated reporting and thinking within the framework on the general business practice as for the public, as well as for the private one sector
SASB	Investors in American public companies	SEK 10-K, 20-K	Create and improve on specific indicators by separate sectors on the economy for investors in the US
TCFD	Investors, Creditors, Financial Institutions	In the annual report	Better understanding of the concentrations of carbon-related assets in the financial sector and the financial system's exposures to climate-related risks. ISSB and EFRAG have completely integrated the TCFD Recommendations into their draft climate disclosure standards.
ISO	Management and external interested countries	ISO certification (ISO 26000:2012)	The standard declared responsibility on the organization for the impact on its decisions and activities on society and the environment environment through transparent and ethical behavior. Includes 7 main ones related topics with the social responsibility .

Source: Official websites of the mentioned organizations

The application of different standards and frameworks for non-financial reporting has even created a new professional jargon - the so-called "Alphabet Soup" , which has become a kind of description of the sea of abbreviations of used frameworks and standards. To this must be added the acronyms of a number of regulatory, certification bodies, industry-specific frameworks, ESG-

specific rating agencies and indices, etc., to make a complete description of the sustainability reporting landscape as in many cases the companies applying them do not even distinguish between these two key concepts - framework and standards for sustainability reporting. (Fig.1)

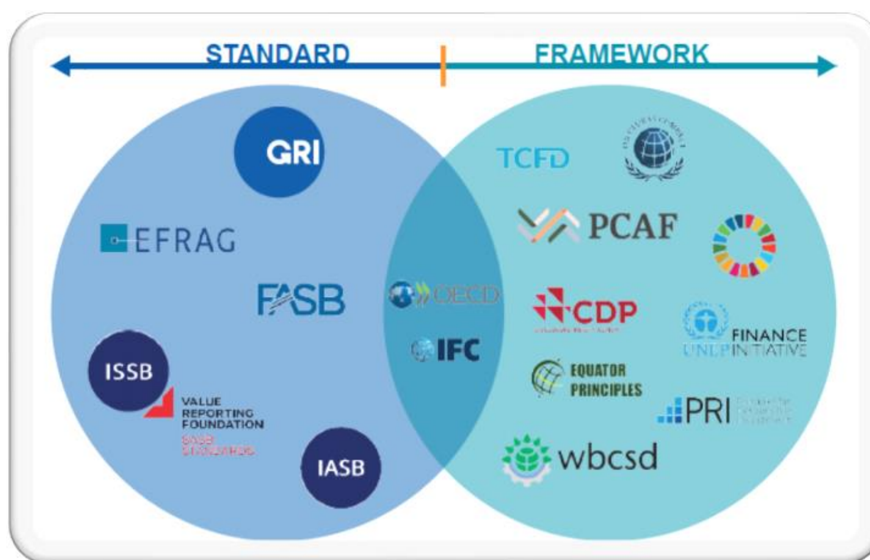

Figure 1. Frameworks and standards for sustainability reporting
Source: ESG standards, frameworks and everything in between[1]

These arguments give us reason to consider that the quality of disclosure is a determining factor for closing the information gap between companies and interested parties interested in quantitative-qualitative data. High-quality disclosures reduce information gaps and fully meet stakeholder requirements, both in terms of mandatory and voluntary disclosures - such as sustainability reports, social responsibility, etc.

According to early study of ACCA since 2013 (ACCA, 2013), 92% of the investors share the view that financial and non-financial information must be integrated which, according to them, is becoming a new business trend as most of the non-financial information can be disclosed together with the financial statements.

Meek et al. provide a definition of voluntary corporate disclosure as "disclosures in excess of requirements - represent a free choice by company management to provide accounting and other information deemed relevant to the decision-making of users of their annual reports". (Meek, et al., 1995) In fact, this definition reveals the essence of voluntary disclosure of corporate information—management's view of its usefulness to users. Therefore, it can be said that corporate disclosure is ultimately used by management as a mechanism to deal with market imperfections, thereby reducing the information asymmetry between managers and investors. However, corporate disclosure also addresses a company's internal need to properly disclose information to the investors about its performance, thereby reducing uncertainty for investors and, as a result, the cost of capital. (Lambert & Verrecchia, 2015).

The results of the KPMG Survey of Sustainability Reporting 2022, which covers 5,200 companies from 52 countries worldwide (KPMG, 2022) shows that 96% of G250 companies worldwide report on sustainability and ESG issues, with 64% of the same companies recognizing climate change as a risk to their business. Adoption of the TCFD (the Task Force on Climate-Related Financial Disclosures framework) has almost doubled over the past two years, rising from 37% to 61% among G250 companies, according to research data. These results unequivocally show that the large companies in different regions of the world are most interested in disclosing specific

[1] The GRI Perspective. ESG standards, frameworks and everything in between, Issue 4 - 10 March 2022, gri-perspective-esg-standards-frameworks.pdf (globalreporting.org), last seen 10.12.2022.

non-financial ESG information, as their activities are most dependent on various non-financial risks. The assessment of these risks is today the basis of even the future financial stability of companies and is no longer considered solely as a reputational risk.

The essence of the issues regarding sustainability reporting turns out to be a driving motive in the legislative regulation within the European Union. In 2014, the European Parliament and the Council of the European Union issued Directive 2014/95/EU regarding the disclosure of non-financial and diversity information by certain large undertakings and groups (the so-called NFRD). With this Directive, in practice, the Union has recognized the importance of the disclosure of sustainability-related information, such as social, environmental and governance factors, by businesses in order to identify sustainability risks and increase investor and consumer confidence. The rules laid down in the NFRD apply only to large public interest companies with more than 500 employees. This, according to the EU's own estimates, includes around 6,000 large companies and groups across the EU, including public companies, banks, insurance companies, other companies designated by national authorities as public interest enterprises, etc.

The deadline for transposition of the NFRD by Member States was 6 December 2016. Undertakings covered by the directive had to report for the first time in 2018 (for the financial year 2017). In 2017, in accordance with Article 2 of the NFRD , the Commission published guidelines on how companies to report non-financial information. In June 2019, under the Sustainable Finance Action Plan, the Commission published further guidance on reporting climate-related information (providing an explanation and on the prospect of double materiality with respect to climate-related information).

Directive 2014/95/EU requires companies to publish annual reports on the policies they implement on several key issues that fall within the scope of ESG (Environmental, Social and Governance) topics: (EU, 2022)

- ✓ environmental protection;
- ✓ social responsibility and attitude towards employees;
- ✓ respect for human rights;
- ✓ anti-corruption practices;
- ✓ diversity on company boards (in terms of age, gender, education and professional experience).

The Non-Financial Reporting Directive had two main tasks: *first* - to provide officially all interested parties with the necessary non-financial information about the business in order to show the way in which companies create value and to present a complete picture of the non-financial risks involved in the formation of corporate value; and *secondly* - to show to the society that ESG responsibility is an extremely important task.

The application of the Directive has also been transposed into Bulgaria national legislation with the introduction of the requirement to draw up a non-financial statement by a certain range of enterprises. The Accounting Act (Zakon za schetovodstvoto, 2021) (Art.43) defines the range of obligated parties who should include a non-financial statement in their activity report or as a stand-alone statement. To fall within this scope, an enterprise must meet three criteria:

a) the enterprise must be large within the meaning of the Accounting Act;

b) to be a public interest enterprise (POI) in accordance with the Additional Provisions of the Accounting Act;

c) to have a staff of more than 500 people.

It is assumed that the enterprise has fulfilled the requirements of the law if the activity report includes information and analysis that in a substantive aspect covers the content of the non-financial statement or if a separate report is prepared for the information required for the non-financial statement, provided that this report shall be published together with the report on the activity and shall be made public in accordance with the procedure specified in the law.

In addition to accounting legislation, it should be noted that certain companies have an obligation to disclose specific non-financial information to various regulatory bodies, which is

another proof of its importance.

Regarding the effects of the introduction of mandatory non-financial reporting Carmo and Rbeiro indicate that there is an increase in the quality of non-financial disclosures in the year of introduction of mandatory non-financial reporting compared to the previous year, and this conclusion is based on a study of public companies in six European countries. (Carmo & Ribeiro, 2022) At the same time, the authors point out that after two years of implementation of the NFRD there are still problems in its implementation. There are companies that do not indicate the non-financial reporting framework used or do not disclose information on sensitive issues such as human rights or the fight against corruption and bribery , indicating that the problems stem from both overly general provisions of the Directive and management's misunderstanding or reluctance to report specific non-financial information.

The lack of specific non-financial data makes published non-financial statements difficult to use. European study covering 1000 large companies from the EU shows that only 21.9% of the companies reveal their own non-financial KPIs in the published reports. (Alliance for Corporate Transparency, 2020, p. 11) The lack on such summarized information at 78 % of all companies significantly undermines the practical usability on their reports. Findings of gaps in mandatory non-financial reporting are noted by Stefanova et al . in the study Corporate Transparency Bulgaria 2021. (Stefanova, et al., 2021) The results show that the presentation of information is often done in an incomprehensible way, without the possibility of comparisons and without supporting the decision-making process. In addition, the number of companies that explain how they have chosen criteria for disclosing non-financial information, how they measure, evaluate and calculate their performance, and what reporting standards and guidelines they follow, is also decreasing.

Quite logically, the NFRD did not achieve the expected result, but it started a process that to this day seems irreversible. Three years after the adoption of the Directive, the so-called post implementation review was conducted. In this review a number of weaknesses were defined which can be distinguished in several main areas:

- Issues related to comparability, coverage, reliability of reported information. From *consumers* point of view - the majority of respondents believe that the non-financial information provided by companies is insufficient in terms of comparability (71%), reliability (60%) and relevance (57%). If these figures are applied only to those respondents who indicated that they are users of non-financial information, they are respectively 84%, 74% and 70%. From *preparers of non-financial statements* point of view - 43% of respondents believe that companies reporting under the NFRD face uncertainty and complexity when deciding what, where and how to report non-financial information. Regarding the scope of reporting, half of respondents believe that companies should be required to disclose non-financial information about intangible assets (i.e. resources without physical substance but with long-term value to the business, e.g. intellectual property, software and human capital). Most respondents agree that all reporting and disclosure legislation should be streamlined (67%), avoiding gaps (36%) and overlaps (29%).(European Parliamentary Research Service, 2021, pp. 4-5)
- Respondents expressed very strong support for requirement for companies to use a common reporting standards. In this context, most respondents support the development of simplified standards for SMEs. In their answers, 82% of the respondents (representing public bodies, large companies and environmental organizations) believe that requiring companies to use a common standard would solve the identified problems such as the lack of comparability, reliability and relevance of the information disclosed. Similarly, many respondents felt that the EU could play a leading role in promoting the creation of a unified set of international standards for non-financial disclosure. (European Parliamentary Research Service, 2021, p. 5)

- Strong support was expressed for the introduction of stricter audit requirements. A significant proportion of respondents (67%) support stricter requirements for auditing non-financial information. 51% of users indicated that they would prefer reasonable assurance, while the majority of drafters preferred the introduction of limited assurance (52%).
- Very strong support for digitization of non-financial information being reported. This, in turn, together with the requirement for an audit of the disclosed information, means that this information should be disclosed based on strict rules and established uniform standards.
- There is strong support for requiring companies to disclose their materiality assessment process.

The main weakness, in our view, is that Directive 2014/95/EU does not prescribe a mandatory format for disclosures, but provides businesses with considerable flexibility in disclosing the relevant information in the way they consider most useful. This in turn has allowed businesses to individually refer to international, European or national disclosure guidelines and frameworks in order to present what they determine to be relevant information, such as: the UN Global Compact, the OECD Guidelines for Multinational Enterprises, ISO 26000, IIRC, the GRI etc.

2. Current European legislation landscape – CSRD, EFRAG's ESRS, ISSB.

As a result of the post implementation review of the NFRD, in 2021 the EU initiated changes to the NFRD which has the aim to remove the main weaknesses identified. In April 2021, the European Commission made a proposal of Corporate Sustainability Reporting Directive (CSRD), which to replace NFRD. After a year and a half of consultation, on December 16, 2022 the Directive was published in the Official Journal of the EU as Directive 2022/2464 (EU). The new directive should support the European Green Deal, as a set of policy measures designed to combat the climate crisis by transforming the EU into a modern, resource-efficient and competitive economy with no net greenhouse gas emissions (GHG) by 2050. The CSRD is part of the Sustainable Finance Package of the EU, which supports the implementation of the Green Deal by helping to channel private investment in the transition to a climate-neutral economy.The package includes: (European Commission, 2021)

- *EU Taxonomy Climate Delegated Act* – its aim is to support sustainable investment (ie investment for sustainable development) by clarifying which economic activities contribute most to the fulfillment of the EU's environmental objectives;
- *Corporate Sustainability Reporting Directive (CSRD)* - it aims to improve the flow of information about the sustainability of enterprises. This directive will make companies' sustainability reporting more consistent so that all stakeholders can use comparable and reliable sustainability information;
- *Six delegated acts* which aim to ensure that financial sector companies include sustainability as a factor in their procedures and investment advice for clients.

According to the Taxonomy (classification of activities), already for the financial year 2021, enterprises that are of public interest (PIE) and with a staff of more than 500 people have obligations to disclose the so-called sustainable economic activities in the EU. In fulfillment of their obligations, preparers must report what proportion of turnover, capital expenditure and operating expenditure for the year is related to sustainable economic activities as they are described in the EU Taxonomy. In addition, businesses must be prepared for these disclosures and due to the fact that they must also report certain additional qualitative information. It is important at the beginning (for financial year 2021) that management reports only the general eligibility of their economic activity following the rules of the taxonomy (without a detailed analysis of whether their activity meets the detailed criteria in the taxonomy). This, in turn, will be the first step towards directing the so-called sustainable investments, which are defined as the investments of the future.

Regarding the change in the Directive, it should be pointed out that it is not only name

change and the replacement of the term "non-financial" with "sustainability information", but rather in the different understanding of corporate accountability on sustainability issues. This thesis is also advocated by Baumüller and Sopp, according to whom the change is dictated by the need and desire for a correct interpretation of the materiality principle laid down in the Non-Financial Reporting Directive. (Baumüller & Sopp, 2022). The changes are in several directions: (EU, 2022)

- In terms of scope: CSRD will be mandatory for all large companies and for all public companies (except micro - companies) that are subject to EU law or established in an EU Member State. The criteria for a large enterprise require it to meet at least two of the following criteria: a) Net sales revenue of EUR 40 million; b) EUR 20 million amount of the accounting balance (statement of the financial position); c) number of employees – 250 people. This represents a drastic change, with around 50,000 companies estimated to have an obligation to report, compared to the current 11,000 under the NFRD as estimated by the EU itself;
- The CSRD will be introduced for implementation in four stages:
  - From the start of financial year 2024 - for companies currently applying the NFRD
  - From the start of financial year 2025 - for large companies not currently applying the NFRD
  - From the beginning of the financial year 2026 - for registered SMEs (with the exception of micro-enterprises), small and non-complex credit institutions and captive insurance companies;
  - From the beginning of the financial year 2028 - for third-country enterprises with a net turnover of more than €150 million for each of the last two consecutive financial years in the EU, if they have at least one subsidiary or branch in the EU exceeding certain thresholds.
- A requirement is introduced for the application of the so-called "Non-European companies". Non-European companies with significant activity in the EU market (net turnover above €150 million in the EU at a consolidated level) and which have at least one subsidiary (major or registered) or branch (with net turnover above €40 million) in the EU are required to prepare a sustainability report at the consolidated level of the final third-country enterprise. It is indicated that the EU subsidiary or branch is responsible for publishing the sustainability report of the third country enterprise. In addition, the Directive will be mandatory for all credit and insurance institutions regardless of their legal form;
- CSRD requires the application of uniform European Sustainability Reporting Standards (ESRS) by all enterprises in the scope of the Directive. It is planned to review the standards every three years in order to harmonize them and eliminate gaps and inconsistencies. The information reported must comply with EU regulations, including the EU taxonomy, an EU-wide classification system that establishes a list of environmentally sustainable economic activities ;
- The new Directive requires companies to disclose how their sustainability strategies and operations are consistent with limiting global warming to 1.5°C and how they contribute to achieving the EU's climate targets. More sustainability-related information is expected to be disclosed than before about the company's business model, strategy and supply chains;
- The CSRD specifies that the sustainability report should include both prospective and retrospective information, as well as qualitative and quantitative information, including information on the existence of incentive schemes related to sustainability issues offered to members of administrative, management and supervisory bodies ;
- Companies in all sectors will disclose more in-depth information on how climate and society affect their own business on the one hand (risks and opportunities - an outside-in perspective) and on the impact that companies have on people and the environment ("inside-out" perspective) by applying the concept of the so-called "double materiality";
- It introduces the requirement for large enterprises and small and medium-sized enterprises,

with the exception of micro-enterprises, which are companies carrying out activities in the public interest, to disclose information about key intangible resources and give explanations about how the business model of the enterprise mainly depends on these resources and how these resources are a source of value creation for the enterprise. The specific here is that, in addition to the intangible resources recognized in the financial statements, companies must also disclose information about resources without physical substance, on which the business model of the enterprise mainly depends and which are a source of value creation for the enterprise, which are not recognized in the financial statements.

- Non-financial sustainability information will need to be disclosed in the management report instead of a separate sustainability report. It is believed that this will help to improve the integration of sustainability information (non-financial) and financial disclosures and enable consumers to have direct access to sustainability information;
- The European Financial Reporting Advisory Group (EFRAG) has been appointed to be responsible for developing standards for sustainable reporting to improve the comparability of disclosed information, with these standards being one of the key points of the new directive. Sustainability reporting standards ensure the quality of reported information by requiring it to be comprehensible, meaningful, verifiable, comparable and presented in a fair manner. A specific point is the requirement in the sustainability reporting standards to be disclosed the information about the value chains that is proportionate and consistent with the capacity and characteristics of the enterprises along the value chains and the scale and the complexity of their activities;
- Companies will be required to prepare their financial statements and their management reports in a single XHTML (ESEF) format and mark the sustainability information according to a digital taxonomy. This requirement is introduced to make sustainability information easier for users and machine readers to find and analyze;
- The directive will require an audit of disclosed information unlike the NFRD. At this stage, the “limited assurance” requirement for sustainability reporting is introduced, with a tendency to move to “reasonable assurance” as an end goal, for example over a period of three to five years.

In response to its assumed responsibility, in March 2022 EFRAG published the first few standards for public consultation. On November 22, 2022 presented the first set of drafts to the ESRS of the European Commission. The standards are grouped into two main categories: (EFRAG, 2022)

1. **Cross-cutting standards :**

o Draft ESRS 1 General requirements
o Draft ESRS 2 General disclosures

2. **Topical standards :**

- ***Environment* :**
  ▪ Draft ESRS E1 Climate change
  ▪ Draft ESRS E2 Pollution
  ▪ Draft ESRS E3 Water and marine resources
  ▪ Draft ESRS E4 Biodiversity and ecosystems
  ▪ Draft ESRS E5 Resources and circular economy
- ***Social* :**
  ▪ Draft ESRS S1 Own workforce
  ▪ Draft ESRS S2 Workers in the value chain
  ▪ Draft ESRS S3 Affected communities
  ▪ Draft ESRS S4 Customers and end-users
- ***Governance* :**
  ▪ Draft ESRS G1 Business conduct

The presented standards cover the three main areas of sustainability reporting - Environmental, Social, Governance. EFRAG is expected to publish the second set of industry-oriented standards by the mid-2023. A leading element in these standards is the concept of the so-called "double materiality". In its 2021 report, EFRAG states that double materiality is key to properly accounting for sustainability. (EFRAG, 2021) The concept of "double materiality" is not really new, as the European Union's Sustainable Finance Disclosure Regulation adopted in 2019 requires investors to disclose not only the risks to themselves, but also their adverse impact on both the planet, as well as on society. This concept of "double materiality" recognizes the fact that risks and opportunities can be material from both financial and non-financial perspectives. Double materiality recognizes that companies and financial institutions must manage and take responsibility for the actual and potential adverse impacts of their decisions on people, society and the environment.

Ultimately, the concept of double materiality describes how corporate information can be important both in terms of its importance to the company's financial value and to the company's impact on the world at large, particularly in relation to climate change and other environmental impacts. The idea of double materiality shows that a company's impact on the world beyond finance can be material and therefore worth disclosing for reasons other than the effect on the company's financial performance. According to data from a study by the European Commission regarding the application of the Directive on non-financial reporting, double materiality is stated as a principle in the non-financial reporting for about 40% of the companies. This is the proportion of companies surveyed that report paying equal attention to the two perspectives of the concept of dual materiality described in the 2019 guidance. A small number of them, under 10%, claim to be unaware of the concept of dual materiality. (European Commission, 2021)

Without making a comprehensive analysis of the concepts of materiality, we consider it necessary to point out one more concept that was launched at the World Economic Forum in 2020, the so-called "dynamic materiality". At the heart of this concept is the notion that while certain non-financial issues may not be material at one point in time, there is the potential for the issues to become financially material over time, and there are some factors that make this process happen. In this case, materiality is seen as a process that develops over time - and often very quickly. Or as Huck describes it, this perspective is based on the consideration that what seems financially inconsequential today can quickly become business critical tomorrow. (Huck, 2022)

It is a fact that the rapid development of ESG issues often transcends the boundaries of the individual companies that have an obligation to disclose information on sustainability. As noted by Frott et al. different requirements are placed on individual companies that are not only within their direct control but also within their value chains. Often complex and transnational in nature, value chains, can pose unique—and even hidden—ESG risks. If companies do not identify and manage these risks, they can lead to reputational, operational and economic losses, the authors point out. (Fortt, et al., 2022) In addition, the introduced requirement may, in our view, result in a transfer of responsibility forward or backward in the chain to counterparties that do not have a direct commitment to sustainability reporting, thereby "burdening" them with additional costs and risks.

The fact that the International Accounting Standards Board (IASB) was also involved in the development of sustainable development standards was received with particular interest. On November 3, 2021, during the event of COP26 (the UN Global Summit on Climate Change), IFRS Foundation Chairman Erkki Liikanen announced the formation of the International Sustainability Standards Board (ISSB). (IASB, 2022) At the moment, two main documents concerning the reporting of sustainability by enterprises have been published for discussion - Exposure Drafts of *General Requirements for Disclosure of Sustainability-related Financial Information* and *Climate-related Disclosure.* Such action by the largest standard- setter’s body, the IFRS Foundation, is a sign for a huge change in the world of corporate reporting. The fact that the IFRS Foundation through ISSB enters in the field of non-financial reporting, in our opinion, is indicative of the fact

that the information from the financial reporting, which is the basis of corporate reporting, must be supplemented with certain non-financial indicators and risks aimed not only to the past to show the "full picture" of the business.

Indeed, the establishment of the ISSB was not the work only of the International Accounting Standards Board. It's a much larger initiative that the Value Accounting Foundation (Value Reporting Foundation) and Climate Disclosure Standards Board (CDSB) will be consolidated into the new Board (ISSB). In turn, the Value Reporting Foundation consists of the Sustainability Accounting Standards Board (SASB) and the International Integrated Reporting Council (IIRC). The presented facts objectively allow us to conclude that four of the top five sustainability reporting organizations will now work in a coordinated manner on the preparation of reporting standards that include specific indicators for sustainability. Outside this new board remains the EU initiative on sustainable reporting and the standards that EFRAG is developing. All this, combined with the support of the new board from the accountancy profession and its favorable reception by governments, financial regulatory authorities and the participation of the World Economic Forum, gives Deloitte reason to indicate in its report that the ISSB is likely to become a leading standard setter sustainability reporting body and will be accepted as the basis for mandatory reporting in many jurisdictions. (Deloitte, 2022) This organizational structure underwent very rapid development as on August 1, 2022 it was announced that Value Reporting Foundation is fully consolidated by IFRS Foundation. The announcement states that the International Accounting Standards Board (IASB) and the ISSB now take joint responsibility for the integrated reporting framework and are working together to agree how to build on the integrated reporting framework in their standard-setting projects and requirements. The ISSB and IASB actively promote the continued adoption of the integrated reporting framework to drive high-quality corporate reporting. (IFRS, 2022)

Table 2 presents a comparative analysis of the two proposals for sustainability reporting standards.

Table 2. Comparability of proposed sustainability standards

Topic	EFRAG	ISSB
Focus	Multi-stakeholder focus, including investors	Investor focus
Scope	The proposed standards cover a broad list of environmental , social and governance topics , with a particular focus on climate disclosure EU area	The standards proposed so far are mainly aimed at climate and other sustainability risks . Additional standards are expected that be issued in the future . Global area (as a project)
Materiality	Impact materiality Impact materiality defines material issues based not on whether they are "of interest to stakeholders" but on whether they have "impacts on the economy, the environment and people"	Financial materiality Information that May influence investment decisions
Where to disclose	Disclosure should be included within a specific section of the management report of the company	A s part of general purpose financial reporting . May be as a part in management commentary , but with flexibility on location

GHG emissions	Scope 1, 2 and 3 Targets: To be disclosed if used	Scope 1, 2 and 3 Targets: To be disclosed based on the Paris agreement
Comparative information	Yes, but after the first year of application	Yes, but after the first year of application
Audit and Assurance	Limited assurance is required, including information on GHG emissions	Does not have mandate to require assurance but Footnote disclosure would be subject to assurance through the financial statement audit and internal control

Source: Based on own research, Navigating the ESG landscape: Comparison of the “Big Three” Disclosure Proposals [2]and KPMG: Comparing Sustainability reporting proposals[3]

The analysis of published standards by ISSB and EFRAG shows that, regardless of the common starting point, there are differences between these standards, some of them fundamental. For example, EFRAG 's sustainability reporting framework and standards have the concept of "double materiality" as a key factor, while the ISSB published standards state quite clearly that the leading factor will be „financial materiality“ as defined in the Conceptual Framework to IAS/IFRS. ISSB 's focus mainly on financial materiality and the information needs of investors and creditors opens a serious gap between the two main standard setting bodies - EFRAG and ISSB. Is is even more serious given that the European Financial Reporting Advisory Group (EFRAG) Project Working Group, leading the technical work on the development of CSRD standards, announced a Statement of Cooperation with the Global Reporting Initiative (GRI) in July 2021. The application of “double materiality” has always been a central theme for the GRI since its inception, largely due to the fact its development is based on a multi-stakeholder approach in which labor unions and civil society groups have significant influence. The GRI are the most widely used standard for ESG reporting worldwide, but at the same time, the GRI is the only significant organization that is not consolidated in the plans of the ISSB.

In the context of the above, the fact that the first discussion document published by the ISSB is entitled General Requirements for Disclosure of Sustainability-related *Financial* Information (*my Italic – At.At.*) should not be overlooked. This is further evidence of the different focus of the two major organizations working in the field of sustainability reporting in Europe. At the same time by the consolidation of Value Reporting Foundation seems that the ISSB is trying to make a choice by adopting a middle choice between focusing solely on investors (financial materiality) and adopting the concept of double materiality, i.e. the so-called "dynamic materiality", where those reporting impacts that do not currently affect the company's long-term value creation are left out of investor-facing reporting, but will be included as soon as they have an impact on the financial result of the company.

It is indisputable that today ESG is becoming the "inevitable tomorrow" for businesses looking for development, external financing and trust among a wide range of stakeholders, which also explains the high degree of commitment of European and American regulators in the field of sustainability reporting. At the same time, a significant part of the published non-financial reports, prepared according to the requirements of the still active NFRD, are rather "pro - forma", without any specifics, with a predominantly descriptive character, aiming only at formal fulfillment of the

[2] Horn , Heather , Valerie Wieman , and Andreas Oh _ 2022. Navigating the ESG landscape: Comparison of the “Big Three” Disclosure Proposals Navigating the ESG landscape : Comparison of the “Big Three ” Disclosure Proposals (harvard.edu) , last seen 12/20/2022

[3]KPMG: Comparing Sustainability reporting proposal , Nov.2022 https://assets.kpmg/content/dam/kpmg/xx/pdf/2022/06/comparing-sustainability-reporting-proposals-talkbook.pdf , last seen 20.12.2022

mandatory reporting and/or image effect for the respective company and all users of corporate information are looking now to CSRD with many future expectations.

Conclusion

While the voluntary disclosure of corporate information can be classified only as an element of the built culture of the corporate managers and the perceived needs and benefits of disclosing non-financial information, the mandatory reporting of sustainability information requires the application of clearly written rules that should provide the necessary information and allow stakeholders to see the “full picture” of the business.

The development of legislation in the field of sustainability reporting is quite fast and will continue at the same pace, as the topic is part of the current agenda of both society and political representatives. At the same time, the creation of two parallel regimes for non-financial reporting – the proposed European Sustainability Reporting Standards (ESRS) on the one hand and the ISSB on the other – we believe will create further confusion among companies as to which standards to be applied. From the proposed drafts, it is clear that the two proposed sets of standards differ significantly on some basic issues. On the one hand, ESRS must be applied by all companies in the EU that fall within the scope of the new CSRD directive and on the other hand - a very large number of these companies currently applying IFRS as the basis for preparing their financial statements, which suggests that they would more easily apply ISSB Standards. This give us arguments to believe that the struggle for supremacy between the EU and IFRS in the field of sustainability reporting will continue, but it should not be at the cost of the companies that have to report their sustainability.

We believe that the understanding by corporate managers of the benefits of this new type of holistic corporate reporting (financial and non-financial) is the basis for increasing its use and its effectiveness without, however, looking at it as a panacea and always taking into account the cost-benefit principle. Otherwise, we risk that this forward-looking concept of sustainability to become another "fashion trend" in the corporate reporting world and a field for “green & social washing”.

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