By Re_Generation

Business Model and Organization

4.3 Transparency and Reporting

Description

Over the past 20 years, corporate sustainability reporting has become increasingly mainstreamed. The proportion of N1000 companies producing sustainability reports has gone from just 18% in 2002 to over 80% by 2020. Unfortunately, there is scant evidence to prove that corporate sustainability reporting has led to genuine improvements in companies' practices and performance. There are a litany of issues with sustainability reporting, including a profusion of vague and inadequate targets, inconsistency between standards setters, opaque supply chains, confusing information, a lack of auditing, and the inherently voluntary nature of reporting mechanisms. Most worrisome of all, however, is the problem that most firms tend only to focus on those social or environmental issues that are deemed 'material' to the company's bottom line. This causes firms to have less interest in reducing their social and environmental impacts than on finding ways to limit how social and environmental problems will harm their overall financial position. To learn more about how firms should improve the credibility of their disclosures and implement a double materiality lens, continue reading this PDF guide.

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Acknowledgements

Written by Gareth Gransaull, Associate Director of Re_Generation, with review by some of Canada and North America's most influential sustainability leaders.

About Re_Generation

Re_Generation is a Canadian youth movement that seeks to build a regenerative, sustainable, and just economy. We aim to reimagine our schools, repurpose our careers, and remodel our companies to be aligned with regenerative principles. In particular, we provide resources for individuals to launch impact-driven careers and advocate for change within their companies and schools. We also aim to advance public policies that promote regenerative and sustainable business practices.

Our successful 'Our Future, Our Business' Manifesto campaign received the support of 65 youth organizations, 130 high-level executives, and 100 civil society organizations recognizing the need for reform in business education on sustainability. After three years of existence as the Canadian Business Youth Council for Sustainable Development, we have changed our name to Re_Generation to become more inclusive of all youth, not just business youth.

We believe that the ideal society is a **regenerative** one. Regeneration to us means putting human and ecological **well-being** at the centre of every decision. It means restoring relationships, both within nature and within society, while helping all communities to thrive. Read more about our history and vision at our **About Us** page.

Issue Summary

Over the past 20 years, corporate sustainability reporting has become increasingly mainstreamed. The proportion of N1000 companies producing sustainability reports has gone from **just 18% in 2002 to over 80% by 2020**. Unfortunately, there is scant evidence to prove that corporate sustainability reporting has led to genuine improvements in companies' practices and performance. There are a **litany of issues with sustainability reporting**, including a profusion of vague and inadequate targets, inconsistency between standards setters, opaque supply chains, confusing information, a lack of auditing, and the inherently voluntary nature of reporting mechanisms. Firms often use sustainability reports to highlight positive behaviours while neglecting to report on their adverse impacts, while their sustainability strategies remain separate (and at odds with) their overall business strategies. For a summary of academic research on the limits of sustainability reporting, see this **open letter to the International Financial Reporting Standards Foundation**.

Most worrisome of all, however, is the problem that most firms tend only to focus on those social or environmental issues that are deemed 'material' to the company's bottom line. This **narrow focus on enterprise materiality** (also known as simple materiality) has the tendency to reinforce the underlying problem of shareholder primacy by exclusively interpreting environmental and social risks through the language of financial accounting. If sustainability reporting is supposed to be about a firm's effect on society and the environment, then the focus on enterprise materiality reverses this principle by focusing exclusively on how social and environmental problems affect the corporate balance sheet. This causes firms to have less interest in reducing their social and environmental impacts than on finding ways to limit how social and environmental problems will harm their overall financial position. It also has the consequence of causing firms to become blind to long-term social and environmental problems that are of grave concern to society but are not yet considered relevant business risks.

Given this tension, it is unsurprising that sustainability reporting and ESG ratings have done little to reverse social and environmental devastation. Academic research shows that companies are motivated to produce sustainability reports less out of a concern for reducing impact than a "**desire to minimise short term profit variations**, gain stakeholder approval and enhance corporate reputation (particularly after reputation-damaging incidents)." As **recent Bloomberg analysis** has demonstrated, ESG ratings have less to do with reducing negative impacts than with ensuring a company's continued profitability. Their analysis of MSCI's ESG metrics showed that a company's "water stress" score had nothing to do with measuring a company's impact on local water supplies, but rather whether local supplies contained enough water to sustain their factories. Research by the OECD has shown that **many ESG indices are not actually less emissions-intensive** than their parent indices, and even that in some instances "high E scores positively correlate with high carbon emissions."

Even within the paradigm of enterprise materiality, corporate sustainability reporting is still falling short. Few firms are fully complying with the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD), one of the most prominent international standards-setters on the risks of climate destabilization to business. **Only 3 in 10 companies fully disclose** their environmental and climate-related aspects of their business model. Very few companies complete scenario analyses against a 1.5˚C or lower scenario, and **only 6% of companies** identify the short, medium, and long-term time horizons over which identified risks would impact the organization. According to **GreenBiz**, few companies overall implement **climate resilience strategies**, use different **climate-related scenarios**, or disclose processes for identifying, assessing and managing **climate risk** or **integrating it into overall risk management**.

As the director of the UN Environment Programme Finance Initiative has recently proclaimed, the TCFD's enterprise materiality approach is no longer adequate. Organizations need to move towards a 'double materiality' approach, an accounting lens which considers both a company's impact on the world, and the effect of social and environment risks on the company's financial position. Double materiality is a combination of both impact materiality and financial materiality, recognizing that the former cannot be adequately absorbed into the latter. Double materiality is now the official approach of the European Union, and mandatory, audited impact reporting is a key component of its proposed Corporate Sustainability Reporting Directive. Without a double materiality approach, the problem of shareholder primacy will not be overcome. In the consultation to the International Financial Reporting Standards Foundation on the creation of the International Sustainability Standards Board, an overwhelming majority of respondents called for the adoption of a double materiality approach. The recently created International Sustainability Standards Board continues to argue that anything other than an investor-oriented approach to materiality would increase complexity and delay the adoption of standards, despite providing no evidence for either assertion.

Forward-thinking organizations should also want to build on the concept of double materiality by introducing a further dimension: context-based sustainability. The notion of context-based sustainability recognizes the inherent fact that sustainability indicators are only meaningful when contextualized with reference to external, globally significant thresholds and limits. This concept of contextualization through a systems thinking approach is what underlies Kate Raworth's doughnut economics framework, in which organizations are expected to operate within the external limits defined by the global planetary boundaries (quantified by Earth system scientists) and the minimum social safeguards recognized in international human rights covenants and other protocols. For example, a company's reporting on its annual carbon emissions is only meaningful when contextualized within the global carbon budget required for a 1.5 degree temperature rise, the global goal outlined in the Paris Climate Accord based on scientific recommendations. At the moment, corporate sustainability reporting exhibits virtually no contextualization within significant social or environmental thresholds; according to a study of over 40,000 sustainability reports, only 5% of companies referred to ecological limits in any given year, and of those 5% only 31 firms sought to align their performance with these limits.

Key Considerations

There are a multiplicity of international sustainability standards setters, so much so that many observers complain of an 'alphabet soup' of standards, rubrics, and frameworks. For a detailed introduction to global sustainability standards, see this guide for Chief Information Officers as well as the materials from Standards Map, the world's largest database for sustainability standards.

The Global Reporting Initiative is the oldest and most commonly employed methodology, providing a comprehensive suite of environmental, social, and governance disclosure standards to evaluate a company's impacts on stakeholders and the environment. The Sustainability Accounting Standards Board, by comparison, employs exclusively an enterprise materiality lens to help businesses understand the social and environmental risks that are most salient to their business models, generating their flagship map of the most material issues on a per-sector basis (the SASB Materiality Map). SASB has recently merged with the International Integrated Reporting Council to form the Value Reporting Foundation, aiding in the harmonization of investor-led approaches to materiality. The Climate Disclosure Standards Board, as well as the Carbon Disclosure Project, are two standards setters focused primarily on companies' climate impacts and greenhouse gas emissions. The Value Reporting Foundation and the Climate Disclosure Standards Board have also recently merged to form the International

Sustainability Standards Board, under the purview of the International Financial Reporting Standards Foundation, the global entity which sets the global standards for corporate financial reporting. Another major international standards setter is the Task Force on Climate-Related Financial Disclosures, which focuses on getting businesses to disclose the physical and transition risks that climate impacts pose to their underlying business models. All of these sustainability standards setters adopt an enterprise materiality approach with the exception of the Global Reporting Initiative, which invokes a double materiality lens and focuses on stakeholder impacts. For more information about global sustainability reporting, see materials from the Reporting Exchange.

Identifying greenwashing in sustainability reports is key to understanding an organization's true sustainability impacts. Key questions to ask when evaluating a sustainability report, as developed by Deloitte Norway, include:

- What reports are released? Are there more than one?
- Are reports attested by a third party?
- How does the company define materiality? Single or double? Have they performed a materiality analysis?
- Do they measure outputs instead of outcomes?
- Do they disclose how KPIs are calculated?
- Do they identify stakeholders? Do they disclose how they work with these stakeholders?
- If SDGs are mentioned, are they integrated with corporate strategy?
- Do they use positive impact measurement?
- Have they committed to the recommendations of the Task Force on Climate-Related Financial Disclosures?
- Do they release a separate GRI report?
- Are they open and honest about how they can improve? Do they do even more environmental work behind the scenes than what is released publicly?

Another important tool to recognize greenwashing in sustainability reporting are the 7 sins of greenwashing, which include:

- Hidden trade-offs: claiming that a product is green without articulating its impacts on other important social and environmental issues;
- No proof: making claims without easily accessible factual evidence or third-party assurance;
- Vagueness: making claims so vaguely defined that their meaning becomes misleading and easily misunderstood;
- False labels: creating the false impression of third-party endorsement where no such endorsement exists;
- Irrelevance: making claims that are truthful but not actually relevant for environmental or social impact (i.e. claiming credit for sustainability practices that are already mandatory under law);
- Choosing the lesser of two evils: highlighting positive relative impacts that help distract the customer from the negative impact of the product category or industry as a whole;
- Making false claims.

Tools

The most comprehensive impact-driven reporting tool developed so far is the Future-Fit Benchmark, an international standard that provides businesses with the self-assessment tools and metrics to estimate their impacts on stakeholders and the environment. These open source benchmarks from the Future-Fit

Foundation focus on double materiality, and integrate context-dependent data wherever possible. They are less focused on risk management than on creating change through organizational transformation, and so they are ideal for businesses hoping to become sustainability leaders.

Firms should also aim to appropriately embed the UN Sustainable Development goals within their business strategies. While 72% of firms cite the SDGs in their reports, only 23% actually integrate them into their corporate strategy. To help avoid SDG-washing, firms should use the tools developed in the SDG Action Manager, which is designed to help businesses understand their impacts, track performance, and collaborate across departments.

Firms starting out on their sustainability journey can use the Basic Sustainability Assessment Tool provided by Sustainability Advantage, which references the Sustainable Development Goals and focuses on three forms of non-financial capital (human, natural, and social). When designing their own indicators for impact assessment, firms should review the Indicator Design Tool from the Shift Project.

1. Context-Based Sustainability

As discussed above, context-based sustainability combines double materiality and impact reporting with context-dependent metrics based on social and environmental thresholds. The Impact Management Platform (IMP) has begun the process of incorporating information about global thresholds and allocations into its reporting frameworks. The IMP provides the world's first integrated tool for comprehensively measuring a company's contribution to the UN SDGs. To get started, see their "wheel" of actions that organizations can take to measure, manage, and report their sustainability impacts. For more information, see the resource list the IMP has compiled, as well as their list of sustainability performance classifications.

Using the IMP, impak Finance has created the Impact Investing Scoring Solution, which provides a universally transparent methodology for analyzing a company's positive and negative impacts with the same systematic framework. The scoring solution generates an 'impact statement', analogous to a financial statement, which scores companies out of 1,000 for their positive and negative contributions. Their tool is described in this case study on Unilever, which demonstrates the limitations of traditional ESG ratings and offers a concrete guide to the IMP methodology. Companies can also use the IRIS+ system, created by the Global Impact Investing Network, to integrate social and environmental factors into investment decisions alongside risk and return.

Organizations hoping to take action on context-based reporting should also review the Sustainable Development Performance Indicators developed by the UN Research Institute for Social Development. These indicators, which are still in the process of being developed, are meant to encompass three tiers of indicators that are context-dependent and focused on transformational change. A pilot project has begun with a series of partner organizations to test the viability of the sustainable development performance indicators, with results to be released this year. To read more about this new approach, see UNRISD's whitepaper on corporate sustainability accounting.

Firms looking to pursue true integrated reporting should see the Generally Accepted Integrated Accounting principles developed by Mark McElroy of the Centre for Sustainable Organizations as of November 2021, which provide a framework for corporate reporting that reflects both the importance of double materiality and context-dependent indicators. Firms can also review the Multi-Capital Scorecard, which helps them evaluate and report on their impacts to natural, social, and human capital.

3. Climate Risk Reporting

For the time being, organizations should still aim to report on climate risk within the more traditional enterprise materiality framework developed by international standards setters like the TCFD. Organizations should begin by understanding the various **forms of climate-related financial risk**, particularly risk of their **exposure to stranded assets** (i.e. fossil fuel reserves and infrastructure that become valueless in a zero carbon world). For more information about aligning with TCFD recommendations, see this **guide from the Net-Zero Hub** as well as the **implementation guidelines** provided by the TCFD. CPA Canada has issued **recommendations for CFOs** in integrating climate-risk considerations into financial valuations.

In issuing TCFD reports, firms are advised to use **scenario analysis** as a planning tool to consider different future risks in different climate impact scenarios. In particular, firms should use the **1.5 degree scenarios developed by the International Energy Agency** (which prohibits fossil fuel development after the year 2021), and integrate the findings of these scenario analyses into business strategy and capital allocation decisions. Firms should review **this article from the Carbon Disclosure Project** on common pitfalls to avoid when conducting scenario analyses. For a database of existing TCFD reports, see **this compilation** from the Net-Zero Hub.

4. Third Party Assurance

Third party assurance of sustainability reporting is a vital ingredient in ensuring the veracity and robustness of sustainability claims. For more information about obtaining third-party verification, see **this report from the GRI**, and **these recommendations** from the World Business Council for Sustainable Development.

Case Studies

impak Finance has developed an innovative tool for scoring companies' positive and negative impacts out of a total possible score of 1000. Their impact scoring tool is described in this **case study on Unilever**, which awards Unilever a total score of 245 out of 1000. While Unilever is often seen as one of the most sustainable large companies on the planet, being in the 95th percentile according to a majority of CSR/ESG ratings, this impak Finance case study highlights some key discrepancies. For example, Unilever is the world's largest purchaser of palm oil, and a key member of the Roundtable on Sustainable Palm Oil. However, Unilever does not report on its overall negative impacts, namely the total number of hectares that have been cut down due to its operations. There is also evidence that the Roundtable on Sustainable Palm Oil may have certified the sale of palm oil that farmed by child labour on illegally cleared land. Overall, the impak Finance case study determines the total positive impact of Unilever group to only represent 2.6% of the firm's activities. As such, the impak scoring methodology illustrates the limits of traditional sustainability reporting and the need for a more robust approach.

Organizations/Initiatives

The major international sustainability standards setters include:

- International Sustainability Standards Board, under the purview of the International Financial Reporting Standards Foundation
- Global Reporting Initiative
- Value Reporting Foundation (a merger of the Sustainability Accounting Standards Board and the International Integrated Reporting Council)
- Climate Disclosure Standards Board
- Carbon Disclosure Project
- Task Force on Climate-Related Financial Disclosures

To learn more about the sustainability reporting landscape, see the following organizations:

- Impact Management Project
- Reporting Exchange
- The SustainAbility Institute
- CPA Canada
- impak Finance
- R3.0
- Centre for Sustainable Organizations