Navigating the Landscape of Sustainability Reporting: A Critical Analysis and Recommendations for Future Harmonization

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Abstract

This paper aims to conduct a thorough examination of the relevant regulations and standards governing sustainability reporting in enterprises. Based on this analysis, the objective is to draw conclusions and provide recommendations for future development, emphasizing the need for harmonization in this area. The research methodology involves a bibliometric analysis of publications in the Scopus Database from 2017 to 2023, review of key publications on the subject, and a critical analysis of existing regulatory requirements.

The analysis of the current situation reveals that, despite some alignment among major sustainability reporting standards, there remains a lack of consensus among standardization bodies on crucial aspects such as the scope of reported information, the specific number of sustainability indicators (KPIs) in various areas and notable inconsistencies in applying the concept of materiality. Consequently, it can be concluded that the process of harmonizing sustainability reporting is an ongoing challenge. The struggle for dominance among major players in this field is expected to persist, but it should not come at the expense of companies obliged to report on sustainability or compromise the quality of the reported information.

Keywords: sustainability reporting landscape, sustainability reporting standards, harmonization, legislation, sustainability KPI

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Introduction

Sustainability is becoming a key characteristic of modern business and is increasingly seen as a necessary condition for the formation of competitive advantages for those businesses that have managed to realize and implement this as part of their business model on the one hand and succeed in an adequate, clear and concrete way to publicize their commitment in the field of sustainability by including in their prepared corporate reports specific non-financial indicators revealing key non-financial characteristics of the company's business model and appropriately linked to the main financial information reported.

In the context of the above, the aim of this study is to carry out a critical analysis of the applicable regulations and standards for sustainability reporting and on this basis to formulate appropriate conclusions and recommendations regarding their future development in the context of the need to harmonize the reporting and disclosure in ESG area.

The research methodology is based on a bibliometric analysis of existing publications on the subject in the Scopus database and an additional analysis of the main publications on the subject for the period 2017-2023. In addition, a critical analysis of the normative regulation of sustainability/non-financial reporting during the researched period was made. Based on the research, conclusions and recommendations have been formulated in relation to the future harmonization of sustainability reporting.

1. A brief bibliometric analysis of publications in the field of "harmonization of sustainability reporting".

In connection with the present study, we analyzed the scientific publications indexed in the scientific database Scopus for the period 2017 - 2023. The selected period covers seven years, starting from the first year of the implementation of the current NFRD until the end of 2023, since from 01.01.2024 CSRD enters into force. The search was carried out by keywords "sustainability AND reporting AND harmonization OR convergence" in relation to all publications included in the database for the studied period, with the search limited to Article title, Abstract and Keywords. The obtained results show that for the researched period, 83 publications in Scopus are available for the indicated keywords, distributed by year as follows:

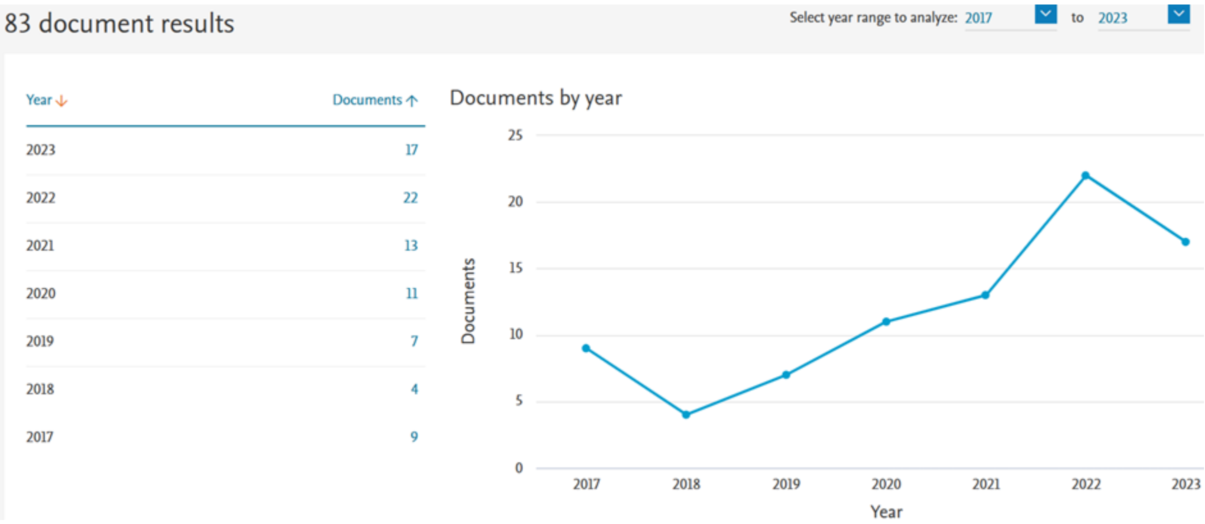

Figure 1. Number of publications by years

The following figure 2 shows the distribution of publications by country, noting that the most publications in this field in Europe are from Italy (15), which is 18% of all publications on the subject. This was followed by publications from the United Kingdom (13), Germany (7), France (6), Croatia (5) and Spain (5). In fact, Italian scientists are among the most frequent publishers in this field, and this is related to the voluntary disclosure practices of sustainability-related information in Italy even before the mandatory introduction of the NFRD. Such a background allows researchers to form a basis for comparing the results of mandatory and voluntary reporting and, on this basis, to formulate various proposals for improving ESG reporting.

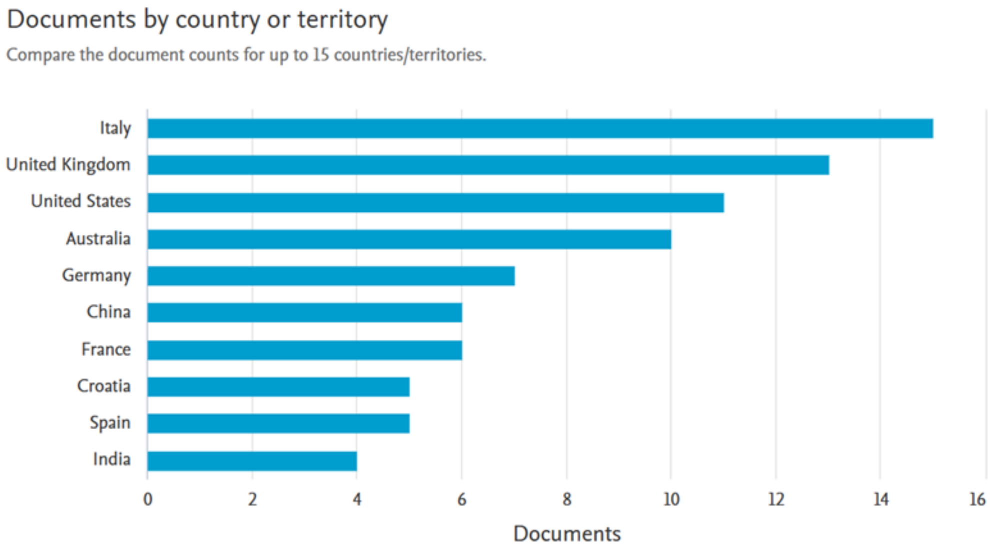

Figure 2. Publications by country

From the data in Figure 3, it can be seen that the issue under consideration is substantial, as 83.1% of the papers on the topic are peer-reviewed journal publications and book chapters devoted to sustainability reporting issues.

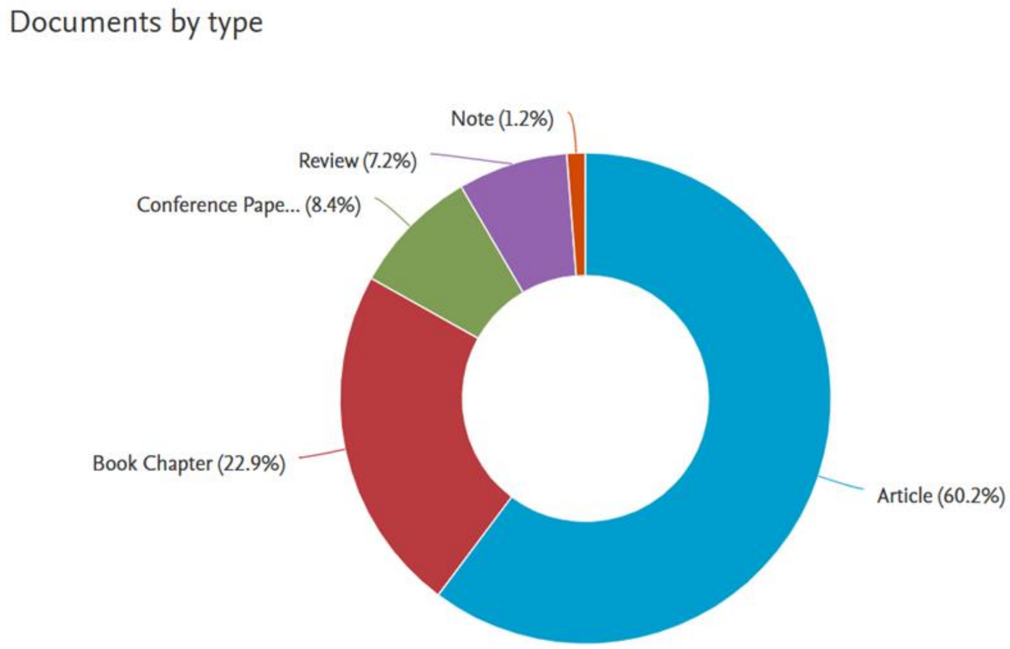

Figure 3. Publications by document type

In order to highlight the importance of the topic, a search was carried out using the same keywords for the same period in the largest database of scientific publications Google Scholar. The search shows 3030 publications, which is much more than the results in Scopus and gives clear indications that the topic is important and subject to consideration in the specialized literature.

Based on the publications from the last seven years, the literature on sustainability reporting harmonization reveals a growing interest in the need for standardized frameworks and industry-specific standards that enhance the comparability and reliability of sustainability reports (Halmi & Poldrugovac, 2022; Stefanescu, 2021; Villiers et et al., 2022). The Global Reporting Initiative (GRI) has been a significant player in this area, aiming that harmonize different reporting systems and promote global standards for sustainability reporting (Ramón-Llorens et et al., 2020). The literature also emphasizes the importance of the quality of sustainability reports, highlighting the need that move beyond impression management and marketing instruments that ensure the credibility and reliability of the information disclosed (Diouf & Boiral, 2017; Carvajal & Nadeem, 2022).

Furthermore, the literature recognizes the challenges in the implementation of sustainability reporting, especially in terms of comparability, definitions, measurements and disclosures, which are crucial for achieving harmonization (Muñoz et et al., 2017). It also discusses the role of boards in enhancing sustainability reporting practices, shedding light on critical board roles for improved reporting (Tumwebaze et et al., 2022). Additionally, in first years of the period there is a call for the institutionalization of sustainability reporting through International Financial Reporting Standards (IFRS) to further promote harmonization and comparability (Cherepanova, 2017).

The literature also addresses the impact of sustainability reporting on firm performance with findings suggesting that financially material sustainability reporting can increase firm value, warranting further investigation into this relationship (Carvajal & Nadeem, 2022). Moreover, the literature highlights the need for empirical validation of theoretical constructs that enhance sustainability reporting, indicating a direction for future research in this area (Abeysekera, 2022).

In summary the literature on sustainability reporting harmonization underscores the significance of standardized frameworks, industry-specific standards and the role of organizations such as GRI, EFRAG and ISSB in promoting global standards. It also emphasizes the need for high-quality reporting, the challenges in implementation and the potential impact of sustainability reporting on firm performance. Future research is encouraged that empirically validate theoretical constructs and address the remaining challenges in achieving harmonization.

2. Regulatory framework of sustainability reporting

In the last few years, there have been significant changes in the field of sustainablility (ESG, non-financial) reporting, which influence modern corporate reporting and highlight the directions for its development. The most significant changes can be summarized as follows:

- In 2021, the European Green Deal introduced new requirements for companies, forcing them to make changes and adaptations in their strategies and business models if they wish to fully participate in future financial instruments for financing sustainability.
- In April 2021, the European Union adopted a Sustainable Finance Package focused on supporting private investment aimed at a climate-resilient economy. The package includes a proposal for a Corporate Sustainability Reporting Directive (CSRD), which will replace the existing Directive 2014/95/EU (NFRD) and expand the scope of companies subject to reporting. The CSRD is envisaged to be introduced for implementation in four stages:
  - From the beginning of the reporting year 2024 for companies currently applying the Non-Financial Reporting Directive (NFRD);
  - From the beginning of the reporting year 2025 for large companies that do not currently apply the NFRD;
  - From the beginning of the reporting 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.
- The new CSRD introduces the application of common European Sustainability Reporting Standards (ESRS) by all undertakings covered by the Directive. On 31 July 2023, the European Commission published its adopted Delegated Act on the first set of European Sustainability Reporting Standards (ESRS), based on the draft submitted by the European Financial Reporting Advisory Group (EFRAG) in November 2022 (European Commission, 2023) The adopted standards include two general standards ESRS 1 – General requirements and ESRS 2 – General disclosures, as well as ten specific standards regarding individual key issues in relation to corporate sustainability reporting.
- In June 2023, the International Sustainability Standards Board (ISSB) published its standards IFRS S1 and IFRS S2, ushering in a new era of sustainability-related disclosures in capital markets worldwide. (ÌSSB, 2023)
- On 4 September 2023, the European Financial Reporting Advisory Group (EFRAG) and the Global Accountability Initiative (GRI) released a joint statement saying that there is a “high level of interoperability” between the European Sustainability Reporting Standards (ESRS)) and the GRI standards. With this, perhaps the largest organization in this field - GRI - once again claimed its place in the field of standardization in sustainability reporting. According to KPMG data, in 2022, 78%

of the top 250 companies in the world and 68% of the top 100 will apply the GRI standards as a basis for preparing their sustainability reports.

These changes were supposed to provide significant progress in the world of corporate reporting, highlighting the need for additional non-financial indicators and risks to provide a comprehensive picture of corporate activity. Moreover, focusing the regulation of sustainability reporting in only a few institutions will make it possible to overcome the problems with the institutionalization of these issues, known as “Alphabet Soup”.

3. Harmonization of sustainability reporting – struggle for supremacy or…?

The need to introduce uniform standards for sustainability reporting and disclosure can be justified by the growing importance of this type of information for all stakeholders and mainly for the companies themselves, which thus reveal the "full picture" of their business beyond just the financial indicators. A global KPMG survey shows a growing sense of sustainability and focus among CEOs on ESG, with more than two-thirds (69%) of global CEOs fully embedding ESG in their business as a means of creating value (KPMG, 2023). These data are complemented by the results of Big shifts, small steps Survey of Sustainability Reporting 2022, which shows that 96% of the top 250 companies worldwide report on sustainability issues and 64% perceive climate change as a risk to their business (KPMG, 2022). Similar results showing the importance of sustainability risks are also found in PwC's Global Investor Survey 2023. According to 75% of investors and analysts surveyed, the way companies manage sustainability risks and opportunities is an important factor in making investment decisions (PwC, 2023).

At the same time, the landscape of applicable sustainability (ESG) reporting frameworks and standards remains fairly saturated. The analysis of the first published standards by ISSB and EFRAG shows that, regardless of the common starting point, there are differences between these standards, some of them fundamental. We examine these two types of standards (ESRS and IFRS S), as we believe that there are significant differences between them and the two standardizing bodies that prepare them are seeking supremacy in the harmonization process. Given the limitations in the volume of the exposition, all significant problematic moments will be defined separately, and their in-depth analysis will be the subject of future publications:

- **Differences regarding the definition of the concept of "materiality"**. As we have already written before (Atanasov, 2022) EFRAG's sustainability reporting framework and standards accept the concept of "double materiality" as a key factor, while the ISSB state quite clearly that the leading factor will be financial materiality as defined in the conceptual framework for 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.

The importance of materiality questions is also highlighted in the cited PwC study for 2023, according to which, in addition to an interest in reporting how sustainability affects financial results (external reporting), 75% of investors question the impact a company has on the environment or society (inside-out reporting), which is an increase of 15% compared to 2022 (PwC, 2023).

- **Differences in the scope and format of the information reported**. This, in turn, makes it difficult for stakeholders to identify the value impact of sustainability risks in financial statements. For example Frecautan & Nita point out that the different scope required by ISSB and EFRAG shows a resistance and lack of desire to harmonize the reports. According to them, EFRAG has an interest in driving sustainability by changing impact in a dynamic materiality 'framework', while the IFRS Foundation is mainly interested in investor protection, focusing on enterprise value creation and, less importantly, disclosure of aspects of the materiality of the impact (Frecautan & Nita (Danila), 2022).
- **Ambiguity in defining the final number of KPIs**.

- **Differences in the place (Where?) to report the information**. The ESRS, in accordance with the CSRD, require this to be done in a special section of the entity's activity report of the company. The ISSB prescribe reporting as part of the reporting entity's general purpose financial reporting, but without specifying where sustainability-related disclosures may be included in the general purpose financial statement.
- **Lack of basic comparability in the number and content of standards issued by the two major standardization bodies**. Even a rudimentary review of the compliances reveals that the ISSB has only two standards issued - IFRS S1 *General Requirements for Sustainability-Related Financial Disclosures* and IFRS S2 *Climate-Related Disclosures* against two main and ten specific ones issued by EFRAG.

Table 1. Comparison between ESRS and ISSB Sustainability Standards

ESRS	ISSB
General standards: • ESRS 1 General requirements • ESRS 2 General disclosures **Standards on environmental-related issues:** • ESRS E1 Climate change • ESRS E2 Pollution • ESRS E3 Water and marine resources • ESRS E4 Biodiversity and ecosystems • ESRS E5 Resource use and circular economy **Standards on social-related issues:** • ESRS S1 Own workforce • ESRS S2 Workers in the value chain • ESRS S3 Affected communities • ESRS S4 Consumers and end-users **Standards on governance-related issues:** • ESRS G1 Business conduct	**General requirements:** • IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information Standards on environmental matters: • IFRS S2 Climate-related Disclosures

Source: Author's elaboration, based on EFRAG and ISSB Standards

The latest survey Global Investor PwC 's Survey 2023 shows that the main users of the financial statements of large public companies - investors and analysts in different geographies - want clearer, more consistent and more comparable information about the material issues facing the companies. This in turn means that existing regulations, frameworks, and standards fail to adequately capture essential aspects of companies' business models and remain beholden to consumers. The survey results show that three-quarters of respondents say that how companies manage sustainability risks and opportunities is an important factor in investment decisions. Investors and analysts surveyed want better information, including on the costs of meeting sustainability commitments and a clear roadmap for achieving them, combined with the effects of these initiatives on financial statements. In addition, investors want details about the impact of the company's actions on the environment and on society (PwC, 2023). Of particular importance, in our view, is the fact that 94% of investors believe that corporate reporting on sustainability results contains at least some unsupported claims, an increase from last year. Such a statement practically means that either the existing regulations are not effective and/or that companies use this to enter the field of so-called "green washing" practices. Distrust of existing regulation is a major factor explaining investor support for new disclosure requirements, such as those of the European Union's Corporate Sustainability Reporting Directive (CSRD) and the International Sustainability Standards Board (ISSB) which they hope could lead to more consistent and comparable sustainability reporting. According to the respondents, the expression of confidence in the sustainability report by third parties will increase the trust in the sustainability reporting. (PwC, 2023)

Criticism of existing regulations can also be found in the specialized literature. According to Afolabi et al . the entry of two institutions making their own attempts to upgrade accounting regulations in the form of the IFRS Foundation and EFRAG could spark a crucial debate about how existing external actors have influenced the shape of sustainability reporting regulations and how they might continue to push for their rules to be enforced, and what this might mean for the future direction of the regulatory framework for sustainability reporting. (Afolabi , Ram , & Rimmel, 2022)

The need to change and harmonize sustainability standards is discussed by Hahn et al., according to which such a framework is needed that disentangles the links between non-financial reporting and real sustainable change, explored through different levels of analysis. They emphasize that there is a difference between sustainability-related outcomes and outcomes that typically materialize at the firm level and ultimately lead to sustainable impact at the societal level. (Hahn , Reimsbach, & Wickert, 2023)

Hao, Dragomir & Radu (NingShan, et al., 2023) note that limitations of the applicable NFRD include both inconsistency in data format and lack of standardization, as well as weaknesses in the reliability and comparability of information used in the decision-making process. The conclusions formulated by the authors are confirmed and complemented by much more serious inconsistencies in the implementation of sustainability disclosure practices by companies in the Roszkowska-Menkes et al. study. They found that companies selectively report negative sustainability events as 69% of negative sustainability events not being fully disclosed. Selective disclosure is observed, which is more common in the social dimension of sustainability. According to the authors, neither the GRI nor external assurance reduces selective disclosure. The last part of the findings is related to the format of the sustainability report, as according to the research results, companies that publish integrated reports are less likely to engage in selective disclosure (Roszkowska-Menkes, et al., 2024). Such findings support our contention that the introduction of mandatory minimum sustainability KPIs, which are appropriately linked to the financial performance indicators, obtained from the application of IFRS, is very important to achieve harmonization between the individual applicable frameworks. Providing an appropriate format for achieving such a binding of structured financial and non-financial information may be the integrated report of the entity.

Syolowy & Paugam have very aptly systematized the factors that negatively affect the likelihood of convergence in short-term sustainability reporting. Their analysis is very conceptual and at the same time thorough, and includes four factors: *the first factor* is the heterogeneity of concepts and definitions related to sustainability (eg ESG, CSR). *The second factor* is the large number of organizations claiming legitimacy in sustainability reporting. *The third factor* is related to the diversity of reporting requirements among three influential international standard setting bodies (i.e. EFRAG, ISSB, SEC) resulting in different corporate reporting options and *the fourth factor* is the diversity in the objectives of standard setting organizations. The reasons they cite make the likelihood of convergence in sustainability reporting seem too limited, at least in the short term (Stolowy & Paugam, 2023).

Looking for an adequate way to report related financial and non-financial information De Villiers et al. conclude that a new conceptual framework for enhanced external reporting (EER) of impacts (EERI) needs to be developed. This framework is innovative as a proposition and, according to the authors, could consolidate the possible determinants and consequences of EER. The authors also examine the factors that influence reporting practices, the processes, and ways of capturing and communicating information for value creation and the value of integrated reporting and security for capital providers (De Villiers, 2022).

Driven by the idea of harmonizing the rules and in response to ongoing criticism of them, EFRAG and the ISSB worked closely together to increase interoperability between the two sets of standards. On August 23, 2023, they issued a memorandum on interoperability between standards, stating that a "high degree of alignment on climate disclosure" had already been achieved…but only for climate!!! Particular attention is paid to the definition of financial materiality, in particular ESRS 1(48) of the Delegated Act. Material financial information under the ESRS is now focused on the needs of the primary users (investors), assuming that the needs of other stakeholders are met either by information on the materiality of the impact or by the information required by investors (EFRAG, August 2023), which essentially does not solve the issue of not applying the concept of the so-called "double materiality" in the ISSB. Seeking a harmonization solution on the "materiality" analysis in December 2023, EFRAG published for public consultation [Draft] EFRAG IG 1: Materiality assessment implementation guidance , on which public consultation is ongoing until February 2, 2024. At the same time, the ISSB does not publish similar document.

It is important to note that despite the declared progress by the two main standard setting bodies, companies applying ESRS will not automatically meet the requirements of the ISSB standards, and therefore it is important to check the differences between the two standards if they are also applied. both sets of requirements.

The struggle for supremacy also entered the European Parliament, where a proposal was submitted to postpone the implementation of the ESRS, which in practice shames the implementation of the CSRD. The proposal was rejected, but it is worth looking at the motives of the proponents. They state that "simple reporting standards are needed instead of overburdening companies" and that "companies in the Union suffer from bureaucracy and have announced that they will publish proposals to reduce the bureaucracy for companies in the Union". In this regard, it states that the administrative burden for companies would increase due to the high complexity of the Sustainability Reporting Standards (ESRS), and clarifies that most standards do not meet usable Key Performance Indicators (KPIs) and thus do not serve the Commission's objective of creating measurable and comparable standards, especially for companies that add value to data providers and data users, managing the dual transition. The other argument put forward is that standards of this type require significant resources from companies, which is particularly burdensome for smaller businesses, as sustainability reporting standards are complex and high volume. The petitioners even point out that the ESRS jeopardize the Commission's intention to reduce bureaucracy and reporting obligations by 25% in view of competitiveness issues within the EU and beyond. As a result of all the negative comments presented, it is suggested that the Commission submit a new delegated act that takes into account the mentioned recommendations (European Parliament, 2023).

Alongside the above, the European Commission has announced plans to defer key aspects of CSRD, including the adoption of requirements for companies to provide sector-specific sustainability disclosures and for sustainability reporting by non-EU companies. In the Commission's 2024 work programme, one of the priorities includes the reporting burden on companies related to reporting requirements, with the Commission including the postponement of the deadline for the adoption of sector-specific European Sustainability Reporting Standards (ESRS) as one of the key actions listed.

After everything stated up to this point, the question is reasonable: *Why financial reporting has managed to achieve a huge degree of harmonization, while attempts to harmonize non-financial* *reporting (sustainability reporting, ESG, etc.) have not yet achieved the desired results?* Perhaps it is time to rethink the whole process of standardization of non-financial information and structure it in a similar way to financial reporting - uniform rules, uniform framework, standardized indicators in reports, development by a single authority while specifying the purposes for which it will be used this information.

Conclusion

We believe that creating two parallel sustainability reporting regimes will create further confusion among businesses as to which standards to apply. It is clear from the standards already published that the two proposed sets of standards differ, and significantly so, on some key issues. On the one hand, ESRS must be applied by all EU companies that fall within the scope of the new CSRD Directive, and on the other hand, a very large proportion of these companies apply IFRS as the basis for preparing their financial statements, which suggests that more would easily apply IFRS S1 and S2. And thirdly - a large number of these companies already accept the GRI standards and have experience in their implementation. This gives us reason to assume that the struggle for supremacy between EFRAG and ISSB in the field of sustainability reporting will continue, but it should not be at the expense of companies that have to report their sustainability.

As the ISSB takes center stage, the mechanisms of interaction with EFRAG on sustainability reporting issues will need to be clearly defined, answering a very important question: should sustainability reporting become largely a tool for investors to minimize risk and seek financial opportunities, or should it serve as a deeper indicator of corporate responsibility, ensuring that companies act more broadly to achieve the long-term interests of society in the field of sustainable development?!

Legislators and standardizing bodies must seriously rethink the messages they send through the normative regulation of sustainability reporting, because there is a risk that this issue will become another topical "chewing gum", the taste and aroma of which will quickly disappear and harmonization will indeed be a mission impossible if the need and benefit of this type of information is not realized.

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