

**XBRL EUROPE**

## 25<sup>th</sup> XBRL EUROPE DIGITAL WEEK

Online conference

15-18th June 2020



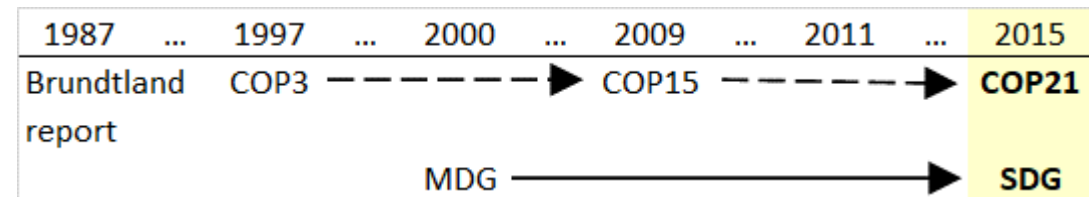
# ESG initiatives and standards

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# Sustainable development – A political agenda

- The **Brundtland report (1987)** define sustainable development as:
  - “**development that meets the needs of the present without compromising the ability of future generations to meet their own needs**”.
- This points on two important factors for ESG standards and initiatives:
  - **Human values**, in terms of sustainable consumption behaviour and production activities
  - Limitations, in terms of **planetary boundaries**
- UN Conference on Parties (COP):
  - COP3 (1997): Kyoto protocol - Greenhouse gas emission reduction to 6 - 8 % below 1990 years level by 2008 -12
  - COP15 (Copenhagen 2009): No new agreement reached
  - **COP21 (2015): Established the Paris agreement**
- The Millennium Development Goals (MDG), were eight international development goals set in year 2000.
  - These goals preceded the **Sustainable Development Goals (SDG)/Agenda 2030**.



# Sustainable finance - Part of the Paris agreement

In the Paris Agreement (2015) we agreed to:

- **“Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.”**

/Article 2 c

- “ holding the increase in global average temperature to **well below 2 °C** above preindustrial levels and pursuing efforts to limit the temperature increase to **1.5 °C** above preindustrial levels”.

/Article 2 a

Source; FCCC/CP/2015/L.9/Rev.1

**Climate change and digitalisation** are two important areas for the new EU Commission, which **will impact corporate reporting** in the EU as (Dombrowski 2020):

- Investors want a broader range of information to access long term performance and value creation.
  - EU intend to review the Non-Financial Reporting Directive (NFRD) during 2020, and will ask EFRAG to **prepare work on non-financial standards.**
- Broadening of the European Single Electronic Format (ESEF) to non-financial reporting.
  - **With a taxonomy for tagging non-financial information.**



# Demand and supply of non-financial information

- The demand for Non-financial information is driven by:
  - **User** to better understand financial risks,
    - from a sustainability perspective
    - and growth in financial products that address environment and social issues.
  - Forthcoming **EU legislation**, as regulation on:
    - Prudential requirements for credit institutions by 2022
    - Sustainability disclosure in the financial services sector by 2021
    - Classification system of sustainable activities (the taxonomy) by 2021
- So far disclosed by companies does not meet the users needs, as:
  - Inadequately publicly available information due to:
    - Its not sufficient comparable or reliable
    - Information is incomplete or not reported at all.
    - Hard to find in the report
  - Companies also incur unnecessary and avoidable costs, as:
    - Uncertainty and complexity when deciding which information to disclose, as well as how and where
    - Financial sector companies also need to consider different EU legalisation
    - Increased pressure from sustainability rating agencies, data providers and civil society on additional information independent of the Non financial Reporting Directive

# ESG standards – A fragmented landscape

- Investors and “companies face a crowded and confusing landscape of 600+ rating and rankings” (corporate-citizenship.com).
- With more than 230 different sustainability standards initiative available (ITC\* 2017), it’s difficult to get valuable and comparable information for investment analysis.
- ESG assessment are not transparent, making it difficult for investors to compare the rankings from different assessment firms.
  
- As a result ESG-factors are not easy to integrate in financial decision-making by managers and investors, despite that most ESG guidelines utilize same or similar international conventions and agreements.

\*International Trade Centre  
<http://www.intracen.org>

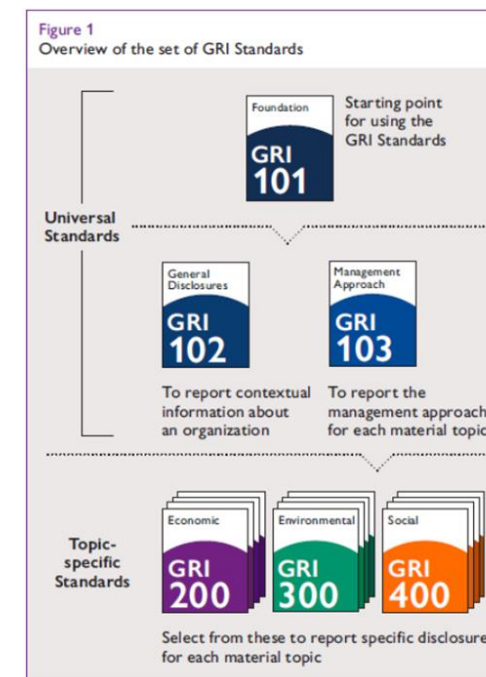
# Financial vs non-financial reporting

| Area   | Financial reporting   | “Middle ground”  | Non-financial reporting  |
|--|---|--|--|
| Legal status   | Regulated standards   |  | Voluntary<br>“recommendations”   |
| Frameworks   | IASB and FASB   |  | GRI, IR, CDP, SASB, TCFD,<br>Agenda 2030/SDG ...   |
| Ongoing key projects   | “Revision of IAS 1”<br><i>Consultation to 30<sup>th</sup> of September</i>            | CDRs “the better alignment project”<br><i>Runs to end of 2020</i>      | Revision of NFRD<br><i>Consultation to 11<sup>th</sup> of June</i>                                       |
| Measurement and units of measurement<br>-> Metrics & targets | Reporting currency<br><i>e.g. USD, SEK,</i><br>Used in financial statements and notes | Number of employees<br><i>e.g. full time equivalent, women</i>         | Physical units<br><i>as Kg, kJ, m<sup>3</sup></i><br>Used for scope 1-3, energy consumption, water usage |
| “Human values” and value focus                               | Business values<br><i>e.g. risk management, business model</i>                        | Governance<br><i>e.g. scenario analysis, risk management, strategy</i> | Environment and social values<br><i>e.g. biodiversity, child labour,</i>                                 |

# Global Reporting Initiative (GRI)

- GRI is regarded as the first global standard for sustainability reporting (launched year 2000), and were created according to international labour and environmental practices.
- It is the most widely used sustainability reporting framework among companies, governments and NGO:s
  - 93 % of the worlds 250 largest firms use it (KPMG 2017)
- It aims to enable third parties to assess environmental impact from the activities of the company and its supply chain
  - Examples of good sustainability reporting practices include **digitalization of organizations' supply-chain management**
- Among its focus areas in coming years are:
  - Harmonize the sustainability landscape
  - Drive effective use of sustainability information to improve performance

In contracts to earlier reporting frameworks the standard have a modular and interrelated structure of recommendations, where each GRI standard represent best global practice.



Source: [www.globalreporting.org](http://www.globalreporting.org)

GRI is a recommendation developed by the Global Sustainability Standards Board (GSSB).

A NGO founded 1997 with headquarter in Amsterdam.

# CDP

- CDP (formerly the Carbon Disclosure Project) is a global environmental disclosure system for companies, cities, states and regions.
  - They piggybacked GRI's concept of environmental disclosure, but with a more narrowing focus to prevent dangerous climate change and environmental damage especially carbon emissions.
  - Cover over 20 % of global greenhouse gas emissions.
- Framework:
    - Initially standard for emissions and energy reporting
    - Focus areas (programs):
      - Climate change
      - Water security
      - Deforestation
    - Its Carbon Action program focus on carbon management of investment portfolios
    - Annual questionnaire to companies
      - 8400+ answered in 2019

CDP is a recommendation developed by the CDP Global System.  
A charity founded year 2000 with Headquarter in Brussels.

Source: [www.cdp.net](http://www.cdp.net)



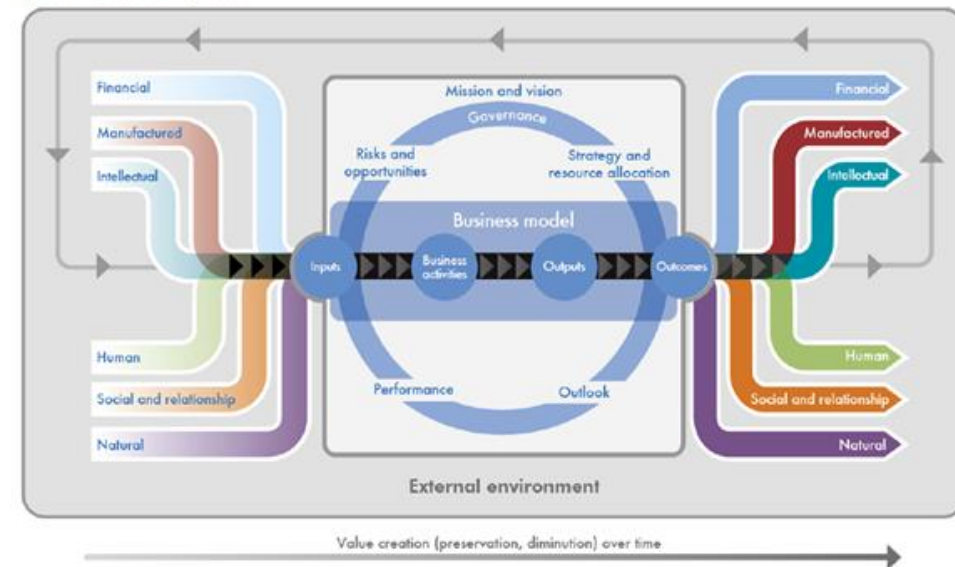
# Integrated Reporting (International <IR> Framework)



- Focus on financial and other value relevant information
- The IR-report is **aimed for capital allocations decisions** as it is a:
  - “concise communication about how an organization’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value”
- An essential concept of <IR> is the value creation process, where the "capitals" are used to denote these various resource from which value is created, namely:
  - financial;
  - manufactured;
  - intellectual;
  - human;
  - social and relationship;
  - and natural.

- The value creation process of Integrated Reporting

Figure 2: The value creation process:



Sources: [www.theiirc.org](http://www.theiirc.org), [www.integratedreporting.org](http://www.integratedreporting.org),

<IR> is a recommendation developed by the International Integrated Reporting Council (IIRC). A NGO founded 2009 with headquarter in London.

# Sustainability Accounting Standards Board (SASB)

- An industry-specific disclosure recommendation across ESG topics.
- Facilitate communication between companies and investors about materially decision useful information.
  - The general principle is “what's measured gets done”
- Focus on financial material issues, which is up to companies to decide and disclose
- Complement the work of FASB, as it can be used for corporate filings to the Security and Exchange Commission (SEC) in the US.

**SASB** is a recommendation developed by the Sustainability Accounting Standards Board Foundation. A NGO founded 2011 with headquarter in San Francisco.

- Industry specific disclosure:
  - Use a Sustainability Industry Classification System (SICS) - 11 sectors and 77 industries
  - With one standard per industry
  - Builds on five material dimensions

#### Environment

- GHG Emissions
- Air Quality
- Energy Management
- Water & Wastewater Management
- Waste & Hazardous Materials Management
- Ecological Impacts

#### Leadership & Governance

- Business Ethics
- Competitive Behavior
- Management of the Legal & Regulatory Environment
- Critical Incident Risk Management
- Systemic Risk Management



#### Business Model & Innovation

- Product Design & Lifecycle Management
- Business Model Resilience
- Supply Chain Management
- Materials Sourcing & Efficiency
- Physical Impacts of Climate Change

#### Social Capital

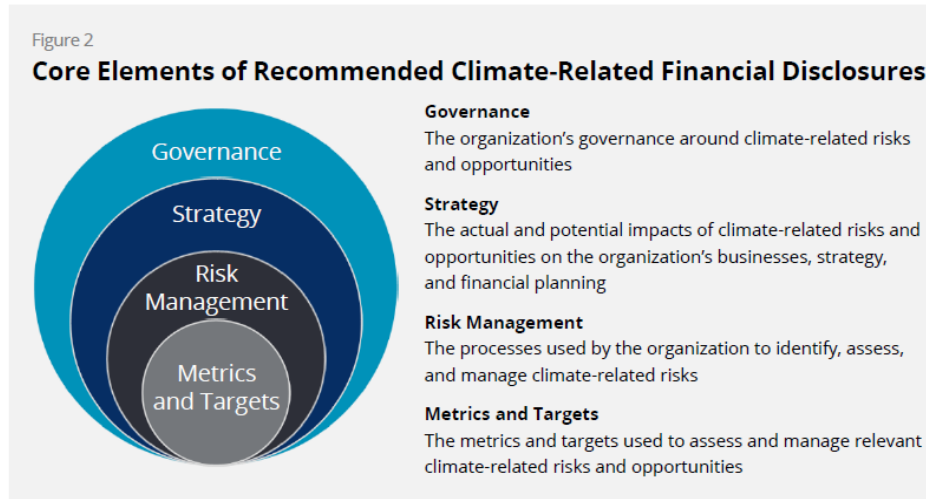
- Human Rights & Community Relations
- Customer Privacy
- Data Security
- Access & Affordability
- Product Quality & Safety
- Customer Welfare
- Selling Practices & Product Labeling

#### Human Capital

- Labor Practices
- Employee Health & Safety
- Employee Engagement, Diversity & Inclusion

Source: [www.sasb.org](http://www.sasb.org)

# Task Force on Climate-related Financial Disclosure (TCFD)



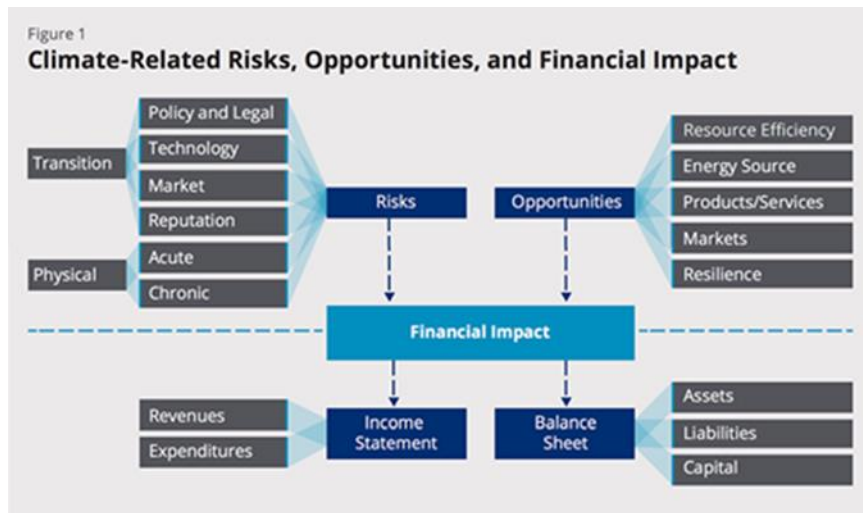
Source: [www.fsb-tcfid.org](http://www.fsb-tcfid.org)

- TCFD is an financial industry initiative was announced in Paris 2015 by the Financial Stability Board (FSB).
- Focus on four thematic areas for climate-related financial disclosure:
  - Governance
  - Strategy
  - Risk management
  - Metrics and targets
- Introduce climate related scenarios for companies, as a tool to reach the Paris agreement to:
  - “Breaking the tragedy of the horizon – climate change and financial stability” /Mark Carney 2015

**TCFD** is a recommendation developed by the Task Force on Climate-related Financial Disclosures. A NGO founded 2015 with headquarter in New York.

# TCFD “innovations”

- Financial impact from climate change  
*Cause effect relationship between ESG risk/opportunity and financial impact.*



- Double materiality principle  
*Company impact on climate can also be financially material.*



Source: [www.fsb-tcfid.org](http://www.fsb-tcfid.org)

# Sustainability Development Goals (SDG) / Agenda 2030



- UN resolution and a “blueprint to achieve a better and more sustainable future for all”
  - Intended to be achieved by year 2030










Source: <https://sustainabledevelopment.un.org>

- Framework:
  - 17 sustainable Development Goals (SDG)
  - 169 targets and 230 indicators
- Goal 12:6:
  - “Encourage companies, especially large and transnational companies, to adopt sustainable practices and to integrate sustainability information into their reporting cycle”

**Agenda 2030** is a resolution adopted in 2015 by the United Nations (UN) in New York.

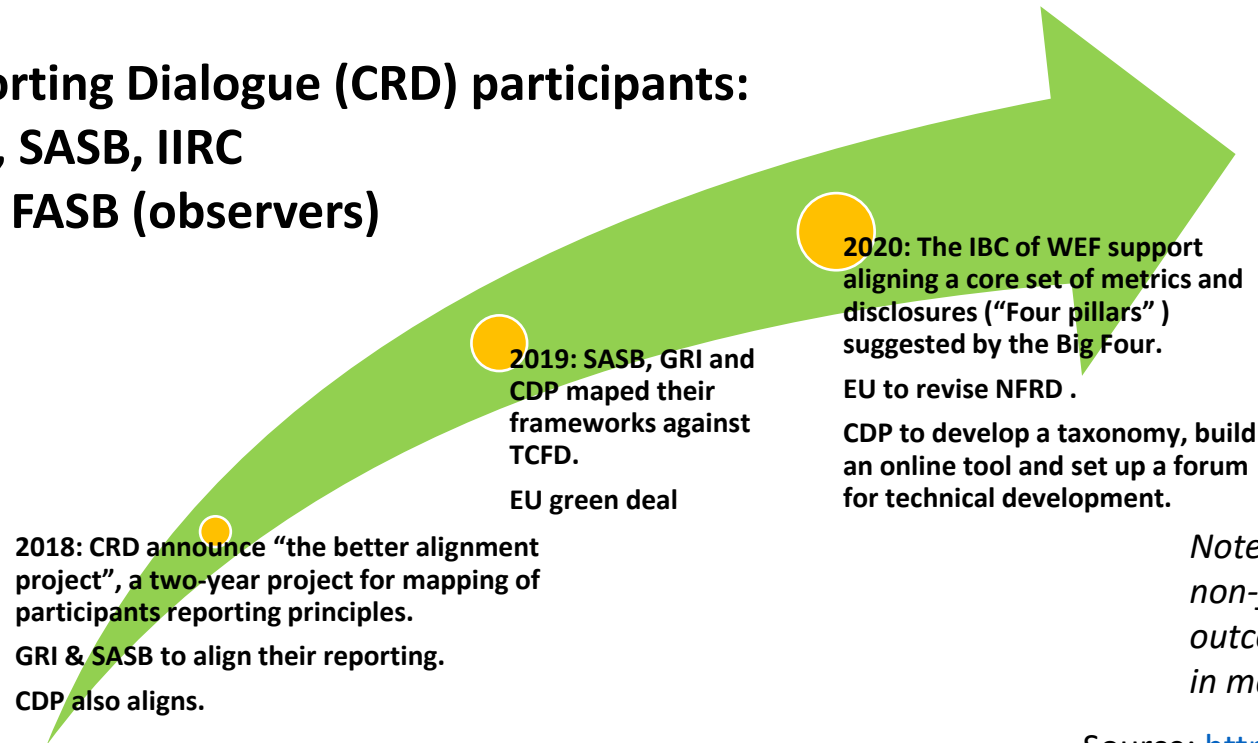
# ESG guidelines – Fragmented focus

| Disclosure “focus” |  |  |  |  |  |  |  |
|--------------------|---|---|---|---|---|---|---|
| Environment        |   | Environment (GRI 300)   | Climate change, Water security, Forest  | Natural capital   | Environment (indicators)  | Climate change risk & opportunity   | SDG 12-15   |
| Social             |   | Social (GRI 400)  |   | Human capital, Social & relationship capital  | Social capital, Human capital   |   | SDG 2-7, 11   |
| Governance         |   | General (GRI 103)   |   | Intellectual capital  | Leadership & governance, Business model & innovation                                | Governance, strategy, risk mgmt. and metrics/targets                                | SDG 16-17   |
| Financial          | Financial performance & position, cash flow                                       | Economic (GRI 200)  |   | Financial capital, Manufactured capital   |   |   | SDG 1, 8-10   |
| Established date   | 1973  | 1997  | 2000  | 2009  | 2011  | 2015  | 2015  |
| Regulation status  | Regulated   | Voluntary framework   | Voluntary questionnaire   | Voluntary framework   | Voluntary framework   | Voluntary framework   | International policy  |
| Framework focus    | General   | General   | Specific  | General   | General   | Specific  |   |
| Other              | Outcome, Fair Value   |   |   | Integrated, Risk & future development   | Financial materiality, US (10K, 20F), “10 industries”                               | Future, risk & opportunity  |   |

# The better alignment project

The project is “focused on driving better alignment in the corporate reporting landscape, to make it easier for companies to prepare effective and coherent disclosures that meet the information needs of capital markets and society.”

**Corporate Reporting Dialogue (CRD) participants:  
CDP, CDSB, GRI, SASB, IIRC  
+ ISO, IASB and FASB (observers)**



**A “golden standard” for financial ESG Performance.  
Or?**

*Note. The CRD project will identify how non-financial metrics relate to financial outcomes and how this can be integrated in mainstream reports*

Source: <https://corporatereportingdialogue.com>

# European Reporting Lab @ EFRAG

- In 2019 the European Lab set up its first project on good reporting practice of Climate-related Reporting (PTF-CRR).
  - The project addressed climate-related reporting by companies in line with the TCFD recommendation and climate-related reporting elements of the EU NFRD
  - Special focus was on scenario analysis
  - The conclusion was that “climate-related reporting is improving but remains a challenge”.
- In 2020 a second project will be set up on the wider domain on non-financial reporting beyond climate-reporting to identify good reporting practice



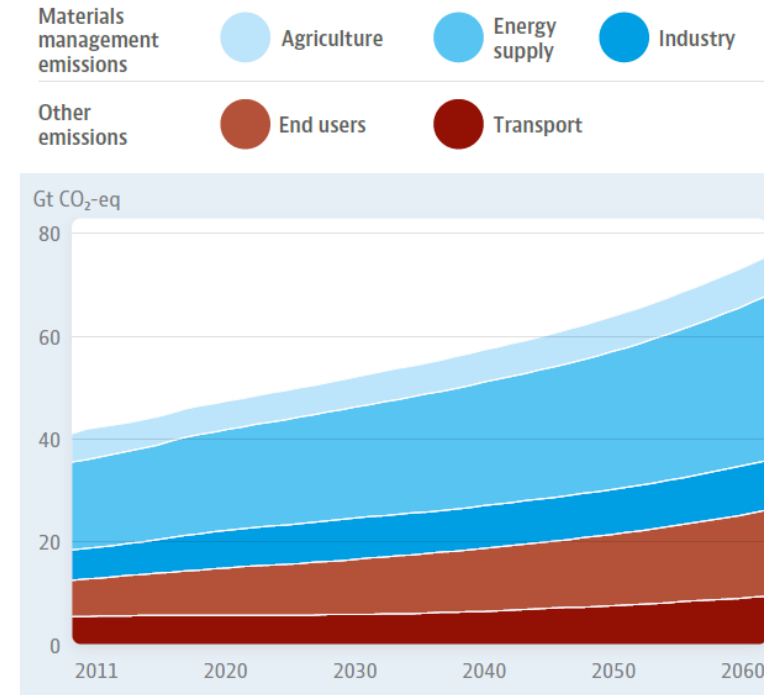
Source: <http://www.efrag.org>



# Decarbonisation of the economy crucial

- **IPCC carbon budget** (SR15 2018) estimated that around 420 Gt CO<sub>2</sub>-eq. can be emitted to stay below 1,5 degree C with 66 % probability.
  - This is 10 year of current emissions levels.
- However, OECD (2018) base scenario project that total emissions will reach 75 Gt Co<sub>2</sub>-eq. by 2060.
  - This implies that expected emissions for the period 2011 – 2060 would be equal to all emissions for the past 200 years pre 2011 (i.e. around 2 800 Gt CO<sub>2</sub>-eq.).
- Decarbonisation of the economy is crucial to fulfil the Paris agreement and CO<sub>2</sub> emissions need to fall to net-zero by mid-century.

Figure 11. **Materials management is a key driver of the increase in GHG emissions**



Source: Global Material Resources Outlook to 2050, OECD 2018

# Recent initiatives on carbon footprint disclosures



- PCAF is a global partnership for **financial institutions** to facilitate transparency and accountability in the financial sector to the Paris Agreement.
- They work together to develop and implement a harmonized approach to assess and **disclose the greenhouse gas (GHG)** emissions associated with their loans and investments.

The Partnership for Carbon Accounting Financials PCAF is an initiative started by 14 Dutch financial institutions. A NGO founded 2015 with headquarter Amsterdam

Source: <https://carbonaccountingfinancials.com/>



- FRC introduced the Streamlined Energy & Carbon Reporting (SECR) taxonomy in UK 2019.
- SECR is a reporting requirement for energy and carbon data introduced 2019 in UK, which applies to all large companies and LLPs.
- While it is not mandatory to tag SECR data, the government is keen that companies file their annual reports digitally.

The Financial Reporting Council (FRC) regulate auditors, accountants and actuaries in UK. A NGO with headquarter in London.

Source: <https://www.frc.org.uk>

# Integrated ESG decision-making - A challenge!

- A central challenge observed by EU Commissions High Level Expert Group (HLEG 2017) was:
  - “to integrate ESG factors into financial decision making” (p 3),
  - as “... managers and investors may have difficulties when trying to incorporate it within valuation models, business strategies and decision-making” (p 21).

Source: [ec.europa.eu/info/sites/info/files/170713-sustainable-finance-report\\_en.pdf](https://ec.europa.eu/info/sites/info/files/170713-sustainable-finance-report_en.pdf)



- This is also recently reflected in the EFFAS course for Certified ESG analysts (2020 module 3)
  - “The biggest challenge still is the integration of ESG factors in the valuation of target companies and investment decision making”
- This challenge is related to that material ESG factors are not easy to integrate into traditional financial decision-making by managers and investors.
- In this context inline XBRL can contribute to this changing reporting landscape by:
  - increasing transparency, being cost effective and giving non-financial data increased credibility.
  - And improve decision making through development of accounting theory.

# Summary and a concluding remark

- ESG standards and initiatives is developed in a political and financial context of sustainable development and sustainable finance.
- Major ESG standards and initiatives have different objectives and frameworks, which create a fragmented landscape where financial integration becomes complicated.
- Ongoing projects focus on alignment of ESG standards and good disclosure practice, which are important as they through TCFD focus on decarbonisation of the economy.
  - But “business as usual” implies as OECD point out that it will be difficult to fulfil the Paris agreement.
  - In this context recent initiatives on carbon disclosure are important, as “what's gets measured gets done”.
- But the challenge is not only on data, as decision making is a challenge in terms of “integrate ESG factors into financial decision making”.
- Digitalisation of ESG data through XBRL can facilitate decision making of ESG factors by :
  - increasing transparency, being cost effective and give non-financial data increased credibility.
  - enable integrated decision making through innovations and research in accounting and finance