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Two Recent Initiatives Aim to Unify the ESG Reporting Ecosystem

This client alert, part of a series focused on ESG disclosure and regulatory developments, should be read together with our ESG Lexicon, available here, which provides definitions of some of the key terms used in ESG reports, disclosures and regulations.

Key Takeaways

- *Five leading ESG standard-setting bodies recently issued a statement of intent to facilitate alignment among their respective disclosure standards, with the ultimate goal of creating a comprehensive and unified reporting system to reduce confusion among market participants.*
- *Just a few days later, the World Economic Forum and leaders of the "Big Four" accounting firms (Deloitte, EY, PwC and KPMG) released a set of universal ESG metrics and disclosures with the aim of establishing a single, global ESG reporting standard.*
- *These two initiatives demonstrate market interest in a single standard to improve the currently fractured ESG reporting ecosystem. How effective each of these initiatives will be towards their goal of ESG standard consolidation, and how the market will respond, remains to be seen.*

Overview

ESG reporting is now recognized as a significant agenda item for businesses and investors alike, yet the plethora of competing reporting standards has caused concern and confusion among those tasked with providing disclosure, as well as the intended beneficiaries of the disclosure. Building upon our recent client alert that provided an overview of ESG disclosure frameworks and standards, available here, we report on two recent initiatives to unify some of the competing standards:

- In September, five leading standard setters for voluntary ESG reporting, including the Global Reporting Initiative ("GRI"), the Climate Disclosure Standards Board ("CDSB"), the Sustainability Accounting Standards Board ("SASB"), the International Integrated Reporting Council ("IIRC") and CDP (formerly, the "Carbon Disclosure Project"), issued a joint statement of intent (the "Statement") announcing a commitment to working together to create a comprehensive corporate reporting system.[1]
- Shortly thereafter, the World Economic Forum's (the "WEF") International Business Council (the "IBC"), in collaboration with the "Big Four" accounting firms, released its recommended set of

universal ESG metrics and disclosures to measure stakeholder capitalism that they believe companies can report on regardless of their industry or region (the "Stakeholder Capitalism Metrics").

Growing Calls for a Single ESG Reporting Standard

While existing ESG frameworks and standards are largely voluntary and non-binding on public companies, market participants look to them for guidance on ESG disclosure. The proliferation of numerous ESG disclosure standards in recent years has amplified calls for a common ESG reporting framework to address "rising frustration" among corporations and investment groups over the "plethora of competing systems for measuring sustainability."[2] Although a number of organizations have emerged to translate existing information for investors and other stakeholders amid this confusion,[3] the fundamental issues related to the multitude of frameworks and standards remain. Without a single standard, it is difficult for investors to compare one company's ESG disclosures to another's, and for companies to decipher how to report ESG information in the event they report such information.

The two recent initiatives aim to establish a universal standard for ESG disclosure. As Charles Tilley, CEO of the IIRC, noted in a press release accompanying the Statement, "[w]e know that there is a lot of interest from the business, investor and regulatory community in obtaining a single standard for sustainability reporting."[4] A Deloitte executive echoed a similar sentiment in connection with the release of the Stakeholder Capitalism Metrics: "[r]ight now, there is an alphabet soup of metrics. It is important for us to have a common set of standards and if there is widespread adoption it will lead to change in behaviour."[5] A survey by the WEF found that 86% of executives agreed that "reporting on a set of universal ESG disclosures is important and would be useful for financial markets and the economy."[6]

Statement of Intent by Standard Setters

The GRI, SASB, CDSB, IIRC and CDP do not propose to create a new or merged framework or standard, but instead have suggested that the combination of their "existing frameworks, standards and standard-setting processes can provide the basis for progress towards a comprehensive corporate reporting system."[7] The Statement expresses a commitment to providing joint market guidance on how the existing frameworks and standards "can be applied in a complementary and additive way."[8]

The Statement describes a shared vision for how the various component frameworks and standards could complement generally accepted accounting principles ("GAAP") to advance a comprehensive corporate reporting system. Along with GAAP, the current standards and frameworks help create the first building block of the system, which is focused on fostering disclosure relevant to enterprise value creation. The second building block focuses on enabling the disclosure of a wider set of sustainability information relevant for a broad range of users and objectives, including the organization's significant impacts on the economy, environment and people. The Statement emphasizes the concept of "dynamic materiality," and suggests that this building block approach "also ensures that sustainability disclosure topics can move seamlessly into the annual integrated report, as and when there is evidence of a link to enterprise value creation."[9]

The Statement also expresses a joint commitment to deeper collaboration among GRI, SASB, CDSB, IIRC and CDP to ensure that their frameworks and standards are "interoperable." The Statement notes that there are several bilateral technical efforts already underway between the five organizations, such as the announcement by GRI and SASB of a collaborative workplan and the creation of a "GRI Corporate Leadership Group on integrated reporting" run by GRI and the IIRC.

The "Stakeholder Capitalism Metrics" Released by the World Economic Forum and the Big Four

In a related initiative spearheaded by the IBC in collaboration with the Big Four, the WEF released a set of "Stakeholder Capitalism Metrics" that can be used to align "mainstream reporting on performance against [ESG] indicators and track their contributions towards the . . . [Sustainable Development Goals ("SDGs")] on a consistent basis."[10] The Stakeholder Capitalism Metrics are a set of 21 "Core metrics" and 34 "Expanded metrics" curated by a taskforce comprised of experts from the Big Four. The distinction between "Core metrics" and "Expanded metrics" is described as a pragmatic approach to enhanced sustainability disclosures. (See Annex A.)

- The "Core metrics" are primarily quantitative metrics that are derived from established metrics – information already being reported or easily obtained by a firm. As shown in Annex A, many of the sources of these "Core metrics" are standards from GRI, SASB, CDSB and the IIRC, as well as the recommendations of the Task Force on Climate-related Financial Disclosures (the "TCFD"), among others. Moreover, this set of metrics primarily focuses on operations within the organization.

- The "Expanded metrics" broaden the scope of analysis to address "emerging issues – such as nature loss, resource circularity, and gender and ethnicity pay gaps – that are not yet well-represented in formal reporting standards."[11] The "Expanded metrics" assess the impacts of a company's operations on a wider value chain.

The Stakeholder Capitalism Metrics generally build upon the efforts of existing standards (*e.g.*, SASB, GRI) and attempt to use metrics from these standards when possible. The Stakeholder Capitalism Metrics also introduce new metrics. Particularly with respect to the "Expanded metrics," more advanced measurements of impact and value creation are introduced, such as reporting impact in monetary terms. Both sets of metrics are grouped under four pillars that align with the SDGs: Principles of Governance, Planet, People and Prosperity.

The authors acknowledge that many organizations may not find it easy to immediately report on both the Core and Expanded sets of metrics in their mainstream disclosures, but aim to empower companies to begin moving towards reporting on both sets "in the spirit of embracing stakeholder capitalism."[12] This approach is underpinned by the idea that materiality is dynamic – a point which is a nod to the Statement – and that the set of sustainability topics that impact enterprise value creation can quickly and rapidly expand. As such, the "Core metrics" represent issues identified as immediately relevant to the financial performance of an organization, while the "Expanded metrics" may represent information that is currently considered "pre-financial" (though a growing number of investors are beginning to integrate information about an organization's societal impact into their investment decisions). The authors encourage the broad adoption of the Stakeholder Capitalism Metrics and their inclusion in mainstream reporting through a "disclose or explain" approach, but recognize that companies will apply their own materiality lens to the metrics.

Implications

While this is not the first time that standard setters have endeavored to align ESG reporting,[13] these dual initiatives mark a significant move by the respective contributors towards clarity for investors and companies that seek to effectively communicate their ESG performance. How these parallel efforts will play out and whether one of these approaches becomes dominant internationally remains unclear. The same day the Statement was released, the International Federation of Accountants ("IFAC") called for the creation of a new sustainability standards board that would exist alongside the International Accounting Standards Board (IASB) under the International Financial Reporting Standards (IFRS) Foundation. The IFAC press release recommended that "the proposed board adopt a 'building blocks' approach [as presented in the Statement], working with and leveraging the expertise and disclosure requirements of the CDP, CDSB, GRI, IIRC and SASB."[14] At the same time, the Stakeholder Capitalism Metrics carries behind it the weight of the IBC as well as the Big Four. At least two-thirds of the IBC's members have indicated that they would immediately embrace the initiative.[15]

These two initiatives also demonstrate how private institutions are stepping in to fill a void, as regulatory bodies have not yet established a standard that has reached global prominence. That said, regulatory bodies may take a more active role going forward, particularly in Europe. The Secretary-General of the International Organization of Securities Commissions ("IOSCO"), an international association of securities regulatory bodies, announced plans in 2020 to create a task force to translate the different standards into "a more cohesive, transparent and more standardized form."[16] In July 2020, the European Commission appointed a task force through the European Financial Reporting Advisory Group ("EFRAG") to undertake preparatory work for the elaboration of possible EU non-financial reporting standards. The task force is scheduled to release a progress report at the end of October 2020.[17]

Looking Ahead

A growing number of organizations are taking steps to provide stakeholders with relevant, comparable information to accurately assess an organization's ESG performance relative to industry peers. The efforts to consolidate sustainability disclosure standards by leading standard setters, the IBC and other international and regulatory bodies suggest that unified standards may be established soon, though their exact form is still unknown. As the creators of the Stakeholder Capitalism Metrics note, many companies may find it challenging to start making non-financial disclosures. In the United States, some companies may also hesitate to make voluntary disclosures on social or other expanded metrics out of concern for potential liability risks. Companies should monitor these developments closely and begin preparing for the possibility of an enhanced ESG disclosure economy, whether required by regulators or in response to market pressure.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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Annex A

Stakeholder Capitalism Metrics: Summary of Core Metrics

ESG Domain	Theme	Core Metrics and Disclosure	Source
Principles of Governance	Governing purpose	*Company's stated purpose*	▪ The British Academy and Colin Mayer ▪ GRI 102-26 ▪ Embankment Project for Inclusive Capitalism (EPIC) and others
	Quality of governing body	*Composition, competencies, demographics, independence, and other descriptors of highest governance body*	▪ GRI 102-22 ▪ GRI 405-1a ▪ IR 4B
	Stakeholder engagement	*Material issues impacting stakeholders*	▪ GRI 102-21 ▪ GRI 102-43 ▪ GRI 102-47
	Ethical behavior	*Anti-corruption training, policies, incidents, and stakeholder engagement initiatives*	▪ GRI 205-2 ▪ GRI 205-3
		Protected ethics advice and reporting mechanisms	▪ GRI 102-17
	Risk and opportunity oversight	*Identification of material risk factors and opportunities facing the company*	▪ EPIC ▪ GRI 102-15 ▪ WEF Integrated Corporate Governance ▪ IR 4D
Planet	Climate change	*Greenhouse gas (GHG) emissions reporting*	▪ GRI 305:1-3 ▪ TCFD ▪ GHG Protocol
		TCFD implementation	▪ Recommendations of the TCFD ▪ CDSB R01, R02, R03, R04 and R06 ▪ SASB 110 ▪ Science Based Targets initiative
	Nature loss	*Land use and ecological sensitivity reporting*	▪ GRI 304-1

<table>
<tr><th>ESG Domain</th><th>Theme</th><th>Core Metrics and Disclosure</th><th>Source</th></tr>
<tr><td></td><td>Freshwater availability</td><td>Water consumption and withdrawal reporting in water-stressed areas, including estimates for entire upstream and downstream value chain</td><td>▪ SASB CG-HP140a.1, WRI Aqueduct water risk atlas tool</td></tr>
<tr><td rowspan="6">People</td><td rowspan="4">Dignity and equality</td><td>Diversity and inclusion indicators per employee category</td><td>▪ GRI 405-1b</td></tr>
<tr><td>Pay equality indicators (basic salary and remuneration) per employee category (e.g., men to women)</td><td>▪ Adapted from GRI 405-2</td></tr>
<tr><td>Wage levels ratios (e.g., standard entry-level wage to local minimum wage and CEO to median employee total annual compensation)</td><td>▪ GRI 202-1
▪ Adapted from Dodd-Frank Act, US SEC Regulations</td></tr>
<tr><td>Risk management for incidents of child, forced or compulsory labor</td><td>▪ GRI 408-1b
▪ GRI 409-1</td></tr>
<tr><td>Health and well-being</td><td>Health and safety indicators, including scope of healthcare access provided for employees</td><td>▪ GRI:2018 403-9a&b
▪ GRI:2018 403-6a</td></tr>
<tr><td>Skills for the future</td><td>Training provided (hours and total spend) by gender and employee category</td><td>▪ GRI 404-1
▪ SASB HC 101-15</td></tr>
<tr><td rowspan="3">Prosperity</td><td>Employment and wealth generation</td><td>Absolute number and rate of new employment and turnover by demographic categories

Direct economic value generated and distributed; financial assistance received by the government

Total CAPEX minus depreciation; share buybacks plus dividend payments</td><td>▪ Adapted, to include other indicators of diversity, from GRI 401-1a&b
▪ GRI 201-1
▪ GRI 201-4
▪ As referenced in IAS 7 and US GAAP ASC 230</td></tr>
<tr><td>Innovation of better products and services</td><td>Total R&D expenditures</td><td>▪ US GAAP ASC 730</td></tr>
<tr><td>Community and social vitality</td><td>Total tax paid by category of tax</td><td>▪ Adapted from GRI 201-1</td></tr>
</table>

1 CDP, CDSB, GRI, IIRC and SASB, "Statement of Intent to Work Together Towards Comprehensive Corporate Reporting" (September 11, 2020), available here.

2 Gillian Tett, "Big Four accounting firms unveil ESG reporting standards," *FT* (September 22, 2020), available here.

3 For example, the Impact-Weighted Accounts Initiative ("IWAI") at the Harvard Business School has published frameworks measuring an organization's environmental, employment and product-related impact, with the aim to "create accounting statements that transparently capture external impacts in a way that drives investor and managerial decision making." *See*

Harvard Business School Impact-Weighted Accounts, "Mission Statement," available here. Moreover, research from the IWAI has connected measures of environmental impact to market valuation and other key financial performance indicators. Moreover, research from the IWAI has connected measures of environmental impact to market valuation and other key financial performance indicators.

4 Charles Tilley, "A shared vision for a comprehensive, globally accepted corporate reporting system" (September 11, 2020), available here.

5 Gillian Tett, "Big Four accounting firms unveil ESG reporting standards," *FT* (September 22, 2020), available here.

6 World Economic Forum, News Release, "Measuring Stakeholder Capitalism: Top Global Companies Take Action on Universal ESG Reporting" (September 22, 2020), available here.

7 CDP, CDSB, GRI, IIRC and SASB, "Statement of Intent," at 13.

8 *Id*. at 17.

9 *Id*. at 13. The authors note that one of the reasons that sustainability disclosure is necessarily more complex than financial reporting is due to "dynamic materiality," a concept which captures how the "nature of sustainability topics, including their interest to different types of users of information and their influence on companies' performance, can also change, sometimes slowly but sometimes rapidly." *Id*. at 2.

10 World Economic Forum, in collaboration with Deloitte, EY, KPMG and PwC, White Paper, "Measuring Stakeholder Capitalism Towards Common Metrics and Consistent Reporting of Sustainable Value Creation" (September 2020), available here, at 3. For more on the UN SDGs, see our recent client alert, available here. The authors define "stakeholder capitalism" as best exemplified by "corporations that align their goals to the long-term goals of society, as articulated in the SDGs, [which] are the most likely to create long-term sustainable value, while driving positive outcomes for business, the economy, society and the planet." *Id*. at 7.

11 *Id*. at 6.

12 *Id*. at 14.

13 For example, in 2018, GRI, SASB, CDSB, IIRC and CDP launched the "Better Alignment Project," which was a "two-year project focused on driving better alignment in the corporate reporting landscape" with a focus on aligning standard with the recommendations published by Task Force on Climate-related Financial Disclosures ("TCFD"). *See* Corporate Reporting Dialogue, "Better Alignment Project," available here. The project issued a report in September 2019 "standards and frameworks against the seven principles for effective disclosure, the 11 recommended disclosures and 50 illustrative example metrics detailed in the TCFD recommendations." Corporate Reporting Dialogue, "Driving Alignment in Climate-related Reporting: Year One of the Better Alignment Project" (September 2019), available here. For more information on the TCFD and the TCFD recommendations, see our client alert here.

14 IFAC, Press Release, "IFAC Calls for Creation of an International Sustainability Standards Board Alongside The International Accounting Standards Board (IASB)" (September 11, 2020).

15 Gillian Tett, Andrew Edgecliffe-Johnson and Billy Nauman, "Davos 2020: Companies sign up to environmental disclosure scheme," *FT* (January 22, 2020), available here.

16 Siobhan Riding, "Global regulatory body to harmonise 'plethora' of ESG standards," *FT* (September 7, 2020), available here.

[17] EFRAG, "EFRAG Mandated to Provide Recommendations on Possible European Non-Financial Reporting Standards" (July 2, 2020), available here.