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# SUSTAINABILITY REPORTING ISSUES

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**Abstract.** For a long time, investors and other interested parties have not been satisfied with the only financial achievements of companies - profitability, dividend payments and other financial indicators. Today, investors are interested in the long-term sustainability of companies -social and environmental responsibility, which becomes the basis for making investment decisions. With the efforts of the governments and financial institutions of the world's leading countries, significant work has been done on defining and evaluating ESG sustainability principles and creating unified global international standards. As of today, the International Sustainable Standards Board (ISSB) has developed draft standards, which are still under review, requiring analysis, implementation and taxonomy with IFRS standards - presentation and disclosure requirements. Familiarization with the ESG principles of sustainability and the IFRS S1 and S2 sustainability reporting projects developed by ISSB; understanding the importance of prospective scenarios for the information on climate change risks (physical and transition); and studying the issues of consolidation with IFRS standards. Guiding recommendation materials of ISSB, international audit companies ("Big Four"), scientific articles, methods of systematization and comparative analysis. The concepts of sustainable development are familiarized; ISSB projects and the "Big Four" methodological materials are analyzed. Furthermore, corporations will be required to submit sustainability reports commencing in 2024.

**Keywords:** ESG-principles; Non-financial risks; ISSB Projects; Physical and transition risks of climate change.

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## 1. Introduction

At present, sustainable development is the focus of shareholders and investors of all large corporations; they are interested not only in the financial indicators of business but also in their business and ethical behavior − the sustainability of corporations and the management of associated risks. Sustainable development of commercial activities is based on three principles of so-called ESG (Environmental, Social, and Corporate Governance; i.e., A set of management characteristics of a company in which the involvement of this company in solving environmental, social and governance problems is achieved): responsible attitude towards the environment, (Environment), high social responsibility (Social); and high degree of corporate governance (G).

Environmental principles determine how the climate changes, how much the company cares about the environment, and how it seeks to reduce damage caused to the environment. Social principles relate to employees' working and remuneration conditions, gender equality, and the company's attitude towards personnel, suppliers, partners, and customers. Businesses should take care of the quality of working conditions, monitor gender balance, and invest in educational and social projects. The corporate governance principles require conducting business in good faith and as transparent as possible, which impacts the quality of the company's management: transparency of reporting, management salaries, a healthy environment in offices,

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relations with shareholders, and anti-corruption measures. Sustainable development principles affect business reputation and financial health (Bainbridge, 2021; Hussain et al., 2022). Comprehensive sustainable reporting should include non-financial information on these three key aspects, providing investors, government institutions and the general public with information on the goals and objectives of business responsibility.

## 2. Sustainable Development Reporting Standards

### 2.1. Creation of TCFD

It is generally accepted that the economy of the 21st century must be efficient and sustainable. At the same time, creating a "green planet" poses a significant challenge to the economy, ecology, and climate. Climate change is an urgent, global and systemic problem that can threaten the sustainability of organizations, markets and economies. It contains physical risks (such as severe weather conditions) and transition risks (associated with transitioning to a low-carbon economy, which may influence asset values or lead to higher business running costs). Transitioning to low-carbon technologies will change how the economy works, creating uncertainty and significant opportunities. Climate change requires reliable assessment of climate risks, flexible business practices, and the disclosure of high-quality information to support fighting against climate change and support adaptation (IFAC, 2023).

The International Organization of Securities Commissions (IOSCO) and others require transparent information on the impact of climate change risks on businesses and business sustainability. Disclosure of essential information about significant risks and opportunities related to companies' sustainability has become crucial for investors to assess business value and implement new investments.
In this regard, in 2015, the leaders of the "Group of Twenty" (G20) appealed to the Financial Stability Board (FSB) with a request to analyze the possible consequences of climate change on the global economy. It became necessary to study the issue in two aspects: the risks that lead to climate change and the risks of a new type of low-carbon transition to a low-carbon economy.

As a result of studies, it became obvious that the disclosed information is unsatisfactory, which is a factor in the instability of the entire world economy. The FSB immediately established the TCFD (Taskforce for Climate-related Financial Disclosures) in response.

The main goal of TCFD is to disclose financial impact information on climate risks and opportunities so that investors and creditors can understand how climate-related risks and opportunities will affect companies' future financial position, allowing them to make sound financial decisions (Carney, 2017). The main essence of the recommendations developed by the TCFD lies in the approach itself: this is the disclosure of information about the impact of climate change on the company's activities and not on the environmental effects of the company.

The ultimate goal of TCFD is to disclose financial information, but the main tool is non-financial information. The reasons for this are the variety of possible climate scenarios and the difficulties of digitizing their financial results.

According to TCFD recommendations, information on the impact of climate on the activities of companies is disclosed in four main areas: Governance; Strategy; Climate Risk Management; Key and Target Indicators (quantitative indicators of the level of climate impact on the company's activities, monitoring and analysis of their behavior). During its work, TCFD, as earlier as in 2017 published its recommendations, which received the support of more than 3,000 companies and 92 countries around the world. The project received special support from the "Group of Seven" (G7).

The impact of climate change on the environment and business income is unconditioned. So, in the US in 2021, companies' losses due to climatic conditions amounted to $145 billion. Business executives need information about the impact of climate change to manage risk and look for new opportunities. At the request of the US Securities and Exchange Commission (SEC), all public companies whose shares are sold on the US Securities Exchange (annual stock trading amounts to $82 Trillion) (Dasgupta, 2022) are obliged to disclose information about the impact of climate risk changes on income.

According to the results of the United States Stock Exchange equity surveys conducted by the EGS Sustainability and leading consulting firm Governance and Accountability Institute (G&A), 92% of companies listed in the S&P 500 index and 70% of the Russell 1000, published Sustainability Reporting in 2020 (G&A Institute, 2022).

Leading companies, such as Apple, Best Buy, Coca-Cola, Cargill, Ford, Gap, Hilton, and Starbucks, have disclosed information about climate change-related risks, including in their production-sale chain. Oil giants such as Shell, Total Energies and Equinor have accumulated experience in greenhouse gas emission reporting in their value creation chain. However, businesses use different approaches to climate risk assessment and disclosure, while most do not publish this information at all, although they manage it. As a result, environmental and social risks and their consequences are unknown to investors.

The analysis of the quality of the disclosed information shows that non-financial information, in accordance with the ESG principles, does not include unified and comprehensive indicators prepared based on the unified methodology and is submitted in various forms: it is published within the framework of an annual report, in the form of an independent sustainable development report like Corporate Social Responsibility CSR) Report (which is the most common approach) or is a form of integrated report. Due to such a condition, information loses its degree of comparability in most cases. Analytical agencies indeed assess the effectiveness of companies according to ESG principles. Still, due to the lack of a unified assessment methodology, the assessment of the same companies in different ratings can be distinguished. Therefore, the need to develop a unified methodology for disclosing non-financial information is on the agenda.

### 2.2. Necessity for ISSB formation

In 2021, the UN Climate Conference in Glasgow COP26 announced the formation of ISSB (International Sustainability Standards Board). The Board aims to create uniform standards for disclosure of non-financial information in accordance with the basic ESG principles and requirements to assess risks and opportunities by investors. In the same year, the G7 Summit noted the importance of this Board and expressed support for creating global reporting standards (George, 2022). Following the Summit, central banks and major companies of G7 member states undertook Environmental Policy and financial stability risk assessments (Moody's Analytics, 2021), which will contribute somewhat to reach by 2050 the "Zero Emissions Level" under the Paris Agreement. In particular, the Summit Communique recorded the countries' consent to submit mandatory climate reporting.

In April 2021, the European Union adopted a new draft on corporate reporting - Proposal for a Corporate Sustainability Reporting Directive (CSRD) (European Commission, 2023), which extends the requirements for Sustainable Development Reporting. The new directive came into force in 2023 of 5 January, and applies to all large and all public companies. According to the new directive, a detailed reporting standard has also been developed and reporting audits will become mandatory. In addition to General Data, it imposes additional obligations on each industry. For example, in the automotive or aviation industry, there are five important common themes within ESG: Product safety, labor practices, fuel economy and emissions, the origin of materials, and efficiency of use and recycling the materials.

The G7 summit in 2022 noted that despite new social and economic problems -the COVID pandemic which continues, and Russia's war in Ukraine, which is exacerbating the cost and access to food and energy, the "Climate Protection:  remains a long-term priority (George, 2022).

### 2.3. Structures and Concepts for Developing ESG Reporting

Currently, through the efforts of governments and institutions worldwide, the following leading structures of sustainability reporting standards developers are operating. Their current goal is to harmonize existing sustainability concepts - to bring them into line within a single report. These include:

The UN Sustainable Development Goals (SDG) - The “2030 Agenda for Sustainable Development" approved by the UN in 2015. The document focuses on global issues such as the eradication of poverty and hunger, health

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and well-being, quality education, gender equality, decent work, economic growth, the fight against climate change, etc. (Government of Georgia, 2019, i.e. In 2015, Georgia, along with all other UN member states, expressed a desire to implement the Sustainable Development Goals and Objectives set for 2030. Considering the country's challenges and national context, all 17 goals and 93 sustainable development objectives (base and target indicators of 201 indicators by 2030) have been identified as national priorities. Decree of the government of Georgia #2328 dated 12 November 2019);

GRI (Global Reporting Initiative, established in 1997) published the CSR - the most widely used Corporate Social Responsibility business model in the world, which helps companies to be socially accountable to themselves, their stakeholders and society, and in 2000 published the Sustainability Reporting Standards (GRI) The GRI Standards are the most widely recognized and widespread standard in the world. According to the 2020 survey, two-thirds of the world's largest and medium-sized companies and three-quarters of the largest 250 companies use the GRI standard for Sustainable Development Reporting (Threlfall et al., 2020);

The SASB (Sustainability Accounting Standards Board – 2011) focuses on rules for reflecting sectoral specifics in sustainability reporting. In particular, determine the environmental, social and governance issues that are most important for the financial performance of various industries and the value of the enterprise (Hummel, Schlick & Fifka, 2019);

Taskforce for Climate-related Financial Disclosures (TCFD), which was established in 2015 and in June 2017, presented the final variant of the disclosure recommendations;

International Sustainability Standards Board (ISSB 2 2021) is involved in the creation of uniform standards for the disclosure of non-financial information;

IIRC (International Integrated Reporting Council) - One of his work programs is the development of unified corporate integrated reporting. This reporting pays special attention to the business's ability to create "new value" based on E.BC. The concept of" integrated thinking". Such global companies as Danone, Deloitte, HSBC, KPMG, Microsoft, Coca-Cola, Unilever, Volvo and others actively support this concept.

Thus, scientists and practitioners express the opinion that reporting based on sustainability concepts will contribute to the disclosure of high-quality and accurate information, reduce the risk of "symbolic behavior" (Hummel & Schlick, 2016), and increase the transparency and reliability of the information. Presenting such information to external consumers will help prevent the "greenwashing" of products, brands and reputations - misleading consumers from unfounded and dubious ecological positioning (Avi, 2022).

## 3. Further development implications

In general, the reports will disclose information about how the company carries out its operations in accordance with the worldwide recognized principles of sustainable development, established international standards and documents (Ibáñez-Forés et al., 2022). The report also reflects promising information in all areas of sustainability, including climate strategy information: quantitative assessment of climate risks, new energy management and energy efficiency solutions, use of renewable energy sources and generation of own electricity.

It is in the interests of the Board of directors and management of corporations to present information relevant to ESG objectives and to assess their contribution to the Sustainable Development Goals, which will contribute to raising their ratings. Companies that do not pay attention to ESG risk lose investors' confidence, access to the capital market and a reputation for sustainable business (Khatri & Khatri, 2023).

### 3.1. ISSB Projects

ISSB aims to create a comprehensive global international sustainability disclosure system that will provide investors and other capital market participants with information on sustainability-related risks and opportunities for companies to help them assess business value and make informed decisions (International Sustainability Standards Board, 2021).

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In view of these goals and taking into account the recommendations of the TCFD, in March 2022 the ISSB published two draft standards for consideration (IFRS Foundation for the convenience of interested parties, 2022). The first includes general requirements for Disclosure of Sustainability Information (Exposure Draft on IFRS S1 general Requirements for disclosure of sustainability-related Financial Information), and the second concerns climate-related disclosure requirements (Exposure Draft on IFRS S2 Climate-related Disclosures). As a result of the initial consideration of the project, the council received more than 1300 responses from state, academic, public bodies, investors and audit associations. Public discussion of the projects took place on 14-15 December 2022.

### 3.2. S1 – General Requirements

The draft general requirements presentation states that an accountable enterprise should be required to disclose relevant and substantive information about all significant sustainability-related risks and opportunities to which it is exposed (Al-Shaer & Hussainey, 2022). Such information will be useful to the main users of general-purpose financial statements when making decisions about the enterprise's resources. The merits of information are assessed by users of general-purpose financial statements in the context of information necessary to assess the value of the enterprise.

Companies are required to disclose up-to-date and reliable information about corporate governance, strategy, risk management, performance and goals. The usefulness of the information provided increases if it is comparable, verifiable, timely and perceptible.

When financial information related to sustainability cannot be quantified but can only be evaluated, using reasonable estimates is an important part of preparing sustainability disclosures and does not violate the usefulness of information if estimates are clearly and accurately described and explained (Shad et al., 2020). When sustainability disclosures include financial data and assumptions, they should be reconciled as far as possible with the relevant financial data and assumptions in the financial statements.

According to TCFD, a company's financial statements should include a complete, unbiased and accurate description of ESG - risks to help the users of financial statements predict future cash flows and valuation of companies.

### 3.3. S2 - Climate

The Board focuses on climate-related reporting due to the general urgency of this issue and the requests for information from investors, banks and lenders on other ESG issues.

Climate change is an urgent, global and systemic problem that can threaten the sustainability of organizations, markets and economies. Climate change causes physical and transition risks. Physical risks generate financial losses associated with natural disasters and gradual climate changes (temperature changes, rainfall amounts, sea levels, constant glacial melt, etc.). Financial losses from physical risks are property depreciation, price increases, income reduction, bankruptcy, etc.

The transit risks generate financial losses associated with the transition to a low-carbon economy, which can affect asset values or lead to higher costs of running a business. Transit to low-carbon technologies will change how the economy works, creating uncertainty and significant opportunities.

Climate change requires reliable climate risk assessments, flexible business practices, and the disclosure of high-quality information to help fight climate change and support adaptation (IFAC, 2022).

Some experience in disclosing climate change risk information has already been accumulated in the banking, insurance, and asset management sectors, while the information disclosed in 2019 by energy sector companies, according to the compliance and quality of TCFD recommendations, was considered the best.

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International audit company EY (Ernst & Young) in 2018-2019, with the recommendations of the TCFD, conducted a survey of disclosed climate change information, which covered 34 companies from 970 countries. The analysis found that only 54% of the companies under consideration disclosed information to this or that degree about the risks associated with climate change, and the quality of the information itself was estimated from 100%, which means taking into account all recommendations, by 27%. The highest rate of the degree of disclosure of information was observed in US companies - 63% compared to the average 27% (Nelson, 2020).

The survey has shown that companies are trying to determine the financial impact of climate change risks and opportunities by exposing risk scenarios for transitioning to a low-carbon economy rather than physical risk impact scenarios for climate change. Estimates are often formed in isolation from climate scenarios. Companies do not use climate scenarios, which reduces their ability to test the impacts of climate risks on their business and make a prospective assessment of its sustainability in the face of the transition to a low-carbon economy (Kang & Kim, 2022).

## 4. Conclusions and recommendations

On 5 January 2023, the Corporate Sustainability Reporting Directive (CSRD) came into force, replacing the NFRD (Non-Financial Reporting Directive). The new directive has updated and tightened the rules for companies to submit social and environmental information that ensures detailed and standardized disclosure of ESG information and its independent verification and audit.

CSRD requirements will gradually cover 50,000 state and non-public companies. The first companies will have to apply the new rules for the first time in fiscal year 2024 for reports published in 2025. The new rules ensure that investors and other stakeholders can access the information they need to assess investment risks related to climate change and other sustainable development issues. They will also create a culture of transparency regarding the impact of companies on people and the environment (European Commission, 2023).

Information on how the company conducts its operating activities in accordance with the principles of Sustainable Development established by international standards and documents will be disclosed in the reporting. Also, the report reflects promising information in all directions of sustainability, including climate strategy, quantitative assessment of climate risks, new energy management and energy efficiency solutions, use of renewable energy sources and generation of own electricity (Alghamdi & Agag, 2023).

It is in the interests of the Board of directors and management of corporations to present information relevant to ESG tasks, and evaluate their contribution to the Sustainable Development Goals, which will contribute to raising their ratings. Companies that do not pay attention to ESG risk may lose investor's confidence, access to the capital market and a reputation for sustainable business.

Companies must present information about their resilience to risks - the risks of transitioning to a low-carbon economy and the physical risks associated with climate change. In addition to climate risk management, information on prospective climate change impact scenarios and integration of climate risk management into the overall risk management process of the company is essential.

Disclosure and analysis of information on climate change risks and their capabilities (legislative, reputational, technological, market, physical) will improve understanding, macroeconomic analysis and modeling of the macroeconomic consequences of climate change (G7 Germany, 2022). Uniform rules for assessing and disclosing climate risks provide quality information, an equal competitive environment and the right investment decision.

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