


EDITORIAL

SUSTAINABILITY REPORTING FROM THE EU PERSPECTIVE: STATE OF THE ART AND RESEARCH OPPORTUNITIES

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The aim of this editorial is to discuss the most recent developments of sustainability reporting – in terms of regulation and disclosure standards – from the EU perspective. Arguably, the EU is one of the institutional contexts that has been investing more heavily on sustainability from a regulatory standpoint. Reviewing the most relevant legislation (in particular, the Corporate Sustainability Reporting Directive – CSRD) and standards (the European Sustainability Reporting Standards – ESRS) is useful to predict possible evolutions in other contexts as well as to identify future research opportunities.

Differently from other contexts¹, in the EU the legislation on sustainability reporting is issued by an institution, the European Commission, that has a broad and political mandate. More specifically, the Commission aims at achieving a resource-efficient and competitive economy without net greenhouse gas emissions until 2050 and is based on the Paris Climate Agreement and the 2030 UN Agenda for sustainable development from 2015, the European Green Deal 2019, the EU Climate Law from 2021 and the EU Biodiversity Strategy 2030 from 2020 (see Odoša & Marošević, 2023). In this context, the establishment of a comprehensive and mandatory European framework for non-financial reporting by companies and the standardization of information on sustainability has been considered key in reaching the goal of a sustainable economy.

In order to encourage the business sector in the direction of strengthening sustainability, the EU has already taken a significant step forward in sustainability reporting in 2014, with the introduction of the Non-Financial Reporting Directive (NFRD). Despite the efforts made, the EU had to recognize the inadequacy of the existing framework of rules for non-financial reporting and the necessity of revising the NFRD.

Therefore, in April 2021, it presented a proposal for a new directive on corporate sustainability reporting (CSRD), for which the Union member states reached a unanimous agreement during the first half of 2022. After that, the Council approved the position of the European Parliament on 16 November 2022, which meant that the legislative act was adopted (see

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¹ For instance, in the United States the Climate related disclosure has been proposed by the Securities and Exchange Commission (SEC), for which the main purpose is to enforce laws against market manipulation.

Odobaša & Marošević, 2023). The application of CSRD started in January 2023. More specifically, CSRD must be applied as from 1 January 2024 (first reports in 2025) for companies that are already subject to NFRD; as from 1 January 2025 (first reports in 2026) for non-listed large companies; as from 1 January 2026 (first reports in 2027) for listed SMEs; as from 1 January 2028 (first reports in 2029) for non-EU companies with branches/subsidiaries.

Compared to NFRD, CSRD led to a significant increase in the number of companies that will have to publish sustainability reports, from approximately 11,700 to approximately 49,000 companies and groups across the Union.

CSRD requires companies to provide the following information: description of business model and strategy as well as opportunities and resilience to sustainability risks and transition plans; targets and their progress status; company sustainability governance (administrative, management and supervisory bodies and their expertise and skills to fulfil their role); incentives schemes linked to sustainability matters; sustainability policies; due diligence of sustainability matters and the process to conduct it; company's principal and adverse impacts and actions to prevent, mitigate and remediate; principle risks and their management; information on business operations, value chain, including products and services and business relationships and its supply chain.

More specifically, companies must report in accordance with the European sustainability reporting standards (ESRS) adopted by the European Commission via delegated acts after technical advice of EFRAG².

One key feature of CSRD and ESRS is the concept of double materiality: companies need to report both on financial (outside-in) materiality and on impact (inside-out) materiality.

Financial materiality is used by private sector developed ESG metrics, such as ESG rating agencies. Besides, some reporting standards (SASB, IR, IFRS) take a financial materiality approach, focusing on investors' information needs. There is a growing body of literature looking at the effects of sustainability reporting on stock returns and market liquidity (Christensen et al., 2021; Holthausen & Watts 2001; Flammer, 2013; Christensen et al., 2017; Albuquerque et al., 2020). The general theme of this literature is that sustainability disclosure can lead to tangible capital-market benefits in the form of improved liquidity, lower cost of capital, higher asset prices (or firm value), and potentially better corporate decisions.

Impact materiality considers to be material any environmental and social impact of the company's activities that has an impact on a broad range of stakeholders. This perspective is typically of most interest to citizens, consumers, employees, business partners, communities and civil society organizations. Such approach is followed by some reporting standards such as the Global Reporting Initiative (GRI).

CSRD and double materiality are consistent with the idea that connections between firms, community and the environment are necessary in the light of the interdependencies between them. As pointed out by Porter and Kramer (2011), shared value is "the policies and practices that enhance the competitiveness of a company while simultaneously advancing social and economic conditions in the communities in which it operates". The central premise behind creating shared value is that the competitiveness of a company and the health of the communities around it are mutually dependent.

These evolutions in the normative and market landscape generate relevant research opportunities.

² EFRAG (European Financial Reporting Advisory Group) is a private association founded in 2001 with the encouragement of the European Commission, and after 2022 and the adoption of CSRD as a delegated organization, it provides technical advice to the Commission regarding European sustainability reporting standards. In this regard, EFRAG is a world-renowned center of expertise.

The research question on the effects of mandated sustainability disclosure is timely and relevant (see Christensen et al., 2021) and the EU context can be used to investigate the impacts of mandated sustainability disclosure from several perspective.

More specifically, more evidence is needed on the effects of mandated sustainability disclosure on capital markets. Even if there is already a wide literature on voluntary sustainability disclosure, such results cannot be applied to the mandatory context. In fact, voluntary sustainability disclosure has been investigated primarily relying on legitimacy theory, which predicts that companies disclose sustainability information to avoid misalignments with societal priorities and therefore stakeholders' "punishments". Mandated sustainability reporting requires different theoretical frameworks as well as empirical analyses: in the mandatory context sustainability reporting cannot be seen as a signal of ethical behavior or long-term orientation and legitimacy theory cannot be applied.

A growing stream of literature is focusing on ESG ratings, which provide information on the sustainability performance of companies to capital markets. This literature generally finds a high degree of disagreements among ESG rating agencies (see, among the others, Berg et al., 2022). Future research may investigate whether mandatory sustainability disclosure reduces or exacerbate ESG rating disagreement. Such results may also be used to advance knowledge on the intrinsic nature of ESG ratings.

Reporting standards are not only used to provide information to capital markets but also to influence corporate culture and corporate behavior. This is the case especially in the EU context, given that reporting has also the aim to guide companies towards a sustainable economy. Researchers may look at the real effects of mandated sustainability reporting. Also in this case, given the different nature of voluntary and mandated sustainability reporting, the results are not obvious (see Christensen et al, 2021 for a review of real effects of voluntary sustainability disclosure). Also relying on the idea of normativity, researchers may investigate whether corporate behavior is driven more significantly by voluntary or mandatory reporting and why.

Finally, from an international accounting perspective, researchers may investigate the conditions under which mandatory reporting can be (or is) effective conditional on the institutional context. The premise of this research question is that a certain "institutional fit" with other institutional features is required for a regulation to be effective.

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