AT A GLANCE

Requested by the ECON committee

Study in Focus

The role of non-financial performance indicators and integrated reporting in achieving sustainable value creation

The original full study[1] is a structured analysis of the current scientific evidence on the effects of sustainability reporting including non-financial performance indicators, stand-alone sustainability reporting as well as integrated reporting. It discusses the benefits and challenges particularly related to internal decision-making, external transparency as well as financial and non-financial/environmental, social and governance effects. Further, it offers policy recommendations in view of the European Commission's proposal on the Corporate Sustainability Reporting Directive.

Check out the original full study by scanning this QR code!

Background

Among its 17 Sustainability Development Goals (SDGs), the UN calls via SDG 12 for "Responsible consumption and production" and directly addresses firms and their behaviour through Target 12.6 "Sustainable practices in companies". The latter comprise not only firms' actions towards more sustainability but also the reporting about it. Non-financial or sustainability reporting allows companies to provide information on their environmental, social and governance (ESG) activities and their impact on environment and society. Such information is necessary for different stakeholders in order to assess whether companies' practices are indeed sustainable.

Most of the non-financial information provided to date is voluntary as there are only few settings with a corporate social responsibility (CSR) mandate. Directive 2014/95/EU, which is the Non-Financial Reporting Directive (NFRD), is an exception as since 2018 it requires large public-interest companies with more than 500 employees in the European Union (EU) to disclose environmental and social information.

This Directive has been the focus for discussion resulting in a proposal by the European Commission (EC) on 21 April 2021 for a Corporate Sustainability Reporting Directive (CSRD) amending the existing NFRD by extending the scope of companies subject to the mandate, requiring the assurance of reported information and envisaging the adoption of EU sustainability reporting standards.

The development of the latter is accompanied by concurrent international initiatives, trying to consolidate and harmonise the scattered landscape of already existing sustainability reporting frameworks. These include the merge between the U.S. Sustainability Accounting Standards Board (SASB) with the Integrated Reporting Council (IIRC) in June 2021, the public announcement in September 2020 of the intent to work together by CDP (formerly Carbon Disclosure Project), Climate Disclosure Standards Board (CDSB), Global Reporting Initiative (GRI), IIRC and SASB, and the announcement in February 2021 by the IFRS Foundation to establish an International Sustainability Standards Board (ISSB) next to the International Accounting Standards Board (IASB).

Policy Department for Economic, Scientific and Quality of Life Policies
Directorate-General for Internal Policies
Authors: Tami DINH, Anna HUSMANN and Gaia MELLONI
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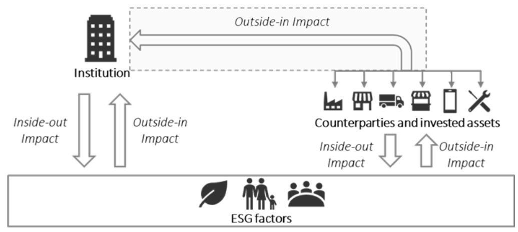
Against this background, this study was written to provide academic insights on the effects of sustainability reporting including non-financial performance indicators, stand-alone as well as integrated reporting in order to understand their role on sustainable value creation. Based on these insights, suggestions for the future of sustainability reporting are proposed.

Key findings

The review of the extant prior literature on sustainability reporting shows that there are different effects related to providing such information. Some of these effects result from higher transparency, which is particularly relevant for external stakeholders such as investors as there are observable benefits for market valuation, liquidity, risk and cost of equity and debt capital. Other effects are internal as they change how managers make decisions affecting investment efficiency and risk management. These real effects can turn into actual ESG effects, i.e. sustainability reporting may result in improved environmental or social conditions such as higher working safety and lower greenhouse gas (GHG) emissions. The scientific evidence is not unambiguous though as some studies also suggest no or negative effects related to sustainability reporting. Particularly if provided on a voluntary base with no or low assurance, there is a risk of greenwashing and impression management.

Relationship between institutions and ESG factors through the outside-in and inside-out perspective



Source: Based on European Banking Authority 2021.

The contradictory findings can be related to the very heterogeneous subject of study as sustainability information and related effects highly vary depending on measures, regulatory frameworks and institutional settings. There are many managerial choices available also for entities subject to the CSR mandate under the EU NFRD, such as, e.g. whether to use KPIs or narratives, to have the information assured or not and how to report it (in a separate or integrated report). Results from previous literature have to be interpreted in the specific context in which they have been obtained.

Hence, specific regulatory mechanisms are needed to ensure that sustainability reporting is beneficial for different stakeholders. Based on the literature review, the study proposes suggestions for the future of sustainability reporting including:

- a mandate for sustainability reporting for public firms and non-listed firms above specific thresholds;
- sustainability reporting standards that ensure comparability but with reasonable flexibility and that allow for managerial discretion, particularly to consider:
  - specifics of the financial sector; and
  - proportionality for small- and medium-sized entities;
- a mandate for assurance, preferably reasonable assurance;
- proper institutions, enforcement and public oversight; and
- a focus on a multi-stakeholder perspective.

The double-materiality criterion inherent in both the EU NFRD and the EC CSRD proposal is a powerful tool to address all stakeholders allowing for a more holistic view when addressing the UN SDGs.

[1] DINH, T., HUSMANN, A. and MELLONI G., 2021, *The role of non-financial performance indicators and integrated reporting in achieving sustainable value creation*, Publication for the committee on Economic and Monetary Affairs, Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament, Luxembourg. Available at: https://www.europarl.europa.eu/RegData/etudes/STUD/2021/662944/IPOL_STU(2021)662944_EN.pdf

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Administrator responsible: Udo BUX; Editorial assistant:s Catherine NAAS, Mina DRAGANSKA
Contact: Poldep-Economy-Science@ep.europa.eu
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