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ESG Reporting: Challenges and Opportunities for Accountants and Auditors

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Introduction

Environmental, Social and Governance (ESG) issues such as climate change, natural resources protection, harmful labor practices, employee diversity and leadership ethics have captured the attention of individuals and communities around the world. As this focus intensifies, businesses and organizations are realizing that effectively addressing ESG considerations is important for ensuring both a positive future for the planet and their own long-term success.

It is becoming increasingly clear that ESG factors can have a significant impact on a company's bottom line. A **2023 McKinsey and NielsenIQ study** found products that claimed to be environmentally and socially responsible averaged 28-percent cumulative retail sales growth over five years, compared to 20-percent growth for products that made no such claims.

As awareness of ESG issues continues to grow, investors, consumers and employees are looking to do business with companies that prioritize sustainability and ethical practices. A **2021 PwC survey** found 83 percent of consumers believe companies should actively shape ESG best practices. This direction makes it crucial for firms to incorporate ESG principles and reporting into their operations.

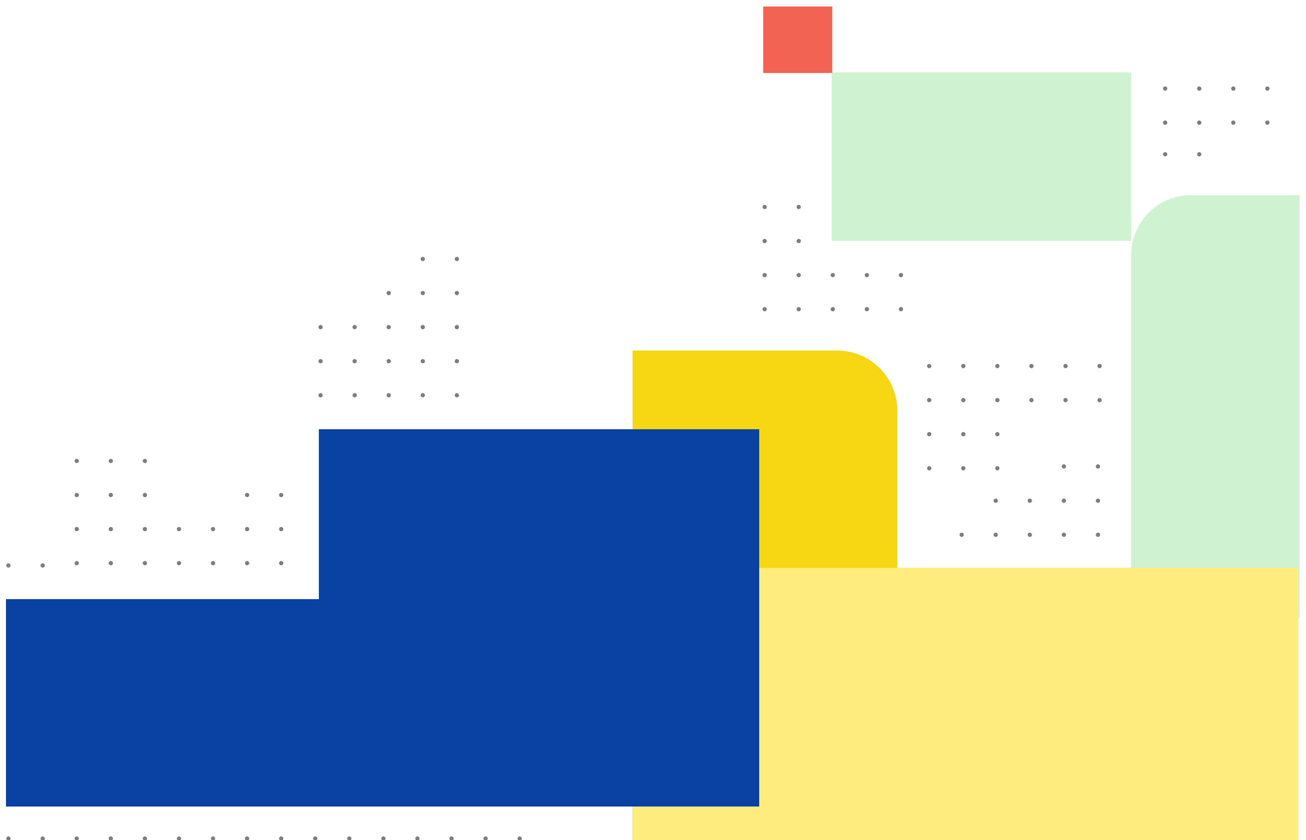
The ESG reporting landscape can seem like a confusing, convoluted acronym soup with standards and frameworks such as CSRD, IFRS and ESRS. But over the decades, ESG reporting has shifted from a useful tool for companies looking to attract ESG-conscious investors to a requirement, as regulators and communities begin to seek concrete ESG information from organizations.

As a result, measuring and reporting ESG data is becoming a key responsibility for accountants and auditors, creating new and exciting opportunities for those wanting to advance their careers or expand their firm's business.

ESG reporting can encompass the following:

- **Environmental:** Sustainability, greenhouse gas emissions, pollution control, energy use, consumption of water and other natural resources
- **Social:** Fair pay and treatment of employees, health and safety policies, community engagement
- **Governance:** Corporate policies, investor rights, corporate management (including the pay of senior executives), transparency in communications

Accountants and auditors, with their expertise in measuring and compiling financial data, are pivotal in monitoring ESG activities. Their duties range from reporting and assurance to business planning, governance and risk assessment. But no matter their role, accountants will increasingly need to stay informed about new developments and trends in ESG regulations and requirements.



The rise of ESG

The focus on ESG reporting for organizations has grown rapidly in recent years, but the concept of ESG has existed for decades. As far back as the 1970s, some investors began to prioritize companies committed to ethical and sustainable business practices as part of the socially responsible investing movement.

ESG grew in popularity in the early 2000s as society became more concerned about environmental deterioration and social issues, such as unsafe labor practices and human rights violations. In 2006, the United Nations created the United Nations Principles for Responsible Investment (UNPRI), a set of principles designed to create a global standard for responsible investing. The UNPRI included guidelines to incorporate ESG components into investment decisions.

Over the last several years, various factors have boosted the importance of ESG for accountants and auditors. These include regulatory requirements, stakeholder expectations, risk management and competitive advantage.

Governments and regulators worldwide require organizations to report their ESG performance. Some examples include:

- The European Union has multiple regulations, including the Corporate Sustainability Reporting Directive (CSRD), which requires EU-listed companies to report on various ESG-related topics, and the Sustainable Finance Disclosure Regulation (SFDR), which is designed to increase transparency about the impacts of investments in sustainability
- The U.K. has the Sustainability Disclosure Requirements to increase transparency around companies' ESG practices
- Germany has the German Supply Chain Due Diligence Act, which requires large companies

to meet environmental and social standards throughout their supply chains

- In the U.S., the Securities and Exchange Commission passed rules that require public companies to disclose any climate-related risks that could have a material impact on their business

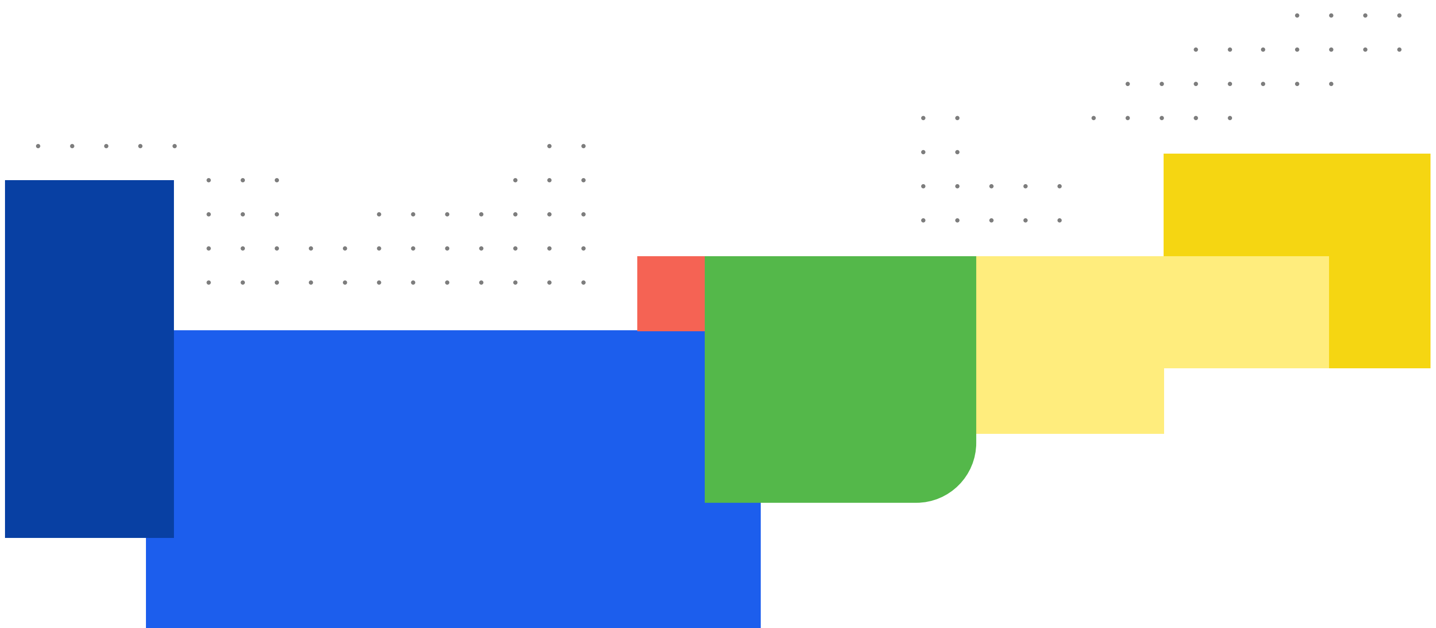
And these are just a few examples of the expanding international ESG regulatory environment.

Stakeholders, such as investors, employees, customers and communities, are increasing pressure on organizations to disclose their ESG performance. These stakeholders expect organizations to be transparent and reliable in their ESG reporting. Meeting or exceeding their expectations can benefit an organization's reputation and financial performance.

The rise in climate-related disasters, such as floods, droughts and wildfires, has shown that ESG factors can pose significant risks to a company's financial performance. Building ESG risk into audit and accounting processes can help companies better detect and manage potential problems while reassuring investors.

Today, 90 percent of S&P 500-listed companies release ESG reports. Eighty-nine percent of investors consider ESG issues in some form when making investment decisions, according to a study from asset manager Capital Group. Global ESG assets surpassed $30 trillion in 2022 and are on track to exceed $40 trillion by 2023, reported Bloomberg Intelligence.

Companies that report transparently on their ESG performance can gain a competitive edge because they appeal more to ESG-aware customers, investors and employees. Demonstrating a responsible attitude toward ESG can improve access to capital, help companies attract top talent and sell more products and services.



Corporate ESG reporting

Traditional financial reporting tracks profit, revenue and sales metrics to inform investors and other stakeholders about an organization's financial performance. ESG reporting, on the other hand, focuses on a broader range of non-financial factors tied to environmental, social and governance issues. ESG reports are also designed to appeal to a broader audience, including stakeholders, consumers, community members, employees and regulators.

ESG reports can include a wide range of information, depending on what regulations an organization needs to meet and which ESG measures its stakeholders value. All annual ESG reports will have information about an organization's efforts to reduce its environmental impact or improve its social responsibility through critical metrics, goals and initiatives. They can also incorporate particulars about organizations' challenges in meeting their goals and how they plan to overcome them.

ESG report components can encompass the following:

- energy consumption and greenhouse gas emissions
- water usage and wastewater management
- diversity and inclusion statistics
- supplier diversity and responsible sourcing practices
- community engagement and social impact initiatives
- governance structure and board diversity
- executive compensation policies and practices

Integrating relevant ESG data into an organization's accounting systems is vital to producing accurate ESG reports. To decide which key ESG metrics to track, companies typically form a governance board. The company can then collect relevant ESG data, verify its accuracy and incorporate that data into a report for stakeholders.

The benefits of ESG reporting

For many organizations, ESG reporting is a regulatory requirement. Others do it voluntarily. Gathering and reporting ESG data can be daunting but can also deliver significant benefits.

The most apparent benefit is boosting a company's reputation. Organizations can improve their standing with stakeholders such as customers, investors, employees and the public by releasing accurate and transparent ESG reports demonstrating their care for the environment and their community.

Tracking ESG data can help companies improve their risk management. By identifying environmental and social risks, they can proactively mitigate the effects of climate change, supply chain disruptions and human rights violations.

In today's workforce, many prospective employees prioritize working for companies dedicated to sustainable and social causes. By providing ESG reports, companies can showcase their commitment to social and environmental responsibility and attract top talent.

Investors are giving more weight to ESG factors when deciding where to put their money. Transparent ESG reporting can provide organizations with better access to capital.

Sustainable activities that reduce an organization's environmental impact, such as lowering energy consumption or producing waste, can result in cost savings. ESG reports can demonstrate the financial advantages of committing to a sustainability strategy.

ESG reporting requirements

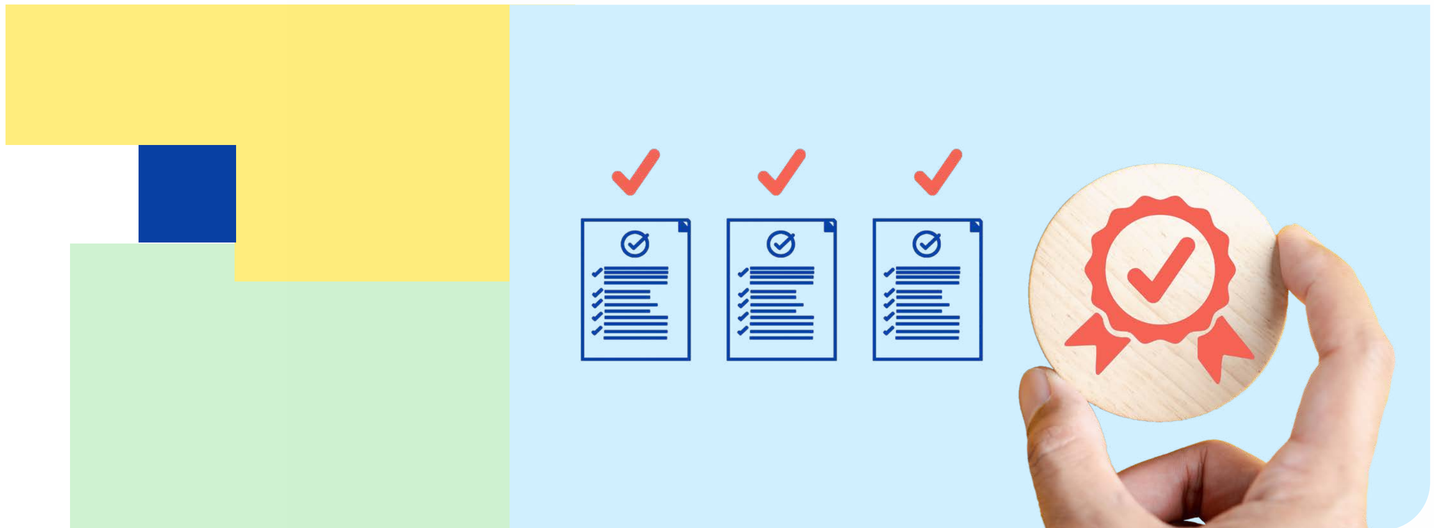
Much ESG reporting is voluntary. However, governments and regulators have begun introducing more mandatory ESG reporting requirements. Examples include:

- The EU Corporate Sustainability Reporting Directive (CSRD) - The CSRD applies to all EU-based large companies and all companies listed on EU-regulated markets. The regulations also apply to foreign companies doing significant business in the EU. The CSRD is being phased in gradually, beginning in 2024, and is expected to apply to approximately 50,000 companies across Europe. Companies must report on various sustainability topics, including the environment, social responsibility, human rights, anti-corruption measures and board diversity. One of the most essential elements of the CSRD is its use of double materiality assessment. Organizations must consider the impact of ESG issues on their finances and how their operations impact the community and environment.

- The U.S. Securities and Exchange Commission (SEC) Disclosure Regulations - The U.S. SEC climate-related disclosure regulations apply to U.S. reporting companies and foreign private issuers (other than Canadian issuers reporting on Form 40-F). The final rules will require organizations to disclose climate-related risks that may have a material impact on their business and any activities to mitigate them. Companies must also disclose specific climate-related impacts, such as greenhouse gas emissions.

- The Sustainable Finance Disclosure Regulations (SFDR) - These EU regulations require asset managers and financial market participants to disclose ESG data about their financial products and investment decisions. The regulations aim to improve transparency around ESG investing.

Other ESG reporting regulations exist that vary by jurisdiction. While the regulations have different requirements, they share a broad goal of improving transparency around organizations' efforts to measure and manage their ESG impact and identify potential ESG-related risks.



ESG reporting standards and frameworks

When reporting ESG results, organizations can't just choose which areas to focus on. To comply with regulatory requirements or stakeholder expectations, they must employ ESG standards and frameworks in their reporting.

It's important to distinguish between ESG standards and ESG frameworks. According to Ernst & Young, there were more than 600 global ESG standards and frameworks in 2023. While standards and frameworks are different, they're designed to be used together.

ESG standards provide the specific metrics companies need to report. These metrics include energy consumption, emissions information, water consumption or employee information. Each standard has particular reporting requirements. Examples of ESG reporting standards are:

- The International Financial Reporting Standards (IFRS) - The IFRS standards are voluntary and designed to offer a global format for sustainability and climate reporting that provides investors with useful sustainability-related disclosures.
- The Sustainability Accounting Standards Board (SASB) standards are voluntary and designed to identify sustainability-related risks and opportunities for investors. They have an industry-specific focus, identifying relevant sustainability issues for 77 industries. In 2022, the SASB standards became a resource for the IFRS.
- The European Financial Reporting Advisory Groups (EFRAG) standards - These are designed for organizations that need to comply with the EU's CSRD. They are mandatory and built to help investors, consumers and other stakeholders evaluate large organizations' non-financial performance in all three ESG areas.

ESG frameworks focus on guiding principles and what information organizations need to collect. They can include a combination of mandatory and voluntary disclosures with information collected by questionnaires or surveys. Some frameworks are designed for specific industries. They all share the common objective of allowing companies to reveal their ESG initiatives comprehensively, enabling stakeholders to assess an organization's performance in ESG categories.

Some frameworks have existed in different forms for over two decades. Over the years, the growth in the number of frameworks has caused confusion and resulted in inconsistent disclosure requirements. In recent years, there has been a move to consolidate several of the major frameworks into a global one.

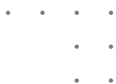
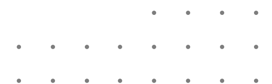
Some of the significant ESG frameworks include:

- The European Sustainability Reporting Standards (ESRS) - The ESRS is the EU's sustainability reporting framework. It's designed to improve the accuracy and transparency of reporting within the requirements of the CSRD. One of the critical features of the ESRS is its handling of double materiality, which requires an organization to consider both the potential ESG risks to its business as well as the organization's impact on the environment and society. The ESRS covers more than 80 specific requirements and some large, complex organizations will need to collect more than 1,000 data points.

- The International Sustainability Standards Board (ISSB) - The ISSB was founded in late 2021, making it one of the newest international organizations dedicated to developing ESG standards. The ISSB framework builds on earlier sustainability frameworks, such as the Climate Disclosure Standards Board (CDSB) framework and the Sustainability Accounting Standards Board (SASB) framework.
  The ISSB's goal is to create standards for a global baseline of sustainability disclosures that meet the needs of investors, allow companies to provide comprehensive sustainability information and interoperate with jurisdiction-based frameworks.

- The Global Reporting Initiative (GRI) - The GRI is an international organization founded in 1997. It has created a framework allowing companies to measure and report on their impact on issues like the environment, corruption and human rights. In 2022, 78 percent of the world's largest 250 companies by revenue used the GRI framework, according to KPMG's Survey of Sustainability Reporting 2022. The GRI comprises three stand-alone standards, making it suitable for different industries, including non-profits and governments. The three are the GRI Universal Standards, which can apply to any organization; the GRI Sector Standards, which apply to specific sectors; and the GRI Topic Standards, which include disclosures relevant to particular topics. In 2022, the GRI announced it had reached a collaboration agreement with the ISSB to align on standard setting.

The plethora of available ESG frameworks can make it challenging to decide which is best for an organization. Ultimately, the choice will come down to what information a company needs to report to meet its goals. Considerations can include what frameworks are being used by peers and competitors, the target audience for an organization's ESG reports, and the regulatory requirements it needs to meet.

ESG reporting challenges and considerations

ESG reporting is still very much a work in progress. While standard-setting ESG organizations have made headway in building a shared vision of ESG reporting frameworks, there isn't one universal standard at the moment, which makes it challenging to collect and report data. For instance, two companies in the same sector could measure their emissions differently and report them using different frameworks, making it impossible to compare one against the other.

Collecting ESG data is a complex process. Organizations must gather information from internal systems, third parties and suppliers to paint a complete ESG picture. Not all parties will use the same systems, making it difficult to compile accurate, objective reports that paint a true picture of a company's ESG efforts.

Once a company has gathered ESG information from its internal systems, suppliers and partners, it should get independent verification of the data's accuracy and the processes used to collect it. However, with ESG reporting still in its early stages, finding consultants and auditors with the necessary expertise to verify organizational ESG reports is difficult.

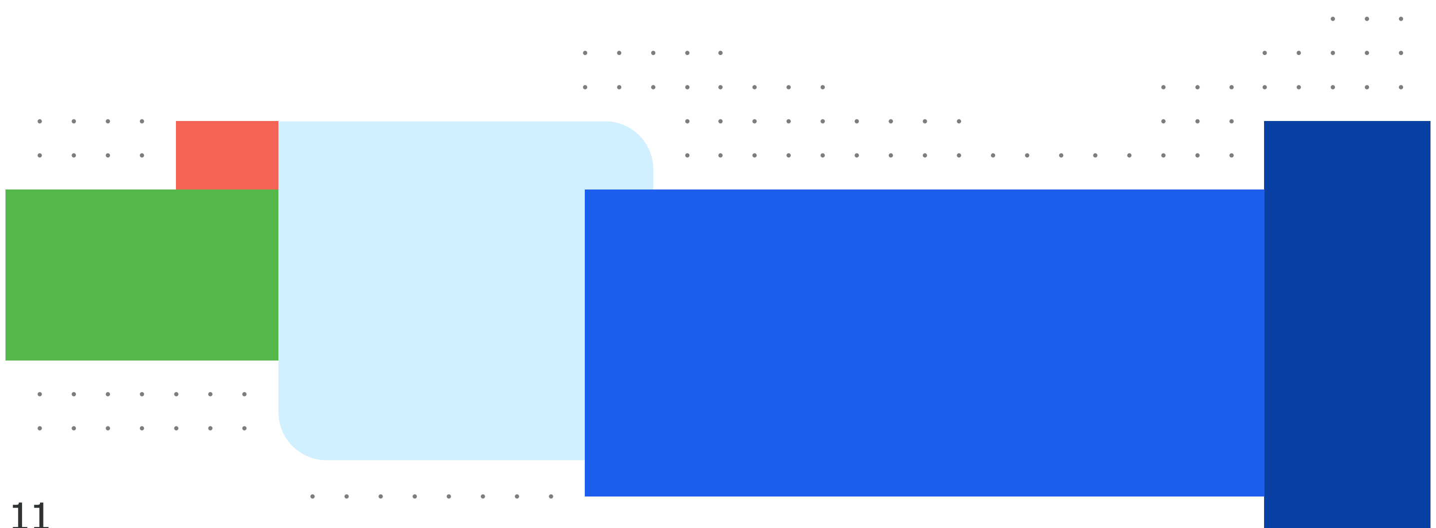
However, it is becoming crucial for companies to ensure their ESG reports are accurate. Stakeholders, including investors, customers and community members, have grown skeptical of organizations' ESG claims. It's easy to understand why. Instances of corporate greenwashing – the act of a company or organization intentionally misleading stakeholders and the general public to believe its actions are doing more to protect the environment than they actually are – abound. Some examples include:

- Volkswagen was fined over $34 billion from various jurisdictions worldwide after the automotive giant was discovered using software that lowered its vehicles' recorded greenhouse gas emissions in 2015.

- In 2022, the founder and former CEO of Nikola, an electric vehicle company, was convicted of securities fraud after making numerous public statements extolling the company's zero-emission trucks, even though it had no functional zero-emission vehicles at the time of his statements. At one point, Nikola had a higher market valuation than Ford.

- DWS, an investment firm controlled by Deutsche Bank, was fined $25 million over misstatements about its ESG funds. DWS's executives described the company as a leader in ESG investing but didn't implement the ESG-friendly policies it had marketed to investors.

These examples and numerous additional instances of greenwashing show why, increasingly, stakeholders aren't going to buy into an organization's ESG claims without proof. Leading companies are making sure they establish clear goals and processes, engage with stakeholders and invest in technology solutions that collect, analyze and manage ESG data to meet the expectations of investors, customers, regulators and the community.



The role of technology in ESG reporting

ESG reporting is a collaborative effort involving representatives from multiple departments throughout an organization. But when it comes to collecting, analyzing and reporting ESG results, accountants are ideally suited to the role.

Due to their training in financial reporting, accountants already have extensive data analysis and risk management skills. They also understand regulations and the requirements for meeting them. As more jurisdictions roll out mandatory ESG reporting, accountants are ideally positioned to ensure their organizations' disclosures meet regulatory guidelines.

Another advantage accountants have in ESG reporting is their attention to detail. They're used to making sure their figures are accurate and verifiable. This is crucial when reporting ESG data because the numbers can affect investment decisions, public perception and regulatory compliance.

Finally, the accounting profession is bound by professional codes of conduct and ethical principles, which are essential factors in ESG reporting. Objectivity is crucial when preparing an ESG report because it can significantly impact investor sentiment and the public perception of an organization.

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How accountants and firms can benefit

The rise of ESG reporting offers accountants and auditors exciting benefits. As more organizations are required to track their ESG performance carefully, they will look to hire staff familiar with ESG regulations, data collection and analysis.

This will allow accountants to expand beyond traditional financial analysis and reporting roles. They can specialize in sustainability accounting, helping their organization meet their ESG goals. Accountants can also develop expertise in analyzing ESG data to identify ESG-related trends, opportunities and risks.

A solid grounding in ESG reporting principles and regulations provides several advantages to accountants. It gives them a complete view of their organization's performance beyond pure financial numbers. It also grants accountants a better understanding of overall risk management. Identifying and quantifying ESG-related issues allows them to develop plans to steer their companies through potential problems before they occur.

Accountants seeking to improve their ESG knowledge have several options. If they're starting in the field, they can look for internships or entry-level positions tied to ESG. Those already established in

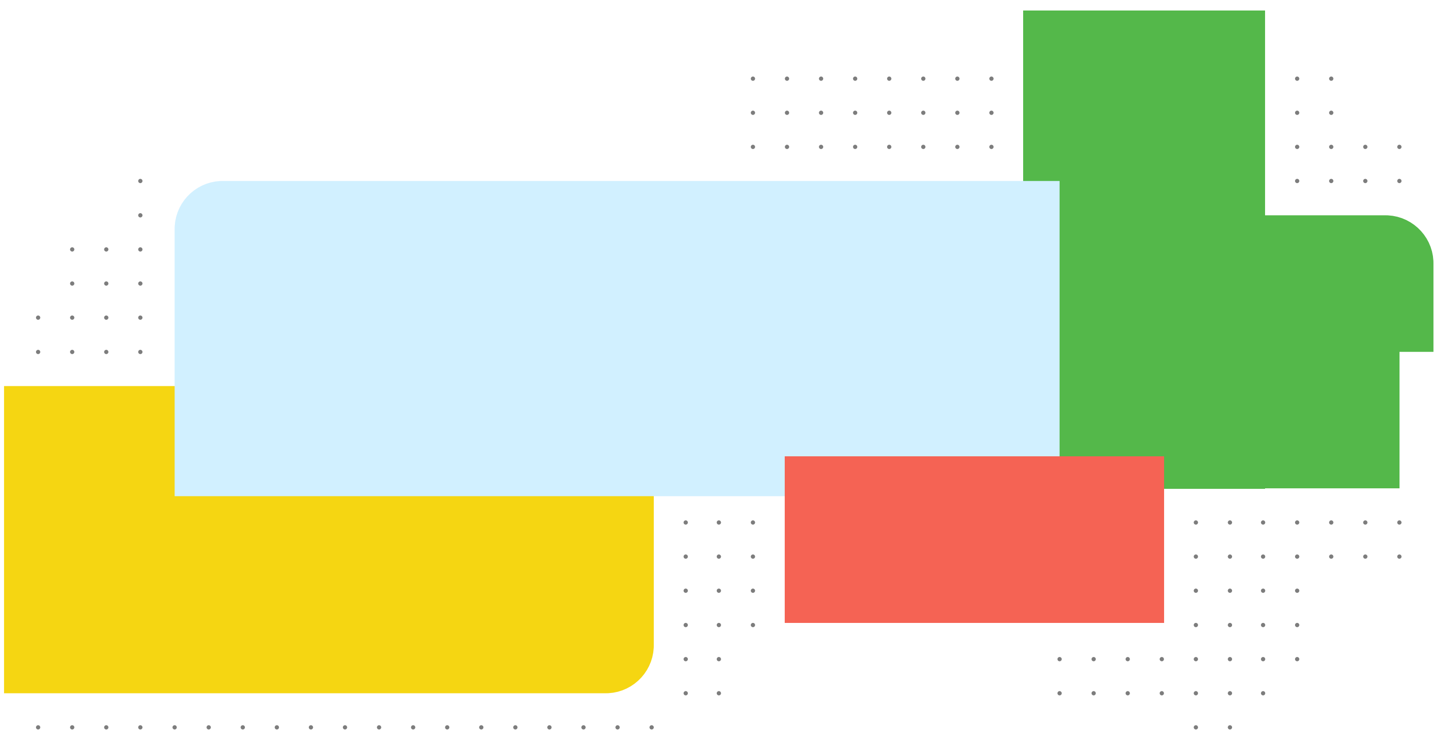
their careers can network with fellow accountants working in ESG roles or take courses or workshops on ESG reporting and standards.

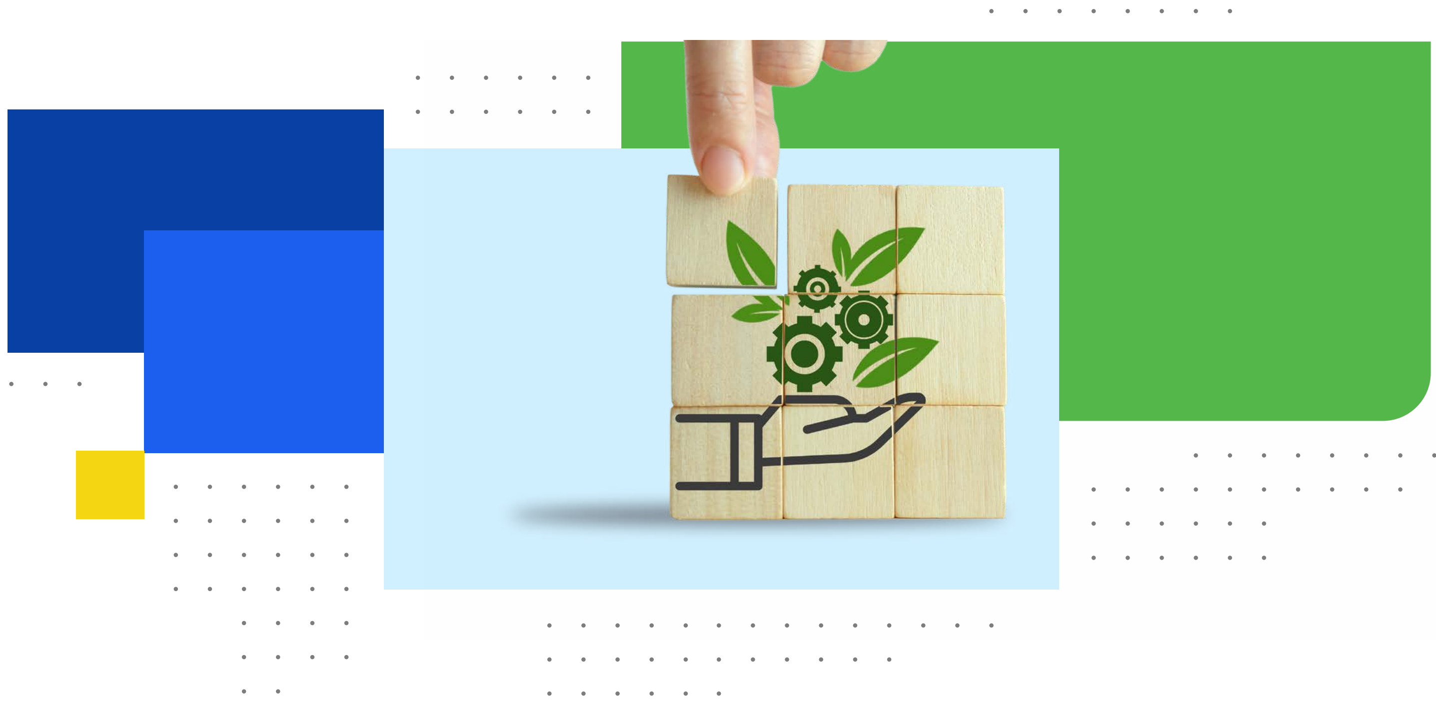
The growth in ESG reporting also presents new opportunities for accounting firms. For example, the “Big 4” already offer a range of ESG advisory services designed to help clients develop ESG strategies and risk assessments.

Accounting firms can provide such ESG offerings as:

- ESG reporting services, such as ESG report framework development and ESG benchmarking and performance measurement
- ESG assurance services verifying the accuracy of clients’ ESG disclosures
- ESG standards and regulation expertise that allows firms to advise clients on how to comply with ESG reporting requirements
- ESG training and education services that help clients understand ESG considerations and reporting

These ESG services help position firms as trusted advisors who can help clients navigate the evolving ESG regulatory and reporting landscape.





Conclusion

Interest in ESG isn't going away. As of 2024, around 50,000 companies, including non-EU companies with EU subsidiaries or listing on EU-regulated markets, are subject to the CSRD's mandatory sustainability reporting.

And ESG investing also continues to grow. A **January 2024** report from research firm Bloomberg Intelligence found global ESG assets surpassed $30 trillion in 2022 and were on track to exceed $40 trillion by 2030.

Knowledge of ESG regulations and frameworks is becoming increasingly important for accountants and auditors looking to enhance their careers. Regulators, shareholders and the general public expect companies to have robust ESG reporting processes. Accountants and auditors, with their expertise in data analysis, risk management and the parsing of regulatory requirements, are ideally positioned to help companies meet these expectations.

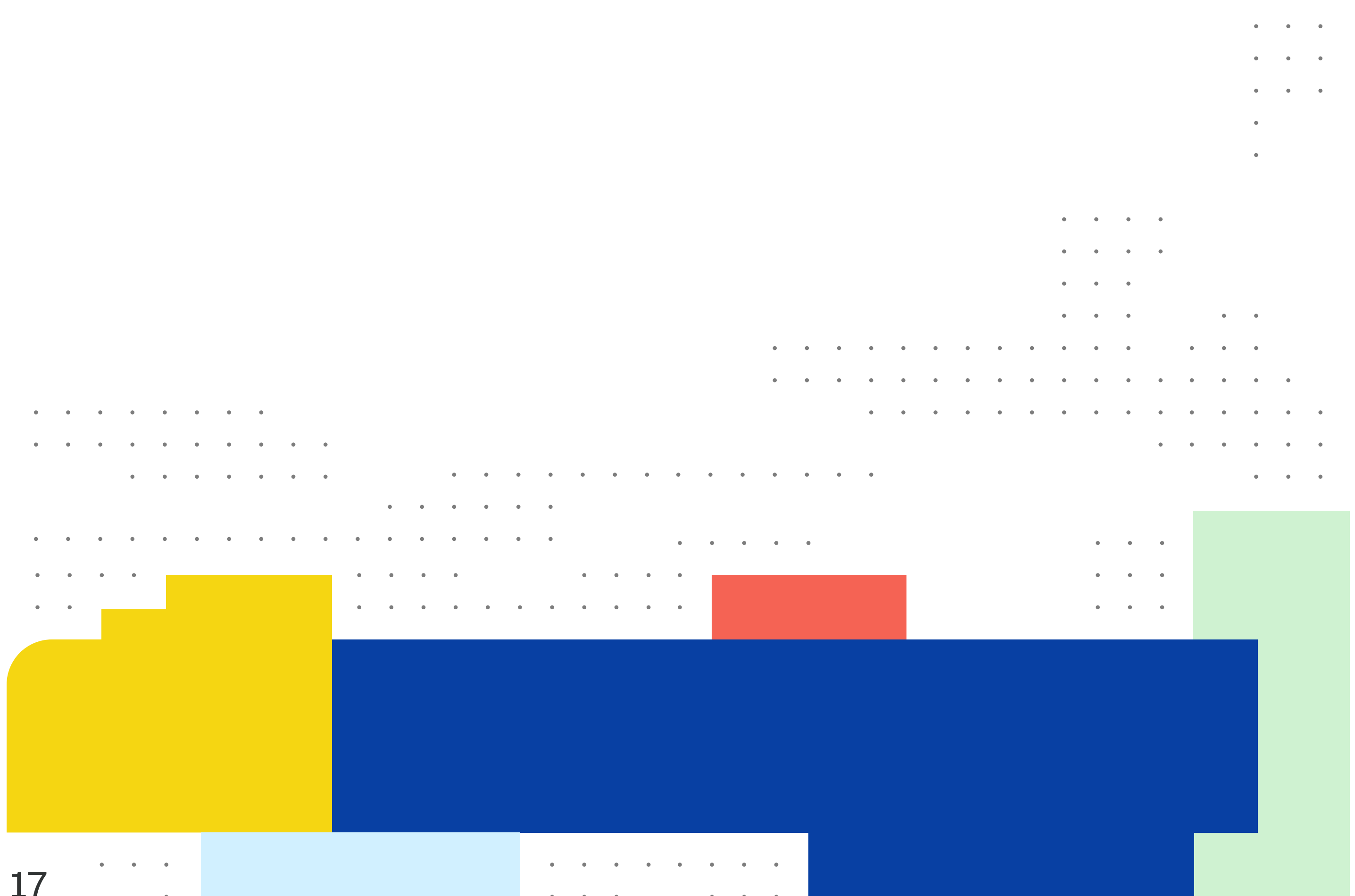
Manual processes and spreadsheets won't be efficient enough for accountants to manage their complex ESG reporting requirements. Defining which ESG categories are material to an organization, gathering accurate data from multiple stakeholders and ensuring all reporting requirements are fulfilled will require purpose-built solutions to meet specific ESG reporting frameworks.

Relying on spreadsheets takes more time and can lead to errors, which can be costly. For example, companies that don't comply with the CSRD's

requirements face the publicizing of their infractions and the burden of hefty fines. As regulations expand, the need for modern, efficient ESG reporting solutions will become a necessity to ensure compliance and accuracy. Companies that continue to rely on outdated technologies risk increased reporting costs, difficulties keeping up with evolving standards and potential reputational damage.

That makes it all the more crucial for organizations to embrace their developing responsibilities and opportunities around ESG with modern solutions and a forward-thinking approach that will set them up for success as this field evolves.

Contact Caseware today to discuss your ESG journey and how we can help guide you to success in this increasingly important focus area.



caseware™

Caseware International Inc.

351 King St E, Suite 1100
Toronto, ON M5A 2W4, Canada

T +1 416 867 9504
F +1 416 867 1906
E info@caseware.com

www.caseware.com