ICAEW SUSTAINABILITY

CONNECTING SUSTAINABILITY AND FINANCE: INFORMATION, PERFORMANCE AND DISCLOSURES

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A paradigm shift towards corporate sustainability reporting practices that are not only standardised and digitised but also regulated and externally assured is driving greater alignment – or connectivity – between sustainability and financial information.

The fundamental transformation for companies lies in their ability to leverage both the insights provided by sustainability information and the power of finance to better manage material impacts, risks, and opportunities (sustainability performance) that convert into value creation (financial performance).

This can only happen if there is a meaningful connection between sustainability and financial information. Understanding and cultivating this connectivity requires an understanding of the differences between measuring, reporting, and disclosing performance, which also drives where each type of information needs to be disclosed. It is fostering much welcomed interaction and collaboration between the sustainability and finance departments. This collaboration offers promise for companies to unlock the value creating potential of embedding sustainability within their strategy and business models.

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INTRODUCTION

The world is changing rapidly, much more than ever before, undoubtedly fuelled in part by our recognition of unsustainable economic activities and their accelerating consequences. Indeed, we now realise that our environmental, social, and economic wellbeing are interdependent. As a result, we are witnessing a global shift, albeit a gradual one, towards sustainability driven capital allocations and responsible business practices. This paradigm shift success depends on a reset of our thinking, operating models and processes, and data needs.

An important manifestation of it is the (equally rapid) evolution towards corporate sustainability reporting practices that are not only standardised and digitised but also regulated and externally assured. This evolution will inevitably drive greater alignment – or connectivity – between sustainability and financial information.

Reporting requirements aside, a more fundamental transformation for companies lies in their ability to leverage the insights provided by sustainability information and the power of the finance function to better manage material impacts, risks, and opportunities (sustainability performance) that convert into value creation (financial performance). This can only happen if there is a meaningful connection between sustainability and financial information. Understanding and cultivating this connectivity is the source of both challenges and rewards.

This paper seeks to unravel the mystery in the connection between sustainability and finance, by shedding light on differences in performance measurement, the distinction between performance measurement and disclosures, and where the connectivity between sustainability and financial information begins.

CONNECTING SUSTAINABILITY AND FINANCIAL INFORMATION

Bridging the gap between financial and sustainability information is a stated objective of the main corporate sustainability reporting regulations such as the Corporate Sustainability Reporting Directive (CSRD) or the SEC climate disclosure rules, and standards such as the European Sustainability Reporting Standards (ESRS) and the IFRS Sustainability Disclosure Standards (SDS). They all require, or strongly recommend, producing disclosures:

i. for the same reporting period,
ii. at the same time and in the same document, and
iii. explaining the connection between sustainability and financial performance.

Of course, these are essential characteristics for disclosures to be aligned. However, they are insufficient for the connection of disclosures to occur naturally.

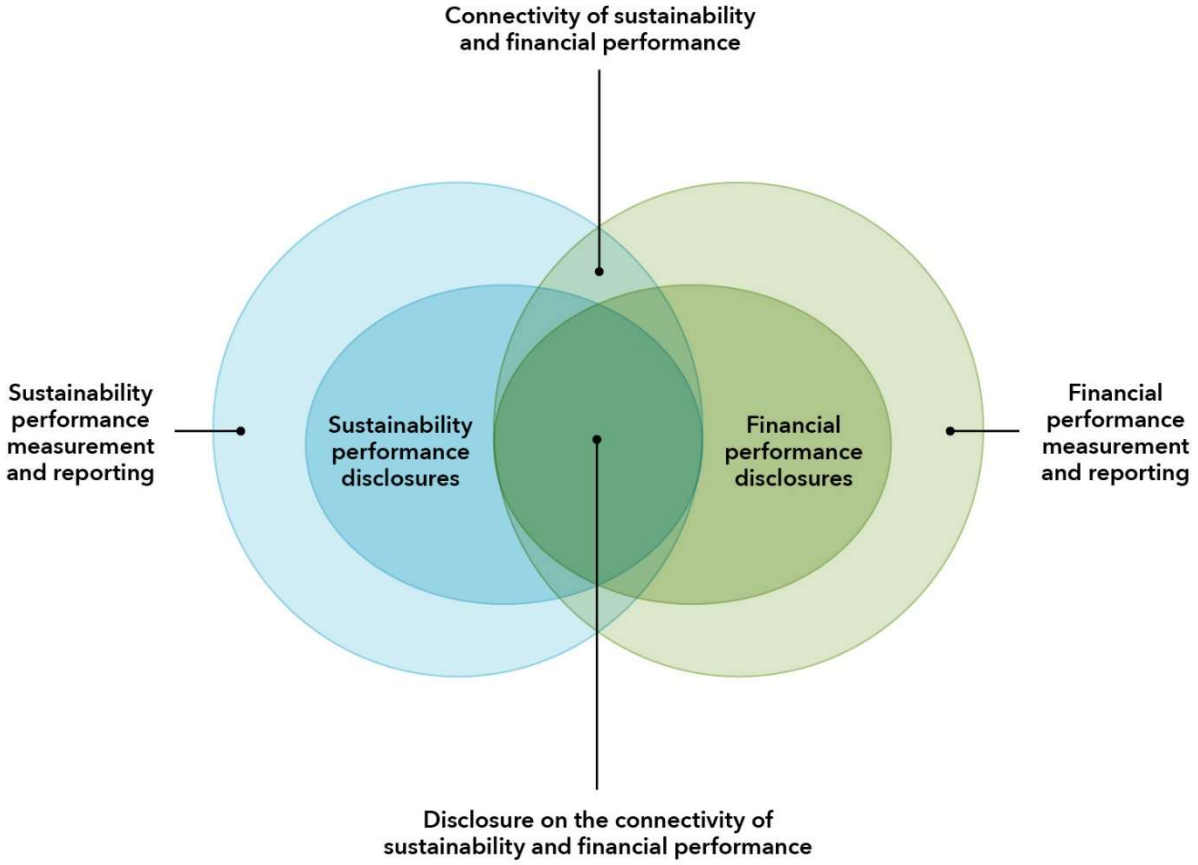
Before we even begin to explore the connection between sustainability and financial information, we must first clarify the distinction between the acts of reporting and disclosing. Reporting includes the process of measuring performance according to a prescribed set of accounting and reporting standards, usually through formats such as the balance sheet, income statement, and statement of cash flows. It may also take other forms depending on the needs of the user. Reporting generates performance information that is intended either for internal management purposes or for external user purposes, when shared externally it becomes a disclosure. Disclosing is the process of converting internal performance information into an external output and format; corporate disclosure is effectively the act of providing relevant and reliable performance information to external stakeholders.

It may be useful to think of disclosure as a subset process step of reporting, usually defined by a regulatory body. Perhaps this helps to explain why there is also confusion between accounting, reporting, and disclosure standards, which are distinct concepts (as illustrated in Appendix 2).

For clarity, throughout this paper we use the term ‘reporting’ to mean producing performance information, and the term ‘disclosure’ to mean making performance information publicly available.

In any event, it is at the level of the information that connectivity needs to happen for companies to deliver results, achieve performance objectives, and create value (financial and societal).

Figure 1: The distinction between reporting and disclosing performance information



Connect information… about performance!

The regulations and standards mentioned above call for connecting the narrative on governance, strategy, and management, which helps to reflect the embeddedness of sustainability into the business model of the company and the mindset of its management. Connecting the narrative on sustainability and financial performance helps to illustrate the very material nature of the sustainability-related matters the company is dealing with.

These regulations and standards are all based on the premise of material information— a concept leveraged from financial disclosure requirements that define information as important to a company’s stakeholders when it could affect their decision-making. They all refer to information about non-financial sustainability-related issues that can reasonably be expected to affect a company’s cash flows, balance sheet, access to capital, or its cost of capital over the short,

medium, or long term. Both the IFRS SDS and the ESRS have specific requirements about connecting sustainability and financial performance information, because it is needed by users of corporate disclosures, and is often lacking today.

Few companies currently align their sustainability and financial reports, let alone connect their sustainability and financial information. This is primarily because only a **handful of** companies are explicitly linking their sustainability performance to their financial performance. Perhaps a result of the historic exclusion of sustainability-related issues from core functions such as strategy, risk management, and performance measurement? Meaningful integration of sustainability to business model and strategy remains elusive, for now. This is a gap that needs to be bridged, but also an opportunity that prompts exploration. It all starts with connecting sustainability and financial mindsets.

One can see how this makes sense when referring to the material environmental, social, and governance (ESG) and sustainability-related issues affecting the business — the “outside-in” concept also known as the financial lens of materiality. Take, for example, the fact that a concrete manufacturer’s principal product depends on water and water scarcity is becoming a growing concern, including within areas previously immune from water shortages.

The sustainability practitioner will tend to focus on ensuring water access and then managing this resource responsibly. The financial accounting practitioner will tend to think in terms of ‘going concern’, including how the company might consider R&D investments to develop new concrete products that require less water, or developing a new concrete product formulation; or how a tax on water consumption might affect the company’s costs and, therefore, profitability.

Perhaps less intuitively, there are real – albeit prospective or difficult to quantify — financial repercussions to sustainability issues that the company affects through its business activities — the “inside-out” concept also known as the impact perspective of materiality. For example, how might the concrete manufacturer consider the social impact its activities are having in areas where water is scarce and critically needed to sustain human life? If it moves its plant away from water scarce regions, how will this affect the local economy in terms of employment, economic contribution, and human wellbeing, and how would this affect its brand, reputation, and customer demand?

All this to say, both inside-out and outside-in material issues have actual and prospective financial consequences; the only question is over the time horizon and magnitude. These objects of connectedness are important to contextualise and disclose.

Use the same words and concepts!

There can be several sources of misunderstanding between sustainability and finance teams: different topics, measurement units, sources of data… and different interpretations of commonly used terms (ie, business language).

For instance, the IFRS SDS, much like the TCFD Recommendations, use the term ‘sustainability-related *financial* disclosures’, which refers to mainly non-financial information about sustainability-related items that can reasonably be expected to affect a company’s operating and financial performance, and its access to and cost of capital. Confusing? Indeed, it can be!

Similarly, definitions can differ. For example, the term ‘measurement’ has a specific definition within the accounting and finance community that can easily be understood differently by other

stakeholder groups. A case in point, a sustainability professional usually understands measuring human resources to mean counting them (ie, number of employees), whereas to the accounting professional it generally means valuing them (ie, labour costs).

It is important to recognise these different perspectives and definitions when trying to connect sustainability and financial information. A common language between all practitioners is key to developing cross-functional understanding and collaboration. A short glossary of terms commonly used by sustainability or finance professionals, including their context, is shown in Appendix 2.

For clarity, throughout this paper we refer to ‘sustainability information’ or ‘sustainability performance information’ as non-financial information about sustainability matters; we refer to ‘financial information on sustainability matters’ as financial information about sustainability matters that fails to satisfy an existing financial reporting measurement or disclosure requirement; and we refer to ‘financial performance information’ as financial performance information that satisfies the existing financial reporting measurement or disclosure requirement, the latter of which must be included in the financial statements (or the notes thereto) as shown in Figure 2.

Embrace a financial accounting mindset to generate financial information on sustainability matters.

When we consider technical accounting and its associated processes and tasks, some skills are “table stakes”. Finance leaders are typically proficient in risk assessments, estimating contingent provisions, asset impairment judgements, planning and forecasting, and capital allocation management. For example, when considering a project for new product development and sales, they will naturally assess capital investment needs to develop and build the product (like R&D resources, capital investments in manufacturing facilities and equipment, marketing programs, operating needs, and so forth) and build a projected income statement, cash flow statement, and balance sheet for the current fiscal year. This will be accompanied by a longer-term strategic forecast of the projected revenues, costs, and profits over one to three years, enabling managers to assess the return on investment for a given project.

So, what changes when we apply this financial management approach to a sustainability-related project? Simple: mindset.

Let’s assume the product development project is for an automotive parts manufacturer. Starting with the design phase, a connected sustainability and finance mindset could lead to designing the part using plastic to make it lighter and sourcing the plastic from recycled polymer fibres that come from ocean and beach clean-up campaigns, which may or may not be more expensive than metal or virgin fibres.

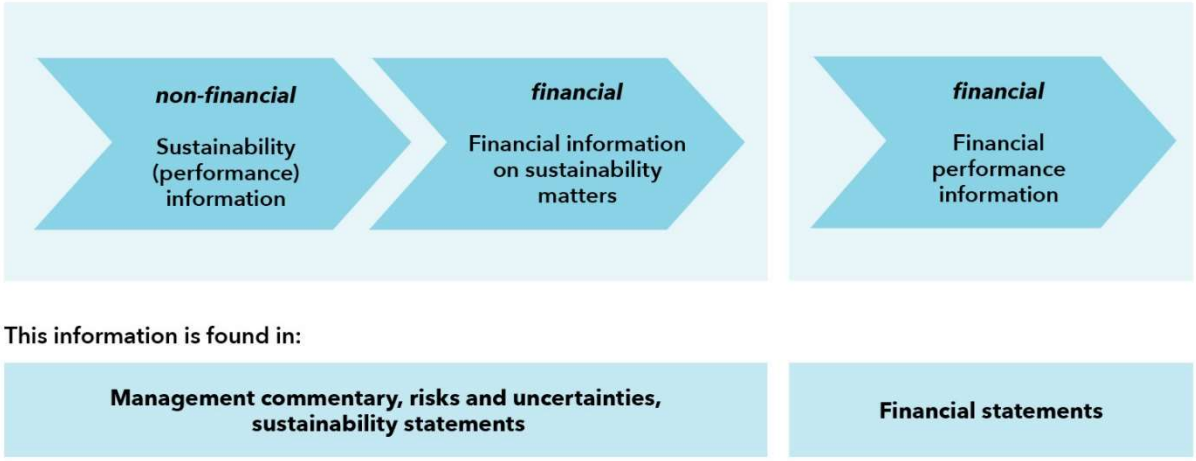
Tangible financial consequences might include, for instance, new capital investments, manufacturing cost changes, inventory valuation changes, and over the longer-term higher profits. Tangible sustainability consequences could include reduced plastic waste, as well as reduced pollution (of customers) from the greater fuel efficiency and increased tire longevity of lighter vehicles; more fuel efficient and longer lasting vehicles could also (all else being equal) improve their owners’ disposable income.

Eventually, the combination of more efficient, less environmentally harmful vehicles made with recycled materials could benefit the manufacturer’s brand, which in turn tends to drive higher sales. The sustainability and finance practitioners need to be able to think through, and quantify, not only the costs of sourcing materials sustainably, but the spectrum of possible outcomes from sourcing decisions and their effects on projected revenues, costs, and capital investments. It is important to

remember these types of activities are essential for internal planning and performance purposes, whereas only those elements that meet financial reporting requirements will be included within the financial statements, or its accompanying notes.

This will lead to different types of performance information:

Figure 2: From sustainability performance to financial performance information



Leverage existing reporting standards to produce financial performance information.

Existing financial reporting standards provide sufficient guidance for companies to consider the financial implications of sustainability matters. The problem is that most decision-makers aren't naturally thinking in this way. If sustainability reporting practitioners may be challenged with seeing the financial repercussions of their programs, financial reporting practitioners are likely challenged with extending their understanding of reporting to encompass considerations that characterise a sustainability mindset. This can be seen in the whole-value-chain approach, looking beyond a 3-5-year strategic cycle, seeing how sustainability issues affect the company's wider operating and financial performance cycles and conversely how the company affects its environment and society through its activities.

For instance, the consequences of sustainability-related issues that are likely to give rise to a future liability would be captured by the accounting and reporting requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets[1] and would also need to be considered under IAS 1 Sources of Estimation Uncertainty and Significant Judgements as well as the various asset and impairment standards (for example, inventory, capital assets, financial instruments, insurance, etc).

The difference between 'measuring and reporting' and merely 'disclosing a contingency' – as explained above – is correlated with the likelihood of settlement and measurement of that settlement. For example, a winery has one location consisting of 500 acres of vineyards, and agricultural and capital assets currently valued at $100m. It has scientific data projecting water reserves in different locations combined with projected harvests versus required yields.

[1] IAS 37 indicates that a "*provision is a liability of uncertain timing or amount. The liability may be a legal obligation or a constructive obligation. A constructive obligation arises from the entity's actions, through which it has indicated to others that it will accept certain responsibilities, and as a result has created an expectation that it will discharge those responsibilities. Examples of provisions may include: warranty obligations; legal or constructive obligations to clean up contaminated land or restore facilities; and obligations caused by a retailer's policy to make refunds to customers. An entity recognises a provision if it is probable that an outflow of cash or other economic resources will be required to settle the provision. If an outflow is not probable, the item is treated as a contingent liability.*"

Management projects that water scarcity will negatively affect its yield starting in five years and peaking in 10 years. As a result, the sustainability and finance managers determine that they will have to relocate no later than 10 years from now, which means that the company's existing agricultural and capital assets will ultimately be abandoned. The agricultural and capital assets (valued today at $100m) will need to assessed for possible impairment, and its amortisation may need to be accelerated such that its residual value will be zero by year 10. Assuming no immediate impairment is required, the company will subsequently recognise a $10m annual expense (for simplicity) in the income statement and an additional amortisation provision in the balance sheet.

The company would further update its capital asset note to advise users of the planned asset abandonment and its financial effect over its revised future useful life. Additionally, information about the new planned site should be disclosed; this will be done in the Management Discussion & Analysis (MD&A) section of the general-purpose financial statements until land is acquired, construction starts, or an existing winery (asset) is purchased in accordance with generally accepted accounting principles and financial reporting standards.

HOW TO DETERMINE THE FINANCIAL CONSEQUENCES OF SUSTAINABILITY PERFORMANCE

Anyone who has tried to implement an ESG or sustainability-related program in their company knows that these issues cannot be confined to one department or function, they live throughout the organisation. The most successful companies are those that implement cross-functional, collaborative processes to help break down silos.

Materiality is the foundation to reporting; sustainability is no exception. The first step in connecting sustainability and financial performance is identifying clearly the sustainability matters that are significant to the company — regardless of the materiality lens chosen.

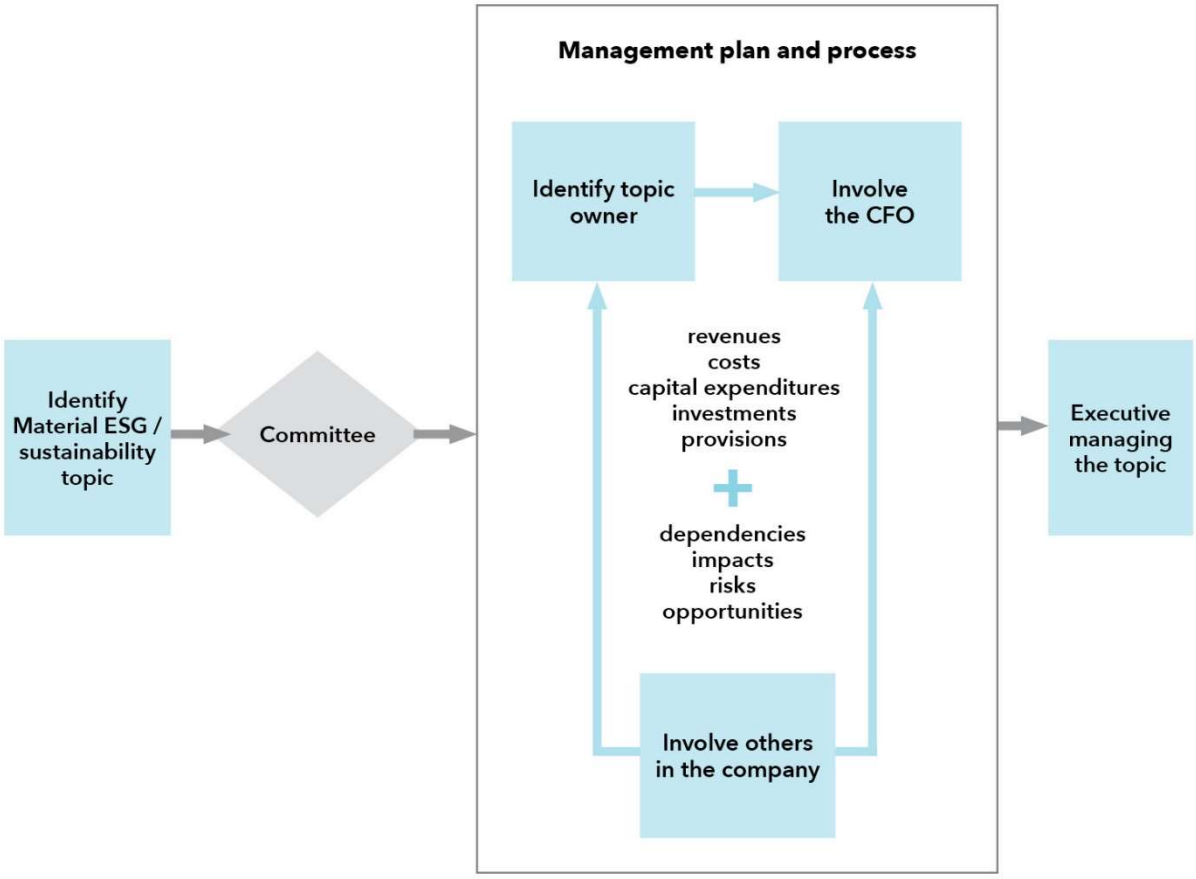
The second, and arguably most critical step, is to include the Chief Financial Officer (CFO) – or their equivalent – in conducting a sustainability assessment exercise and developing the strategic and operational plans to support it, whether it's for the overarching sustainability approach or an issue-specific program to put in place. The CFO is the key person to lead this cross-functional collaboration. If cash is the "lubricant of business activity", the CFO is the glue that enables the organisation to operate effectively. They have the full picture of its strategy and operations, as well as the planning capabilities and capital allocation authority.

Why is this step so important? Because as the examples used throughout this paper illustrate, the translation from sustainability matter to financial implications usually happen during the operational planning and forecasting processes, ie, when managing sustainability matters. This process will, by the same token, naturally seek to identify and address material dependencies, risks, opportunities, and impacts.

"CFOs can help to ensure an organisation's commitment to ESG is translated into meaningful outcomes. This is not just by measuring and reporting on ESG indicators, but by influencing resource allocation, such as investments in eco-friendly tech, energy efficiency measures, waste reduction programs and projects with social impact."[2]

[2] 4 key trends CFOs need to know for 2024, 27.02.2024, CPA Australia

Figure 3: Sustainability project assessment process, typically led by the sustainability manager



IMPLICATIONS FOR FUTURE REPORTING

Location, location, location

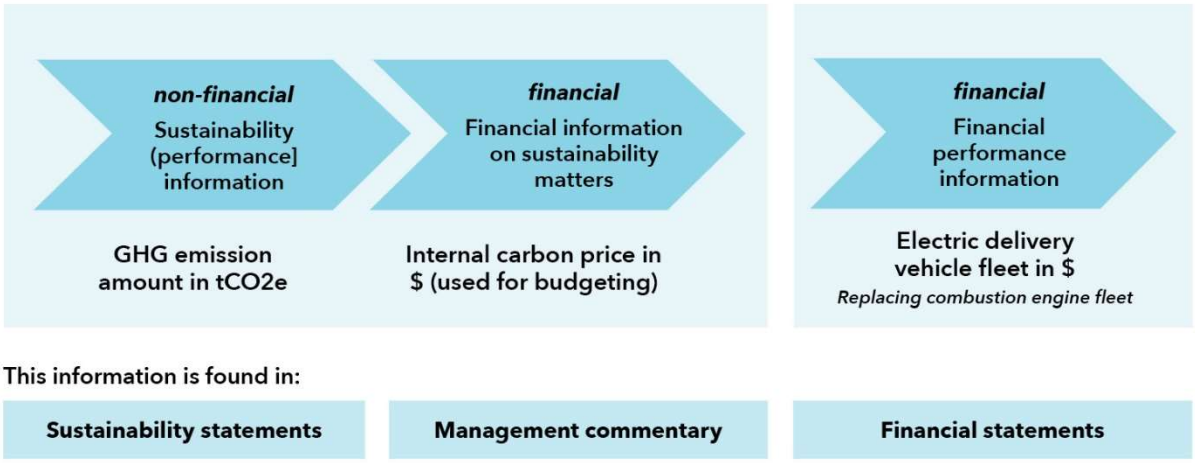
Hopefully, it is clearer how sustainability and financial information differ. This has implications for where information is located within the general-purpose financial statements. For example, CO2 emission values will not appear in the financial statements, first and foremost because they are not measured in a currency, rather are measured in tonnes of carbon dioxide equivalent (tCO2e). However, their value in dollars may be calculated by using a price per carbon ton, which could be included within the value of inventory (ie, on the balance sheet), ultimately making its way into (future) cost of sales and profitability (ie, in the income statement).

Today, many sustainability and accounting leaders apply a shadow carbon price for internal management reporting to internalise the cost of polluting emissions into their financial forecasts. In some cases, companies disclose this shadow carbon forecast result externally. In terms of where to disclose this information, the general quantitative and qualitative information about CO2 emissions will reside in sustainability statements, the MD&A, or in the risks and uncertainties section. Their value in dollars will also be included within the financial statements if doing so meets the requirements of financial reporting standards.

This information will be presented in various sections and manners reflecting the fact that the information conveyed through each differs; connectivity is about explaining how they are connected, how sustainability performance (ie, emission levels) can affect actual financial

performance (ie, inventory costs that require financing or cost of sales that affect profits) and prospective financial performance (ie, outcomes of a scenario analysis in the MD&A or as contingencies in financial statement footnotes.

Figure 4: Example of emissions-related information



Seeing sustainability performance through the prism of financial reporting

When it comes to connecting sustainability and financial performance information in disclosures, companies use a typical financial thought process sequence as follows:

Table 1: Thought process in determining the type of sustainability-related information.

Level	Description	Example
First level	Information is disclosed in the MD&A, minimally within the risks and uncertainties section.	Water scenario analysis projections for all manufacturing site locations materially dependent on access to water. These projections carry estimation risk given uncertainty around climate (for example, rainfall, water tables), government-imposed water restrictions, or population growth projections.
Second level	In addition to the above, information on the sources of estimation risk, significant judgments (IAS 1), or contingencies that meet the criteria of liability disclosures under IAS 37 will be disclosed in the notes to the financial statements.	Site restoration costs for a plant that may be abandoned in 10 years' time or may be refurbished and run for another 10 years or more. Although the company expects to incur a cash outlay in 10 years' time, it is not yet reasonably measurable, nor has the event leading to the contingency been taken (ie, the usage decision). Disclosure occurs in the footnotes (in accordance with IAS 16 Property, Plant and Equipment).
Third level	An event triggers an update to the above disclosure approach, which results in a financial measurement such as an asset impairment or a liability provision reported in the balance sheet.	A decision is made to close a factory in five years rather than 10 years which requires incremental site restoration costs of $10m. The additional expected costs are added to the balance sheet value of the factory asset, and then an immediate assessment of possible impairment follows; the change in the useful life and estimated restoration costs for the plant, as well as the additional impairment analysis are disclosed (in accordance with IAS 36 Impairment of Assets).

Understanding this journey helps illuminate where different levels of information pertaining to sustainability matters may find themselves in relation to financial performance, and ultimately financial disclosures. It helps explain why sustainability information is often found in regulatory disclosure documents, yet remains outside of the financial statements themselves, either because it's non-financial, or it is financial yet fails to meet the requirements of financial reporting standards (ie, it is not measurable yet). Furthermore, sometimes the financial implications of sustainability performance are so deeply intertwined with financial performance metrics that they cannot be separated out, such as higher productivity rates resulting from strong employee engagement levels.

It helps us contextualise why most financial information on sustainability matters within the financial statements tends to be negative in nature. This is because accounting reporting standards are skewed towards downside risk and contingencies. In other words, the probability threshold for recognising risk-related negative outcomes such as losses or impairments is easier to meet than the corresponding threshold for recognising opportunity-related positive outcomes such as incremental assets, revenues, or cost savings. As a result, contingencies are recognised for expected losses, however opportunities are generally only recorded when they materialise.

In any event, both negative and positive performance information pertaining to material sustainability matters remains relevant and important to disclose.

What the disclosure standards say

IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information[3] states that information disclosed should enable users to understand the connections between different material sustainability matters, between different sustainability information, and 'across' sustainability information and financial information.

Similarly, ESRS 1 General requirements[4] states that companies must connect narrative elements, such as governance, strategy, risk management, and performance metrics and targets for a specific sustainability matter, with its counterpart in the financial statements, whether in narrative or quantitative form.

"For example, in providing connected information, the undertaking may need to explain the effect or likely effect of its strategy on its financial statements or financial plans or explain how its strategy relates to metrics and targets used to measure progress against performance.

"Furthermore, the undertaking may need to explain how its use of natural resources and changes within its supply chain could amplify, change, or reduce its material impacts, risks and opportunities. It may need to link this information to information about current or anticipated

[3] IFRS S1 article 21, Connected information states that: *"An entity shall provide information in a manner that enables users of general purpose financial reports to understand the following types of connections: (a) the connections between the items to which the information relates —such as connections between various sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects; and (b) the connections between disclosures provided by the entity: (i) within its sustainability-related financial disclosures—such as connections between disclosures on governance, strategy, risk management and metrics and targets; and (ii) across its sustainability-related financial disclosures and other general purpose financial reports published by the entity —such as its related financial statements."*

[4] ESRS 1, 9.2, Connected information and connectivity with financial statements states that *"The undertaking shall describe the relationships between different pieces of information. Doing so could require connecting narrative information on governance, strategy and risk management to related metrics and targets. For example, in providing connected information, the undertaking may need to explain the effect or likely effect of its strategy on its financial statements or financial plans, or explain how its strategy relates to metrics and targets used to measure progress against performance. Furthermore, the undertaking may need to explain how its use of natural resources and changes within its supply chain could amplify, change or reduce its material impacts, risks and opportunities. It may need to link this information to information about current or anticipated financial effects on its production costs, to its strategic response to mitigate such impacts or risks, and to its related investment in new assets. The undertaking may also need to link narrative information to the related metrics and targets and to information in the financial statements. Information that describes connections shall be clear and concise."* (par 123)

financial effects on its production costs, to its strategic response to mitigate such impacts or risks, and to its related investment in new assets."[5]

This is entirely consistent with existing financial reporting standards, which specify that any material quantitative information must be accompanied by narrative explanation.

In its recently finalised climate disclosure rules, the US Securities and Exchange Commission (SEC) takes a very similar approach. In fact, these rules are even more explicit about detailing the required financial information on climate-related issues, perhaps because of the very deliberate care the SEC has taken to stay within its remit in the face of intense scrutiny and pressure.

For example, in addition to requiring companies to disclose climate-related risks that can have an impact on their business strategy, results of operations, or financial condition, the rules also require disclosing "material expenditures incurred and material impacts on financial estimates and assumptions that directly result from [...] mitigation or adaptation activities", as well as "capitalised costs, expenditures expensed, charges, and losses incurred as a result of severe weather events and other natural conditions", and "capitalised costs, expenditures expensed, and losses related to carbon offsets and RECs, subject to disclosure thresholds."

The rules explain that these capitalised costs, expenditures expensed, charges, and losses "represent quantitative information that is derived from transactions and amounts recorded in a registrant's books and records underlying the financial statements".

The SEC requires registrants to disclose these financial statement effects in a note to the financial statements, indicating where within the balance sheet and income statement these capitalised costs, expenditures expensed, charges, and losses are presented (rule 14-01).

Connected and combined, but not integrated!

The evolution towards interdependent sustainability and financial management is likely to close the debate on whether we need both types of information, for the same reporting period and scope, delivered at the same time. But will it also close the debate on separate documents?

On one hand, the EU's CSRD and its ESRS are prescriptive, requiring a specific format for sustainability statements to be included in the regulatory annual management report, which includes narrative on governance and strategy, business activities, MD&A, sustainability statements, financial statements, and the auditor's report.

On the other hand, the IFRS SDS, while requiring sustainability-related disclosures to be part of general-purpose financial reports, have avoided requiring them to be in the same document as financial statements. Domestic securities regulators and legislators that mandate adoption of the IFRS SDS may further prescribe the location of sustainability information. Given the interconnectedness of sustainability and financial performance information, there can be little doubt that best practice places all material information in a single document.

However, this is very different from an integrated report produced following the Integrated Reporting Framework, for which the IFRS Foundation has assumed responsibility following the consolidation of the Value Reporting Foundation in 2022. Both the International Accounting Standards Board (IASB) and the International Sustainability Standards Board (ISSB) have confirmed their lack of appetite for any near term work on integrated reporting.

[5] ESRS 1

The natural place for information on the connectivity of sustainability and financial performance appears to within the MD&A, as a companion to structured sustainability statements and financial statements.

This was the intent of IASB's 2021 project to overhaul the Management Commentary by developing "a comprehensive set of requirements and guidance that would enable companies to bring together, in a single, concise and coherent narrative, information about financial, sustainability-related and other factors that are fundamental to the company's ability to create value and generate cash flows, including in the long term".

Thankfully, the IASB decided in its June 2024 Board meeting to finalise this project after a prolonged period of it being on hold.

Perhaps Larry Bradley, Global Head of Audit at KPMG, said it best in a post on ESG Today:

"A company's report provides a window on its business. The financial statements provide one window; sustainability disclosures another; and management's discussion and analysis (MD&A) another. Three windows on the same business. In my opinion there will be true connectivity when investors can recognise the same business model and strategy through all three windows – and when there is a consistent narrative that connects the dots between the financial and non-financial information presented in those windows."

CONCLUSION

Unlocking the mystery behind the connection between sustainability and finance requires an understanding of the differences between measuring, reporting, and disclosing performance. This in turn helps determine where different types of information will be disclosed. Users of sustainability disclosures are demanding a relevant and clear connection between sustainability and financial performance, which companies would do well to provide. Better disclosures lead to more efficient markets and high-quality disclosures enjoy many benefits, including a lower cost of capital.[6]

This need for connectivity is driving greater interaction and collaboration between the sustainability and finance departments. It is necessarily pulling the Chief Financial Officer (CFO) into the decision-making process as an essential contributor to support the identification of material issues and implement management programs and initiatives. The sooner this happens the better. In the adoption of this holistic approach, companies can make the most of the financial consequences of their sustainability performance, create financial value, build long-term resilience, and strengthen reputational capital. Sustainability can ultimately become meaningfully and profitably embedded within their strategy and operating business model.

[6] References: Sengupta (1998) found full disclosure resulted in a lower cost of capital (0.02%) for every 1% increase in disclosure quality and Botosan & Plumlee (2002) found a 0.7% lower cost of capital with high quality reporting.

APPENDIX 1: STANDARDS DIFFER

Developing a common language for sustainability and finance practitioners to collaborate involves a more nuanced understanding of the different types of standards.

Accounting, reporting, and disclosure standards are not one and the same thing. If today we have both financial accounting and financial reporting standards as well as financial disclosure standards, we have only recently witnessed adoption of sustainability reporting and disclosure standards. However, we do not have specific sustainability accounting standards notwithstanding the arguments that the IFRS standards technically suffice.

What are the differences?

Accounting standards prescribe how to measure things.
Reporting standards prescribe how to present things that are measured (or unmeasurable).
Disclosure standards prescribe things to disclose publicly, which are typically defined by a regulatory body.

Table 2: Examples of the different types of standards

Type of standard	Example
Accounting	FASB's Generally Accepted Accounting Principles (GAAP) IFRS's International Financial Reporting Standards
Reporting	EFRAG's European Sustainability Reporting Standards (ESRS) ISSB's IFRS Sustainability Disclosure Standards
Disclosure	Corporate Sustainability Reporting Directive (CSRD) US SEC climate disclosure rules

In accounting standards, measurements may allow for options, but these are i) known and ii) fixed. In other words, once you choose a measurement option, you must continue using the same. A good example is the accounting standard to count inventory, for which two methods are allowed: first-in-first-out (FIFO) and weighted average cost (WA)[7]. Once the company chooses its allowable method, it must apply it consistently thereafter.

In sustainability, measurements are generally not yet consistently defined, or when they are, they may vary from one set of standards to another and are not yet universally agreed upon. This results in performance measures, and therefore data, that may not be easily comparable. A good example is the counting of full time equivalent (FTE) employees. Every company has an FTE number, but it seems every company has a different way of measuring or counting an FTE. While most sustainability reporting or disclosure standards require this number be disclosed, few prescribe how to define and count it.

An accounting standard would tell you the "x" number of ways to calculate this number. It may take time before we have sustainability accounting standards that produce truly comparable sustainability performance disclosures. In the interim it is important to disclose both the FTE number and calculation methodology thereby allowing users to compare across companies.

[7] Note: the last-in-first-out (LIFO) method is prohibited under IFRS but allowed under US GAAP

The best advice in sustainability reporting is to start somewhere and use what you have. Some disclosures are better than none, and we are collectively taking the first steps on a longer journey of change where sustainability disclosures will ultimately be on par with financial disclosures.

Sustainability accounting standards may finally bring into focus the use of measures for true context-based and absolute sustainability performance, such as the UNRISD's Sustainable Development Performance Indicators (SDPI).

APPENDIX 2: GLOSSARY OF TERMS

Term	Definition
Accounting measurement	A concept that measures something in monetary terms; allows for comparability and a consistent understanding; reflected in financial statements.
Disclosing (Disclosure)	The process of converting internal information into an external output (or the output itself). Corporate disclosure is the act of providing relevant information to stakeholders; the structure, frequency, and format are typically defined by a regulatory body (such as a securities regulator) and apply to all aspects of the general-purpose financial statements.
General purpose financial statements Financial statements	Financial statements released to a broad group of users. They are intended for a wide range of primary uses, such as credit analysis and stock valuations. These statements include the income statement, balance sheet, statement of cash flows, statement of shareholders' equity, and any accompanying disclosures. If the financial statements have been audited, then they should also include the audit report. Financial statements are typically a regulatory disclosure obligation for publicly listed companies.
Management Discussion & Analysis (MD&A)	Often referred to as the front half of the annual report, where management explains performance through qualitative narrative and quantitative measures that help users understand details and context not otherwise available through the reporting standards. It includes industry context, the company's strategy and mission, its major risks, and uncertainties[8], and other elements relevant to explaining current performance and how future performance may differ from past performance. While separate from financial statements, the MD&A is typically a regulatory disclosure obligation for publicly listed companies.
Reporting	The process of measuring performance according to a prescribed set of reporting standards; a required information structure defined by and compliant with a particular set of financial accounting and reporting standards, such IAS 1 or ASC 205 and 505, SEC Regulation S-X, Article 3; applies to all aspects of financial statements; may or may not be shared externally.
Sustainability measurement	A concept that measures things in units, such as number of people, metric tons, etc.; not reflected in financial statements; can be reflected in other statements, such as sustainability statements; when disclosed, should be in the MD&A, risk section, sustainability report, or elsewhere in the annual report.

[8] Risks and uncertainties may be separate from the MD&A section, such as in the Form 10-K.

Sustainability-related financial disclosures	A particular form of general purpose financial reports that provides information about the reporting entity's sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium or long term, including information about the entity's governance, strategy and risk management in relation to those risks and opportunities, and related metrics and targets.[9]
Sustainability-related financial information	Information about the sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium, or long term.[10]
Sustainability statements	A dedicated section of the regulatory annual disclosures presenting information about sustainability matters. In the EU, the information must be prepared in compliance with the requirements of the CSRD and its ESRS.

About the authors

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[9] IFRS S1
[10] IFRS S2

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