# Impact of Mandatory Sustainability Reporting on Corporate Functions

## Future of Reporting Policy Brief

UPDATED IN JULY 2024

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# Introduction

This policy brief outlines how corporate sustainability reporting requirements stipulated by the EU Corporate Sustainability Reporting Directive (CSRD)/European Sustainability Reporting Standards (ESRS), the International Financial Reporting Standards (IFRS) Foundation's inaugural Sustainability Disclosure Standards, and the US Securities and Exchange Commission (SEC) climate disclosure rule are impacting businesses and their internal functions.[1] The brief is informed by companies' shared experiences in navigating the evolving reporting landscape, complemented by BSR research. Per function, the brief includes a summary of key implications with recommendations. Please note that while we have sought to produce a document that includes universal and transferable learnings, each company's context is unique.

# Key Regulations/Standards and their Characteristics

The impacts covered by the brief refer to sustainability reporting regulations and international standards outlined in the below table. Note that this brief is not a complete overview of global sustainability disclosure regulations or standards and that there are other pieces of legislation companies should follow, such as the climate bills enacted in California.

BSR has found that while some leader awareness or other internal decisions may have been driven by a specific rule or disclosure standard, the *impacts* on corporate functions and the requisite preparatory actions to comply with the requirements are in response to the changing regulatory landscape as a whole. There are few instances where a specific impact or action appears uniquely attributable to just one of the below developments.

| | **US SEC Climate Disclosure Rule** | **EU CSRD and ESRS** | **IFRS Sustainability Disclosure Standards** |
|---|---|---|---|
| **Scope/ companies impacted** | The SEC rule applies to all SEC registrants, foreign private issuers, and emerging high-growth companies. The SEC rule also applies to | The CSRD applies to companies based in the EU meeting two of the three following conditions: 1) €50 million in net annual turnover, 2) €25 million in assets, 3) 250+ employees. It is estimated that around 49,000 companies will be covered by CSRD requirements. | These standards apply at the discretion of authorities in various jurisdictions. In theory, most companies are impacted by the presence of these standards, as additional stakeholders (e.g., investors) |

[1] Note that at the time of writing the policy brief, the US SEC Climate Disclosure Rule was in draft form.

| | | | |
|---|---|---|---|
| | companies entering the US capital markets through M&A by public companies or by conducting initial public offerings. | Application of CSRD will occur progressively also for non-EU companies or groups whose securities are admitted to trading on an EU-regulated market. Additionally, non-EU companies with significant business in the EU (i.e., annual turnover of above €150 million) will also need to comply. | will likely request disclosure in line with the regulation. |
| **Implemen-tation time frame** | Depending on the size of the company, companies will need to report information for the first fiscal year beginning in the year 2025 (for large companies), 2026 (for medium companies), and 2027 (for small companies), generally in a filing the following year. | Large companies already subject to the Non-Financial Reporting Directive (NFRD) will have to apply the new rules in their 2024 financial year, impacting reports published in 2025. Large companies that are not subject to NFRD will have to comply from 2025 and publish their first CSRD-compliant annual report in 2026. Non-EU companies with significant business in the EU will have to comply from the 2028 financial year and publish a report in 2029.<br><br>Select requirements feature a phased approach to implementation. | Both the General Requirements Standard (S1) and Climate Standard (S2) are effective for annual reporting periods beginning on or after January 1, 2024. The IFRS standards also require companies to report their sustainability-related disclosures at the same time and for the same period as their related financial statements.<br><br>Select requirements feature a phased approach to implementation. |
| **Legal status of the regulation/ framework (is this anticipated to change?)** | The SEC adopted the Climate Disclosure Rule on March 6, 2024.[2] | The EU Commission adopted the sector-agnostic standards through delegated acts in July 2023. | A range of jurisdictions have signaled intent to adopt IFRS S1 and S2. The ISSB will consult on priorities and seek further feedback on four projects in its upcoming consultation on agenda priorities: biodiversity, ecosystems, and ecosystem services; human capital; human rights; and connectivity in reporting. |

[2] The US appeals court has temporarily halted the enforcement of new rules in response to lawsuits filed by several companies and states, pending further judicial review (March 2024).

# Implications for Corporate Functions

## Sustainability

### Current State

Sustainability teams are evolving to meet the demands of rapidly changing regulations and standards. The roles of the team are being expanded, with new responsibilities that imply wider and deeper collaboration across internal functions and leadership to help navigate the evolving landscape and prepare for new reporting rules. Sustainability teams increasingly collaborate cross-functionally to navigate this evolving landscape to address environment, social impact, human rights, and governance.

For some companies that have already been working on and disclosing sustainability performance, we see a more structured way of cross-functional collaboration. This takes the shape of a sustainability reporting council or steering committee—including Finance, Internal Audit, Operations, Supply Chain, HR, Legal, and Comms, among other functions—meeting on a regular basis to discuss the latest sustainability developments and strategies. This committee often focuses on operationalization of the standards/directives, outlining what needs to be done, when, and by whom with clear accountability and outcomes. These working groups are increasingly shared with or led by the finance team, which ensures alignment with evolving disclosure requirements. Most leading companies also conduct a mapping exercise and gap analysis against the ESRS and other standards requirements. Some companies noted that these can start small with the sustainability team or key reporting functions, then involve others to socialize the results and fill gaps.

> "Reporting is the impetus to have a lot of conversations that otherwise might not have happened."
> – Reporting Practitioner

### Governance of Sustainability Reporting

Disclosure regulations affect sustainability teams' reporting lines in several ways: shifting toward (or to sit within) Finance, Legal, etc. To better understand the current landscape, BSR asked companies to which function their sustainability reporting teams are reporting.

- **Reporting to Finance:** For annual reporting purposes, many sustainability teams have or are shifting to place part of their work within the Finance department, allowing them to align sustainability reporting with that of financials. When the finance team oversees sustainability data, this, in many cases, gives space to the sustainability team to continue to create qualitative framing, which is needed to explain the data. This frees sustainability practitioners to focus more on impact, forward-looking strategy, and cultural change within the organization, instead of merely collecting and reporting the data. However, the risk of this model is that finance might not have the requisite expertise to control data on certain issue areas (e.g., human rights). There are some examples of companies doing rotational assignments whereby a finance member sits on the environmental, social, and governance (ESG) team for a year to upskill required expertise to understand disclosure requirements and data.

- **Reporting to Legal:** Changes in regulatory requirements have led some organizations to either shift the sustainability team to the Legal department or to create new dotted lines and collaboration mechanisms. This appears partially driven by readiness and scoping assessments implied by new regulations, which increase the importance of understanding which entities are in scope of which rules, where and when, and what is newly required for disclosure. Some companies are establishing a dedicated sustainability legal team within the Legal department, with subject matter experts on sustainability reporting to ensure that the company can interpret new legislation and how it affects their approach to disclosure.
- **Reporting to Risk:** In other cases, sustainability teams operate within the risk function under the Chief Risk Officer. This alignment between enterprise risk and sustainability has been prompted by the need to address double materiality and adapt to changing disclosure requirements, fostering closer integration between sustainability and enterprise risk management (ERM). While the risk team is concerned with identifying and managing risks that could impact the reliability of financial reporting, the finance team is responsible for the actual preparation and presentation of the financial—and in some cases, sustainability—statements. In financial reporting, both functions collaborate to ensure that financial reporting is not only accurate but also takes into consideration potential risks that could affect the quality of the reported information. Companies where sustainability teams report to or are embedded in this function often integrate sustainability reporting “fully” into corporate reporting.
- **Reporting to Corporate Affairs or Marketing:** Some companies have moved their sustainability team closer to Corporate Affairs and/or Marketing for better alignment with the corporate narrative and external positioning. While such an approach does not imply a lag behind recent governance structure trends, it may mean that additional cross-functional connections by the sustainability team are needed to ensure understanding of and readiness to comply with disclosure regulations’ requirements. The same would apply to government relations or public affairs to ensure that sustainability issues are more fully integrated into the narrative, positioning, and strategy for the company’s public policy, government relations, or regulatory affairs.

## Future State/Impacts

**Beyond governance, sustainability reporting practitioners pointed to several significant shifts in their roles driven by disclosure regulations:**

- **Reporting to the CEO or specific committee:** Ideally, the sustainability team or sustainability officer reports directly to the CEO or has a direct link to the C-suite. For companies where this is the case, the strategic importance of sustainability is often already embedded throughout the business and directly into the long-term business strategy. In certain cases, reporting structures evolve toward cross-functional sustainability (reporting) committees dedicated to sustainability reporting matters. Direct reporting to a sustainability committee or the board of directors is seen as a potential shift from prior reporting hierarchies.
- **Increased focus on compliance:** Some sustainability teams fear a move toward sole focus on regulatory compliance, with efforts overly directed toward understanding and adhering to new and evolving regulations. While some members feel that compliance means accepting a lower standard or following a check-box approach, BSR believes that laws such as the CSRD elevate business practices above where they are today and will drive the change we want to see in the medium to long term. While there is a risk of compliance at the expense of performance, sustainability practitioners should strive to ensure compliance with both the letter and the spirit of the law (i.e., what the law says as well as the impact it's trying to achieve).
- **Intrinsic link to business model:** There is growing recognition that sustainability is intrinsically linked to the business model and value creation, particularly in the context of major impacts such as climate change. This greater level of attention and visibility, together with scrutiny of compliance (e.g., senior executive and board duty of care and review), significantly increases the visibility of sustainability practitioners' work. This awareness of inward impacts of sustainability on the business, and the relationship between a company's outward impacts on the world and how those impacts can come back to affect financials or reputation, may serve to increase the level of influence or authority that sustainability teams wield internally.
- **Data complexity:** Managing the growing complexity of sustainability data and its integration with financial data is a significant challenge. The lines between traditional financial data and sustainability data are blurring—the responsibility for data quality, assurance, and controls is increasingly shared, and the consequences of having unverifiable data or audit findings will increase.
- **Emphasis on innovation to reporting:** Innovation in reporting platforms and data management solutions supporting sustainability reporting may play a more prominent role in discussions. Automation is seen as a potential tool to streamline sustainability tasks and make the job more manageable, though there is not yet a platform that can meet every team's needs. Third-party reporting software is seeking to integrate materiality, data collection and verification, and qualitative reporting in line with multiple jurisdictions' requirements. While these innovations hold promise, their full utility is yet to be seen, and

questions remain as to where responsibility sits to implement (and pay for) such platforms.

- **Budget constraints:** Sustainability is increasingly integrated within the company's strategy and aligned with its purpose due to external demands from customers, supply chains, investors, and legislation. Despite the additional work required, some companies are also flagging budget cuts and other constraints (e.g., reduced or flat head count). Failure to secure additional resources to meet the rigor demanded by reporting regulations poses a risk that sustainability teams are forced to focus on compliance, rather than performance and forward-looking strategy and impact.
- **Rising stakeholder interest**: Stakeholders, including investors, customers, current and future employees, suppliers, shareholders, local communities, and governments, are continuing to increase their interest and sophistication with respect to sustainability information, as has been the trend for several years. Demands for sustainability information by investors, who have their own sustainability disclosure requirements, and other stakeholders are driving increased collaboration across teams to respond to new and specific requests—whether they be RFPs, investor presentations, or provision of information to civil society stakeholders. Employees often prefer to work for companies that demonstrate a commitment to sustainability, focusing on green and responsible practices, to both retain and attract talent. Customers are increasingly demanding transparency, products, and services that are sustainable. Suppliers are also demanding high-quality sustainability information, as they may only do business with companies that are aligned with their own sustainability standards. Local communities influence performance and communication on sustainability because companies may face backlash if they operate in a manner that harms local communities or the environment, which, in turn, could harm a company's reputation.

Sustainability reporting practitioners consistently highlight the complex and evolving landscape of sustainability roles. The interplay between regulations, resource constraints, and stakeholder demands is creating unique challenges that are felt differently by every company, but also opportunities to increase the visibility and impact of sustainability work.

## Challenges and Recommendations

- **Convene functions, advise leaders**
  - Establish executive-level steering committees and working-level cross-functional groups, bringing in finance (including risk and audit), strategy, legal, corporate affairs, operations, procurement, IT, HR, and product development, among others
  - Act as a key advisor to executive management and the board
- **Enhance sustainability governance**
  - Conduct sustainability governance reviews to assess ownership and ensure readiness for compliance

    - Help set up or strengthen internal controls on sustainability data and impact
- **Drive the sustainability agenda**
    - Build capacity on sustainability, reporting, due diligence, and requirements across business functions
    - Update materiality assessments (double materiality methodology, evaluating both impact materiality and financial materiality). These assessments should identify existing and potential sustainability impacts, risks, and opportunities.
    - Ensure regulatory requirements don't supersede focus on sustainability performance.

# C-Suite (Management as a Whole)

## Current State

Leading companies are empowering individuals across the organization to feel a sense of ownership by incorporating sustainability into their roles. In areas like procurement, where sustainability plays a vital role, dedicated leaders may guide the organization's sustainable sourcing practices. By aligning these individuals with the broader leadership vision led by the C-suite, companies foster a more comprehensive approach to sustainability, reflecting a shared commitment to sustainability throughout the entire organization. This approach ensures that sustainability is not merely a compliance-driven effort but rather an intrinsic part of the company's DNA, aligning it with the evolving landscape of regulatory requirements.

## Future State/Impacts

The disclosure regulations and standards governing the oversight and management of sustainability issues have become a central focus for companies with established sustainability programs and strategies. Increasingly, it is recognized that true sustainability leadership requires the integration of all dimensions of sustainability principles into leadership structures. To achieve this, strong internal commitment and buy-in are paramount, ensuring that sustainability objectives are not merely superficial "greenwashing" efforts. Companies without strong governance in place will need to disclose their lack of ownership/oversight and the fact that, for example, the company's sustainability performance is not tied to executive compensation in the way that financial performance is. Those that are "fast followers" are likely to allocate leadership responsibility and tie some measures of sustainability performance to CEO and C-suite staff remuneration calculations.

### Challenges and Recommendations

- Build leadership accountability
  - Establish accountability for central management in the C-suite (i.e., Chief Sustainability Officer role and distributed accountability across all roles, including Chief Financial Officer, general counsel of corporate affairs, etc.)
  - Update leadership and management about ongoing sustainability efforts and requirements
  - Review compensation practices, incentivize leadership by tying executive compensation to sustainability performance metrics (using impact metrics, rather than achievement of basic process targets)
- Deepen involvement
  - Involve leadership in sustainability impact, risk, and opportunity identification as well as disclosure
  - Require final review of sustainability reporting alongside the board. Sign-off needs to happen by board, but the C-suite will need to review and ensure execution

## Board of Directors (or Committee with Sustainability Oversight Duties)

### Current State

Sustainability teams play a pivotal role in engaging boards on regulatory changes, sustainability targets, and evolving perspectives. Various companies have adopted strategies to educate and upskill their boards on sustainability matters, ranging from topical briefings to comprehensive sustainability training.

Companies and their boards are taking the following actions:

- Changing board composition to incorporate greater sustainability expertise and upskilling
- Updating charters to reflect how sustainability is incorporated into an organization’s mission, vision, or values statements, which inform and align key stakeholders with a company’s sustainability commitment
- Creating new committees responsible for overseeing the systems, policies, and processes to achieve a company’s sustainability objectives. This includes monitoring sustainability risks, reassessing the sustainability charters, and recommending changes to the board.

The frequency and depth of discussions related to sustainability and sustainability reporting regulations at the board level vary among companies. For instance, some companies have made it standard practice to discuss sustainability issues at every board meeting. One company provided its board with early insights into the ESRS mapping process and relevant data points. While this level of transparency and granularity is a recent development, it highlights the increasing importance of considering sustainability issues at the board level.

Common practice is to integrate sustainability into the nominating and governance committee's agenda two to four times per year, along with an annual sustainability update provided to the audit and risk committee if sustainability data are already subject to internal audit (as it should be). These updates serve to keep the board informed about the company’s progress in these areas, though deeper engagement is coming, due in part to sign-off requirements.

## Future State/Impacts

Regulations will have a profound impact on the responsibilities and practices of a company's board of directors, with regards to materiality and the formulation of a sustainability strategy vis-à-vis that of the core business. As regulations evolve, companies are expanding the role and engagement of their boards in addressing sustainability risks, thereby enhancing transparency and accountability.

For those companies where the board composition remains unchanged, companies need to explore the integration of sustainability considerations into their annual review of directors, including upskilling opportunities and educational resources. Turnover, while an insufficient driver of change, is also an opportunity to bring on new directors with requisite sustainability expertise.

## Challenges and Recommendations

- Provide closer oversight (full board and specific committees)
    - Expand board skills and knowledge, receiving more regular and more detailed updates on sustainability matters
    - Update board composition and/or committee structure/charters
    - Sign off on materiality and sustainability reporting
    - Oversee link between sustainability impacts, risks, and opportunities to company strategy and long-term business model
    - Create processes for escalating updates on material impacts to the board
- Align compensation practices (compensation committee)
    - Review compensation practices for executives and across cohort levels to ensure that performance incentives drive improved sustainability outcomes

# Finance

## Current State

The Finance department is increasingly charged with connecting sustainability information to financial disclosures. Many sustainability and reporting teams have already been integrated into finance, reflecting an ongoing trend toward more integrated approaches to disclosure where financial and sustainability information are presented together, whether in the 10-K, proxy statement, or other annual management reports.

However, while some companies have long maintained an integrated approach between sustainability and financial reporting, this shift is relatively new for most organizations, and it is happening at a rapid pace. This transition highlights a growing need for finance teams to learn the nuances of sustainability. While finance practitioners can grasp the high-level, conceptual understanding of how sustainability efforts impact financials, they often face challenges in translating these concepts into practical financial terms today.

Moreover, an increasing number of companies are leveraging data tools and software solutions to collect and report sustainability data in addition to financial data. Several companies that have already been using such software are contemplating system changes, as new regulations demand the inclusion of sustainability performance data within financial reporting.

## Future State/Impacts

Finance and sustainability teams must work to operate using the same language and methodology. To foster integration, both functions need to make efforts to enhance mutual understanding if they haven't already started doing so. For example, how can a finance practitioner work to understand controls for human rights information? How can a sustainability manager “SOXify” their data (a reference to Sarbanes-Oxley, the US law mandating certain financial recordkeeping and reporting practices) and, in the process, teach the ins and outs of sustainability matters to their colleagues in finance?

A closer connection between sustainability and finance can unlock new resources for sustainability performance and disclosure. Whereas sustainability teams are often seen as a discretionary expense, finance departments may bring with them a larger “compliance” budget, which can support the increased reporting responsibilities, and sustainability more broadly.

To comply with the regulations, and to bring the sustainability and financial data together, it is key that the reporting timelines of the two are aligned. The sustainability information will be included in the financial reporting, and therefore the internal data collection and approval timeline should be aligned.

For US-based companies, where SEC regulations carry significant weight, there is a growing emphasis on adopting sustainability software solutions that either are financial reporting software or seamlessly align with existing financial reporting software. It is important to have a data collection process that is audit-ready and ensures that data can seamlessly integrate into existing financial reporting software. The technology in managing and reporting sustainability data in a compliant and effective manner is important, but data management is not a prerequisite to compliance—robust governance comes first.

### Challenges and Recommendations

- Integrate and control sustainability data
    - Ensure sustainability data is held to the same level of rigor as financial data, including via assessment of sustainability data collection and validation at a functional level
    - Align sustainability reporting timelines with financial reporting

## Audit

### Current State

Most global companies already internally validate or externally assure some sustainability data. However, new regulatory requirements will mandate third-party assurance, in some jurisdictions on the entire sustainability statement and its full contents.

Historically, climate data, including Scope 1, 2, and 3 greenhouse gas (GHG) emissions, has been subject to limited assurance in many organizations. Yet this represents just a fraction of what may now fall within the scope of assurance, particularly given the CSRD's breadth. Companies' sustainability teams are currently increasingly coordinating with the internal audit function to understand data collection and documentation, drawing on the experience of Sarbanes-Oxley (SOX) compliance, and applying those principles to the review of sustainability data.

### Future State/Impacts

Over time, it is expected that internal audit teams, in conjunction with finance, will take a leading role in this data verification process. Forward-thinking companies have established dedicated working groups to focus on assurance in anticipation of legislation such as the CSRD. In doing so, they've increased collaboration between their audit and sustainability teams. Audit teams across various companies are now taking on the responsibility of establishing internal controls related to sustainability information. This is a novel task for many, driven by the various regulations, where climate has thus far been the entry point.

Internal audit teams may operate in an advisory capacity, offering expertise to sustainability reporting practitioners in defining what constitutes auditability and assurance readiness—what the process should look like, what aspects need verification, and how to work backward from the end goal.

Finally, when it comes to external assurance, challenges regarding the skills of external auditors have already surfaced. The Big Four are scaling up and building the expertise required to understand and provide reliable assurance for sustainability data, as the demand will be high. The work they need to do includes, in some cases, technical and topic-specific review work to come to the right conclusions for materiality assessments. For example, if a company says climate is not material to them, this needs to be verified by the auditor. Given this potential shortage and the broad scope of topics that will need to be assured for companies that fall under the EU's rules, other third-party specialists may conduct assurance too.

Lacking assurance standards is another challenge that will impact companies. This, combined with the fact that many assurers will verify CSRD (and the SEC's climate disclosure rules) data for the first time, brings uncertainty. The European Commission (EC) does not have to pick a limited assurance standard until 2026, several years into the CSRD reporting cycle. The EC has even longer to decide on a reasonable assurance standard, with the deadline set for 2028. The IAASB *hopes* that ISSA 5000 becomes the core of EFRAG's sustainability assurance requirements (the standard may not gain traction if not adopted by the EU).

To meet expectations, companies will seek to hire ESG controllers because they understand both the operational and financial aspects of reporting efforts, including internal controls, processes, reporting guidelines, and stakeholder expectations, all critical elements to maintain a high level of reporting.

In the near term, there could be a high degree of variance in terms of what assurance looks like, who is conducting it, and which standards are employed. This is expected to become more uniform over time, reflecting feedback from investors, regulators, and other stakeholders.

As the shift continues, it's clear that the assurance space is undergoing change, and how this evolution unfolds will be an interesting development to observe.

## Challenges and Recommendations

- Integrate and control sustainability data
    - Establish controls for data collection processes, and enhance consistency and robustness as needed
    - Lead on data verification and management approval
- Mitigate skills gap and prepare for assurance
    - Augment current capacity by hiring qualified talent or training existing audit staff on sustainability information
    - Conduct internal audits and identify requisite support for third-party validation
    - Prepare for a likely surge in assurance demand that may lead to or exacerbate external skills gaps

# Risk

## Current State

Sustainability disclosure rules are beginning to affect companies' approaches to enterprise risk management, which are starting to be embedded within, or otherwise are informing, the financial/business dimension of materiality assessments. This alignment is due to most disclosure rules requiring companies to assess whether sustainability topics trigger, or could reasonably trigger, financial effects ("outside-in" perspective), which has become a pivotal nexus in bridging corporate strategy and sustainability topics.

Some companies that undertook double materiality assessments involved their risk teams in the process. Challenges identified by companies include:

- The ERM and materiality assessment time horizons do not perfectly sync nor do the thresholds for reporting risks (and opportunities). Whereas ERM focuses on a shorter time dimension, materiality and other elements for compliance (such as climate scenario analysis) look much further into the future.
- As double materiality involves assessing a company's actual or potential, positive, or negative impacts on society and the environment, questions may remain on how these outward impacts pose risks or opportunities to the business.

## Future State/Impacts

While the risk team has extensive knowledge of the traditional business perspective, it often has a narrower view, given how infrequently we see sustainability risks in companies' financial reporting. The regulations explicitly call for qualitative and quantitative evaluation of climate and other ESG risks and opportunities, and that companies do this for the short, medium, and long term. Therefore, it is expected that the risk team may have a larger role to play with respect to strategic foresight, at least for assessing risks and opportunities for the business.

We expect that these processes will gradually become more integrated over time. Leading companies incorporate their ERM results into the financial dimension of double materiality methodology, with the risk team serving as a vital internal stakeholder to ensure consistency across the risk register and the materiality assessment.

## Challenges and Recommendations

- Integrate sustainability into risk management framework
    - Identify and assess ESG risks alongside traditional financial risks to provide a comprehensive risk profile
    - Focus on both material topics and monitoring of emerging sustainability topics
- Support scenario analyses for sustainability risks

    - Support assessment of the potential impact of various ESG risks on the organization’s operations and financial performance, in partnership with the sustainability team and others
    - Align risk assessment criteria for various assessments; e.g., scope, scale, and remediability
- Collaborate with sustainability team
    - Foster collaboration between risk management and sustainability teams to align objectives and ensure a holistic approach to risk identification and mitigation
    - Collaborate with sustainability teams to conduct a materiality assessment, identifying ESG issues based on their potential impact on business, society, and environment.

# Legal/Compliance

## Current State

Legal teams play a crucial role in navigating the complex and evolving landscape of regulations and are increasingly being pulled into discussions about sustainability reporting. These teams can display varying degrees of risk aversion, ranging from sustainability champions and executive sponsors that are willing to go beyond compliance to resistant parties that are staunchly opposed to exceeding minimum requirements.

For instance, if a topic needs to be disclosed in the management report for European authorities, it is the legal team that will help determine whether that information needs to be filed in the 10-K for US authorities. Similarly, since materiality definitions under various legal regimes and frameworks may vary (even while they are aligned, or not in conflict with each other), a highly risk-averse general counsel may parse the definitions. This risks a disclosure approach that stymies efficiencies, demands reporting similar information in slightly different ways for different jurisdictional authorities, or otherwise reduces reporting to bare minimum compliance to reduce potential legal liabilities.

Legal practitioners emphasize that standalone sustainability reports in their voluntary current form are not regulated documents. A sustainability report is only regulated if it is a section in a company’s annual report, in a 10-K, or other equivalent filing. Some companies are creating dedicated sustainability teams within their Legal departments to interpret and respond to the suite of sustainability-related disclosure regulations, in partnership with the sustainability function.

## Future State/Impacts

Legal teams will need to interpret new reporting rules and regulations. Therefore, they are working to:

1. map which regulations apply to which corporate entities and when (and in which jurisdictions),
2. interpret the compliance obligations that these regulations carry, and
3. understand how these obligations affect where/how/what the company discloses (including follow-on effects for reporting governance at the company).

Some legal teams may want to walk back prior disclosures or freeze new voluntary ESG work, given increased scrutiny and newfound liability. However, others are considering how best to prepare for high-ambition requirements and are treating the most stringent European regulations as a performance floor, thus seeking to support development action plans that are grounded by a corporate-wide policy to govern performance. For the California bills and SEC rule on climate disclosure, there is an open question about where US companies' ESG reporting should live (i.e., 10-K vs. elsewhere), and its broader look and feel, but legal teams that have been following the developments know these US rules are only a subset of those coming out of the EU and other jurisdictions.

In addition to the reporting rules and regulations, legal teams are often leading or at least involved in due diligence work, which can help a company to identify and assess impacts and to assess materiality for reporting purposed based on the criteria of severity and likelihood. Human rights due diligence is required by the EU's Corporate Sustainability Due Diligence Directive (CSDDD), German Supply Chain Due Diligence Act, EU AI Act, Digital Services Act (DSA), etc., and legal teams will play a determining role in how these are enforced.

## Challenges and Recommendations

- Understand new obligations
    - Determine which entities are in scope for sustainability reporting (and when)
    - Understand compliance obligations and effective dates
    - Assess the impact on language and location of disclosures
- Learn sustainability vocabulary
    - Align terminology across disclosure regulations and upskill to recognize differences, such as "materiality" definitions in US securities law vs. EU requirements
    - Build capacity on relevant regulations and the frameworks they build upon (including human rights frameworks), and hone ability to effectively interpret reporting rules' language and what they expect companies to disclose
- Engage the corporate secretary

    - Understand new board accountabilities for sustainability matters, and work with the corporate secretary to elevate these
- Collaborate with finance and sustainability teams
    - Partner to define the scope of audit and assurance, and potentially integrate into financial disclosures

# Procurement/Supply Chain

## Current State

Sustainability reporting regulations are beginning to shape the landscape for supply chain and procurement teams. However, compared to other functions, these teams appear behind, potentially as they are not leading the initial assessments (such as a scoping or materiality assessment) or because other rules that may apply (such as the EU's CSDDD) are not yet final.

However, the CSRD still requires that undertakings report on their own operations, upstream and downstream value chain, including its products and services, its business relationships, and its supply chain.

The CSRD defines "value chain" as: *"The full range of activities, resources, and relationships related to the undertaking's business model and the external environment in which it operates. A value chain encompasses the activities, resources, and relationships the undertaking uses and relies on to create its products and services from conception to delivery, consumption and end-of-life. Relevant activities, resources, and relationships include:*

1. *Those in the undertaking's own operations, such as human resources;*
2. *Those along its supply, marketing, and distribution channels, such as materials and service sourcing and product and service sale and delivery; and*
3. *The financing, geographical, geopolitical, and regulatory environments in which undertakings operate*

*Value chain includes actors, upstream and downstream from the undertaking (e.g., suppliers) provide products or services that are used in the development of the undertaking's products or services. Entities downstream from the undertaking (e.g., distributors, customers) receive products or services from the undertaking."*

Some companies are taking proactive measures, like establishing vetting, onboarding, and audit/validation processes for new suppliers in response to specific regulations, such as the German Supply Chain Due Diligence Act and Norwegian Transparency Act. For current suppliers, companies are considering how best to request or require information. Meanwhile, questions arise relating to the level of influence businesses can exert upstream, and many companies are skeptical of the amount or quality of data that might be shared.

## Future State/Impacts

Regulations will bring additional supply chain obligations, but from the perspective of many companies, it may be too early to understand the various ways in which these will impact procurement teams. BSR sees potential impacts via the following elements:

1. *Value chain impact identification and supplier due diligence/vetting*: The CSRD requires companies to conduct due diligence to identify and manage impacts, including through affected stakeholder engagement. The CSDDD and other jurisdictional regulations will amplify this and extend obligations beyond Tier 1.

2. *Onboarding and ensuring availability of performance data*: Organizations are expected to engage more with their suppliers in various ways, and it is increasingly seen as good practice to provide support to suppliers through educational and training materials. Many organizations have already begun to measure Scope 3 greenhouse gas (GHG) emissions. For those who have not yet embarked on this, these measurements will become necessary to meet specific rules' disclosure requirements. Procurement and sustainability teams will need to collaborate to ask what data needs to be collected from suppliers and to understand what they will do with that data (i.e., will it be used to select suppliers and mitigate upstream risks, or is it simply for disclosure in line with regulatory requirements?).

3. *Engaging and changing behavior via codes of conduct:* To initiate changes in line with the regulations, companies are starting with comparatively simple fixes, such as modifying existing codes of conduct and other practices such as supplier scorecards and evaluation mechanisms.

4. *Rewards for performance and termination for noncompliance:* Some companies are contemplating additional incentives and penalties to encourage their suppliers, e.g., to take climate action via science-based targets. Rewards could take shape as preferable contract terms or financing, for example. Companies appear torn on terminating relationships because there must be a substitutable supplier identified to ensure business continuity. Furthermore, ending the partnership also ends the company's ability to positively influence that supplier's performance—potential negative impacts on the supplier's part would likely remain unencumbered.

## Challenges and Recommendations

- Assess value chain impacts
    - Improve knowledge about the structure of the value chain, specific actors involved, and associated impacts and dependencies
    - Identify and disclose impacts across the value chain, in partnership with other functions (i.e., human rights teams, sustainability)

  - Solicit (and require) increased transparency from vendors, and engage with them directly when conducting supply chain due diligence
  - Leverage indices and third-party tools to map value chain impacts
- Update procurement approach and sourcing practices
  - Collaborate with other departments, including by adjusting supplier questionnaires, scorecards, etc., to capture relevant information for salient and material topics
  - Start with suppliers and customers with whom you have an existing relationship, even though the full value chain is in scope
- Understand pending regulations
  - Align with legal, sustainability, and other teams on upcoming regulations, like the EU Corporate Sustainability Due Diligence Directive (CSDDD).

# Human Resources (HR)/Diversity, Equity and Inclusion (DEI)

## Current State

For many companies, collecting and/or reporting on employee data is already established. However, companies are newly grappling with challenges related to regional sensitivities surrounding demographic data, among other considerations. One obstacle is the geographic diversity of the global workforce and the complexity of collecting data across different regions where norms or rules vary. High-growth companies may have significant fluctuations in employee head count, for example, which adds a layer of complexity to workforce data management.

Another noteworthy challenge is the inconsistency of data within HR. Inaccurate employee data arise due to the absence of robust data collection systems and/or segmentation across locations.

## Future State/Impacts

The evolving regulations bring about significant implications for HR and DEI teams, particularly in terms of workforce data collection and disclosure, which encompasses a broader set of social metrics than companies may have historically gathered and held internally.

As a result of regional sensitivity to data and inconsistent or inaccurate data, HR and DEI teams face difficulties in ensuring the reliability and consistency of their data, making it more challenging to meet the new reporting (and external audit) requirements. These issues underscore the critical need for improved data collection and management practices within organizations to align with evolving sustainability regulations. This partially ties back to definitional issues as well—how is “employee” defined? What does this imply for companies that are straddling the head count threshold for being in scope of the CSRD? Coordination with the legal team will be critical, as they will likely fall in scope soon and will need to ensure readiness to comply.

### Challenges and Recommendations

- Align regional and national requirements with global approaches
    - Understand scope and expectations of various disclosure rules and their limitations or where there may be contradictions with other jurisdictions’ rules (particularly crucial for employee data, where demographic data is not always allowed to be collected)
    - Consider other sensitivities and variations that require utmost care in data handling (e.g., diversity data in the EU, LGBTIQ+ status disclosure in regions where homosexuality is outlawed, etc.)
    - Prepare non-quantified information for disclosure (i.e., the “I” of DEI)
- Conduct pay assessments
    - Conduct pay equity, pay gap, and living wage assessments
    - Conduct assessment of actual and potential human rights impacts, risks, and opportunities
    - Prepare for increased transparency on internal practices

## Marketing/Communications

### Current State

There is an open question—as sustainability disclosure shifts to look and feel more like financial reporting—on how to present sustainability information in a manner that continues to meet the needs of diverse stakeholder audiences, including the integrity of needed data. Specifically, the CSRD is clear on the format of how sustainability information should be disclosed, in a sustainability statement as part of the management report.

In some cases, marketing, communications, and PR teams at companies may treat sustainability as “fluffy” case studies on the website, with high-level narrative for nonexpert, nontechnical audiences that simply aim to drive more business. In some cases, sustainability communications border on or cross into the realm of greenwashing. In others, sustainability marketing materials and comms efforts truly tie back to the core business (i.e., verified environmental product declarations for customers).

### Future State/Impacts

Regulations have placed a new spotlight on the work product of marketing and communications teams within companies and raise questions on how their role and outputs might change. In some cases, regulated, mandatory sustainability disclosure may reduce the role of marketing/comms teams by standardizing the look, feel, and location of reporting in financial filings. The extent of this adaptation is closely tied to a company's maturity and the degree to which its sustainability strategy aligns with its broader corporate objectives and ERM approach. For businesses that have historically aligned their materiality assessments with enterprise risk frameworks, or embedded sustainability information in financial reporting, the impacts of these regulations may be comparatively small.

Conversely, for companies that are still in the process of grappling with these new requirements—or have historically treated sustainability more as a public relations exercise—the challenge lies in figuring out how to navigate the changing landscape. It is essential for companies to shift their perspective from only contemplating where the information should be placed and instead consider what information is most relevant for them to collect and disclose. As one practitioner said, "*It's not enlightening to investors to report, 'here's our scope 1 emissions.' More important (or equally mandatory) is the narrative on what we're doing to reduce it, but no one wants to include that in the mandatory financials."*

### Challenges and Recommendations

- Align narratives with management report disclosures
    - Work with legal and sustainability teams, among other functions, to join up the corporate narrative across the 10-K, other assured sustainability disclosures, and any other voluntary outputs (websites, thought leadership, white papers, other communication, and PR material, etc.).
    - Consider how to communicate the story despite potential rollbacks in imagery and case study callouts, or other changes to the look and feel of reporting.
- Complement "core" disclosures to meet specific audiences' needs
    - Realign on target audiences and whether their information needs will be met by the reporting produced to comply with new disclosure rules; tailor additional information to meet their specific needs. Companies' internal stakeholders signaled concern that the volume of reporting requirements might undermine the overall readability of the company's sustainability report. There is a challenge in finding balance between effective storytelling and the disclosure of information required.
    - Identify in partnership with other teams where or how information might shift, (i.e., to the website or other supplemental disclosures)
    - Work with Public Affairs to align advocacy activities, including policy engagement.

## IT/Cyber

## Current State

Currently, IT already plays a role in sustainability reporting for most companies by supporting reporting teams on data management, automation, integration of data collection, and more. Specifically for mature reporters where sustainability and financial data are treated in the same way, including data controls, IT has been key in setting up robust ERP and ESG data systems.

## Future State/Impacts

IT and cyber teams will be pivotal players in the evolving landscape of sustainability regulations, as they embark on a spectrum of projects and initiatives to help integrate sustainability information into financials and mitigate additional reporting burdens. This includes software implementation aimed at streamlining the calculation and tracking of KPIs pertinent to sustainability goals and disclosure requirements.

IT teams have a critical role to play in facilitating the onboarding and implementation of sustainability data management platforms and reporting software. Where specific functions' metrics are stored in a particular system, or where core enterprise resource planning (ERP) systems hold critical business data that is needed for compliance with new sustainability reporting requirements, the IT team will likely be called upon to ensure that systems are interoperable. Where the CSRD requires that companies normalize data, e.g., by revenue or head count, but a company's sales or employee data cannot link to where the requisite ESG information lives, then the company will need to invest time or resources to meet baseline compliance obligations or connect the two systems.

Likewise, cybersecurity considerations are paramount when selecting new vendors or handling sensitive data points. Any sustainability software platform—whether for reporting or performance management—will need to uphold the highest standards, and the IT team will be critical in any RFP process, in partnership with the sustainability and procurement teams.

## Challenges and Recommendations

- Enhance data and disclosure connectivity
    - Support finance and sustainability teams and other functions (i.e., operations) to help increase connectivity between sustainability and financial information
    - Support improvement of systems to collate data and disclosures
- Mitigate compliance burdens
    - Understand where and how core business systems (i.e., ERP software) can tie into and support collection or calculation of sustainability data points
    - Support assessment and alignment of sustainability data management tools and reporting platforms (financial and/or sustainability), including via application programming interfaces (APIs)

This brief builds on insights shared within BSR’s Future of Reporting collaboration. Companies interested in discussing the topic further are welcome and encouraged to join the initiative, which has been closely tracking these developments.

## About BSR

BSR is a sustainable business network and consultancy focused on creating a world in which all people can thrive on a healthy planet. With offices in Asia, Europe, and North America, BSR provides its 300+ member companies with insight, advice, and collaborative initiatives to help them see a changing world more clearly, create long-term value, and scale impact.