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Sustainability Reporting and Sustainability Disclosures Like Grade School and Dating: Here's How

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It's Sustainability reporting season. Or is it Sustainability *disclosure* season? Or both? "Reporting" and "disclosure" are often used interchangeably. I suggest that both preparers and users of Sustainability information would be well-served if they understood the difference and did not conflate the two.

Capital markets are key users of Sustainability information; they are accustomed to "reporting" and "disclosure" of financial information. Many functions are involved in preparing and using financial information: Finance, Accounting, Controllers, Audit. These functions understand "internal controls" and other lingo. Preparers of Sustainability information are often elsewhere in the organization: Environmental, Operations, Procurement, Safety, Sustainability, etc. They are not as well-versed in the lingo or concepts.

Grade school and dating can help bridge the gap.

REPORTING

First, "reporting." Reporting involves collecting, analyzing and presenting information to stakeholders. On the financial side[1], financial **reporting** includes items such as income statements and balance sheets.

Attributes include:

Quantitative: For investors and analysts, it's all about the numbers. What were the revenues, profits, return on investment (ROI), and earnings per share.

Qualitative: Users also need information to explain the numbers. Narrative can provide context to the numbers and trends. Did the company sell a business unit? Did they write off or adjust the value of key assets? Did the company have outlays involving major capital investments, product recalls, fines or penalties?

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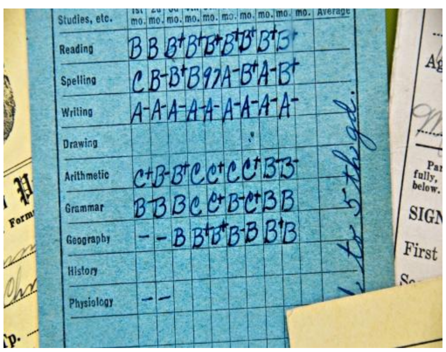
[1] I have supported financial audits as a technical specialist at a Big 4 firm for six years. I have supported Internal Audit in engagements involving financial reporting and disclosures, Sustainability efforts, climate-related efforts and others. I am an author of COSO's publication "Achieving Effective Internal Controls over Sustainability Reporting (ICSR)", where the author team consisted of myself and five CPAs of distinction. I am not a CPA.

The key attribute of reporting is a **defined reporting period**. For financial reporting, it is the fiscal year. Everything in the financial report pertains to the fiscal year. Bar charts and graphs show [quantitative] performance compared to prior (defined) reporting periods. Note that reporting periods are all in the past.

The Joys of Grade School

One of our fondest memories of grade school was getting report cards. They're called REPORT cards, not DISCLOSURE cards. Back in the day (I grew up in Mayberry), these were actual cards printed on heavy card stock paper. Teachers indicated grades, each with a numeric value for use in calculating grade point averages. A to F was 4.0 to 0.0. B+ was 3.5, etc.



Teachers sometimes provided narrative as context for the letter (e.g. numeric) grade. I looked forward to "best in class", "showing improvement" or "consistently participates in class." I was not as happy with "always late" or "talks too much during class." This was context for the numeric grade. **They each pertained to a *specific reporting period*.** We all tracked performance during the year. We tracked our performance year-on-year as we zeroed in on those important college applications.

DISCLOSURES

Disclosure involves making information publicly available. This includes financial reports and other information. In addition to the basic financial statements, financial filings include information about the company's operations, strategy and corporate governance. The Form 10-K includes a Management Discussion and Analysis (MD&A) section with much of this useful information. Companies and users wrestled with what should (or should not) be included in MD&A. The U.S. Supreme Court decided that a fact is material "if there is a substantial likelihood that a reasonable shareholder would consider it important" in making an investment decision or if it "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available[2]."

[2] See TSC Industries, Inc. v. Northway, Inc.; 1976; at https://www.loc.gov/item/usrep426438/.

Disclosures in financial filings can be quantitative or qualitative. Prospective investors are considering decisions that could determine their future situations. As such, disclosures can include information about the past, the present, and [unlike reporting] *forward-looking statements* about plans for the company's future. If the company has announced plans to expand or close certain operations in the near future, this could be material, and subject to disclosures.

The Sustainability Accounting Standards Board[3] began with this definition of materiality to develop their Sustainability accounting standards for each sector and industry. The topics – quantitative and qualitative – are intended for disclosure in the MD&A section of Forms 10-K filings [in the U.S.]

The Dating Game

Dating is a process. Both parties in the dating game are making incremental decisions based on information provided – visual, written and verbal. What should one disclose, and when? Context matters.

Information for potential disclosure: I have $50,000 in credit card debt. I am moving to another city when this job assignment ends. I do/ do not wish to have children. I have children by a prior marriage. I am allergic to cats.

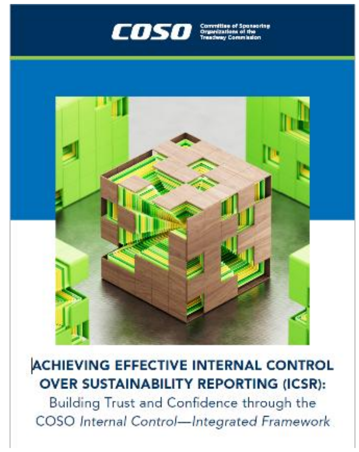
Timing of the disclosure: Before meeting your date's family? Before (or after?) moving in together. Who's paying for dinner? When deciding whether to meet for coffee on a third date?

Disclosures help the other party make decisions. Should I invite them to meet the parents, or not? There's a choice between cohabitating and keeping the cat. We learn what is significant (aka "material") to the other person over time, through engagement and meaningful conversation.

The same is true for Sustainability reporting. Investors consider reporting and disclosures in their decisions about making money for the future. Sustainability encompasses a broad array of stakeholders, who may want different types of information to make different decisions. I suggest Sustainability disclosures aren't so different from dating – except a company may be dating a dozen or more stakeholders at the same time.

[3] SASB, now merged into the International Sustainability Standards Board – itself a subsidiary of the International Financial Reporting Standards (IFRS) Foundation.

AUDITABILITY AND INTERNAL CONTROLS



I suggest two other differentiators between "reporting" and "disclosures."

Auditability: Investors look to financial auditors to gain trust in financial statements. The auditors provide "an opinion that the financial statements present fairly, in all material respects, the financial position of the company as of the balance sheet date and the results of its operations and its cash flows for the period then ended …[4]" This does not include content in the MD&A.

It does not include content in Sustainability reports or disclosures, or other publications. As users demand greater confidence in published Sustainable information, there has been a trend towards assurance of Sustainability reports (all, or portions thereof). Laws in the EU and California will require assurance of climate-related reporting in the coming years. Assurance is intended to provide greater confidence than a more routine "audit." However, they both pertain to a defined reporting period. The financial statements must be regarded as complete and reliable. Similarly, content in a Sustainability report has been trending away from marketing and feel-good content to data and information that could survive an audit.

Internal Controls: If data (revenues, carbon emissions, water use, safety statistics) are to be reliable, they must be the result of robust processes and internal controls. COSO's Internal Controls Integrated Framework (ICIF) has served as the bedrock of internal controls over financial reporting (ICFR) for more than two decades. As an author of the document, I am obliged to highlight that COSO's "Achieving Effective Internal Controls over Sustainability Reporting (ICFR)" provides a useful starting point for similar confidence in Sustainability reporting.

How did the teacher arrive at the B+ for the semester in Biology? Following the same process, another student with the same exam grades, the same contributions to lab experiments, and the same attendance should get the same grade. On the disclosure side, should you disclose that dissecting a frog creeped you out? It depends on who you're talking to and the decisions being made.

[4] AS 3101: The Auditor's Report on an Audit of Financial Statements with the Auditor Expresses an Unqualified Opinion; section .08; found at https://pcaobus.org/oversight/standards/auditing-standards/details/AS3101.