New Initiative to Streamline Climate Data Will Transform Compliance & Investment Decision Making: In Their Own Words…

By Gundi Jeffrey, Managing Editor

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The US Securities and Exchange Commission is estimating the cost for public companies worldwide to comply with the new climate disclosure rules could reach more than $10.2 billion. But, without global standardization and comparability of climate change disclosures, these costs could increase even further for all stakeholders creating and using ESG data for decision making – including future human capital, cybersecurity and other global reporting issues.

As a result, efforts are underway with both global and national securities regulators, standard-setting bodies, technology firms and professional associations to create open, new, freely available standardized technologies. These will drive comparability of disclosed ESG/climate change data which in turn will expedite climate finance to tackle global warming. In addition, there are new, standardized compliance technology solutions that companies will be able to utilize to bring costs down – especially helping SMEs and emerging countries most at risk to comply.

The initiative includes creating a ground-breaking global baseline of sustainability-related disclosure standards, which will result in agreed ESG/climate data metrics and methodologies. The taxonomy initiative, led by XBRL International, has involved the creation of a new special interest group (SIG) made up of regulators and standard setters – uniquely bringing together the International Financial Reporting Standards Foundation (IFRSF), the International Sustainability Standards Board (ISSB) and European Financial Reporting Advisory Group (EFRAG).

It also includes establishing a new Digitization Sustainability Data Lab (DSD Lab, using technology to expedite worldwide comparable ESG data for “apples to apples” comparison of key climate metrics so investors and the public can make better decision-making. The data lab and global blueprint will help align climate disclosure mandates from over 100 countries, helping regulators and standard setters bridge the gap between net zero commitments and the global economy.

But how will all this be accomplished? This interview with John Turner, CEO of XBRL International, will offer some enlightening answers. Editor-In-Chief Gerald Trites and Managing Editor Gundi Jeffrey conducted the interview jointly.

ThinkTWENTY20: *The world of sustainability reporting has been plagued by too many bodies issuing standards, which often differ from each other. Should the digitization process focus on all of them or just one or two, like the ISSB and perhaps EFRAG?*

John Turner: It's important to remember that the XBRL standard is simply a uniform alphabet and grammar for representing business reports of any kind in digital form. It can be used by anyone for just about anything. Today it's used in nearly 200 regulatory mandates in around 60 countries for everything from financial disclosures to tax, real estate and energy. It's used to shift reporting from a paper paradigm to a digital one and provides all the benefits of standardization in terms of interoperability, lower costs of production, lower barriers to entry and a large ecosystem of innovation built up around a single standard.

ESG reporting is a new kind of mandate and certainly the question of comparability is, and should be, at the top of everyone's list of questions about the shift from voluntary to mandatory sustainability disclosures.

To bring digital reporting to life, regulators and standards setters need to construct dictionaries of the terms that they want to see reported using just the letters in the digital alphabet and following the digital rules of grammar. These XBRL dictionaries are a digital representation of the disclosure rules that operate within a specific domain.

Companies can then report using the words in the dictionaries. Those reports and the dictionaries they are using must use the letters in the alphabet and follow the rules of grammar set down within the XBRL specifications. When these three layers: (1) alphabet and grammar; (2) dictionaries that follow them; and (3) reports that use the words in the dictionaries, the letters in the alphabet *and* the rules of grammar, are all in place then digital reports that can be prepared, published, consumed and analyzed are the result.

Reports that use the same dictionaries are comparable. Comparing reports that use different dictionaries from different domains is not nearly so simple and requires expert knowledge of the rules that govern each reporting environment in order to determine what can be compared and what can't be.

So, to put your question somewhat differently: how big is each ESG domain? Will we see lots of country-specific ESG disclosure regimes, like there were in the days before IFRS for accounting? Will we see large geographic and economic blocks of rules (IFRS v US GAAP *redux*)? Is there any chance that things will come together in this field so that there is just one international set of disclosure standards?

Well, the good news is that over the past 12 months we've gone from alphabet soup to a much more concentrated bouillon. I think most people are familiar with the very significant number of national, regional and industry sustainability standards and sustainability frameworks that exist, some addressing just specific aspects of sustainability, while others are more comprehensive. In some places, the resulting reporting was done voluntarily while, in others, it was mandated. But, overall, everybody understands that sustainability reporting has been extremely fragmented.

Then came a really concerted effort by a group called the Impact Management Project, which included the leaders of all the sustainability efforts and the main accounting groups working together to find a way forward. So far, we have gone from about 200 groups down to, arguably, a couple plus one. So, the alphabet soup is now a more concentrated and soon, mandatory, kind of broth.

> The ISSB announced from the very beginning, with support from all kinds of groups, including IOSCO, that it should be digital from the outset.

It's worth understanding what has happened. To a certain extent, this is all a question of timing. Two new sustainability standards-making efforts have emerged simultaneously. The European Parliament and the EU Commission's Green Deal Agenda – which was their Number 1 policy priority – made it very clear that having vastly better information, particularly climate related, but also on other ESG measures, coming directly from corporations are vitally important. They directed that the European Financial Reporting Advisory Group (or "EFRAG") which has until now provided advice to the EU on the IFRS financial standards, should itself develop a comprehensive set of standards, to construct the European Sustainability Reporting Standards ("or ESRSs").

More or less at the same time, the IFRS Foundation, which had maintained for several years that it wouldn't be involved as a sustainability standard setter, started to change its tune. The Trustees formed a group to help determine what could be done, leading up to an announcement of a new body, the International Sustainability Standards Board or "ISSB" at last year's COP26. The ISSB will be the sister standards setter to the IASB within the IFRS Foundation. There has been a considerable amount of collaboration behind the scenes to try to bring together a number of sustainability bodies, including the SASB's merger with the International Integrated Reporting Council to create the Value Reporting Foundation ("VRF"), followed swiftly by the ISSB's creation, where it was also announced that both the newly formed VRF and the Carbon Disclosure Standards Board or "CDSB" would transfer their standards, activities and staff to the new ISSB.

Actually, the formation of the ISSB happened at lightspeed in IFRS terms – IFRSs take a long time to develop as they impact a huge number of people and organizations right around the world and in contrast, the formation of the ISSB happened extremely quickly. Nevertheless, Europe was already looking at the idea that they could introduce, on a very rapid timetable, a range of sustainability standards to be developed as new ESRS for the new Corporate Sustainability Reporting Directive (CSRD). The CSRD is legislation that will oblige some 50,000 companies to make sustainability disclosures at the same time as their financial disclosures. As I've already mentioned, that initiative was pulled together quickly and announced some months before the ISSB was created.

We've seen formal announcements from several major economies (including the UK) that they intend to use the ISSB standards as soon as they are available. Europe will follow the ESRSs. That leaves the United States.

The SEC was quiet for quite a long time while a new Commission was trying to work out how to address these requirements. Of course, it turns out that their March proposals – that have recently been out for consultation – turned out to be pretty substantive and link climate related disclosures to financial statements explicitly.

Importantly, the ISSB announced from the very beginning, with support from all kinds of groups, including IOSCO, that it should be digital from the outset. Furthermore, the CSRD legislation in Europe proposed that all of the disclosures that companies would be making should be digital. The SEC *also* included a requirement that these disclosures be digital in all respects.

So, in markets large and small right around the world, we are seeing a shift – from a largely voluntary set of arrangements using disparate standards and frameworks for sustainability reporting to a world in which regulators intend to make them not only mandatory, but also to make them subject to independent assurance, which is a very important aspect of those policies. And further, to make them digital, meaning to expand existing Inline XBRL arrangements to go beyond financial disclosures to cover sustainability.

If you think about this from the perspective of corporations, this is a seismic shift. They are going to need to ensure that they have the people, the policies, the processes and systems all in order to be able to establish controls around the way they collect this information in order to allow it to be audited.

This is a very substantial change for companies, many of whom will have, until now, been viewing sustainability reporting as a communication function rather than as something that is a core part of corporate reporting compliance. Of course, it will need to continue to be an important communication function – but, going forward, it will be a regulated one. It remains to be seen how exactly how this will shake out in a number of areas. And it leaves us with a very significant number of questions around comparability.

Just a word about the SEC. Europe is going its own way in terms of setting its own standards – at least for the moment, but the ISSB – which is getting a very significant amount of support from governments around the world – Canada included – is looking to develop an additional set of complementary IFRS standards for ESG that can be used by companies everywhere. The US is in a different situation.

At present, they can't delegate the creation of US ESG disclosures to an independent standards setter. That's true whether it would be the FASB, (which sets the US GAAP accounting standards), or the ISSB, which would be a larger step. They might consider it for the future but, right now, it seems that they don't have that legislative power. Therefore, they have developed their own set of climate related disclosure rules in-house as the SEC can, and does, make rules surrounding disclosure.

That means we have three ingredients in our bouillion – EFRAG's European Sustainability Reporting Standards (ESRS), the IFRS ISSB and the SEC – not necessarily with completely comparable disclosures. Each have somewhat different requirements and timing. That said, there is goodwill between all of those bodies to try and ensure that there is comparable information where possible and (hopefully) more cohesion going forward. We've gone from an alphabet soup to a more concentrated broth with a smaller number of letters in it! How will users around the world find this new recipe? We wait to see.

> There almost certainly will need to be changes going forward and there will be a period of fairly rapid consolidation as we understand what can and can't be provided by companies.

ThinkTWENTY20: *What about digital reporting?*

Turner: I think people should understand that the linkages in sustainability disclosures are somewhat different from those in the financial reporting sphere. There are two headlines to that. One has to do with what I'll call "extraterritorial reality" and the other has to do with the need to synthesize the information that is provided by companies and use it for other kinds of disclosures, particularly in funds management.

Right now, the extraterritorial aspect is particularly important to substantial companies domiciled outside of Europe that have material operations in Europe. Because, if they do, they will almost certainly have a reporting obligation under the CSRD about their activities, using the European (EFRAG ESRS) standards.

In addition, there is a regulation in Europe that obliges asset managers to disclose information about their fund offerings, in terms of their sustainability. That process is being helped by the ratings agencies and others, but the policy intention was always that the information would flow from the corporate disclosures through to funds management disclosures. The only way for that to happen is to have *a digital* information supply chain.

That's another small complexity in this exercise. I think it is also worth noting that those companies that might not have any activities in Europe, but whose *securities* are part of the portfolio of a fund manager in Europe, may also have reporting obligations under the SFDR. So, this whole process is quite connected and, the more that the information can be consistent, and the faster it can accurately flow from point to point, the better.

ThinkTWENTY20: *Do you see XBRL International as a coordinator of those different standards?*

Turner: The preparation of digital disclosures for sustainability has some nuances that are quite different from financial reporting. For example, there is a lot of narrative disclosure in sustainability disclosures. There have been a significant amount of cross referencing and linking between documents in sustainability disclosures in the voluntary era and these raise technical questions that need to be addressed consistently. There are a number of other, smaller complexities, such as new units of measure for various things. Those kinds of issues need to be worked through in order to ensure that digital reporting goes smoothly in this field. It would really be desirable if all the standard setters and regulators involved would be doing that in a consistent fashion – which is possible.

XBRL International is certainly involved in these discussions and will continue to work to ensure that, at a *technical digital* level, ESG disclosures work the same way. We are not the rule makers though: getting definitional consistency requires agreement amongst the ISSB, EFRAG and SEC. XBRL International is just trying to make sure that the rail gauge is the same and that the signaling works consistently: we don't have any say on what runs on the rails.

That said, there are any number of areas across those three groups where the information they are trying to get across is identical. There are examples of that in the climate disclosures about greenhouse gas emissions, as well as risks and opportunities that organizations face in that field. The TCFD framework is being closely followed within the SEC environment, in the ISSB environment and in the EFRAG environment too. So, this should result in information that is comparable – right?

Except that computers are dumb. If you have a disclosure called "SEC: Scope 1 Emissions" and you are trying to compare that with something else that says "EFRAG: Scope 1 Emissions" and *even if* the documentation about Scope 1 Emissions is identical in both environments, computers *still* don't understand that those are the same. You may need a mechanism to create comparability above and beyond what is possible at the moment.

With some help from the Impact Management Project, we've been running a special interest group which is just for the standard setters and regulators that are involved in this exercise (SIG). It meets twice a month and the idea is to identify the challenges in this field and propose solutions. We are about to publish the first round of those proposals. These proposals will now need to be considered by the standard setters and by XBRL International's own Standards Board and Best Practices Board to determine whether or not to adopt them.

The ongoing dialogue among these agencies and standard setters about digital disclosure is a very positive effort.

No doubt, in a few years, we might say that it would have been better if we could wave a magic wand and have just one ESG standard. Who knows? Maybe we will get there. The reality is that is not quite where we are, for perfectly reasonable reasons – because perfectly reasonable policy decisions are taken in different parts of the world, taking account of perfectly reasonable different legal situations at slightly different times. Efforts around bringing those groups together to enhance comparability will ensure that the utilization of this information can happen very quickly and that the quality of the information around the world will also be high. So, just trying to coordinate our efforts among these different groups is all we're doing at the moment.

ThinkTWENTY20: *And they are all using XBRL, right?*

Turner: Yes, and that does help, mostly because of the communications aspect. This might be helpful as an example. The first voluntary public company report containing XBRL tagged climate risk information that we have come across is the recent UK FCA filing by Aviva. With that digital representation of this information we were able to construct a very simple report about that entity. It's pretty trivial to produce your own analytics when you have digital disclosures prepared in XBRL.

Once there are thousands of these reports, it's really important to try to ensure that there is as much consistency as possible. Some of that work is just the standard setters getting together, and there was an announcement from the ISSB recently about their intention to work much more closely with the other standard setters to try to overcome what could be issues with comparability.

I think the other thing that is worth noticing is that this is going to be a field where there will be a lot of change. For those of us familiar with financial reporting, while there have been some significant changes within financial reporting, it's taken decades and we are pretty clear about the way all that works around the world.

The sustainability space will almost certainly involve fairly significant changes over a much more rapid period. For example, when it comes to climate disclosure, there is obviously a lot of urgency from the perspective of policy makers. There will be changes and those changes will impact companies, and, as a result, will impact the ESG standards and the resulting (digital) disclosures in this area.

ThinkTWENTY20: *We see all this as being tied in with integrated reporting. This has been around for the last 10 or 15 years. The thinking behind it is quite well developed. But then we start getting into sustainability and ESG reporting, and people are saying that we have to do that for investors and other stakeholders. That would bring the objectives of sustainability* *reporting and financial reporting a bit more in line. But people seem to be falling short in some place in talking about fully integrated reporting.*

Turner: I think the jury is out about what is going to happen there. There has been a huge amount of really positive work within the integrated reporting community. And you mentioned "thinking." With integrated reporting, that is the most important aspect. It's a way of approaching and connecting every aspect of a business with all of its stakeholders, with a view to ensuring the sustainability – the healthy long-term operations – of that firm. There is already very positive work being done by the IFRS Foundation in this field as they work to fuse Integrated Reporting into their operations as part of the merger between the Value Reporting Foundation and the IFRS Foundation. Exactly what that integration looks like – well I think it is just a little bit too early to understand.

From an XBRL perspective we see machine executable data quality rules as a very important part of reporting in every environment: a mainstay in good digital practice.

ThinkTWENTY20*: I spent about 20 years of my career heavily involved in financial reporting standard setting. It boggles my mind as to how the standard setters will grapple with all of this. Frankly, they have been slow to adapt just in the financial world.*

Turner: The thing that everybody should understand is that all those involved in this process – whether it's standard setting or policy making – thinks that this is really an extraordinary package of changes and worry that there will be parts that are skipped or that miss the mark. There almost certainly will need to be changes going forward and there will be a period of fairly rapid consolidation as we understand what can and can't be provided by companies, which tend to offer boilerplate reporting rather than something that is really helpful where sourcing is too difficult, or impractical, or where companies have concerns about future litigation. Reaching high quality and consistent ESG standards will be a challenge and one that involves a period of intensive change. Standards setters and regulators have no choice: they will need to rise to that challenge.

One of the things that companies all around the world are grappling with is that reputation risk is something that historically they have spent very little time on. Today, there are any number of sustainability questions that can impact reputation risk in truly material ways.

Therefore, these questions will always be on board agendas going forward. Whether it's working conditions in suppliers' environments or the carbon emissions created in the production of products, there are many, many more stakeholders looking at what used to be "boring" corporate reports in way they haven't been looked at in the past. That's just a new reality for companies of all sizes.

Looked at from a different angle, the number of investors that use ESG factors in their decision making continues to grow extremely quickly. With voluntary and largely unregulated ESG disclosures, the way that ESG factors are taken into account has been extremely hit and miss, with so called "greenwashing" a real issue. By providing a new basis for mandatory, comparable, audited and digital disclosures the regulators are doing what they are supposed to be doing: they are levelling the playing field. No matter your perspective on ESG factors, that level playing field is a necessity going forward.

I'm very interested in what is going to happen in terms of the systems landscape within companies because, arguably, this is the area where there should be significant standardization inside corporations: the steps involved in sourcing, checking and preparing sustainability disclosures. That, to a large extent, is more a function of markets than policy. Which isn't to say that voluntary standards in this field couldn't have a significant impact. This is an area which is changing just as rapidly as the standards themselves. And there are a lot of established players in corporate reporting that are looking for opportunities for helping their existing clients through sustainability reporting.

We don't have a crystal ball in that field. I think this is an area where there could be some significant innovations and hopefully, significant collaboration. There's work being done to examine what could happen in terms of controlled vocabularies and appropriate information governance. It is just a little too early to understand exactly what it will look like – a consistent framework for figuring out this process would make it simpler for corporations who need to comply. And, for many of them, this is brand new.

For all of these reasons (and no doubt many that we've not seen yet) you are exactly right. This *is* a challenge for disclosure standards setters. Equally, it is one that they can, will and must rise to.

ThinkTWENTY20*: One of the other questions we had is talking about the costs involved. The US Securities and Exchange Commission is estimating that the cost of public companies worldwide complying with the new climate disclosure rules could reach more than $10.2 billion. What I would like to know is how would digitization reduce these costs?*

Turner: I think it's worth stepping back for a minute and think about that policy landscape. Policy makers around the world are reacting to what investors are asking for: much more information, particularly around climate, and (depending on location and the societies they serve) a range of other metrics around sustainability. Also, they want to know the strategies that companies have for quantifying and mitigating risk in this area. Policy makers know, and indeed they acknowledge, that there will be some costs associated with these implementations. I think we can look with favour at what's happened in the financial reporting sphere to be confident that standardization will also assist with sustainability reporting.

The United States has had, for some time now, a very thorough mechanism, for digitizing financial statements. The costs associated with that were, at first, relatively high. Competition did its usual thing and pushed those prices down. But, also, people started to think about how to manage their processes for producing external reports. If you look at some of the integrated disclosure management reporting mechanisms, companies use a number of tools to collaborate on the creation of both internal and external reports and to ensure that the workflow associated with that doesn't miss any steps. They also want to ensure that all of the processes for reviewing and consulting internally on what is being reported and the way that things are designed are digitized, with digital workflows becoming much more important to companies than the traditional and manually intensive approach. This has created more consistent, better controlled and hopefully higher-quality reports, with much better workflows around them. These newer systems have replaced older approaches, which involved an astonishing amount of manual effort for many financial professionals, which most will be happy to leave behind.

It's worth noticing that costs in Europe have been significantly cheaper than the costs in the US, partially because of scope but also partially because of competition. There are more than a dozen fiercely competitive groups that are working in that space.

ThinkTWENTY20*: A new Digitization Sustainability Data Lab (DSD Lab) was recently announced to bring together multiple national regulators and climate disclosure mandates in one manner for the first time. The new lab appears to have a huge mandate. The data lab and global blueprint will help align climate disclosure mandates from over 100 countries, helping regulators and standard setters bridge the gap between net zero commitments and the global economy. Will this mandate be achievable given the large number of players involved?*

Turner: The DSD Lab is an effort to bring together a number of groups under a pretty broad umbrella. I would highlight not just the work we are doing. It's really an effort to try and ensure that the standard setters, regulators and others will coordinate the specific standards of digital disclosure that they are imposing in different markets around the world. We hope that it can expand to provide support to issuers and to users so that they quickly come to grips with what all of this means for them. And we are very optimistic that the DSD Lab Framework will free up the resources to make that possible.

There are a number of other efforts that are focused on much broader questions of digitization, for example, looking at the way that you move information throughout the supply chain. With some of this information – whether it is carbon reporting or whether it is the sustainability of fisheries, or any number of other sustainability priorities – the supply chain is what it really important. So, there is a group that is looking at ways that digitization can assist in that field, as well as the efforts that are focused on the necessary controls and governance mechanisms needed to assist organizations inside their own environments before they start to do their external reporting. The idea is to produce high-quality information that can feed regulatory reporting but also statistical reporting at a national level. There is some very good thinking in that space, but it's very early days before we see exactly how all that pans out. Stay tuned.

ThinkTWENTY20*: What they have been working towards is gradually merging various taxonomies?*

Turner: “Taxonomies” is a badly misused term. Lots of taxonomies in this space are classification schemes. Europe is using a “taxonomy” that just classifies industries in terms of their carbon intensity. There are other mechanisms. I think the linkage between these various data sets is what is really important and that is likely to be a key focus as we move forward

ThinkTWENTY20*: How will quality be maintained and monitored with the new digitization standards?*

Turner: Regulators say that they want consistent disclosure made by companies across a country or region or internationally. They also say that they want to ensure that the information is auditable and then audited, and that it needs to be disclosed in a digital manner using the Inline XBRL standard. That gives you a much better and faster lens with which to focus on quality.

For example, everyone will have seen that an emphasis on quality and minimizing greenwashing is important for many involved in this process. That’s one aspect of quality. There are other, more mundane aspects of quality – ensuring that we measure things with the same units of measure, ensuring that the processes used to consolidate organizations – all of the different parts of an enterprise and its ESG activities. Those are all very important and why the audit function has a very relevant part to play.

From an XBRL perspective we see machine executable data quality rules as a very important part of reporting in every environment: a mainstay in good digital practice. You produce digital dictionaries, you publish them. You also publish publicly accessible accompanying quality rules to ensure that you minimize “garbage in” and, thereby, minimize “garbage out”.

So, between enforcement, audit, high-quality standards and, indeed, machine executable business rules, there will be a unified quality process surrounding these disclosures as they start to bed down.

All of these present challenges, but that can and will be overcome by the standards setters, regulators, auditors, companies and users that form the reporting ecosystem. The XBRL standard has its own small part to play and we are working toward helping to ensure that there are high-quality, comparable and easy to use disclosures in the ESG field.