# DEFINING AND EVALUATING THE INFORMATION CONTENT OF SUSTAINABILITY REPORTS

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**Abstract** Environmental, Social and Governance (ESG) is a company framework that focuses on environmental, social and corporate governance sustainability. Incorporating ESG into company operations plays a significant role in investment decision-making and can provide a significant advantage over competitors. The challenge is that the ESG does not yet have uniform standards, but several international initiatives have been launched to develop these standards. The European Union's ESG reporting framework is already being developed and is expected to enter into force in 2023. The purpose of reporting is to show how the company fits into its global sustainability goals. The number and depth of ESG topics is significant. The chosen framework will determine which topics are relevant to the company. The aim of our study is to identify and examine financial, economic information and possibilities and methods from which the objectives set out in the Sustainability Report can be verified for both internal and external stakeholders; in this paper we deal with the private sector only. It is important to note that the preparation of a sustainability report will be data-intensive and successful reporting will depend on existing, well-designed reporting systems.

**Keywords:** sustainability, ESG, sustainability report, EU, reporting framework

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## 1 Introduction

Recent years have shown that global demand for resources is greater than what the Earth can provide. In order for companies to move to net zero emissions cost-effectively, close collaboration with the latest technological innovations is needed. In doing so, companies can protect both their competitiveness and the environment.

By optimising the use of renewable resources, increasing (maximising) the life of products and the use of waste, the benefits of a circular economy[1] can be increased. However, the transition to a circular model often requires a transformation of the business model – one factor of which is digitalisation. For digitalisation to be effective and new technologies to work well, challenges must be overcome that involve the use of digital solutions. The level of investment costs and return on investment must be taken into account from the very outset. In addition to creating other conditions for digitalisation, it is also necessary to think about whether workers are competent enough to use new technologies and, if not, a decision has to be made whether to spend money on further training or to look for new employees. These are all factors that require careful consideration and are essential to staying ahead of the competition. Digitisation has different effects in all areas, thus it also affects accounting and taxation systems (Hegedűs, 2019a).

The ESG is a company framework that focuses on environmental, social and corporate governance sustainability. However, integrating ESG into company operations is not just for branding goals. The integration of sustainability objectives also plays a significant role in investment decision-making. On the investor side, an increasing amount of capital can be seen flowing into the so-called green investments (Máté, 2022). The challenge is that there are not yet any uniform standards of measuring ESG, however, several international initiatives have been launched to develop standards. The introduction of standards will play a major role in making companies more comparable in terms of sustainability, thanks to a common methodology. Thus, if standards are created, the risk of a company communicating about its sustainability more or differently than it actually makes is reduced.

[1] The circular economy is closely linked to the concept of sustainable development: the process meets the needs of the present without reducing the ability of future generations to meet their own needs.

The operating framework of a sustainable company also means that the organisation actively manages and understands the environmental, social and governance impacts, and ensures that the business model remains viable in the future. Companies face a variety of challenges and issues in their transformation of ESG. The introduction of ESG must take into account the dynamics of the industry, the company's strategy, existing and changing regulations. A company-specific sustainability strategy needs to be developed to implement the ideas. By providing management support, there is a need to intervene in operational processes and involve the green perspective of investors in value creation. This schedule then needs to be incorporated into the workflow and company culture. In order for sustainability to be integrated into the performance management system, it will be necessary to build appropriate measurement and incentive systems.

## 2 Sustainability accounting and its features

In addition to maximising profit, companies need to pay increasing attention to environmental impacts, thus expressing their environmental responsibility through accounting tools. For example, the unreasonable use of resources and the emission of pollutants must also be examined emphatically. Today, strategic management must deal with the protection of the natural environment as well as the well-being of people. Sustainable strategic management enables companies to use strategic tools and methods to link social, environmental and company management and strategies, and integrates social and environmental information with company governance information and sustainability reports (Fülöp, Hódi Hernádi, 2014).

A wealth of information is required to assess the use of resources and their impact on the environment and society. The source of the information and the data owners must be sought, and the process must be documented. However, the collection of information is not enough, as this data needs to be systematised and analysed. The biggest challenge, in addition to collecting data, is to define units of measure that can be used to quantify the extent to which each event has had an impact on the environment.

According to Schaltegger and Burrit (2010), sustainability accounting is the pinnacle of accounting because it examines a company's operations along environmental, social and economic lines (Schaltegger, Burritt, 2010). The purpose of a sustainability accounting system is to measure a company's performance from an economic, social, and environmental perspective. Within the company, it is particularly important how the business interprets sustainability, what strategy it follows and how it can make its related goals measurable. It reflects the financial consequences of the environment and society for the company and vice versa – the effects of company activity on the environment and society – and examines the interactions and relationships between the three dimensions of sustainability (Fülöp, Hódi Hernádi, 2014). The information used in the analyses should be understandable and clear to both external and internal users. This allows external stakeholders to assess the impact of the company's economic activity on society and the natural environment, or they can compare the results with those of a similar organisation. For internal stakeholders, sustainability accounting also plays an important role in governance, as it helps in making decisions and provides a basis for preparing for a possible intervention. The results of the measures taken to achieve the sustainability objectives can be assessed using the results of the accounting.

Figure 1 shows the process with the five components of the sustainability accounting framework. Point 4 (Reports) is discussed in the next section.

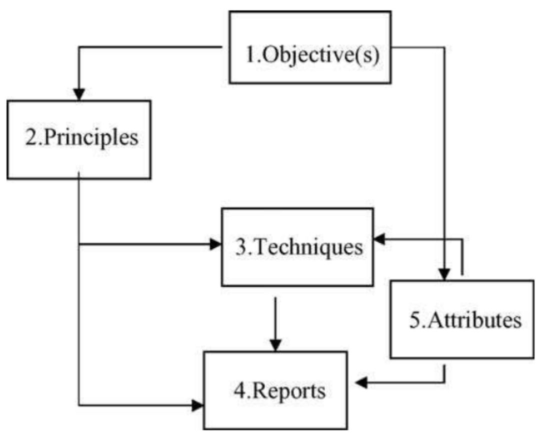


**Figure 1: Components of the sustainability accounting framework**
Source: Lamberton, 2005, p.16

## 3 The Sustainability Report

In the European Union, Directive 2014/95/EU of the European Parliament and of the European Council requires that large companies that are public interest entities and exceed the criterion of an average of 500 employees during the financial year (the balance sheet date) must also include a non-financial statement in their management report, which includes the information necessary to understand the financial year. The aim of the directive is for companies to develop methods that promote the integration of non-financial information, taking into account existing frameworks. These include, for example, the development, performance, position and impact of the business – at least in relation to environmental, social and employment issues – respect for human rights, anti-corruption and bribery (PricewaterhouseCoopers, 2022). Disclosure of non-financial information helps to monitor and manage the measurement of business performance and its impact on society.

However, reporting practices need to be greatly improved as companies do not report to a uniform standard and use different methodologies, making comparisons impossible within and outside the sector, regionally and at the company level. The International Business Council (IBC) and the World Economic Forum (WEF) have proposed the development of a methodology that includes both general, financial and quantitative metrics (Ransom, 2021, 2021). This would make it easy to integrate into the sustainability framework used by companies, thus making different reports comparable. These methods have been developed by professional organisations such as the GRI[2] and the CDP (Carbon Disclosure Project). As the application of standards was not widely mandatory, there have been harmonisation efforts in the past, however, full convergence and standardisation have not yet been achieved. As a result, the reports were not complete, factual, reliable and comparable, and lacked an investor approach.

[2] The GRI can be seen as a framework that can be applied to any organisation in the world – large or small. The principles of GRI reporting can be divided into two groups – the principles of the content of the report, and the principles of the quality of the report (GRI, 2015). The methodology of the framework is constantly evolving, although many companies report according to the previous methodology (e.g. GRI G3 or G3.1), GRI G4 was replaced in July 2018 by GRI Standards (Szennay, Szigeti, 2019).

# 4 Methods for data collection, measurement, recording and control of data

One of the biggest current challenges in the joint effort for sustainability is the availability of reliable data. At present, it is still not mandatory to report in Hungary according to an international standard (e.g. Global Reporting Initiative), however, the recommendations of the Budapest Stock Exchange ESG already contain specific requirements for issuers (Becsei et al., 2021). However, European Union regulations could make a difference in this respect, therefore an objective, common and equally measurable system of indicators would be a major step forward.

One of the most popular reporting standards in the international market is the Global Reporting Initiative (GRI), whose comprehensive framework includes various indicators. The explicit principle of the standard is that reports should be prepared taking into account materiality considerations.

If a company is unable to comply with this, the presentation of the information must be substantiated taking into account the timeliness of the data. Thus, the authors of this paper are convinced that the GRI-based sustainability report, as well as the annual report and the business report regulated by the Hungarian accounting act (Act C of 2000), are suitable representatives of Corporate Social Responsibility (CSR), however, the picture obtained from the documents of the two sets of rules may differ.

There are a number of ways to collect and record data, although it is worth pursuing the cost-benefit considerations. The economic, social and environmental data collected can be used to measure a company's sustainability performance, however, this requires a variety of performance indicators as well as evaluation methods. For example, the most complete tool for strategic management is the Sustainability Balanced Scorecard (SBSC), an integrated system of indicators for assessing a company's performance, which is used to inform Indicators and monitor the achievement of goals. The SBSC also includes Key Performance Indicators (KPIs) and perspectives on sustainability, i.e. the idea of sustainability is integrated into the framework of the SBSC. This can be achieved in several ways, for example, by supplementing the indicators of the perspectives with the topic of sustainability, or the framework containing not four but five perspectives, with sustainability as the fifth (Szóka 2022).

One of the main documents of the sustainability accounting system is the company's balance sheet, which presents a company's assets, equities and liabilities. Based on the general ledger statement (accounts), the values that can be related to environmental protection and sustainability should be highlighted from these data. Let us look at a few specific examples. In the case of tangible assets, environmental protection devices (such as an electric car instead of the old petrol engine) or $CO_2$ quotas in stocks can be displayed as a separate item. The ratio of a company's tangible assets to environmental protection can easily be determined in relation to all tangible assets, as well as their development, opening value, change in stock and depreciation. Also on the asset side, the proportion of carbon dioxide in stocks or how much it received free of charge from the state in relation to total inventory values should be examined. Among the liabilities and equities, it is important to define a provision for environmental liabilities or one to cover the emission quota. In the case of a provision, reserves for environmental liabilities, soil and groundwater remediation tasks and follow-up processes must be shown. This may be among the short-term liabilities, for example, a loan from an organisation to cover a $CO_2$ emission quota. In the case of accruals, the amount of the emission quota or other performance incentive received free of charge must be shown as a separate item.

In the Income Statement, the authors of this paper recommend that items related to environment protection and social activity are highlighted up to the level of operating profit. Companies required to report on sustainability must provide details of revenue, costs and expenses for audit purposes. Let us look at some examples of this, too. From the net sales revenue, for example, the revenue from the sale of $CO_2$ quotas can be highlighted. From other incomes, for example the provision for CO2 quotas or other environmental protection can be highlighted. Among the material-type expenses, the costs for environmental protection, waste recovery and disposal can be highlighted, or the amount of the $CO_2$ quota (the amount for the $CO_2$ quota was purchased), the cost of education or the cost of healthcare from the purchase value of the goods sold. If the general ledger statement (accounts) is compiled in sufficient detail during the business year, the accounts for these costs can be immediately recorded in the appropriate general ledger account and the year-end Income Statement can be easily compiled. It is expedient to show as a separate item the depreciation of tangible assets acquired for environmental protection in the given business year compared to the total amount of depreciation. Other expenses include those related to the $CO_2$ quota, impairments, the total sum of provisions for environmental protection, specific subsidies and benefits (Fülöp, Hódi Hernádi, 2014).

## 5 Discussion

The authors of this paper are of the opinion that performance data should be included in the annual reports in an integrated manner. By defining this information, an effective planning, decision-making process and control system can be implemented. In this case, efficiency means that this can be ensured in a timely manner, with the right quality and within a defined budget. If the reports are standardised for all companies, then shareholders, customers, business partners and institutions dealing with sustainable development issues will receive comparable information about the company's results and performance.

The transformation and gradual modification of an existing accounting system does not cause as drastic a change in the operation of a company as it would if the company had to introduce an entirely new system. In the authors' view, for companies in which a transformation of the accounting system is not possible, a new stand-alone information system is needed in order to prepare sustainability reports. It is necessary to clarify the information content of sustainability reports and the method of their evaluation. The SBSC is a recommended tool and, of course, the parts of the annual accounting report should be linked to sustainability. In addition to defining financial ratios, the employment of well-trained, creative and motivated employees, a quality and innovative approach to the operation of the business, a commitment to safety, health and the natural environment, and a lasting and fair business relationship are important and fundamental values.

In today's fast-paced, changing world, to meet the need for change, companies are taking advantage of the opportunities offered by digitalisation. Digital development also contributes to the efficiency of companies and significantly reduces the use of paper, among other things, thus placing protection of the environment at the forefront (Hegedűs, 2019b). Unfortunately, due to archiving and administration, in practice, electronic invoices are printed on paper. These invoices should only be stored electronically.

There are several initiatives in the European Union. The non-financial reporting eco-system is changing at an accelerated pace. The European Financial Reporting Advisory Group (EFRAG) and the International Sustainability Standards Board (ISSB) have both already issued first drafts of the sustainability reporting standards. The EU Taxonomy Regulation provides guidance to both funders and companies; its first supplementary regulations were implemented in 2021 (International Federation of Accountants, 2021). The draft EU standard for non-financial reporting is expected to enter into force by 2024. In November 2021, the issuer of International Financial Reporting Standards announced the establishment of a new standard-setting body – the International Sustainability Standards Board (ISSB). The Board aims to establish a comprehensive agreed framework, taking into account Central Securities Depositories Regulations (CSDR), which provides internationally accepted, relevant and comparable information to investors and capital market participants. Greenwashing has become a real risk in recent years, which shows that companies have recognised that taking action on climate or social issues is important for their stakeholders. One of the problems these days is that companies can make findings that no one can really verify. This makes it extremely difficult for stakeholders to make effective capital allocation decisions.

High quality global standards for the disclosure of sustainability information can help in this, thus significantly reducing the risk of greenwashing. If a company's accounting system links social and environmental issues to financial opportunities and controls it, it can preserve and increase the company's economic opportunities.

This study addresses the private sector. This limits the organisations analysed in the study, as it only covered for-profit companies. However, sustainability reports should be compiled by all institutions, as they have an impact on their social, economic and economic environment in the course of their activities. The fact is that private sector companies are more willing and flexible to produce such reports. The authors of this paper are of the opinion that non-profit organisations are not yet prepared to compile such reports. It would be useful for all organisations to produce a sustainability report in the future.

## 6 Conclusions

The aim is to develop a management accounting model that supports the definition of environmental, financial and social indicators and the integration of these indicators into practice. With the tools and methods of management accounting, this model can emerge in company information systems, providing an opportunity to integrate sustainability practices and company strategy. Thus, company social responsibility and sustainability become supportable through management accounting. The biggest challenge is to develop appropriate measurement systems that can be used to quantify the extent to which certain environmental impacts have changed the company's financial and financial position. Displaying these costs is also a problem for businesses, as in most cases environmental costs are treated along with overheads. The development of a reliable indicator system is essential for accurate, detailed measurement and comparison of environmental, social and sustainability performance.

KPIs should be defined through regular reporting, which should be continuously developed, and the circular system should be integrated into sustainability reports. The reliability of the data requires a wide range of expertise from both institutional, investor and audit perspectives. In most cases, the prudential assessment of the non-financial risk of businesses is assessed with the help of rating agencies. This is because non-financial reports provide a wide range of information and because the reports are very different in terms of both form and content.

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