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Chapter 1

Non-Financial Disclosure and Sustainability Regulation: Voluntary or Mandatory Effectiveness

Maurizio Comoli

University of Eastern Piedmont 'A. Avogadro'
e-mail: maurizio.comoli@uniupo.it
ORCID: 0000-0002-2662-3295

Patrizia Tettamanzi

LIUC – Cattaneo University
e-mail: ptettamanzi@liuc.it
ORCID: 0000-0002-3871-4397

Francesco Bavagnoli

University of Eastern Piedmont 'A. Avogadro'
e-mail: francesco.bavagnoli@uniupo.it
ORCID: 0000-0002-6626-3175

Michael Murgolo

LIUC – Cattaneo University
e-mail: mmurgolo@liuc.it
ORCID: 0000-0001-6328-4053

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This chapter provides a representation of what are the general directions taken by international and European institutions, from the point of view of accounting, reporting and disclosure activities, in order to address the current 'ESG' challenges, from the health emergency to the most pressing environmental and social issues, such as climate change and the energy crisis. In fact, corporations – made of assets and people – play a central role even and especially in extraordinary circumstances,

such as a crisis or, keeping with the times, a pandemic, and the pursuit of the shareholder value cannot be the sole objective in the execution of economic activities anymore, as ESG (i.e., *Environmental, Social and Governance*) dynamics must also be given due consideration. Adequate and effective corporate governance should, in fact, lead to a higher quality of disclosure, which might represent an incisive tool in order to protect the entire planet and ecosystems. The main role of accounting, reporting, and disclosure activities should, therefore, be increasingly geared toward the goal of bringing out what is and what is not being done by companies in their operations, and along their entire value chain, since the disclosure of merely financial information is increasingly deemed inappropriate for pursuing sustainable growth in the medium and long term. The objective of this chapter is, therefore, to investigate – after a brief theoretical overview on what is considered, in the extant literature, to be the most effective to the mentioned purposes between enforcing disclosure on a 'mandatory' basis or a 'voluntary' one (i.e., structured, for instance, on the 'comply or explain' paradigm) – and by means of archival data and bibliographic analysis techniques, what international and European institutions have planned to do so to align corporate objectives (and with a focus on SMEs) with the environmental and societal requirements over the coming years.

1.1. Introduction to Non-Financial (or ESG) Disclosure

Understanding the evolution of non-financial disclosure regulations globally is, in fact, crucial. It would provide a representation of the general directions taken by international institutions from the perspective of reporting and disclosure[1] activities in addressing current 'ESG' challenges. Corporations and small/medium-sized enterprises (SMEs) and economic stability, in general, all play central roles in this context, even in extraordinary circumstances, such as an economic crisis or the COVID-19 pandemic. Thus, the ultimate goal of a company is not solely the creation of economic value for shareholders. It must also take ESG dynamics into account in carrying out its business activities. Adequate and effective corporate governance systems could, in fact, help the upper echelons make informed decisions, possibly leading to a better quality of disclosure as well. Corporate governance and accounting/reporting mechanisms influence and inform each other virtuously. The main role of accounting, reporting and disclosure activities should, therefore, be increasingly focused on bringing out the actual impacts of

[1] The title of this chapter refers to the topic of '*non-financial disclosure*', which could be perceived as ancillary and secondary to the traditional 'financial disclosure'. This choice is not accidental. In fact, in the current landscape, non-financial disclosure has reached an equal and integrated level – 'financial reporting & disclosure' activities now stand beside 'sustainability reporting & disclosure' ones.

business operations with reference to the **entire value chain**. The disclosure of mere financial information is, indeed, no longer deemed to be sufficient since – in order to pursue sustainable growth in the medium and long term – companies' objectives must go hand in hand with the pursuit of social and environmental ones, disseminated through the so-called 'non-financial disclosure' (Comoli, Tettamanzi, & Murgolo, 2023; Tettamanzi, Venturini, & Murgolo, 2022).

Hence, highlighting whether disclosure activities are more effective on a 'mandatory' basis (i.e., compulsory as required by law) or on a 'voluntary' one – as a free choice of the company to provide a corporate disclosure statement to users and structured, for instance, on the 'comply or explain' paradigm – is deemed timely and necessary. The latter stance has been chosen by most international, European and national institutions, which have opted for voluntary disclosure to enable companies to align their business objectives with environmental and social requirements. To date, the IFRS (International Financial Reporting Standards) Foundation (at the global level) and the EFRAG – European Financial Reporting Advisory Group (at the European one) are operationally addressing the above issues in order to propose 'non-financial' disclosure standards in line with the necessary improvements required by the sustainable revolution.

In this context, the 2030 UN (United Nations) Agenda and the most important international organizations have also been working to find an explicit solution to these various issues so as to finally define a limit to economic activities that – although profitable from a purely financial standpoint – actually have a negative impact on the environment and/or on the communities they serve. At the same time, the academic and scientific community has confirmed that reporting and disclosure practices play a key role in aligning the goals and strategies adopted at the corporate level with the needs of different stakeholders (Christensen, 2022; Ruiz-Blanco, Romero, & Fernandez-Feijoo, 2022; Saini et al., 2022; Saxena et al., 2023; Tettamanzi et al., 2022).

One of the first goals of COP26 (i.e., the 26th United Nations Conference of the Parties on Climate Change) was to call attention to the need for 'transparency and accountability', defining a set of rules under which countries should be held accountable for achieving (or not) results related to their climate action plans and self-defined targets among the nationally determined contributions (NDCs). At the same time, at COP26[2], in 2021, the Trustees of the IFRS Foundation announ-

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[2] In 2022, COP27 reaffirmed these objectives, whose five main achievements could be synthesized as follows: (a) establishing a dedicated fund for loss and damage, (b) maintaining a clear intention to keep 1.5°C within reach, (c) holding businesses and institutions to account, (d) mobilizing more financial support for developing countries, and (e) making the pivot toward implementation. In November 2023, COP28 will be held, whose intention appears to be *to unite, in this decisive decade for climate action, the world towards agreement on bold, practical, and ambitious solutions to the most pressing global challenges of our time*.

ced the creation of a new board alongside the IASB – International Accounting Standards Board: the so-called ISSB – International Sustainability Standards Board. International investors with global investment portfolios were increasingly asking companies for high-quality, transparent, reliable and comparable reporting on **Environmental, Social and Governance** (ESG) issues. In November 2021, the IFRS Foundation, therefore, opted for the aforementioned creation of the ISSB with the ultimate goal of meeting this demand. The objective of the ISSB is to determine a comprehensive global foundation of sustainability disclosure standards that will provide investors and other capital market participants with information on the risks and opportunities related to corporate sustainability in order to help them make informed decisions. Moreover, in 2022, the US Securities and Exchange Commission (SEC) proposed changes to existing rules that would require listed entities to include climate-related information in their registration statements and periodic reports, including information on 'climate-related' risks that could have a material impact on their business, results from corporate operations or their financial condition, and climate-related financial statement metrics that would then be externally audited. This information would also include disclosure of greenhouse gas emissions, which have become a commonly used metric for assessing the exposure of reporting entities to such risks (Rüger & Maertens, 2023).

At the European level, on the other hand, in 2021, the European Commission proposed a draft for a sustainability directive (i.e., CSRD or Corporate Sustainability Reporting Directive or Directive 2022/2464/EU) to essentially amend the requirements already defined for 'non-financial disclosure' under another directive, i.e., the NFRD – Non-Financial Reporting Directive or Directive 2014/95/EU. At the end of its implementation process, a first set of sustainability accounting principles and standards would be in place. In November 2022, the European Parliament approved this directive, which will result – for the European context – in (a) reporting for transparent ESG information becoming an integral part of corporate economic and financial disclosure, (b) setting the EU itself as a benchmark in global sustainability reporting standards, and (c) initially impacting about 50,000 companies with the new standards, up from the current 11,700, although the range of companies involved may be even wider over time. Therefore, it will be necessary to have suitable and timely accounting systems in place to meet this increasing information demand, especially in the context of less structured companies and SMEs.

In this endeavour, EFRAG[3] has been tasked, through the Sustainability Reporting Board (SRB), to define the above standards. The EFRAG SRB, with the

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[3] EFRAG is an association founded in 2001 with the support of the European Commission, whose purpose is to serve the public interest in international financial reporting standards initiatives at the European level. As of 2022, EFRAG's activities are organized into two pillars:

support of the EFRAG Sustainability Reporting Technical Expert Group (EFRAG SR TEG), has arrived at the definition of twelve draft ESRS (i.e., European Sustainability Reporting Standards) that have been also recently adopted (at the end of July 2023) by the European Commission. That said, these final standards are not in force until the delegated regulation has passed the scrutiny of the European Parliament and the Council.

This chapter is structured as follows. First, we clarify the methodological approach (Section 1.2) that stands behind the proposed literature/documentary review. After having synthesized the main findings emerging from the extant literature (Section 1.3), we delved into, from a more practical standpoint, the most relevant advances on the wide topic of ESG disclosure internationally (Section 1.4), at the European level (Section 1.5), and in relation to SMEs issues and the value chain (Section 1.6). At the end of the paper (Section 1.7), we put forward some final thought-provoking insights, the limitations and some practical implications for policy-makers emerging from our analysis.

1.2. Research Aim and Methodology

As anticipated, the ongoing development of the International and EU regulatory framework on sustainability related issues and the several policy-making attempts in the area of non-financial reporting (NFR) have highlighted the necessity for the academic community to contribute towards understanding the multitude of implications resulting from the several sustainability disclosure frameworks currently available. The risk could, indeed, be an oversimplification of a complex issue that cannot easily be solved without considering its practical implications on each category of stakeholders. Hence, through this critical analysis, we have delved into a few crucial points pertaining to the general topic of ESG disclosure, with the aim of providing the academic community – but also policymakers and regulators – with a balanced report between theory and practice. By means of archival data, content analysis and bibliometric techniques, we conducted a review of the extant literature[4] concerning the issue under investigation,

(a) a financial pillar (i.e., *Financial Reporting Pillar*) that contributes to the IASB's standard-setting process by providing European advice, including proactive research activities and technical advice to the European Commission on the endorsement of IFRS standards, and (b) a sustainability one (i.e., Sustainability Reporting Pillar) that is currently providing technical advice to the European Commission in the form of draft EU sustainability reporting standards and/or draft amendments to them.

[4] The methodological approach employed in this chapter is based on the application of some specific bibliographic techniques pertaining to the systematic literature network analysis (SLNA) protocol.

providing an overview on the rationale concerning a possible optimal solution between voluntary or mandatory systems on the sustainability reporting dilemma. Sub-sequently, we examined in depth professional and official documents published by the most prominent bodies worldwide, mainly focusing our attention on the ISSB and EFRAG activities. First, we further investigated to what extent the international initiatives put in place by the International Sustainability Standards Board (ISSB) could improve the environmental performance of companies, investors and institutions. Second, we explored the role played by the European Financial Reporting Advisory Group (EFRAG), by means of its sustainability pillar activities, on the same issues in the European context. The analysis closes by presenting possible future improvements of international and EU policy and frameworks so as to support an efficient achievement of the 'Twin Transition' objectives, also in light of SMEs criticalities and, therefore, along the entire value chains which stud the current economic systems.

1.3. Voluntary or Mandatory: The Sustainability Disclosure 'Dilemma'

In recent years, environmental, social, and governance (ESG) dynamics have become critical to institutional and retail investors. Increased demand for ESG performance indicators from the latter has, in particular, led some companies to disclose information voluntarily. Indeed, most US companies included in the S&P 500 now publish sustainability or corporate responsibility reports. Moreover, at least 25 countries have so far imposed mandatory ESG disclosure requirements on publicly traded companies, and similar legislative attempts have been made by the US Congress (Aghamolla & An, 2021; Comoli et al., 2023; Saxena et al., 2023; Zhou, 2022).

Understanding the extent to which such disclosure requirements influence ESG activities and investment decisions is essential, as is the question of whether they are likely to improve the overall quality of information. Indeed, despite the growing popularity of sustainability reporting and mandatory environmental, social, and governance (ESG) disclosure requirements, theoretical investigations of ESG disclosure and investment are relatively scarce (Zhou, 2022). The aim of this chapter is, therefore, to provide a theoretical overview of the topic of ESG reporting, both in mandatory and voluntary disclosure regimes.

Reviewing the extant relevant scientific literature from the period 2002–2022, only 34 research studies specifically addressed the analysis of 'non-financial' disclosure in both 'mandatory' and 'voluntary' contexts. We tested to see which contributions dealt with the following topics in both contexts: 'sustainability reporting', 'integrated reporting', 'ESG reporting', 'climate-related disclosure', and 'non-financial disclosure'.

In addition, a bibliometric network[5] of the keywords used in these contributions was created with the ultimate aim of bringing out the prevalent topics addressed in this context (see Figure 1.1), as well as in relation to their temporal relevance (see Figure 1.2).

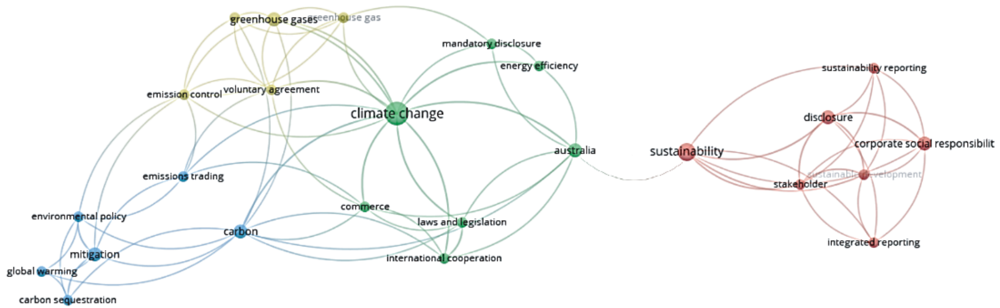

Figure 1.1. Keyword Network in the area of *Non-Financial Disclosure*, organized by thematic clusters

Source: (Tettamanzi, 2023).

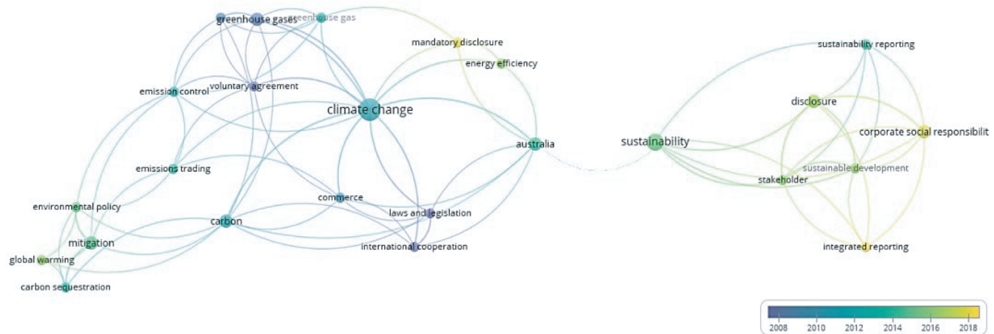

Figure 1.2. Keyword Network in the area of *Non-Financial Disclosure*, organized by temporal relevance

Source: (Tettamanzi, 2023).

From the perspective of investors, there is as yet no framework that can be considered 'optimal' in terms of disclosure, leaning toward neither mandatory nor voluntary disclosure (Nicolò, Zanellato, & Tiron-Tudor, 2020; Rüger & Maertens, 2023). That said, although voluntary disclosure of ESG performance has increased

[5] *VOSviewer* is a software used for the construction and visualization of bibliometric networks. These networks can include, for instance, journals, researchers, or individual publications, and can be constructed based on connections between citations and/or authors. *VOSviewer* also offers text mining capabilities that can be used to construct and visualize co-occurrence networks of important terms extracted from a body of scholarly literature.

exponentially over time, several countries have implemented regulations governing the disclosure of non-financial information. From a microeconomic point of view, in the voluntary regime, the company would withhold negative signals, releasing only positive ones. In short, it would be biased against the 'first--best' scenario since the company can always deviate privately in an attempt to manipulate the market (Aghamolla & An, 2021; Shin, 2003). However, the mandatory regime often leads to overinvestment, which suggests that mandatory ESG regulation may also have undesirable effects anyway due to, among others, the presence of voluntary disclosure in specific reporting areas (Saxena et al., 2023; Zhou, 2022). In this context, the company would continue to have the discretion to disclose information regarding future corporate performance. As a result, the company would, once again, have a greater incentive to deviate – as it would under the voluntary regime – from a sustainable to an unsustainable project. Therefore, clearly identifying the conditions under which voluntary or mandatory disclosure is more efficient for investors has been deemed crucial (Sullivan & Gouldson, 2012; Vigorito, 2022). In particular, previous studies have shown that when the fraction of shareholders concerned about the quality of 'ESG' information is not sufficiently high, the voluntary regime appears more efficient, improving overall shareholder welfare than the mandatory one (Loprevite, Rupo, & Ricca, 2019). This result is, perhaps, surprising since we could have expected the company would have less incentive to deviate privately from the 'sustainable project'[6] when it has no discretion on this dimension. However, if high-quality ESG information is always disclosed in the mandatory regime, it would also intensify the entity's incentive to privately deviate from the unsustainable project whenever the market expects such an investment. This 'overreaction' could, as a result, result in lower overall efficiency and a greater variance from the 'first-best' scenario.

When the share of investors interested in ESG dynamics is high, the company's lower incentive to deviate privately from the sustainable project, once again, prevails, but voluntary disclosure would overall be, also in this case, more efficient for shareholders (Camilleri, 2015; Ferguson, Sales de Aguiar, & Fearfull, 2016; Gabe, 2016; Saxena et al., 2023). The implications described so far can also be applied to sectors that have seen changes ('*shifts*') in their ESG-matrix disclosure regimes as well as across sectors: high-growth sectors should, in fact, have higher 'ESG' disclosure than low-growth or stable sectors (Aghamolla & An, 2021). In short, the proposed forecasts of investment efficiency should be non-monotonic following a change in the disclosure regime, and an increase, on average, in sustainable

[6] In this chapter, we have generally referred to the concept of 'sustainable project' as a microeconomic simplification of any activity that is incremental in positive externality or decremental in negative externality, in line with the nomenclature generally used in the field of sustainability.

projects is highly likely following a shift from voluntary to mandatory ESG reporting (Comoli et al., 2023; Vigorito, 2022).

That said, information is, in general, the currency of market economies: it is a cost for the companies for it has to be produced, but it is value for them that, if diffused, is depleted. A market participant will always, except in virtuous cases or in a monopoly context, seek to retain its valuable information. In a 'mandatory' regime, therefore, a 'minimum' level of disclosure – equal to the amount of information mandatorily requested – should be expected. The dilemma for policy-makers lies precisely in this recess: on the one hand, in order to obtain environmental, social and governance (ESG) information, they could increase the level of detail of the information request; on the other hand, they will always be confronted with the uniqueness and distinctiveness of each entity whose valuable information – and specifically the 'ESG' one – is difficult to standardize. When such information is provided, they will not even be certain that it meets, at the present time, the expected standards of quality due to, among others, a lack of official and accepted auditing and assurance procedures. In any case, these considerations should offer a number of perspectives for further discussion, helping inform the policy debate on the disclosure effectiveness of 'ESG' data and information.

1.4. International Initiatives on ESG Disclosure

Over the past few years, there has been not only a change in the socio-economic environment but also the enhancement, at the global level, of a new public awareness with regard to ethical and environmental issues. This has been leading to revisions and adjustments on the companies' expected behavioural level, both in terms of pursuing stakeholder interests and communicating non-financial information. This phenomenon enabled the emergence of social and environmental reporting practices, leading to the development of the first standardized guidelines for ESG and sustainability reporting. For instance, reporting for the organization and stakeholders (including employees, the referential community, customers and others) interactions, together with the description and analysis of their overall consequences, has been termed 'social accounting' (Gray & Bebbington, 2000). From this standpoint, the purpose of social accounting is identified with the 'need' or 'desire' to make the social (and environmental) impacts of a certain economic entity evident to stakeholders or, in general, the society as a whole in order to meet their expectations regarding corporate responsibility (Pyatt, 1991).

That said, awareness regarding the environmental and social 'non-sustainability' of economic activities can be formally associated with the first accomplished definition of 'sustainability' in terms of sustainable development, presented in the *Our Common Future* Report (also known as Brundtland Report), published in 1987,

by the World Commission on Environment and Development (WCED). In particular, the report in analysis proposed an original long-term strategy with regard to sustainable action, dictating guidelines that are still valid today. In fact, it states that the concept of sustainability must be brought back to the definition of development to ensure the needs of present generations without compromising those of future ones. Moreover, in response to community and stakeholder concerns that, over time, have increasingly taken on the role of real 'legitimate expectations', companies began to adopt approaches marked by increasing transparency regarding the impacts – beyond the financial ones – generated. Thus, transparency in communicating economic strategies that were less impactful to humans and the environment started to be, between the 1980s and 1990s, increasingly promoted by large industrial groups, which sought to reaffirm their importance and role in society as they came under particular criticism from civil society more and more aware of the environmental and social costs they were generating (Comoli et al., 2023). In short, transparency of information has become, over the years, a key requirement as a result of increased societal attention to environmental and social issues, leading to an overall increase in the frequency of disclosure by companies of information relating to dimensions that are not strictly financial (Frias-Aceituno, Rodríguez-Ariza, & Garcia-Sánchez, 2014). The transition from mere financial information disclosure to the gradual expansion to other relevant dimensions (i.e., ESG) has not only been fostered by the attention of stakeholders and civil society in general but also by the emergence of a gradual awareness of financial markets with regards to the usefulness that social, environmental and governance (ESG) information can also have in the current panorama (Graham, 2005; Rüger & Maertens, 2023).

According to a historical reconstruction based on the extant literature, the transition in the analysis is characterized by four phases, each of which is marked by a progressive modification and extension of the previous one. Several contributions have, in fact, made it possible to reconstruct the stages that have historically been the most relevant to non-financial reporting and disclosure (Eccles & Spiesshofer, 2015; Rinaldi, Unerman, & De Villiers, 2018).

The first phase, also named 'corporate experimentation', originated in the early 2000s. In this period, some listed companies voluntarily began supplementing financial information with non-financial disclosure. Over time, these companies have periodically published information on financial performance and governance, enriched with non-financial data, even in the absence of relevant standards for reporting. The second phase is referred to be the 'critical' one, as there were still no unambiguous standards to which companies could refer when preparing their corporate reports. Consultants, academics and experts were, therefore, involved in this phase in order to identify basic principles capable of standardizing non--financial disclosure: one of the first attempts that allowed the identification

of the costs, benefits and challenges that ESG reporting tools generate for companies that use them dates finally back to 2005. Moreover, in these very years, the idea that this practice generates, in the long run, a substantial improvement in company performance began to take hold. The beginning of the third phase, the so-called 'codification', can be chronologically placed at the end of the 2000s. The intervention of non-governmental organizations in collaboration with companies, investors and auditing firms led to the emergence, among others, of the **Integrated Reporting** (IR) framework and the **Global Reporting Initiative** (GRI). The broadening of the audience of actors in the reporting process characterizes this third phase, which also involves the relevant economic and financial communities: associations, local authorities and non-profit organizations. The last phase – identified as 'institutionalization' – is the result of the efforts made by pioneering companies in recent years to codify and foster non-financial reporting practices. It is precisely at this stage that voluntary codes of conduct, increasingly sophisticated reference standards, and relevant laws and regulations have been diffused (Pearson & Seyfang, 2001; Saxena et al., 2023).

Fundamental to the establishment of the NFD (Non-Financial Disclosure) at the global level was the action of the UN Assembly, which, at the end of World War II, published the Declaration of Human Rights (1948), thus making it possible to delineate better the basic concepts of dignity and equality (i.e., rights that are incumbent on the individual, even when establishing relationships with social groups) and to define fundamental freedom, economic, social and cultural rights. Subsequently, by means of the publication of the Global Compact (2006), it indicated 10 fundamental principles to which institutions, public bodies, economic entities and organizations should have aligned their strategies of action. These principles cover the protection of human rights, the environment, occupational safety, and the fight against corruption. Economic entities that voluntarily adhere to the Global Compact have to release annual communications that must make explicit the sustainability policies implemented, the practical actions taken, the evaluation of the results achieved, and the future goals to be achieved by them, using as indicators those developed by the Global Reporting Initiative (GRI). These communications represent evidence of the commitment that companies have made towards global ESG objectives. In addition, in 2015, the UN Assembly also adopted the 2030 UN Agenda, a universal program that aims to *contribute to global development, promote human well-being and protect the environment*. In particular, the Sustainable Development Goals (SDGs) were presented through a UN resolution and then unanimously adopted by 193 member countries. The SDGs are addressed to the so-called 'major groups' identified by women, children, indigenous peoples, non-governmental organizations, local authorities, workers and trade unions, industry and business, the science and technology community, and citizens. In addition, the mentioned resolution also provided, on a voluntary

basis, an annual monitoring report designed to record progress made in the pursuit of the goals. Thus, 17 UN SDGs have been becoming, with the GRI indices, beacons of social responsibility reporting for large and medium-sized global companies.

Another major contribution in this regard has been made by the Organization for Economic Cooperation and Development (OECD), which aims to promote economic coordination among member countries: i.e., the *OECD Guidelines for Multinational Enterprises* (OECD, 2011). These guidelines bring together recommendations that countries should instil in their enterprises, defining their corporate principles and setting standards to promote their responsible behaviour in the execution of economic activities, including the disclosure of information. The aforementioned guidelines stipulate that companies must contribute to economic progress by (a) developing a form of governance capable of taking ethical actions that involve relevant stakeholders, (b) seeking to do the least harm to the environment, and (c) developing a high-quality communication strategy capable of providing additional information to that related to merely financial and operational results. In this context, the International Standard Organization (ISO) is defined as one of the world's most important organizations for drafting technical standards based on the will of various stakeholders such as governments, public and private enterprises, workers, consumers and non-governmental organizations, published in 2010 the *Guidelines on Social Responsibility* (International Standard Organization [ISO] 2010). In detail, ISO 26000 is an international standard that provides guidelines on Corporate Social Responsibility (CSR) for economic and non-economic organizations, proposing the definition of concepts, standards and ways of implementing and promoting CSR at the corporate level.

Social Accountability International (SAI), a global non-governmental organization that promotes human rights at work, published from 1989 to 2014 the SA 8000 certification standards which encourage organizations to develop, implement and maintain business practices consistent with CSR. Finally, the Global Reporting Initiative (GRI), made public in 1997 by the Coalition for Environmentally Responsible Economies and the UN Environment Program, is worth mentioning. For instance, the GRI standards, published in 2002, are now one of the most widely used reporting systems in the world. These standards allow for the identification of sustainability metrics – the GRI indices – that are used in annual corporate reports to demonstrate the commitment that GRI adopters invest in implementing social responsibility policies and in measuring corporate performance with respect to the environment, society, and governance dimensions. As already said, due to the increasing importance of the institution itself and the volume of adoptions, GRI standards are currently the most widely used.

All that said, the actual definition of Environmental, Social and Governance (ESG) is associated with the field of socially responsible investments (SRIs), dating

back to 2005. The term was, in fact, coined in a landmark report entitled *Who cares wins*, resulting from the conference between the United Nations and 50 CEOs of major financial institutions from around the world. The goal of the conference, in the wake of the Global Compact, was to integrate ESG factors into the financial sector. Unlike SRIs – which are based on ethical and moral values and use mostly negative screens such as, for instance, not investing in tobacco, alcohol, or weapons companies – ESG investments rest on the assumption that 'ESG factors are financially relevant' (Kell, 2018). In short, ESG factors have introduced the topic of sustainability in a more structured way in the financial world (Comoli et al., 2023).

However, the concept of ESG is often confused with CSR (Corporate Social Responsibility), although they refer to two very different areas. The European Federation of Financial Analysts (EFFAS), in fact, asserts that ESG is a generic term used in financial markets, which is often mistakenly confused with terms such as CSR or sustainability. Specifically, ESG indices focus on two key aspects: the risks due to poor ESG performance and the opportunities due to good ESG performance. In contrast, corporate social responsibility reports deal with the latter's sustainable approach on multiple levels and target all stakeholders, not just investors or financial analysts like ESG indices.

In conclusion, ESG factors should be seen as integrative financial indicators used to determine the degree of risk of an investment. In this context, the attempts and initiatives of the IFRS Foundation and the SEC (through the 'SEC Response to Climate and ESG Risks and Opportunities') emerge, which are dealing internationally with the translation of these factors, and related risks, into performance measurement and subsequent reporting (Saxena et al., 2023; Tettamanzi et al., 2022). In fact, the IFRS Foundation only recently saw fit to provide a supplement to international accounting and reporting guidelines, working on the introduction of specific standards that would address the assessment of climate and sustainability effects on financial statement recognition, measurement and disclosure activities. At COP26, the IFRS Foundation announced the creation of the new International Sustainability Standards Board (ISSB), to which it entrusted, together with the Climate Disclosure Standards Board (CDSB), the task of defining the standards that would enable environmental measurement and reporting as well as the consolidation of the Value Reporting Foundation (VRF), which would be grafted onto the Integrated Reporting Framework and SASB standards (McBrien, Zimonyi, & Astley, 2021). With this choice, the ISSB will be able to work toward the realization of a comprehensive base of sustainability disclosure standards and will be able to provide a broader and more shared reference point so as to meet the information needs of investors and other ESG-conscious stakeholders. In December 2022, the ISSB presented an official update through which it highlighted some preliminary decisions in relation to

its ongoing projects in this regard. In particular, the projects affected by these decisions are listed in the *IFRS Foundation Work Plan* (IFRS, n.d.). The ISSB's final decisions on the IFRS Sustainability Disclosure Standards are currently being voted on, as set out in the *IFRS Foundation Due Process Handbook* (IFRS, 2020). At that meeting, deliberations were also held with reference to the proposed Exposure Drafts (ED) called *IFRS S1 General requirements for disclosure of sustainability-related financial information* (Draft S1) and *IFRS S2 Climate-related disclosures* (Draft S2). ISSB redeliberated the proposals after considering the feedback on the ED, issuing the first two IFRS Sustainability Disclosure Standards (IFRS, 2023), in their official version, in June 2023. This issue is considered to usher in a new era of sustainability-related disclosures in capital markets worldwide. The Standards shall help to improve trust and confidence in company disclosures about sustainability to inform investment decisions. And for the first time, the Standards create a common language for disclosing the effect of climate-related risks and opportunities on a company's prospects.

In particular, the objective of IFRS S1 is to require an entity to disclose information about its sustainability-related risks and opportunities that is useful to users of general purpose financial reports in making decisions relating to providing resources to the entity. IFRS S1 requires an entity to disclose information about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium or long term (collectively referred to as 'sustainability--related risks and opportunities that could reasonably be expected to affect the entity's prospects'). It also prescribes how an entity prepares and reports its sustainability-related financial disclosures, setting out general requirements for the content and presentation of those disclosures so that the information disclosed is useful to users in making decisions relating to providing resources to the entity. On the other hand, IFRS S2 sets out specific climate-related disclosures and is designed to be used with IFRS S1. More in detail, IFRS S2 is effective for annual reporting periods beginning on or after January 1, 2024 with earlier application permitted as long as IFRS S1 is also applied. The objective of IFRS S2 is to require an entity to disclose information about its climate-related risks and opportunities that is useful to users of general purpose financial reports in making decisions relating to providing resources to the entity. Both fully incorporate the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

Now that IFRS S1 and IFRS S2 are issued, the ISSB will work with jurisdictions and companies to support adoption. The first steps will be creating a Transition Implementation Group (TIG) to support companies that apply the standards and launching capacity-building initiatives to support effective implementation. The ISSB will also continue to work with jurisdictions wishing to require incremental

disclosures beyond the global baseline and with GRI to support efficient and effective reporting when the ISSB Standards are applied in combination with other reporting standards.

1.5. European Initiatives on Sustainability Reporting

Several initiatives on 'non-financial disclosure' have been put forward at the European level throughout the years. The need for companies to pay attention to environmental and social issues had already been recognized by the European legislator in Communication 1999/263/EC on the common market and the environment. Moreover, Directive 2003/51/EC contemplated some considerations on the need to integrate financial information in annual reports with non-financial one. Since 2011, the European Union's action has intensified and has been directed toward the establishment of a modern conception of corporate and entrepreneurial activity in order to achieve a new CSR approach which would have, finally, configured more transparent, virtuous and efficient economic systems (Saxena et al., 2023). This was done, among others, first with some communications (such as 'The Single Market Act. Twelve Levers to Stimulate Growth and Strengthen Confidence – Together for New Growth' and 'Renewed EU Strategy 2011–2014 on Corporate Social Responsibility') and, later (in 2013), with a European Parliament resolution, i.e., 'Corporate Social Responsibility: Transparent and Accountable Business Behaviour and Sustainable Growth'. In 2014, Directive 2014/95/EU, amending Directive 2013/34/EU concerning the disclosure of non-financial and diversity information by certain companies and certain large groups, was issued by the European Parliament and the Council. This directive, also known as the 'Non-Financial Reporting Directive' (NFRD), aimed to include, in the information flows addressed to consumers and investors, non-financial and diversity data by a certain group of entities. Even though it did not represent a real novelty in the European landscape, the directive in analysis introduced for larger Public Interest Entities (PIEs)[7] an obligation in order to provide (a) in the annual management report, a statement covering a much broader range of non-financial information than just environmental and personnel issues, and (b) in the report on corporate governance and ownership structures, a statement about the policies to be adopted regarding the composition of management and supervisory bodies so to ensure adequate gender diversity and professionalism, also specifying the objectives, implementation methods and results of this policy in the reporting period.

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[7] The Directive 2014/95/EU states that *large enterprises, which constitute public interest entities, with at least 500 employees must include in the management report at the end of the financial year a non-financial statement containing environmental, social, personnel-related, human rights, and active or passive anti-corruption information to understand the performance of the enterprise, its results, and on the situation and impact of its business.*

Thus, the NFRD started to impose non-financial disclosure requirements on certain entities, namely the largest or most significant Public Interest Entities. The innovative scope of this directive is evident and, to a certain extent, anticipatory of similar initiatives undertaken globally and even more extensive in scope. Subsequently, the Commission intervened on the same directive, expanding it. In fact, Art. 2 of Directive 2014/95/EU already made reference to later actions undergone by the Commission, as it was aware of the incompleteness of the provisions. Therefore, following the stakeholder consultation, in 2019, the Commission issued the document Guidance on the Disclosure of Non-financial Information: Integration concerning the Disclosure of Climate-Related Information, also known as Non-Binding Guidelines in the area of climate change-related disclosures.

The effectiveness of the aforementioned actions will be greater depending on their successfulness in developing common international reporting standards capable of ensuring a high level of comparability of NFIs (Non-Financial Information), which is the only way to effectively guarantee equal treatment for EU companies and those operating in the same area. Such convergence could be ensured through international bodies such as the Financial Stability Board, the Task Force on Climate-related Financial Disclosure, the IASB (in particular, the ISSB) and the EU's technical bodies (EFRAG).

In December 2015, G20 finance ministers and central bank governors indeed asked the Financial Stability Board (FSB) to examine how the financial sector could take climate-related issues into account. As part of its remit, the FSB identified the need for better information to support informed choices in investment, lending, and insurance coverage and to improve understanding and analysis of climate--related risks and opportunities, particularly climate change (Gadinis, 2012). In order to improve the quality of disclosures, the Task Force on Climate-related Financial Disclosures (TCFD) was formed and tasked by the FSB with issuing recommendations and guidance on climate-related risk disclosures. After extensive public consultation, the TCFD issued in 2017 a first set of recommendations on climate-related risk disclosure, i.e., *Recommendations of the Task Force on Climate-related Financial Disclosures*, with a focus on four topical areas: governance, strategy, risk management, and metrics and targets. These recommendations could be adopted by a wide range of organizations pertaining to all sectors and jurisdictions.

In this context, among the key initiatives promoted by the European Commission's Sustainable Finance Plan, 'Strengthening Sustainability Reporting and Accounting Standards Development' communication is worth mentioning. This task, in the European context, was entrusted to EFRAG[8] with the establishment

[8] EFRAG (European Financial Reporting Advisory Group) is the European Commission's advisory body in the field of both financial and sustainability corporate reporting.

of a European corporate reporting body aimed at promoting innovation and the development of best practices in corporate reporting, such as environmental accounting. The first project resulted in the establishment of the European Lab Task Force on Climate-related Reporting (Lab PTF CRR) on the topic of climate change-related reporting, which drafted in 2020 the document *How to improve climate-related reporting* (EFRAG, 2020), providing an analysis of a few best practices on the topic in analysis. The European Commission, partly as a result of the insights conducted by PTF-CRR, also requested EFRAG to examine the possible development of common European-wide standards for non-financial information reporting by companies. To carry out this task, EFRAG formed the Project Task Force – Non-Financial Reporting Standards (PTF-NFRS). At the end of the first phase of its work, the Task Force (TF) organized a series of online events with the aim of presenting principles and guidelines for the development of the standards and gathering insights from key financial stakeholders in reporting (David & Giordano-Spring, 2022; Saxena et al., 2023).

In giving this task to the new TF, the Commission was keen to point out that the findings of the assigned work would have represented an in-depth technical study that must have been developed in an open manner, i.e., taking into account existing reporting standards and frameworks as broadly as possible. The connection with the NFRD review process is, therefore, evident, although the decision to include any reporting standards is, in fact, political and must always be taken by the Council and the European Parliament. The work of the PTF-NFRS was, in any case, completed with the publication in 2021 of the *Report on the development of common European standards for reporting non-financial information* and the so-called 'Roadmap' to achieve these goals (Comoli et al., 2023). In more detail, two documents have been published: (a) one on the more technical aspects of European standardization of this type of reporting, and (b) one, on the other hand, concerning the political-institutional aspects related to the necessary transformation of EFRAG to accommodate a second 'Board' dedicated to European standardization of non-financial information. In this regard, in 2022, EFRAG's General Assembly approved the latter revision, integrating the new reporting body (Sustainability Reporting Pillar) into its organizational structure. In addition, it appointed the members of the aforementioned board named the EFRAG Sustainability Reporting Board.

From a technical and substantial point of view, in 2021, the European Commission accepted a legislative proposal for a Corporate Sustainability Reporting Directive (CSRD). This requires companies within its scope to report using a dual materiality perspective in accordance with the European Sustainability Reporting Standards (ESRS) adopted by the European Commission as delegated acts. As part of the CSRD proposal, EFRAG was officially appointed as a technical advisor to the European Commission for the development of the draft ESRS.

The Exposure Drafts (EDs) of the ESRSs prepared by the EFRAG Project Task Force on European Sustainability Reporting Standards (EFRAG PTF-ESRS) in the period from June 2021 to April 2022 were published for feedback from April 30 to August 8, 2022. The EFRAG Sustainability Reporting Board (EFRAG SRB), with the advice of the EFRAG Sustainability Reporting Technical Expert Group (EFRAG SR TEG), took this feedback into consideration and amended accordingly the 12 draft ESRSs that were subsequently submitted to the European Commission. In this regard, the European Commission had consulted EU bodies and Member States on the drafts of the various standards before adopting the final version as delegated acts. Reporting requirements will be phased in for different types of companies. In fact, the first companies subject to these obligations will ideally have to implement the standards for annual reports pertaining to 2024, published in 2025. Listed SMEs will be obliged to prepare financial statements starting in 2026, with an additional possibility of voluntary 'opt-out' until 2028, and will be able to prepare financial statements according to separate and proportionate standards that EFRAG is in the process of developing. Finally, it should be noted that the twelve drafts mentioned are grouped as follows: (a) two concern general traits (i.e., ESRS 1 *General requirements* and ESRS 2 *General disclosures*), (b) five deal with environmental issues (i.e., ESRS E1 *Climate change*, ESRS E2 *Pollution*, ESRS E3 *Water and marine resources*, ESRS E4 *Biodiversity and ecosystems*, and ESRS E5 *Resource use and circular economy*), (c) four deal with social issues (i.e., ESRS S1 *Own workforce*, ESRS S2 *Workers in the value chain*, ESRS S3 *Affected communities*, and ESRS S4 *Consumers and end-users*), and (d) one focuses on the area of governance (see ESRS G1 *Business conduct*). In July 2023, the European Commission has closed the comment period of the standards developed for the Corporate Sustainability Reporting Directive (CSRD). Subsequently, the European Commission adopted the final version of the European Sustainability Reporting Standards (ESRS) for political approval at the end of the same month. This adoption process is expected to result in the official ESRS publication before the end of 2023, in time for companies to begin reporting in 2024. In fact, these standards will be in force once the delegated regulation passes also the scrutiny of the European Parliament and the Council.

In the European context, therefore, significant progress has been made in the area of 'non-financial disclosure', both through the development of common standards for accounting and reporting of non-financial information by companies and, prospectively, by laying the groundwork for the future development of standards aimed at better environmental, social and governance practice measurement and reporting at least in the European panorama.

1.6. Sustainability, SMEs Criticalities and the Value Chain

That anticipated, at the national level, in a multitude of jurisdictions, the level of regulation on mandatory non-financial disclosure still concerns a very limited group of companies, basically 'large sized' – leaving aside (and, therefore, out of scope) a plethora of companies which are, on the other hand, small to medium-sized. However, the ESG 'revolution' has been pushing towards improvements in the accessibility to non-financial data by the so-called corporate stakeholders on multiple levels. In fact, thanks to the publication of more transparent and inclusive disclosure documents, potentially throughout the entire value chain, which would describe all the capital invested in the company and the related performance and provide a brief and concise image, encapsulating within it all the actual value created and destroyed by a certain entity, stakeholders would be put in the condition of taking informed and aware decisions (Tettamanzi et al., 2022). From a different standpoint, this would lead companies to adopt more virtuous behaviour, with a view to improving their reputation in the eyes of investors and maintaining a competitive edge over their competitors over time. At a general level, therefore, non-financial disclosure should contain evidence of the main variables of the company's business model, especially with regard to social, environmental and governance aspects, measuring them through appropriate key indicators that illustrate both its short-term and expected medium- to long-term performance from a forward-looking perspective. In some contexts, this information has to be provided by means of the 'comply or explain' principle, according to which companies that fail to adopt the specific requirements should provide adequate justification for these choices. In fact, as has been previously argued (see Section 1.3), non-financial disclosure appears to be a very useful tool not only from the perspective of mandatory disclosure but also for companies that want to make disclosures voluntarily. Some substantial objectives related to this choice could be, for instance, (a) the ongoing measurement of their sustainability performance, (b) the judicious adoption of a long-term strategy that allows for well-calibrated decisions in terms of cost efficiencies or innovation input, and (c) meeting certain stakeholder acquisition and retention objectives (Rüger & Maertens, 2023).

Both companies are obliged to disclose NFIs, and organizations that voluntarily decide to do so, however, must address a fairly critical issue with regard to non-financial aspects, namely the measurement of sustainability performance, and this holds true irrespective of the reporting tool and/or framework actually adopted. In fact, in order for the non-financial disclosure to concretely report a value that by its nature is intangible – such as social and environmental aspects, and not (at least temporarily) objective and quantifiable as the financial ones –

it is necessary for organizations to develop advanced performance measurement and information systems internally. These mechanisms must especially enhance a few critical aspects of the business model to be disclosed internally and transparently to all business areas and departments so that decisions are always taken wisely and capable of maximizing effectiveness and efficiency according to the new ESG paradigms (Comoli et al., 2023; Rüger & Maertens, 2023).

In contrast to traditional financial accounting systems, such as financial statements, management accounting systems are totally voluntary and internal to the company, as well as useful primarily to fulfil managerial functions and only secondarily to produce useful information for external disclosure.

In this context, however, their presence and effectiveness are crucial to the success of an effective sustainability report – be it voluntary or mandatory – that concretely reflects the state of the organization and the overall value created both internally and externally, evidently based on a 'new' definition of value, which cannot be only financial anymore (Tettamanzi et al., 2022). In this context, consider, as mentioned earlier, those national landscapes which are mostly characterized by small- to medium-sized companies, often inadequately structured at the information system level and with a culture that is not particularly oriented towards the 'best-suited-to-the-purposes' managerial accounting tools. Hence, when considering sustainability at large, several levels of criticality related to the absence of such suitability at the SME level should be considered since the value chain itself is part of the problem and of the solution to the issues in discussion. The first concerns the incorrect valuation of costs related to products, processes and the resources needed to materialize them. This, subsequently, leads to making incorrect assessments of cost-effectiveness with respect to the main pillars of sustainable business strategies, also having major repercussions in terms of 'cost-benefit' assessments of processes that can lead to significant benefits and positive externalities (or dramatic costs and negative ones) at the level of social and environmental sustainability. This ties in with a second major critical issue, again related to the SME dimension that characterizes a multitude of European (and international) landscapes: it is, at times, difficult to measure what is hard to track, especially when this is done in relation to the production/value chain in order to understand the overall impact generated by upstream (and downstream) supply chain partners. To cope with this, implementing extremely prudent supplier selection strategies is crucial, allowing companies to define a strategic supplier base with which to maintain an ongoing sustainability-oriented relationship. Some key indicators in this context may be sustainability certifications or other parameters that, thanks to the non-financial disclosure required to be compliant with regulations, ensure transparency and traceability over time and space.

With regard to sustainability regulations and certifications, in addition to ISO systems, there are at least two initiatives worth mentioning when it comes to speaking about solutions at the moment accessible also to companies of any size that are willing to introduce a sustainable business model from both environmental and social perspectives: the B Corp certification[9] and the benefit corporation legislative acts nationally imposed. The spread of B Corp has, in fact, alerted and inspired several national jurisdictions at the global level so to take into due consideration a number of aspects related to the direct and indirect impacts of companies on society and the local areas, leading to the enactment of pieces of legislation aimed at regulating legally the ways in which companies could achieve social objectives related to corporate sustainability (i.e., pursuing the so-called dual mission)[10]. In short, in several legal systems, entities can now be transformed or incorporated as benefit corporations, which are exactly business organizations that, as part of their economic activity, must combine a profit-making purpose with the pursuit of *one or more purposes of common (or shared) benefit* operating in a *responsible, sustainable and transparent manner towards people, communities, territories and the environment, entities and associations, and other stakeholders* by providing them with *cultural and social goods and activities*. In order to preserve this status, benefit corporations are required, among others, to mandatory disclosure an annual report certifying congruent and pertinent managerial and strategic choices with the achievement of the 'shared benefit', providing specific details on the following aspects: (a) the objectives pursued, the methods used, and the action plans implemented in the reporting year, (b) the assessment of the company's impact, by means of appropriate indicators and materiality analysis of the externalities produced by the company on the environment and society, and (c) any new objectives that would be introduced in the following reporting year (Tettamanzi & Murgolo, 2022).

In order to ensure the publication of true and correct information that conforms to the activity actually carried out by the entity, some jurisdictions have stipulated that this disclosure must be monitored by external and independent bodies to the company, such as the Antitrust Authority. The effect

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[9] The B Corp certification mandatorily requires the periodic disclosure of an impact assessment on certain social, environmental and governance aspects, certifying the company's commitment and progress on its sustainability practices. Regardless of obtaining this certification, however, a number of entities use the B Impact Assessment, i.e., the specific reporting tool required for obtaining the certification, as a framework for non-financial disclosure, due to its measurement effectiveness and comprehensiveness that make it optimal for measuring corporate progress in the area under analysis.

[10] US regulations, unlike other jurisdictions, refer, in this context, to 'corporations' whereas, in other parts of the world, regulators have tended to prefer wider definitions such as 'companies', 'entities' and 'organisations'.

of misleading information is equated with the exercise of unfair business practices, assuming that the benefit corporation has been, in fact, implementing greenwashing practices so as to appear to investors and other stakeholders as an environmentally and socially conscious company for mere reputational and commercial purposes.

1.7. Conclusions, Limitations and Practical Implications

ESG issues are now at the heart of various legislative changes, both at the international and European levels, also from the non-financial disclosure standpoint. It is, indeed, evident that disclosing non-financial (or, rather, sustainability) information, especially related to its societal and local impact, is increasingly important to capture the true value of organizations, as purely financial data is no longer sufficient. We are currently in a period of readjustment and overall revision of international regulations based on the 'new' paradigms and the need for companies to bring out their intangible value, which is increasingly relevant and considered a critical factor for long-term sustainable growth. Following the attempts of the Non-Financial Reporting Directive, the Corporate Sustainability Reporting Directive (CSRD) certainly places greater emphasis on the goal of introducing greater homogenization of sustainability reporting at the international level, just as was done over the past decades for financial reporting through the establishment of international accounting standards. Furthermore, a secondary yet pivotal role has been played by the extension of mandatory sustainability disclosure to a wider range of companies, given the European landscape where SMEs are currently not obliged to disclose any information pertaining to non-financial issues. However, this is to be considered a necessary but not sufficient condition for the effective achievement of the sustainable development goals of the ongoing ESG 'revolution'.

In fact, at least two main problems emerge. The first relates to the effective harmonization of standards through the new initiatives; two of the most important international standard-setting bodies have been moving towards the achievement of this goal but doing so individually. On the one hand, at the European level, EFRAG has been entrusted to respond technically to CSRD, and on the other hand, the IFRS Foundation has established the ISSB for the same purpose. As a result, since there is still no definitive indication of the scope of the future standards to be applied, there is the risk of introducing an additional element of complexity for companies, which would find themselves in an obviously critical situation should the two bodies of standards in analysis be extremely different or consider strongly divergent variables. The common goal of the two entities should, therefore, tend toward the simplification rather than the complexity of disclosure, also with

a view to improving comparability between corporate realities in every aspect, the latter being a crucial element for investors' decision-making and the effective achievement of the objectives of the above-mentioned revolution.

The second problem could be related – especially with regards to SMEs – to the spread of greenwashing practices rather than to the disclosure of reporting since the overwhelming majority of small- and medium-sized companies traditionally use, as input data for disclosure, not very robust sources, given the still generally low level of non-financial performance measurement systems worldwide. Should the sustainability report (or any comparable form of disclosure) become mandatory for smaller companies, appropriate sustainability performance measurement tools and systems should also be mandated to produce data that are correct, auditable and indicative of the company's actual commitment in terms of organizational structure, products and processes. From a forward-looking perspective, in addition to mandatory non-financial disclosure regulations (which, in fact, would concern only the depiction of something that has already happened), both national and international bodies must focus on the actual development of systems to strategically support them. This could be achieved by defining minimum standards that justify the presence of sustainability performance data that are effective and representative of the reality under consideration while maintaining a certain level of standardization that allows for the comparability of reporting.

Having said that, this analysis is not exempt from limitations. For example, the main bibliometric analysis is carried out primarily based on Scopus data and, as a result, may not include all academic works relevant to the study topic in the analysis. Furthermore, the adopted methodological approach may lead to some degree of subjectivity, even if it is still lower than other review methodologies would imply (Comoli et al., 2023). Finally, the overall study is based on a few papers, which may be insufficient to indicate genuine new research avenues. However, the relatively embryonal stage of ESG reporting quality, effectiveness and implementation might confirm the adequacy of this research design and strategy from a methodological standpoint. To circumvent this limitation, the SLNA is often combined with additional research approaches such as global citation score and index analyses, keyword analysis, and burst detection (Comoli et al., 2023). In this case, we integrated the academic literature with recent professional guidelines and/or operational documents so as to make it actual and pertinent to the research objectives.

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