

# The role of finance and the board in corporate reporting

Takeaways from the Think ESG webcast



## Speakers



### Leslie Seidman

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### Jim Campbell

is the Vice President, Corporate Controller and Principal Accounting Officer at Alphabet and formerly the Corporate Controller at Intel.



### Mark Kronforst

is an Ernst & Young LLP Professional Practice Partner focusing on SEC matters, formerly the Chief Accountant at the SEC's Division of Corporation Finance.



### Marc Siegel (moderator)

is EY Americas Corporate and ESG Reporting Thought Leader and a current SASB board member, formerly a FASB board member.

## About this report

On June 24, we hosted the *Think ESG: the role of finance and the board in enhanced corporate reporting* webcast that provided key takeaways for finance professionals on emerging environmental, social and governance (ESG) practices and regulatory and market expectations. It featured professionals with technical and practical experience in corporate reporting and oversight. The webcast addressed board governance, the role of the finance function and regulatory activity. [Click here](#) to watch the on-demand version of the webcast.

## Key takeaways:

- ▶ The regulatory agendas in both the US and the EU are moving quickly. Both could have meaningful ramifications for US-based companies, so it is important for finance professionals to keep abreast of SEC and EU regulatory developments.
- ▶ Corporate boards are increasingly focused on management's approach to ESG matters. It is a strategic issue for a company, as it can impact the ability to attract capital, retain employees and engage with customers, as well as other key stakeholders.

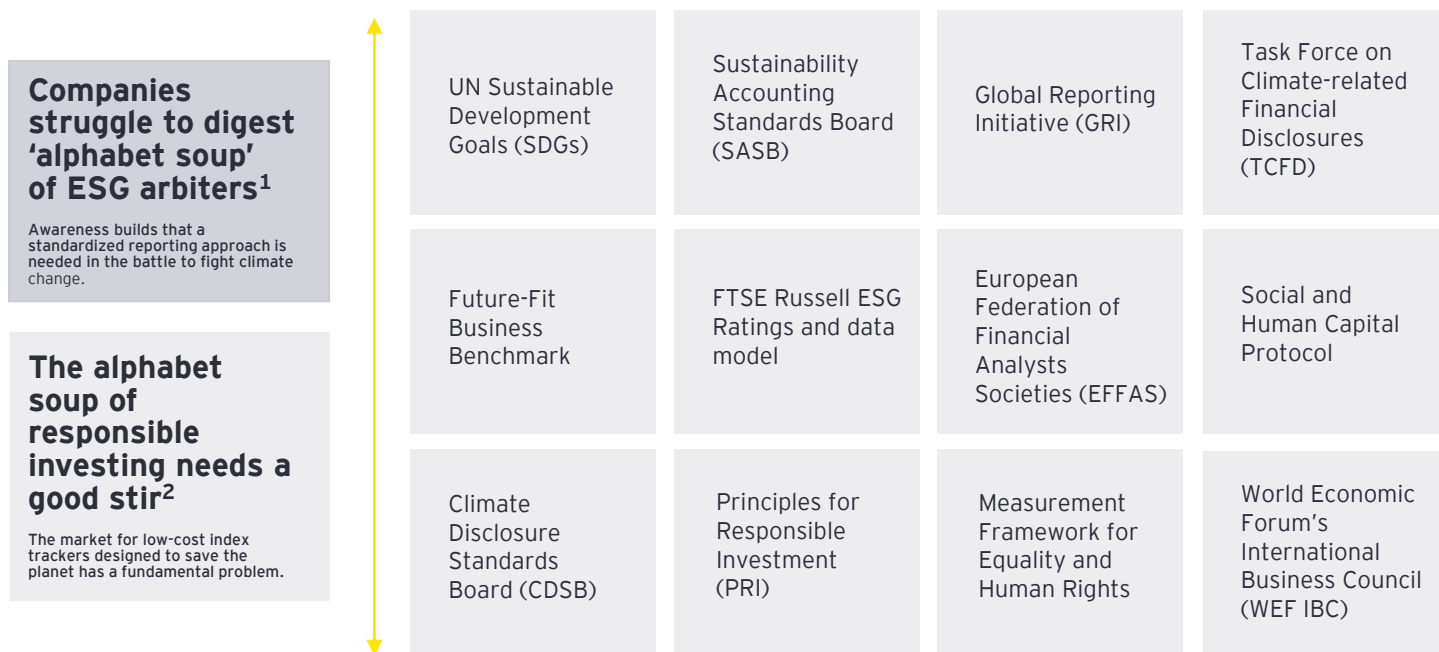
- ▶ As investors, creditors and other market participants are making decisions or rating companies based on available information, it's important for companies to take the opportunity to tell their ESG story or run the risk that others will do so.
- ▶ Depending on the ESG issues that are most important to a particular company, management and the board are likely to organize governance structures accordingly. Finance professionals should recognize that boards and audit committees are increasingly interested in ESG reporting and, in particular, beginning to look to finance to help develop high-quality reporting to investors.
- ▶ The role of the finance function with respect to ESG is still evolving, and some companies are increasing their investment in resources to help enhance the quality of the information rolling into ESG reports. ESG reporting is a shared responsibility, with finance playing a role in processing, controlling and reviewing the data included in sustainability reports.
- ▶ Many companies today report on ESG using different systems from those of financial reporting, with fewer internal controls in place. Some even report ESG information with a significant time lag as compared with the annual financial report. There is not yet a high degree of readiness to report ESG data in the same time frame as financial information nor with the same level of rigor. Finance professionals should prepare now for potential new standards that could be required.

## ESG ecosystem

The ESG ecosystem is fragmented, with many organizations providing recommendations for disclosures, issuing voluntary disclosure frameworks and metrics, or creating ratings. To make this somewhat easier to grasp, we have divided them into the following four categories:

1. **Standard setters** provide specific recommendations for ESG disclosures, such as the Sustainability Accounting Standards Board (SASB) or Global Reporting Initiative (GRI).
2. **Guidelines and frameworks**, such as the Task Force on Climate-related Financial Disclosures (TCFD) and the United Nations Sustainable Development Goals (SDGs), provide high-level, principles-based approaches but not specific disclosure recommendations.
3. **Data aggregators**, such as Bloomberg, accumulate data from third-party sources to make available to customers.
4. **Rating agencies**, using available publicly available information (some also supplement with surveys from the company), formulate a rating or a ranking/score through algorithms.

## ESG reporting landscape: standards and guidance



## SEC updates

The Division of Corporation Finance announced that it is going to assess companies' compliance with the SEC's 2010 climate change guidance. Also, the SEC announced that the Division of Enforcement has set up a task force to look for securities law and disclosure violations. Additionally, in March, the then SEC Acting Chair issued a request for input on how best to regulate climate disclosure. The comment period ended on June 13.

### Themes from comment letters

- Overall, most of the comment letters expressed broad support for the SEC to require some ESG-related disclosure with limited exceptions, with most of the support geared toward climate disclosures. Many investors and those connected to investors suggested that the SEC require a robust set of climate disclosures integrated within annual reports. Additionally, there was support for the SEC to mandate assurance on these disclosures.

While there was general support for requiring companies to provide additional ESG disclosures, there were also concerns about the practical challenges of implementing any new requirements, such as readiness, cost, liability protections and adequate implementation time.

<sup>1</sup> FT.com, Patrick Temple-West, October 2019.

<sup>2</sup> Bloomberg.com, Opinion, January 2021.



Additionally, some commenters expressed concerns about whether Scope 3 greenhouse gas emission disclosures should be included.

There were mixed views on whether new requirements should be principles-based, prescriptive or a hybrid model and how the SEC might incorporate the concept of materiality, if at all. Many companies suggested that the SEC adopt principles-based requirements, while investors or their representatives tended to recommend more prescriptive disclosures. The discussion of the materiality concept centered around whether the definition of materiality would differ from the definition established by the U.S. Supreme Court and be included in a number of the SEC's existing rules. Questions also were raised about whether the SEC could or should require these disclosures even if they are not material. It was noted that the SEC has often considered materiality in the past when considering whether to adopt new requirements, and some explicitly allow companies to omit immaterial disclosure.

Additionally, there was widespread support among the commentators for a single set of global standards, which the International Financial Reporting Standards (IFRS) Foundation is pursuing in earnest.

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### **Ernst & Young LLP (EY US) comment letter**

The EY US comment letter (found [here](#)) reflected the early nature of the SEC's rule-making process; there has been no formal proposal yet from the SEC with specific ESG disclosure requirements. As there appear to be several viable alternatives, the EY US comment letter identified these alternatives and explored how the SEC could make each of them work. The EY US comment letter also discussed issues that could arise as companies transition to the new requirements, and how to best achieve an objective of providing ESG disclosures to investors in the near term while mitigating the practical challenges that exist.

## EU updates

The proposed EU Corporate Sustainability Reporting Directive (CSRD) will increase the number of entities subject to mandatory ESG reporting standards, including a requirement to obtain limited assurance on the ESG information being reported and the maintenance of internal controls. The specific ESG requirements will not be limited to climate matters and will be drafted by the EU's primary financial reporting advisory group (EFRAG). To not disadvantage EU-based companies, the CSRD proposes to scope in certain non-EU-based companies that are either listed on EU exchanges or have significant operations in the EU. As such, multinational companies based in the Americas should monitor regulatory developments in Brussels, as they could have far-reaching impact. It should be noted that the EU objective with the CSRD goes beyond improving investor communications, and, therefore, the regulations will likely consider a broader stakeholder-intended audience.

### Key takeaways:

- ▶ The regulatory agendas in both the US and the EU have been moving quickly – both could have ramifications for companies based in the Americas. Finance professionals should keep abreast of SEC and EU developments.

## Board governance updates

### 1 Has the governance model of ESG changed at boards over the last couple of years?

During the past year, boards of directors have realized the importance of focusing on sustainability issues. Large institutional investors have written letters to CEOs and boards asking them to disclose what they are doing to oversee issues related to ESG, in particular around climate change and diversity and inclusion. There have also been a record number of shareholder proposals related to ESG as shareholders and other stakeholders, such as customers, employees and investors, look to boards to oversee these areas. ESG is a strategic issue, not just a financial reporting issue. Companies can see impacts in both the cost of and access to capital, the employee base and the customer base depending on the level of ESG engagement.

**2 How do you think about the role of the finance function at companies? What should finance professionals be paying attention to over the rest of 2021?**

For most companies, the finance function has not been playing a crucial role regarding ESG. The responsibility of the audit committee varies company by company. Boards are still trying to understand how management views the most material ESG topics for the company and how that can be mapped to the full board or committees within. Boards are beginning to recognize that investors are now making investment decisions and valuing companies based on much more than solely traditional financial statements and are including ESG attributes, so this is an important consideration.

Determining where oversight should take place at the board level (i.e., the board at large and, as applicable, by area or committee, such as the audit, risk, compensation, and nomination and governance committee) is informed by an evaluation of materiality and current board structure. It is important to reflect on what issues are most important to a company. Companies have many communication channels to their investors, including surveys, sustainability reports and investor presentations, to name a few. As such, boards are taking note that these communications may be developed by different functional areas, so they are asking questions, such as who is creating this ESG information, and what are the controls in place, if any, as the data is reported to assess that there is a good process in place for high-quality reporting? It is also important to talk about these matters in the proxy statement. It is a good location to discuss ESG governance matters, including which of the various board committees are involved, so investors can understand how the board is approaching oversight of these items. Since ESG information is used by third parties to create ratings or rankings, it is also important for the company itself to communicate the overall corporate progress on ESG that could appropriately and proactively inform these ratings. If they do not, they risk others creating the narrative.

**3 Is a global set of standards in the cards?**

The IFRS Foundation has committed to launch a new organization, adjacent to the IASB, which will be called the International Sustainability Standards Board (ISSB). It is important to also consider which countries will adopt global standards and principles, the manner in which they will follow them or whether they will opt to create their own or use other standard setters.



There are currently some differences in the demand for ESG information around the world, while at the same time, there is a desire to converge existing ESG standards. A global set of standards may help to address the urgency. At the same time, existing ESG standard setters should conduct post-implementation reviews of what information is being provided as a starting point for analyzing consistency and quality. If information is not currently being provided, why not? This information can and should be leveraged by both the existing standard setters and the new ISSB.

**Key takeaways:**

- ▶ Boards are increasingly focused on which ESG factors are material to the company and how management is reflecting them in strategic planning and risk management. Key ESG issues are being considered by investors, customers and employees in deciding whether and how to engage with a company, which makes it a strategic issue relating to long-term value creation and sustainability.
- ▶ Depending on the ESG issues that are most important to a particular company, management and the board are likely to organize governance structures accordingly. Finance professionals should recognize that boards and audit committees are increasingly interested in ESG reporting and, in particular, are beginning to look to finance to help develop high-quality reporting to investors.
- ▶ As others are making decisions or creating ratings based on all available information, it's important for companies to take the opportunity to tell their ESG story or risk having others do so.

## Finance functions updates

### 1 **How generally is ESG reporting organized? What is the role of finance, and has it changed in the last couple of years?**

ESG reporting has evolved in the last couple of years. Its structure generally is a combination of embedded functional management and support, along with centralized governance and reporting. ESG reporting should be a shared responsibility and provide a basis for better decision-making by both management and investors. Therefore, finance should play a role in quality review before reports are released. Companies are adding additional resources to strengthen reporting and are increasing their investments to address the expanding market and regulatory expectations in preparation of future standards that will potentially be adopted.

### 2 **How ready are companies and their finance functions for reporting well-controlled ESG information?**

There is a wide variety in readiness across companies. Some have relatively mature integrated ESG reporting up through their annual reports, and others have more fragmented reporting utilizing SASB and TCFD frameworks. Generally, there can be latency in terms of ESG reporting compared with financial reporting as it is not real time and often also includes information provided by third parties. For example, many companies report climate information statistics a year in arrears. The buildup to make the systems ready for high-quality annual ESG reporting along the lines of financial reporting drives some of the commentary to the SEC about transition timing.

### 3 **What observations can you make around the concept of materiality in conjunction with ESG reporting?**

Materiality will likely be an increased area of focus from a company point of view and an ongoing discussion, as there is some departure from the SEC framework of materiality with the variety of materiality concepts that are emerging in ESG (i.e., double, dynamic and nested materiality). It will likely be beneficial to have consistent and comparable disclosures with a standard materiality defined by the SEC related to ESG that is consistent with financial reporting.





### **Key takeaways:**

- ▶ The role of the finance function with respect to ESG is still evolving, and some companies are increasing their investment in resources to help enhance the quality of the information rolling into ESG reports. ESG reporting is a shared responsibility, with finance playing a role in controls and review.
- ▶ Many companies today report using systems outside of financial controls, and some even report ESG information with a significant lag. There is not yet a high degree of readiness to report ESG data in the same time frame as financial information nor with the same level of rigor. Finance professionals should prepare now for potential new standards that could be required in the future.

## **Conclusion**

There continues to be significant and rapid developments with everything related to ESG. Regulatory developments and the role of the board of directors and finance function are all moving very quickly. Finance professionals should be aware of possible new mandates coming from regulators around the world, which could impact the content included in filings. At the same time, expectations of audit committees are ramping up, including that the finance function should have some level of involvement with ESG reporting. Some finance functions are increasing their investments such that while they don't expect to be ESG subject-matter experts anytime in the near future, the skill sets of compiling, controlling and reporting information should be brought to bear in creating high-quality sustainability data, irrespective of where it is ultimately reported.

## Additional resources

### 1 **2020 EY Climate Change and Sustainability Services investor survey**

The majority of investors surveyed signal a move to a more disciplined and rigorous approach to evaluating companies' nonfinancial performance. Investors surveyed have become increasingly dissatisfied with the information they received on ESG risks. Nonfinancial performance plays a pivotal role in investment decision-making of the investors surveyed.

Learn more by viewing the [report](#) or reading the [article](#).

### 2 **How and why human capital disclosures are evolving**

A company's intangible assets, which include human capital and culture, are now estimated to comprise, on average, 52% of a company's market value. Businesses are redefining long-term value and corporate purpose through a stakeholder lens. Nonfinancial performance plays a pivotal role in investment decision-making of the investors surveyed.

Learn more by viewing the [report](#).

### 3 **The evolving ESG strategic imperative – webcast**

Panelists discuss strategic imperatives for companies to better communicate how they are creating value through ESG.

[Watch on demand](#).

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