

Key Actions for Establishing Effective Governance Over ESG Reporting

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INTRODUCTION

With ESG information increasingly being used by the capital markets and other stakeholder groups, it has never been more important to ensure that ESG disclosures are of a high quality. Effective governance practices can promote the production of high quality ESG disclosures. To that end, the American Institute of CPAs and Center for Audit Quality have teamed up to provide insight into key actions companies can take to establish effective governance over ESG reporting.

GOVERNANCE OVER ESG REPORTING

Good governance plays a critical role in a company's ability to produce high-quality, accurate and reliable information. However, ESG initiatives are often managed separately from the rest of the business by functions such as sustainability, marketing, corporate communications, or public relations. As a result, sustainability information is generally prepared separately from the finance function and outside of the financial reporting systems—without the necessary governance and internal controls over the reporting process. The processes are generally very manual, often using spreadsheets and may differ among departments, business units and geographical regions.

COMPANIES JUST STARTING OUT

Establishing appropriate governance over the reporting of ESG information is a journey. Companies that are just starting out should identify their most material matters to address, begin with them, and grow from there. This process takes time and should be viewed as a journey.

ESTABLISHING EFFECTIVE GOVERNANCE

To improve the credibility and reliability of sustainability information, effective governance and internal controls are required. The same level of rigor applied to the measurement and reporting of financial information should be applied to sustainability reporting. This precision will lead to greater user confidence in the information and help

drive decisions that create value for the business and stakeholders.

Key Actions

The actions described below form part of an iterative process that will help a company to establish effective governance over reported ESG information (to a level that is acceptable for SEC reporting) and allow for continuous improvements over time.

1. Conduct a materiality or risk assessment to determine which ESG topics are important or 'material' to the organization, its investors and other stakeholders.

Conducting a materiality assessment or risk assessment allows a company to identify and prioritize the ESG matters that are most critical to the business, its investors and other stakeholders. This enables a company to focus its effort on its most critical (or 'material') ESG matters and also helps the company make optimal use of limited company resources. Although various efforts are underway to encourage companies to disclose a minimum set of pre-determined ESG metrics in public financial filings, a company would nevertheless still need to conduct its own materiality or risk assessment to ensure that it is focusing on ESG matters that are considered material to the company, its investors and other stakeholders.

Several existing resources share insights or tools for performing ESG materiality assessments. Certain sustainability reporting standards and frameworks provide considerations for how material matters should be identified when reporting in accordance with those standards and frameworks. During the materiality assessment phase, a company may not yet have decided which reporting standard or framework it plans to report in accordance with, but reviewing the various approaches provided in those standards and frameworks could provide a company with helpful considerations to use as a starting point for establishing its own materiality assessment process. Helpful resources include:

+ [Sustainability Accounting Standards Board \(SASB\) Materiality Map](#) – This map identifies sustainability issues that are likely to affect the financial condition or operating performance of companies within an industry.

- + **Global Reporting Initiative (GRI) Standards** – The discussion of the materiality reporting principle in *GRI 101: Foundation 2016* provides considerations for the identification and prioritization of material matters.
- + **International Integrated Reporting <IR> Framework** – The discussion of the guiding principle of materiality in the <IR> Framework sheds light on what “the materiality determination process” may involve.
- + **Task Force on Climate-related Financial Disclosures** - The Financial Stability Board established the TCFD to develop recommendations for more effective climate-related disclosures that could promote more informed investment, credit, and insurance underwriting decisions and, in turn, enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system’s exposures to climate-related risks.

2. Implement appropriate board oversight of material ESG matters.

As with other critical company matters, board members should be involved in the governance and oversight of material ESG matters. The board has an important role to play in setting the tone and seeing that company ESG efforts are appropriately prioritized. Further, just as boards play a role in providing independent oversight and establishing and maintaining effective governance over financial reporting, boards should assume a similar role in sustainability reporting. This is especially true for ESG matters that will be reported in a company’s regulatory filings.

A company can take various steps to strengthen ESG governance at the board level. They include incorporating or making available ESG experience and expertise at the board level, clearly defining ESG-related roles and responsibilities of the board or other committees, ensuring board oversight of the most critical ESG matters, developing ESG-related policies, and implementing regular monitoring of company ESG performance.

Several existing resources offer insights for strengthening board oversight of material ESG matters.

- + **ESG Oversight Framework for Directors: Demystifying ESG for Board Members**- This SSGA publication includes guidance designed to help boards prioritize ESG within their organizations and is specifically geared toward SSGA investee company boards.
- + **Guidance for Applying Enterprise Risk Management (ERM) to Environmental, Social and Governance (ESG)-related Risks** – A comprehensive publication by the Committee of Sponsoring Organizations (COSO) and the World Business Council for Sustainable Development (WBCSD) shares guidance designed to help risk management and sustainability practitioners apply ERM concepts and processes to ESG-related risks. The chapter “Governance and culture for ESG-Related Risks” provides numerous insights into board involvement in ESG matters.

- + **The Role of Auditors in Company Prepared ESG Information: Present and Future** – Although this CAQ publication primarily outlines how investors are using ESG information and the evolving, more prominent role of auditors in advancing the reliability, comparability, and relevance of this reporting, the document also includes a section on ESG Considerations and Questions for Boards.

3. Integrate/align material ESG topics into the enterprise risk management process.

Given the pervasiveness of ESG-related risks and the fact that they constitute most of the world’s top 10 global risks,¹ it is essential that these risks be managed as part of a company’s overall ERM process - not as separate, standalone risks. Managing ESG risks as part of overall ERM will help ensure that all risks receive the appropriate attention and resources. Further, this will play an important role in reducing the possibility that material ESG-related risks reported in sustainability reports or on a company’s website are not omitted from regulatory filings. According to a WBCSD study, which compared WBCSD member

¹ See <https://reports.weforum.org/global-risks-report-2020/chapter-one-risks-landscape/>.

company sustainability and risk disclosures, on average only 29 percent of the areas deemed to be “material” in a sustainability report were disclosed in a company’s legal disclosure of risks.²

A helpful resource that includes comprehensive guidance for incorporating ESG-related risks into broader enterprise risk management is the COSO and WBCSD publication, *Guidance for Applying Enterprise Risk Management (ERM) to Environmental, Social and Governance (ESG)-related Risks*. The guidance is designed to help risk management and sustainability practitioners apply ERM concepts and processes to ESG-related risks.

4. Integrate ESG matters into the overall company strategy.

Incorporating ESG into the overall strategic planning process will enable a company to develop an ESG strategy that is informed by the broader company vision and mission. Similar to integrating material ESG topics into the ERM process, having an integrated strategy will help to further reduce the risk of omission of material ESG-related matters from regulatory filings.

Resources that provide insights for integrating ESG matters into overall company strategy include:

+ *Guidance for Applying Enterprise Risk Management (ERM) to Environmental, Social and Governance (ESG)-Related Risks* – The chapter on *Strategy and objective-setting for ESG-related risks* provides insights for integrating ESG matters into the overall company strategy.

5. Implement effective internal control over the ESG data collection, processing and reporting process.

A company’s ability to provide accurate and reliable ESG information to investors and other stakeholders depends, in large part, on the design and effectiveness of the company’s internal controls (i.e., the processes, policies and procedures in place regarding measurement and reporting). Applying the same level of rigor to the processes and internal controls for measurement and reporting of ESG

information as is applied in financial reporting could help improve internal control over ESG reporting. This is particularly important where ESG information is to be reported in regulatory filings alongside high quality, reliable financial information.

Actions that companies can take to improve internal control over ESG reporting include: setting the tone (see action 2 above), developing and documenting sustainability reporting policies and procedures, developing a data management system, developing and documenting control activities, involving the right functions/resources in the process (e.g., finance, internal audit), and taking steps to monitor policies and processes and make necessary improvements over time.

Leveraging the COSO Internal Control–Integrated Framework to Improve Confidence in Sustainability Performance Data, is a comprehensive resource which includes guidance for applying the COSO *Internal Control–Integrated Framework* to ESG reporting. The publication indicates that SEC registrants already have a control framework in place to evaluate and support assertions regarding the effectiveness of ICFR and that companies likely would find it most effective to leverage the control framework currently used in financial reporting to establish internal control over ESG reporting. The publication explores how this might be done and includes “Key Takeaways from Market Outreach” which shares practical insights gained from more experienced companies regarding leveraging existing expertise and controls, and enabling technologies and platforms to establish and maintain an effective system of internal control over ESG reporting.

CONCLUSION

As ESG information is increasingly used by the capital markets and other stakeholder groups, such information needs to be reliable, credible, and well supported. Good governance plays a critical role in a company’s ability to produce high-quality, accurate and reliable information. While there is not a one size fits all approach, this document provides a starting point highlighting key actions companies can take in their journey to establish effective governance over ESG reporting. •

² See <https://www.wbcsd.org/Programs/Redefining-Value/Business-Decision-Making/Assess-and-Manage-Performance/Resources/Sustainability-and-enterprise-risk-management-The-first-step-towards-integration>.



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