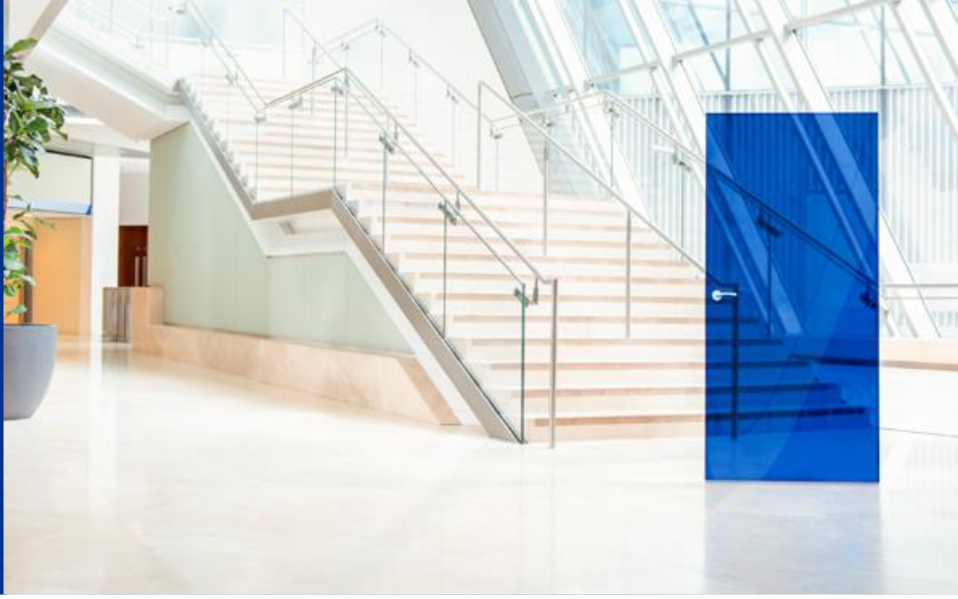
An audit committee lens on ESG reporting

KPMG Audit Committee Institute



Expectations for public and private companies to build sustainability and awareness of environmental, social and governance (ESG) issues into their business have grown significantly in a year impacted by a global pandemic, racial injustice, and economic weakness, as well as the ongoing effects and long-term impact of climate change.

Such ESG risks and opportunities and their impacts on long-term value creation are top of mind for investors and other stakeholders. They want to understand which issues are of greatest risk or strategic significance to the company, how they are embedded inti the company's core business activities, and whether there is strong executive leadership behind the ESG efforts as well as enterprise-wide buy-in.

To that end, boards should encourage their management teams to reassess the scope and quality of the company's sustainability and ESG reports and disclosures. How is the company benchmarking against peers? What reporting frameworks have been considered? Are risks explicitly stated and disclosure provided on how they are mitigated? Is the link to the strategy clear?

How oversight for ESG strategy is handled at the board level is often a matter of preference. Many companies have separate committees dedicated to the oversight of environmental, health and safety issues; others include ESG oversight within the governance committee. Yet, no matter where the issues sit at the board level, the intensity of data and information in sustainability reporting brings the audit committee's expertise into play.

For boards and audit committees taking a deeper look at the company's ESG reporting practices, here are some critical questions to consider:

What are the ESG topics that align to the company's and stakeholders' priorities?

Audit committees should take time to understand stakeholders' priorities and the company's material ESG issues, particularly, where those two topics overlap.

Sometimes referred to as an ESG materiality assessment, this practice helps focus decisions on corporate initiatives as well as reporting strategies. Fundamentally, reporting should reflect both what the company is doing now and where it is going, with accompanying metrics and goals.

Is the company currently reporting on its ESG efforts, and where?

The data's importance to a company's ESG strategy, including financial materiality, should align with corresponding regulations and levels of risk associated with the data. This should determine the reporting method. Of course, ESG information included within the annual report should be monitored with the same rigour as conventional financial data. Audit committees should be probing the risks that come with different approaches to sharing these metrics as stakeholder demands increase.

Are there established processes and controls in place for data collection and reporting?

Collecting data in a consistent method is important, especially for businesses with global operations and multiple product lines. In some cases, there is an established standard that is accepted by almost all investor groups. For example, the Greenhouse Gas Protocol is widely recognised as a way to report on emissions.

Still, tracking greenhouse gas emissions means companies need to have all those responsible for collecting data to gather it in the same way. Every level of the business should understand the metric, and how often it should be reported among other criteria. The audit committee line of inquiry should focus on understanding the procedures and controls in place.

What level of assurance is the company getting on ESG metrics? What is being assured, by whom, and what is the value of the assurance?

There's no single approach to ESG assurance. While it may be distinct for every industry and company, it's critical for companies to begin to identify their priorities before pressure from customers, shareholders, and others push to accelerate the company's timeline. Carbon, as described above, is a common and oft-recommended first place to start because standards are well-known.

Audit committees are best positioned to understand which metrics merit assurance. For example, labour in the supply chain could be a key area where a retail company's customers may want assurance. Or a consumer goods company's share holders may want assurance on their claims of sustainable sourcing. Given its understanding of the rigour required to get the numbers right, the audit committee can help the company decide how far the journey goes, even potentially working toward assurance of a full sustainability report.

How should audit committees think about value creation and competitors when engaging on ESG?

Audit committees should take steps to understand the business and competitive environment regarding ESG strategy and reporting. What are competitors measuring and reporting? Are there emerging regulatory requirements that a company should be aware of?

Understanding the current landscape and the company's way forward, coupled with strategic investment in data collection and integrity, not only responds to stakeholder demands, but also may expand an organisation's perspective, exposing new risks to its business model along with opportunities for growth and transformation. This is the true significance of bringing standardisation and rigour to ESG measurement and reporting.

Developing a clear ESG strategy, along with a standardised reporting process, can set a company apart from its competition as investors, customers, and other stakeholders increase their scrutiny. Regardless of whether a company is still developing goals and policies, focusing on metrics and reporting, or working to push the limits – effectively addressing ESG strategy and reporting should be a long-term objective aligned with the company's core business.

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