On the 2025 ESG committee agenda

KPMG Board Leadership Center

How companies address climate change, diversity issues and other ESG risks is now viewed – by investors, research and ratings firms, activists, employees, customers, and regulators – as fundamental to business and critical to long-term sustainability and value creation. Especially when facing economic headwinds, oversight of these risks and opportunities will be a significant challenge, involving the full board and potentially multiple board committees.

There has been a steady increase in the number of boards that have established a committee to address issues that fall under the sustainability banner, and many companies now have some form of sustainability or ESG committee. The exact names of these committees vary, as do their remits – which cover a wide range of topics, including climate change, decarbonization, biodiversity, human rights, labor standards, good citizenship, workforce engagement, and diversity, equity and inclusion Drawing on insights from our interactions with directors and business leaders, we highlight seven issues for ESG committees to keep in mind as they consider and carry out their 2025 agendas.

Clarity of purpose

Oversight of ESG risks and opportunities is a significant challenge, involving the full board and potentially multiple board committees. For example, elements of climate and of diversity, equality and inclusion oversight likely reside with the audit committee, other committees and the ESG committee.

Consideration needs to be given to coordination between committees as well as the information flows to the committees from the corporate functions (risk, operations, legal, etc.) and also from the committees to the whole board. For example, climate change might initially appear to reside with an ESG committee, but it will also likely touch the audit committee (data, the systems that produce that data, and corporate reporting); the remuneration committee (management incentives); and the nomination committee (skills and experience of board members and senior management). Overlap is to be expected, but this puts a premium on information sharing, communication, and coordination between the committees. It also demands that committees have the expertise to oversee the issues delegated to them.

An ESG-competent board

Oversight of ESG risks – and equally importantly, the opportunities – starts with an ESG-competent board. Not every board member needs to have deep-dive ESG expertise, but the board as a whole needs to have ESG risks – as well as their impact on long-term value creation – top of mind. They need to understand which issues are of greatest risk or strategic significance to the company, how they are embedded into the company's core business activities, and whether there is strong executive leadership behind the company's response to ESG matters.

An ESG committee can play an active role in educating not just the committee members, but the whole board, on ESG issues including the landscape of stakeholder expectations and demands. Questions to ask are:

- Is the board ESG literate? Is it structured to engage and report meaningfully on ESG issues potentially as diverse as modern slavery and human rights, energy efficiency and renewable energy transition, scope three emissions, and other supply chain issues?
- Does the board evaluation process assess whether the board has the right mix of skills and whether the ongoing development activities are sufficient?
- How does the board get ESG literate?
- Are ESG matters (including issues around diversity and inclusion, empathetic leadership) a factor when hiring board members and the executive team?

Work with the company secretary and senior executives to determine how best to get up to speed and build a strong foundation for informed oversight. Consider one-on-one conversations with the key players in the business and deep dives within committee meetings, alongside in-house briefings and externally organized training opportunities.

Engage proactively with shareholders and other stakeholders

Investors are increasingly holding boards accountable for ESG matters. They are eager to understand whether boards have sufficient knowledge and adequate processes to oversee the management of the key ESG-related risks and to provide informed, proactive guidance as stewards of long-term value.

And beyond the investor community, other stakeholders, whether that be employees, customers or the communities that provide companies their licence to operate, are also voting with their feet against companies they perceive to be paying insufficient attention to ESG issues – whether that be related to climate change matters, diversity and inclusion issues and the treatment of individuals, or the company's contribution to society through (say) responsible taxation.

Good stakeholder engagement – particularly through the supply chain – can also provide an opportunity for the company to encourage others to behave responsibly and "do what's right over the long-term."

To best understand the views of its key stakeholders and the ability of the company to exert responsible influence, the board should request periodic updates from management as to the effectiveness of the company's engagement activities:

- Does the company engage with, and understand, the ESG priorities of its largest shareholders and key stakeholders?
- Are the right people engaging with these shareholders and stakeholders – and how is the investor relations role changing?
- What is the board's position on meeting with investors and stakeholders? Which independent directors should be involved?
- Will the organization be open to criticism from activists? Does the board have a roadmap to defend itself?

In other words: Is the company providing investors and other stakeholders with a clear picture of its ESG performance, its challenges, and its long-term vision (or ambition) – free of "greenwashing"? Investors, other stakeholders, and regulators are increasingly calling out companies and boards on ESG-related claims and commitments that fall short; and all indications are that they will continue to do so.

Embed ESG, including climate risk and diversity issues, into risk and strategy discussions

How companies address ESG risks is now viewed – by investors, research and ratings firms, activists, employees, customers, and regulators – as fundamental to business and critical to long-term sustainability and value creation.

Climate change as a financial risk has certainly become more urgent over the last few years – not least because of the accelerating physical impacts of the climate crisis – the frequency and severity of floods, wildfires, rising sea levels, and droughts.

But for many, the associated transition risks are as important and arguably more immediate (whether that be tax and regulatory interventions, technological changes, or customer behaviors). A challenge for the ESG committee is to help ensure that these transition risks are properly addressed as the company plots its future strategy – together with other climate change risks.

Equally, some of the challenges within the "S" of ESG have rapidly risen up the agenda in recent years. Social factors such as how a company manages its relationships with its workforce, the societies in which it operates, and the political environment, are now central to a company's financial performance. Wellbeing and diversity issues have become mainstream.

Several fundamental questions should be front and center in boardroom conversations about the company's ESG journey – not least how material ESG risks are identified and assessed in line with the organization's risk appetite. Embedding ESG identification and assessment into the existing enterprise risk management process might be a good starting point, however it is important to avoid focusing only on the downside risks. The ESG committee should also encourage management to consider the potential for innovation, disruption and value creation posed by ESG activities. Businesses that see through effective ESG investments to realize transformative growth will have the upper hand as economies strengthen, whereas delaying key ESG initiatives could leave businesses behind the curve and exposed to rapidly changing stakeholder expectations and regulation.

After determining which ESG issues are of strategic significance, how is the company embedding them into core business activities (strategy, operations, risk management, incentives, and corporate culture) to drive long-term performance? Is there a clear commitment and strong leadership from the top, and enterprise-wide buy-in?

On behalf of the board, the ESG committee could consider:

- How is the ESG lens applied to the organization's strategic thinking?
- Is ESG thinking incremental to a bolt-on to the existing strategic thinking or is it transformative?
- Is the board playing an active role in developing and supporting any transition plan? Is it an iterative process – with milestones and opportunities to recalibrate – and does it bring in perspectives from throughout the organization and beyond?
- Does the process challenge the validity of the key assumptions on which the company's strategy and business model are based? Is there a case for taking a "clean sheet" approach to the strategy/business model, asking what our business would look like if we started up today?
- How does the board establish a culture that supports the transition towards a more purposeful ESG-oriented organization?
- How does the board address the tensions between the "E" and the "S"?
- Are the incentives connected with executive compensation and the compensation philosophy of the organization as a whole a fit for purpose? When compensation becomes intertwined with something like ESG, other systems and processes quickly fall in line: recruitment, training and development, strategic planning, performance management.
- What metrics are monitored and reported to ensure the organization is on track?

Driving the transition toward a more purposeful ESG-oriented organization through culture

Given the critical role culture plays in integrating ESG factors throughout an organization, the ESG committee can play a role in helping the board take a more proactive approach in understanding, shaping, and addressing any necessary cultural changes by considering:

- Does the board understand the culture it wants within the organization?
- Are key processes (hiring, promotion, reward) aligned with desired culture? How is poor behavior addressed?
- Is culture embedded into decision-making processes? An organization is not truly living its values until it costs it money. There has to be a price to pay such as turning down a profitable business opportunity because the customers/clients values or modus operandi are at odds with your own organizational culture.
- How does the board measure the culture and get assurance that it is what they think it is? What are the different inputs? How can the board pull them together?
- Is the board leading the charge from the top? Are the board and the senior executive team presenting a unified front? Culture starts with the board and it is often the little things that matter.

Monitor management's preparations for new climate reporting frameworks/standards and oversee the quality and reliability of the underlying data and reported metrics

The ESG committee can encourage management teams to reassess the scope and quality of the company's ESG reports and disclosures. Keep it simple and transparent – integrating with the business model to focus on what matters.

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?

Some critical questions for the ESG committee to consider include:

- What are the ESG issues that align most closely to the company's and stakeholders' priorities?
- What are the ESG issues that drive the company's financial performance and prospects?
- Is the company currently reporting on its ESG efforts, and where?
- Do the company's disclosures comply with the appropriate laws, regulations and sector best practices?
- Do the company's disclosures reflect both what the company is doing now and where it is going, with accompanying metrics and goals?
- Is ESG-related data handled appropriately and aligned with corresponding regulations and the level of risk associated with the data?
- Is the ESG information included within the annual report monitored with the same rigour as conventional financial data?
- Is the company free of greenwashing? Beyond the reputational risk, greenwashing has been an area of significant regulatory focus in 2024.
- What are competitors measuring and reporting? Are there emerging regulatory requirements that a company should be aware of?

One of the biggest challenges boards face is staying on top of rapidly evolving ESG standards and regulations given the fast-changing landscape. This means keeping abreast of what is now in force, coming up for implementation and on the horizon. So, in the coming months, the state of the company's preparedness will be a priority – requiring periodic updates from management including gap analyses, materiality assessments, resources, assurance readiness and any new skills needed to meet regulatory deadlines.

Of specific focus for many is the EU's Corporate Sustainability Reporting Directive (CSRD) which is driven by the concept of double materiality and requires in-scope companies to prepare extensive sustainability reports, including information on how their activities and value chain affect the environment and people, as well as how sustainability-related matters affect cash flows, financial position and financial performance. Such reporting requirements have a consequential impact on the scope, volume and granularity of sustainability-related information to be collected and verified. Companies in scope will need to have robust governance and controls to enable them to:

- perform effective double materiality assessments; and
- deliver the granular sustainability information needed to meet the qualitative characteristics of useful information.

A key question is whether management has the necessary talent, resources, and expertise – internal and external – to gather, organize, calculate, assure, and report the necessary data, and to develop the necessary internal controls and procedures to support both the regulatory and any voluntary climate disclosures.

The ESG committee should be cognizant that the finance function shouldn't be working in isolation. For many companies, climate (and other ESG) reporting will require a cross-functional management team from legal, finance, sustainability, risk, operations, IT, HR, and internal audit. Identifying and recruiting climate and GHG emissions expertise for a climate team and implementing new systems to automate the data-gathering process will be essential.

We recommend the following areas of focus in addition to ensuring management's climate-related expertise and resources:

- Management's plans to meet compliance deadlines, considering materiality and double materiality.
- Disclosure controls and procedures, and internal controls.

It is vital that ESG and/or audit committees are equipped to challenge management appropriately and resist any inclination to focus only on the good news stories.

Preparations will be a complex and expensive undertaking, involve difficult interpretational issues, and likely may take months, or perhaps years, for some companies. Disclosure will be an iterative process (apart from any phase-in). Companies should closely monitor legal and regulatory developments and consider the disclosures of their peers and others in their industry.

Getting ready for assurance

The board, perhaps through its committees, should understand how management are collecting, measuring, and reporting ESG data. Many companies have standalone ESG teams that are responsible for ESG-related reporting but may lack expertise around internal controls.

Finance may be able to offer advice, leadership and resources such as process and control templates to the broader organization given their knowledge of the control systems and processes used for financial reporting. This will become increasingly important as companies start to seek assurance and integrating ESG information into their annual reporting.

The ESG committee should work with management to identify which information would be considered material to stakeholders and the business, and therefore merit assurance.

For example, labor conditions in the supply chain could be an area in which a retail company's customers may want assurance, while shareholders of a consumer goods company may want assurance on claims of sustainable sourcing.

It is essential that what companies report to the public is accurate, robust and credible. Aside from being a regulatory compliance requirement in some cases (e.g., CSRD), assurance will give companies the opportunity to test any significant judgments they may have made in measuring ESG metrics, spur investor confidence, reduce exposure to risks, and support in securing access to better financing.

CSRD reporting is subject to mandatory assurance from the first year of application. Starting in 2025 for those companies producing the first reports on the financial year starting on or after 1 January 2024, all companies in scope for CSRD are required to obtain limited assurance from a third-party assurance provider from their first reporting year.

We have seen many companies restate some of their ESG metrics and anticipate some modified assurance opinions in the first round of CSRD reporting due to a lack of available evidence to support the disclosures. Audit committees should be proactively asking management how they are going to mitigate this risk – not least because a modified assurance report might impact the way investors vote at the annual general meeting. Boards and audit committees should be prepared to articulate their position and manage the risk of any votes against the reappointment of directors.

Current status and further developments in Switzerland

Public interest entities were required to publish a report on non-financial matters for the financial year 2023 for the first time. The content of such reports is similar to that of the EU Non-Financial Reporting Directive (NFRD). The Federal Council has specified that reporting on climate-related matters has to be based on the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD).

In June 2024, the Federal Council opened the consultation process to align the current legal obligations with international developments. The proposed changes are very similar to the CSRD:

- According to the Federal Council's proposal, the scope of companies subject to the new reporting requirements is significantly enlarged (from public interest entities to private companies of economic importance).
- Instead of a somewhat general report on non-financial matters, a sustainability report in accordance with CSRD will be required.
- Sustainability reports will be subject to assurance by an external provider.

The consultation period ended in October 2024. The Department of Justice has received about 180 submissions that must now be analyzed in preparation for parliamentary discussion of the proposal. No official date has been communicated for the start of parliamentary deliberations.

Boards need to closely follow these developments. Although the draft contains a two-year transition period, companies should already be taking the proposal into account when deciding which sustainability standard to apply. Some listed companies have already decided to prepare their sustainability reports in accordance with European sustainability reporting standards, whether due to a significant footprint in Europe or an active choice to adhere to one standard worldwide.

We recommend performing a thorough analysis of costs and benefits, focusing not only on new reporting requirements but also on how to embed ESG holistically into risk and strategy discussions.

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- *On the 2025 board agenda*
- *On the 2025 audit committee agenda*

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Contact us

KPMG AG
Badenerstrasse 172
PO Box
8036 Zurich
Switzerland

kpmg.ch

Rolf Hauenstein
Partner, Head of the
Board Leadership Center
KPMG Switzerland

+41 58 249 42 57
rhauenstein@kpmg.com

Prof. Dr. Reto Eberle
Partner, Member of the
Board Leadership Center
KPMG Switzerland

+41 58 249 42 43
reberle@kpmg.com

Silvan Jurt
Partner, Head Corporate
Sustainability Services
KPMG Switzerland

+41 58 249 50 25
sjurt@kpmg.com