ESG Financial Reporting Concepts

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Lynn Fountain has over 38 years of experience spanning public accounting, corporate accounting and consulting. 20 years of her experience has been working in the areas of internal and external auditing and risk management. She is a subject matter expert in multiple fields including internal audit, ethics, fraud evaluations, Sarbanes-Oxley, enterprise risk management, governance, financial management and compliance.

Introduction

- The newest acronym in the business community is ESG.
  - Environmental, Social and Governance
- ESG concerns focus primarily on two elements:
  - Actions companies take to ensure their own practices have a positive impact on society and the environment
  - Actions companies take to manage business and financial risks related to those matters.
- Today's focus will be on the accountant's role in ESG.

Agenda

- Evaluate the concepts involved in ESG
- Determine responsibilities of accountants, management and the board
- Examine various accounting considerations
- Consider impacts on financial reporting and DCP

POLLING QUESTION

Which topic would you like to be covered during next month's Lunch & Learn webinar?

A. Further detail on ESG requirements
B. Need for IT literacy in the accounting field
C. The rise of accounting automation
D. Forensic accounting

Concepts of ESG

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What is ESG?

“E” — Environmental: Climate change is a true risk to businesses.

- One of the most significant concerns of ESG is **environmental**.
  - Investors’ demand enhanced information about how companies are approaching environmental sustainability. (Sustainability accounting).
  - The foundation of sustainability reporting is for an organization to identify and prioritize its impacts on the economy, environment, and people — to be transparent about their impacts.

“E”

- Environmental issues in today’s world span far and wide.
- There are four main areas that may impact the activities of a business:
  - Climate change
  - Pollution
  - Sustainability
  - Waste reduction

https://f.hubspotusercontent40.net/hubfs/5091640/PDFs%20and%20Document%20Downloads/Antea%20Group%207%20Steps_ESG%20Program.pdf

"S"

"S" — **Social**: Regulators/investors want companies to focus on their **social** impact.

- Questions being posed include:
  - How a company can manage relationships with its workforce, the societies in which it operates, and the political environment.
  - What social factors can affect a company's financial performance, ranging from short-to long-term challenges.
    - Social factors to consider include a company's strengths and weaknesses in dealing with social trends, labor, and politics.

https://www.spglobal.com/en/research-insights/articles/what-is-the-g-in-esg

"S" *(cont'd)*

Social factors don't just depend on how consumers will judge a company's behavior. Other events include:

- Geopolitical events that prevent companies from producing or distributing their products
- Labor issues
- Risks that come with the safety implications of a product or the politics of a company's supply chain
- Complex social dynamics, from surges in online public opinion to physical strikes and company boycotts by different groups

https://www.spglobal.com/en/research-insights/articles/what-is-the-g-in-esg

“G”

”G” — Governance: In today’s world, all stakeholders expect companies to ethically manage their businesses.

- Stakeholders are interested in how companies address **governance** processes including business ethics, risk management legal compliance.
- The “G” in ESG refers to the governance factors of decision-making.
  - This extends from sovereigns’ policymaking to the distribution of rights and responsibilities among different participants in corporations, including the board of directors, managers, shareholders, and stakeholders.

https://www.spglobal.com/en/research-insights/articles/what-is-the-g-in-esg

"G" *(cont'd)*

- Governance is the rules and procedures for countries and corporations and allow investors to screen for appropriate governance practices.
- The purpose of the corporation, the role and makeup of boards of directors, and the compensation and oversight of top executives have emerged as core issues in companies' corporate governance structures.

https://www.spglobal.com/en/research-insights/articles/what-is-the-g-in-esg

ESG Program

ESG programs are not a one size fits all.

- Organization's must take a disciplined approach to identifying what elements are required within their program.
- Involves assessing the organization's needs at several levels.

ESG Program

STEP ONE

Determine business specific ESG issues

STEP TWO

Evaluate existing programs

STEP THREE

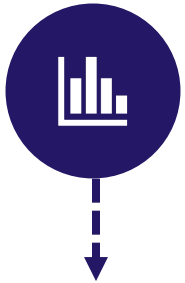
Identify gaps from current state

STEP FOUR

Set goals and framework plan for ESG

STEP FIVE

Develop actionable plans and KPI measurements



STEP SIX

Report progress

See Appendix on Program Considerations Recommendations

Roles and Accounting Considerations For Financial Reporting of ESG

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Financial Reporting ESG Roles

- Considering the framework outlined on the previous slide, what roles must the Board, Management and Accountants take?
- Armed with analytical skills, business knowledge and the ability to understand/apply reporting standards, accountants are positioned to work in several areas when addressing ESG concerns including:
  - Reporting/Cost Analysis/Audit and assurance activities.
- **Reporting** — Financial systems and tracking systems could be modified to incorporate environmental and social information.

Financial Reporting ESG Roles

Cost analysis — Professionals frequently analyze investments using data from analysis of economic profits to make decisions relating to social and environmental initiatives.
They may evaluate:

- Purchasing decisions and cost/benefit impact (E & S)
- Evaluating facility and location choices (E & S)
- Considering energy efficient concepts (E)
- Tracking emissions or natural resource usage (E & S)
- Evaluating manpower needs (G)

- These can all be extended to the collection, analysis and reporting of non-qualitative information.

Financial Reporting ESG Roles *(cont'd)*

- **Audit and assurance services** — Financial statement integrity requires clear processes and procedures and internal controls.
  - Accountants can provide auditing and assurance on CSR reports.
  - Systems in place and reports produced can be audited by external independent groups or individuals.

Financial Reporting ESG Roles *(cont'd)*

- The Center of Audit Quality (CAQ) found 95% of S&P 500 companies had detailed ESG information publicly available primarily outside of an SEC submission.
- Audit committees indicated 66% of their companies issue an ESG report.
- 69% obtain or are actively discussing obtaining third-party assurance on components of ESG or sustainability data.
- 10% of audit committees responded as having oversight responsibility for ESG reporting.
- All of these findings point to the need for enhanced DCP on ESG.
- CAQ recommendations on AC involvement outlined on next slide.

CAQ Recommendations

- Focus on internal/DCP for metrics publicly disclosed in a sustainability report.
- Work closely with other committees to understand how ESG risks are identified and prioritized and how materiality is defined.
- Understand connection between ESG strategy and related goals and metrics — and how management considers any impacts it may have on the FS's
- Coordinate ESG/risk oversight connections between committee members.
- Monitor assurance-related activities and oversee any third-party providing that assurance.

https://www.thecaq.org/wp-content/uploads/2022/01/caq-deloitte-audit-committee-practices-report_2022-01.pdf

Financial Reporting and DCP

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Financial Reporting and DCP

- Companies are increasingly disclosing non-financial key performance indicators around environmental, social, and governance (ESG) matters. This includes:
  - Corporate environmental footprint
  - How the company treats employees
  - How leadership operates.
- These Non-financial performance disclosure provides insight into how management is navigating global trends, risks, and opportunities.
  - Information beginning to appear in financial reports like 10-Ks, may help stakeholders assess a company's long-term resilience and value.

Financial Reporting and DCP *(cont'd)*

- The Sustainability Accounting Standards Board (SASB) serves as a foundation for reporting the non-financial information investors demand in addition to financial information, when making investment decisions.
  - Companies must consider if non-financial information they report meets investor needs.
- In June 2020 The Investor Advisory Committee of the SEC recommended the SEC promulgate specific DP regarding ESG topics.
  - Under current SEC regulations, the disclosure of ESG issues is required only if "material".
- In March 2021 the SEC announced the creation of a Climate and ESG Task Force in the Division of Enforcement.
  - The task force requested comments from the public.
- Public comments are available at: https://www.sec.gov/comments/climate-disclosure/cll12.htm

Financial Reporting and DCP *(cont'd)*

- The SEC expects to see investment advisers and advisers to private funds providing accurate disclosures of ESG investing strategies.
  - They also expect policies, procedures, and practices be implemented that are consistent with their ESG-related disclosures.
- For advisers who engage in ESG investing, Division's staff will focus on the following:
  - *Portfolio Management*: Whether the Adviser's practices related to ESG are consistent with written policies, procedures, and disclosures regarding ESG investing approaches.

Financial Reporting and DCP *(cont'd)*

- *Proxy Voting*: Whether the Adviser's public ESG-related proxy voting claims are consistent with internal ESG disclosures and marketing materials
- *Regulatory Filings and Marketing Materials*: Whether the Adviser's materials are consistent with actual practices and performance results, are timely updated, and contain material disclosures required.
- *Compliance Programs*: Whether the Adviser's written policies sufficiently address the Adviser's ESG investing analysis, decision-making processes, and appropriate compliance oversight.

Financial Reporting and ESG

- As more ESG issues come through the financial disclosure process, companies may be expected to provide more specifics surrounding exact environmental, social or governance issues the company is dealing with.
- Companies should be preparing now and examining whether their financial disclosures adequately acknowledge systemic risks.
- Materiality is considered dynamic and ever-changing.
  - As we navigate through the current economic crisis, organizations should continue to focus on the future and how ESG risks could impact their operations.

POLLING QUESTION

Has your organization considered some of the elements we have discussed related to ESG disclosures?

A. NA
B. Yes
C. No

Summary

- ESG issues are becoming front and center to disclosure issues.
- Companies should pro-actively monitor the horizon and begin to strategically evaluate their current sustainability reporting to determine how it may need to be adapted to formal SEC DCP.

POLLING QUESTION

Do you currently subscribe to an accounting research service?

A. Yes, I have a subscription to CCH Accounting Research Manager
B. Yes, I subscribe to another research service
C. No, I do not have a subscription to an accounting research service

Additional Answers in CCH® Accounting Research Manager®

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Matt Seegmiller

Matt Seegmiller is a Sales and Business Development Manager for Accounting Research Manager at Wolters. He works with both CPA firms and Corporations sharing best practices to ensure they are utilizing CCH Accounting Research Manager to its fullest.

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POLLING QUESTION

Would you like a more in-depth demo of the tools and content available on CCH Accounting Research Manager?

A. Yes

B. No

Thank you for attending

ESG Financial Reporting Concepts

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(Check pop-up blocked setting if window does not appear)

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Appendix

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ESG Program

- The Global consulting firm of Korn Ferry, rated Sustainability as one of the seven areas dominating the future of work trends in 2022. One of their most recent reports indicated:
  - *Investors, Partners, Customers, Employees are all all turning their backs on businesses that won't commit to building a sustainable future. And demand for companies to act will only grow in 2022.*
- Korn Ferry indicated that they expect to see organizations accept the reality that they need to commit to action that transforms.
- They proposed a series of 5 questions organizations and accountants should consider:

https://www.kornferry.com/insights/featured-topics/future-of-work/2022-future-of-work-trends?utm_source=google&utm_medium=ppc&utm_term=environmental%20social%20governance&utm_content=report&utm_campaign=21-11-gbl-fow-trends&gclid=Cj0KCQiA_8OPBhDtARIsAKQu0

ESG Program *(cont'd)*

- Purpose
  - Why are we doing this, who are we trying to satisfy, what is the time horizon, how is success measured, who should oversee the program?
- Leadership and talent
  - How do we attract, develop, and retain the leadership, talent, and skills needed to drive ESG strategy and outcomes?
- Governance
  - How does our board need to evolve to oversee, enable, and support delivery of our ESG strategy?

https://www.kornferry.com/insights/featured-topics/future-of-work/2022-future-of-work-trends?utm_source=google&utm_medium=ppc&utm_term=environmental%20social%20governance&utm_content=report&utm_campaign=21-11-gbl-fow-trends&gclid=Cj0KCQiA_8OPBhDtARIsAKQu0

ESG Program *(cont'd)*

- Operating model
  - How do we organize to deliver our ESG and sustainability strategy?
    - Companies may need to change the way they operate to meet goals.
- Culture and mindset
  - How do we create the right culture and mindsets, engage our people, and reinforce the right behaviors?

https://www.kornferry.com/insights/featured-topics/future-of-work/2022-future-of-work-trends?utm_source=google&utm_medium=ppc&utm_term=environmental%20social%20governance&utm_content=report&utm_campaign=21-11-gbl-fow-trends&gclid=Cj0KCQiA_8OPBhDtARIsAKQu0