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ESG Reporting Impact on Accounting, Finance

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Abstract

The terms *ESG (Environmental, Social, and Governance)*, *sustainability*, and *corporate social responsibility* (*CSR*) reporting are used interchangeably in industry practice. E (environmental), S (social), and G (governance) reporting encompasses qualitative discussions and quantitative metrics, including the company's performance measures against ESG risks, opportunities, and related strategies. Companies have turned to ESG reporting to meet the information needs of their stakeholders and be transparent about their commitments to ESG risk management. ESG issues are growing in importance to companies, investors, and other stakeholders. Users of the companies' ESG reports seek transparency about the initiatives in addition to accurate and reliable reporting. This paper reviews the current state and a few examples of global companies' ESG reporting, suggests an implementation model and discusses the role of financial professionals in adopting ESG reporting and enhancing stakeholder value.

Keywords: ESG reporting, sustainable development goals (SDG), Global Reporting Initiatives (GRI), regulatory guidelines

Introduction

The terms *ESG (Environmental, Social, and Governance)*, *sustainability*, and *corporate social responsibility* (*CSR*) reporting are used interchangeably in industry practice. ESG reporting encompasses qualitative discussions and quantitative metrics, including the company's performance measures against ESG risks, opportunities, and related strategies. *E (*environmental) component of ESG refers to the company's exposure and management of risks and opportunities related to climate, natural resource scarcity, pollution, waste, and other environmental factors, in addition to the company's impact on the environment. *S (*social) component refers to information about the company's values and business relationships. It includes social topics such as labor and supply-chain information, product quality and safety, human capital topics such as employee health and safety, and diversity and inclusion policies and efforts. *G (*governance) component includes information on the company's corporate governance, including information on the structure and diversity of the board of directors, executive compensation, critical event responsiveness, corporate resiliency, and policies and practices on lobbying, political contributions, and bribery and corruption.

Companies report ESG information to communicate to key stakeholders:

- Key ESG risks, opportunities, and their management.
- Progress on the company's commitments to the environment and society.
- ESG strategy and value creation for all stakeholders.
- Leadership and commitment to prioritizing and advancing ESG.

The United Nations (UN) describes the 17 Sustainable Development Goals (SDGs) with 231 separate indicators as "the blueprint for achieving a better and more sustainable future for all," and the SDGs are presented below.

Why Is It Important?

The Sustainable Development Goals (SDGs) are being used by global companies for their CSR goals focusing on ESG issues. Companies use detailed goals with specific targets and indicators addressing global social and environmental problems. The Governance & Accountability Institute, Inc. (2018) published a grid showing the sustainability materiality of the SDG targets and Global Reporting Initiative (GRI) indicators by sector. Table 1 below identifies the goals and results for the seventeen (17) UN 2030 SDGs. The SDG Targets, GRI Indicators, and Progress and Information for each SDG for 2016- 2019 can be found at https://sustainabledevelopment.un.org/sdgs by clicking on each SDG icon.

Table 1

UN 2030 Sustainability Development Goals

SDG #	Goal	Result
SDG 1	Poverty	End poverty
SDG 2	Hunger	End hunger; achieve food security, improved nutrition, sustainable agriculture.
SDG 3	Health and well being	Healthy living and well-being at all ages
SDG 4	Quality Education	Inclusive and equitable quality education and lifelong learning
SDG 5	Gender equality	Gender equality and empowerment of women
SDG 6	Clean water and sanitation	Available and sustainable management of water and sanitation
SDG 7	Clean energy	Available, reliable, and sustainable management of energy
SDG 8	Work and economic growth	Inclusive, sustained economic growth, productive employment, and decent work for all
SDG 9	Industry, innovation, infrastructure	Inclusive and sustainable industry, foster innovation, and promote resilient infrastructure.
SDG 10	Reduced inequalities	Equality within and among countries
SDG 11	Sustainable cities and communities	Safe, resilient, and sustainable cities and communities
SDG 12	Consumption and production	Sustainable production and consumption
SDG 13	Climate	Combat climate change and its impacts
SDG 14	Water	Conserve ocean and marine resources with sustainable development
SDG 15	Land	Protect, restore, and promote ecosystems, forests, and land resources

SDG 16	Peace, justice, societies	Peaceful and inclusive societies, equal justice for all, effective and accountable institutions
SDG 17	Partnerships for sustainable goals	Strengthen implementation of the ESG goals and the global partnership for sustainable development.

All 193 member states of the UN adopted the plan in September 2015 to achieve a better future world by outlining a path over the next 15 years to end extreme poverty, fight inequality and injustice, and protect our planet. "Agenda 2030" is centered around the SDGs to define the future desired state of the world in all nations and leaving no one behind. (Business.un.org, 2019). Table 2 shows the ten principles of the UN Global Compact and the definitions and actions that global companies can follow.

Table 2

The 10 Principles of the UN Global Compact (Summary)

Principles	**Principles**	**Definition and actions**
1	Human Rights	Assessing and integrating human rights policies in the company by taking action, monitoring performance, and reporting on results and remediation as needed,
2	Human Rights	Have explicit policies to protect human rights, establish monitoring systems, and try to persuade stakeholders in protecting human rights
3	Labor	Respect the rights of labor by enforcing non-discriminatory policies and procedures.
4	Labor	Eliminate forced and compulsory labor in own company and other suppliers and vendors.
5	Labor	Condemn and abolish child labor practices in own company and other suppliers and vendors.
6	Labor	Eliminate discrimination relative to employment and occupation by conducting training,

		monitoring, keeping records of practices, and having a robust grievance process in place.
7	Environment	Adopt a proactive approach to manage environmental challenges at the highest management level. Support scientific research and industry-wide collaboration.
8	Environment	Implement audit, management, and reporting tools to promote environmental responsibility.
9	Environment	Encourage development and adoption of environment-friendly technology innovations and changes.
10	Anti-corruption	Introduce anti-corruption policies internally. Report on policies and action taken and share best practices to all external and internal stakeholders. Participate in industry-wide anti-corruption efforts, including signing the "anti-corruption call to action."

Current Status

There are several indications that ESG issues are growing in importance to companies, investors, and other stakeholders. Some of the leading investors' and regulatory institutions' efforts showing their commitment to ESG reporting are given below:

- Morningstar reports asset flows into sustainable funds in the US and elsewhere at $31 billion through the 3d quarter of 2020, an increase of $9 billion from similar asset flows in all of 2019.
- CEOs of investment companies BlackRock and State Street Global Advisors (SSGA) sent letters to investee company executives and Boards in 2020 about better management and transparency into ESG matters and stressing the importance of sustainability in their investment strategies.
- The World Economic Forum's (WEF) list of the world's top 10 global risks (both by impact and likelihood) identifies many issues as qualifying as ESG risks to be managed actively.

- Wall Street Journal report "Management Top 250 ranking" report developed by the Drucker Institute (WSJ 12/13/21) measures corporate effectiveness and performance in 5 areas: customer satisfaction, employee engagement, innovation, *social responsibility* (including assessing the company's actions against the UN's 2015 SDGs as the framework for their ESG commitment), and financial strength.
- Engine No. 1 brings its active ownership approach to stock index funds in its investor retirement accounts to focus on ESG issues of the 500-plus largest US companies. The company plans to stress the long-term shareholder value by holding companies accountable for key environmental and other decisions. Engine No. 1 and other investment companies have been instrumental in changing the composition and strategy at Exxon Mobil and General Motors. (Choe, Associated Press, Houston Chronicle, 12/28/21, B7)
- The Investment Company Institute Board called for enhanced ESG disclosure by public companies.
- The US Securities and Exchange Commission (SEC) has:
    - adopted amendments to Regulation S-K.15 involving revisions to the rules for the Description of Business to embrace a principles-based standard identifying a list of non-exclusive topics considered material. A "description of registrant's human capital resources" is one of the topics included in the amendments.
    - The SEC Investor Advisory Committee's report encouraged the SEC to develop a framework for ESG reporting in SEC submissions.
    - The ESG Subcommittee of the SEC Asset Management Advisory Committee recommended that SEC should: 1) require the adoption of standards by which corporate issuers disclose material ESG risks, 2) utilize standard setters' frameworks to require the disclosure of material ESG risks, and 3) require that material ESG risks be disclosed in a manner consistent with the presentation of other financial disclosures.
- The International Organization of Securities Commissions (IOSCO) established a board-level Task Force on Sustainable Finance in an effort to explore the role of securities regulators in sustainable finance. This group will translate the different standards from around the world into a more cohesive, more transparent, and more standardized system.

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- In April 2021, the International Financial Reporting Standards (IFRS) Foundation Trustees issued an exposure draft that included the creation of the International Sustainability Standards Board (ISSB) to develop and streamline a global sustainability disclosure standard for the financial markets. The ISSB and the International Accounting Standards Board (IASB) will cooperate in developing IFRS Sustainability Disclosure Standards to provide comprehensive information to investors.
- The European Commission's revisions to the EU Non-Financial Reporting Directive expanded the scope of the directive to more companies and required additional disclosures and assurance engagements over ESG matters in annual reports.

The ESG report is a document to inform about a company's ESG performance and impacts, but the reports can vary in format, content, and intended audience. Many companies are slowly adopting ESG reporting to meet the information demanded by stakeholders and to show their commitment to ESG risk management. Investors' and regulators' desire to assess the risks, opportunities, and impact on the enterprise value of companies from ESG issues is causing increased demand for quality information and global disclosure standards. Voluntary reporting frameworks and guidance have been adopted, but a lack of common standards has confused stakeholders who have requested the IFRS Foundation to use its prior experience in creating global accounting standards as a model to develop globally uniform sustainability reports. Table 3 below summarizes selected examples of ESG reporting by US companies in different sectors.

Table 3

Summary Table of Selected Corporations' Use of ESGs, GRI, and SDGs

Company	Industry/Products	ESG Reporting
Compass Minerals	It provides essential minerals, including salt and magnesium chloride, for road deicing and dust control, food processing, water treatment, and plant nutrition.	The company has improvements toward sustainability. Its annual ESG report aligns with GRI and SASB.

Eli Lilly	Global biopharmaceutical company.	Its CSR reports date back to 2012, and it lists the SDGs.
Energy recovery	The company manufactures energy recovery devices for oil and gas, chemical, and water industries globally.	Its annual report identifies the energy recovery devices installed to avoid carbon emissions.
Etsy, Inc.	It is a consumer crafts marketing company.	The report included ESG information in the Form 10-K for 2019, and an external third party performed attestation of its ESG metrics.
IDEA	Indiana-based construction engineering company providing infrastructure management services for various industries.	It has a cross-functional ESG team to integrate ESG issues and published its first annual ESG report in 2020.
Johnson and Johnson	It is involved in the research and development, manufacturing, and sale of healthcare products.	Its progress is measured annually against SDGs 3. 5, and 17 on the dashboards.
Kimberley-Clark	The company produces personal care, consumer use, and health care products.	It has adopted the GRI guidelines and aligns goals with SDGs 1, 3, 5, 6, 7, 9, 10, 11, 12, 13, and 14.
Nestle	It produces food and drink products.	Its “Creating shared value and meeting our commitments 2018” report shows the match against SDGs 1-17.
Nike	It produces apparel and footwear.	It uses GRI for its Sustainable Business Report. SDGs 8,9,12, and13 are highlighted.
Proctor & Gamble	It produces beauty, home care, and family care products.	It produces Corporate Citizenship Reports from 1999, and SDGs 3, 4, 5, 6, 12, and 15 are highlighted.
Tex-Isle Steel company	Family-owned steel pipe manufacturing company in Houston	It sources from suppliers with electric arc furnaces, purchases power from renewable energy companies, and uses special coatings. Third-party consulting firms have verified

		the company's commitment to sustainability.
Unilever	It produces food and beauty products.	It uses GRI and SDGs 2, 3, 6, 17.
UBS Group AG	It is an investment and banking company and a foreign private issuer.	The *Sustainability Report 2019* in its Form 6-K to the SEC included an independent assurance report in accordance with International Standard on Assurance Engagements 3000 and included a summary of work performed and a conclusion.
Vornado Realty Trust	It deals with real estate investment trust and has its ESG report includes an independent accountants' examination report and review report.	The accounting firm performed an examination engagement in accordance with SASB Standards and a review engagement over the sustainability disclosures and GRI Standards.

The above table of selected corporations shows that corporations are adopting ESG reporting in all sectors, but the need for uniformity, accuracy, and format exists.

Roles of Finance, Accounting, and Technology in ESG Reporting

Availability of detailed and accurate sustainability data and a clear understanding of format and content are essential for quality ESG reporting. The 2021 Financial Education & Research Foundation (FERF) report on ESG titled "Financial Statement Preparers and the ESG Journey: Charting Course" examined the involvement of finance in the ESG reporting process, the extent of integration with financial reporting, and challenges to finance professionals. The survey found that confusion about disclosure frameworks, methodologies, and stakeholder demands are causing delays in finance efforts. The report found that finance involvement in ESG is in its early stages, with 53% of respondents not yet starting the integration of ESG and financial reporting.

Respondents felt data to be the biggest single challenge to ESG reporting, and issues related to data collection, processing, analysis, and control were frequently mentioned. 85% of companies are using multiple ESG reporting frameworks. Finance professionals had difficulty providing relevant and concise ESG metrics to their stakeholders due to the lack of clarity. ESG management software packages are being developed now by vendors (Locus, UL 360 Sustainability reporting software, Novata, and others) to integrate data from multiple programs in cross-functional areas. Finance teams can test and implement them to report on their own ESG reporting progress and help management with strategic decision-making.

Market demands are driving ESG strategy, actions, and reporting in companies. 96% of the top 250 global companies reported on sustainability in 2021, up from 64% in 2005 (https://bit.ly/3mhdxVR), albeit using a multitude of standards and frameworks, making comparability and consistency difficult. The most commonly used standard is the Global Reporting Initiative (GRI), but Sustainability Accounting Standards Board (SASB) standards are catching on. 20% of global companies, including 32% of the top 100 US companies, use recommendations from the Task Force for Climate-related Financial Disclosures (TCFD) (https://bit.ly/3mhdxVR). Only 22% top 250 global companies reporting on sustainability have adopted the integrated reporting (IR) model.

Third-party assurance of sustainability reports is increasing. Investor interest in ESG disclosures as part of SEC submissions (including proxy statements, annual and quarterly reports) has led to a growing appreciation of the value of external attestation in accordance with attestation standards by an independent auditor. To date, two domestic registrants and several Foreign Private Issuers have included an attestation report in their SEC submissions. Auditors will be playing a greater role in the future in assuring the validity and accuracy of external ESG information provided to investors and other stakeholders. The new version of the European Union’s (EU) Corporate sustainability reporting directive for companies located in or have significant operations in the EU could increase enforcement of assurance requirements. Organizations such as the International Federation of Accountants (IFAC) and Institute of Management Accountants (IMA), as well as audit companies, have expressed support for auditor assurance of ESG reports and felt that the new EU directive would motivate management and boards to be cognizant of their own roles in sustainability reporting.

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Technology tools such as Data Analytics, Artificial Intelligence (AI), and Blockchain can be used to process the data and explore the relationship to SDGs. UN's AI4Good initiative is aimed at using AI, including machine learning to speed up the work on the SDGs. The core tenet of ESG reporting is about communicating the positive and negative impacts of a company's activities to all stakeholders. Data Gumbo, a technology company in Houston, reviews the use of Blockchain technology to track a company's progress on ESG practices and improvements. Investors demand that companies report on reducing their carbon footprints, investing in communities, or incorporating more diversity among leadership positions. The companies can use technology platforms to monitor information about emissions or fuel-efficiency or hiring practices to create a ledger of the work being performed and give auditors, board members, or shareholders access to the ledger to track the progress and alignment with agreed goals. Blockchain technology can automate the contract execution and provide audit files in perpetuity. Using AI and Blockchain-based on a robust framework built on SDGs for ESG accounting and reporting will help provide transparency and deep analyses. The next section provides a possible model for the implementation of ESG reporting.

Model for Implementation

IFAC opined, "A robust, high-quality set of sustainability reporting standards will provide a better foundation for any future assurance standards or methodologies, as well as bring greater clarity and focus on the roles and duties of management and directors who are integral to any assurance engagement" (bit.ly/3rvVUC9). The implementation model below is a listing of steps that can be enhanced by the companies based on their reporting needs.

- Get strong commitment from management.
- Identify ESG issues important to the company's strategy and values.
- Use cross-functional teams from areas including supply chain, technology, and infrastructure to formulate a plan to integrate ESG and metrics for reporting.
- Use existing technology and an integrated reporting model for data collection and analysis.
- Identify gaps and deficiencies in current practices,

- Report risks, rewards, and financial performance to management and the Board of Directors.
- Identify emerging technologies such as automation, blockchain, AI, and data analytics that can be used to improve efficiencies in ESG reporting.
- Use ESG reports to bring transformative changes to enhance stakeholder value.

Future Trends for Finance, Accounting

Interest in ESG has been on the rise in the private markets, with private equity firms increasingly focused on quantifying societal impact for investors. ESG measurement remains challenging for the companies, most of which are still in the early stages of quantifying sustainability and social impact. The emerging authoritative sustainability standards being developed by ISSB will bring new responsibilities and accountabilities for the finance function. Finance professionals need to think about the ESG reporting framework for their companies through the lens of shareholder value and risk management. They need to develop a set of policies, procedures, and mechanisms for efficient and consistent data management, flows, and controls. In addition to understanding the format and content of ESG reports, access to detailed and accurate sustainability data, along with technology tools for data analytics, is absolutely essential. The required data will be different from traditional finance. However, finance professionals will need to apply the same level of rigor to and infrastructure around ESG reporting as with financial reporting. ESG management software can help track sustainability metrics for a wide range of programs.

As IFAC concluded, "...market-driven, voluntary reporting cannot achieve relevant, reliable, and comparable information globally, which is what global capital markets require. Nor is it likely to have legitimacy and backing from public authorities." As an increasing number of countries represented by IOSCO and the US adopt IFRS sustainability standards, finance professionals will be dealing with ESG issues on a regular basis. Financial reporting teams will need to ensure the quality of internal and external ESG data. Educational institutions must prepare today’s students for the expected demand for accounting and finance professionals who can work on multi-disciplinary teams from various functional areas. The challenge due to barriers between financial accountants and the ESG reporting team must be resolved, and a robust and effective governance structure must be present.

The report “Key actions for establishing effective governance over ESG reporting” by The American Institute of Certified Public Accountants (AICPA) and the Center for Audit Quality (CAQ) can provide a good road map for companies’ governance structure over ESG reporting. The following excerpt lists key actions and existing resources in the report.

- Conduct risk assessment to determine material ESG topics. Existing resources: SASB and GRI standards, International Integrated Reporting (IRR) Framework.
- Enhance Board oversight of ESG matters. Existing resources: ESG oversight framework for Directors, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Guidance for applying Enterprise Risk management (ERM) to ESG, and World Business Council for Sustainable Development (WBCSD) reports.
- Include ESG topics with the ERM process. Existing resources: COSO’s Guidance for applying ERM to ESG risks and WBCSD.
- Incorporate ESG matters into the overall company strategy.
- Apply internal control over the data collection, processing, and reporting process. Existing resource: COSO Internal Control-Integrated Framework.

Conclusion

The core tenet of ESG reporting is about communicating the impacts of the company’s ESG issues to all stakeholders. Technology tools such as Data Analytics, AI, and Blockchain can be used to process the data and explore the relationship to SDGs. Using new technology based on a robust framework built on SDGs for ESG accounting and reporting will help satisfy investors’ information needs and facilitate strategic decisions by managers. It will require companies to disclose direct and indirect effects, as well as societal and economic effects. Subpar ESG performance compared to other companies can lead to a competitive disadvantage in dealing with both capital markets and consumers and attracting good employees. The success of early adopters of robust and efficient ESG accounting and reporting is already evident in the global marketplace, and the trend is likely to accelerate.

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