



Center for Board Effectiveness

On the audit committee's agenda

Navigating the ESG journey in 2022 and beyond

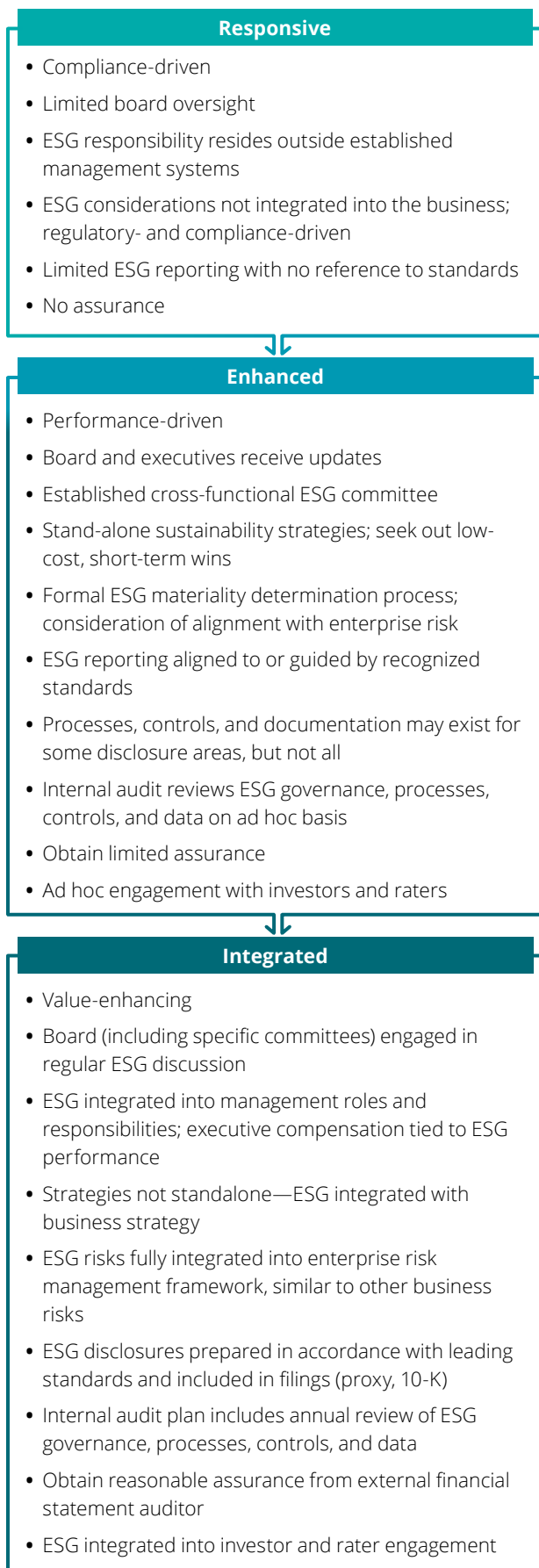
Introduction

The conversation within and beyond the boardroom around environmental, social, and governance (ESG) is rapidly maturing. In recognition of the important role ESG plays in driving long-term value creation, more and more boards are focused on and are disclosing how their governance structure is evolving to consider ESG more intentionally. Having a defined plan for overseeing the integration of ESG and the interconnectedness across the pillars of "E", "S", and "G" into strategy and disclosure helps demonstrate the significance and prioritization of ESG efforts from the top, to both investors and broader stakeholders.

Amid this shift in board governance, investors continue to increase expectations on climate and ESG matters, as noted by the [number and breadth of shareholder proposals on related issues in the 2021 proxy season](#). As investors update and finalize their proxy voting

guidelines for 2022, there is the potential for more votes to be cast against board directors who do not demonstrate an adequate understanding of ESG and sufficient disclosure.

Change is also coming quickly on the regulatory front. The SEC has disclosed its regulatory agenda and has included four important areas that fall under the ESG umbrella: climate change, cyber risk governance, board diversity, and human capital management; proposed rules are expected in early 2022. The SEC also has begun to focus more on ESG-related comment letters. In late September, the commission issued a "[Dear CFO](#)" letter that provided a sampling of the types of comments issued about climate change and sustainability disclosures, with a particular emphasis on the consistency of climate-related risk disclosures and the relevance to financial reporting. ➤

Figure 1. Deloitte ESG maturity model

In addition, there has been significant movement toward the global convergence of standards. The IFRS Foundation [announced](#) at the UN Climate Change conference in Glasgow in early November the formation of the International Sustainability Standards Board (ISSB), which will consolidate the Climate Disclosure Standards Board and the Value Reporting Foundation (which includes the Integrated Reporting Framework and Sustainability Accounting Standards Board (SASB) Standards) by June 2022. The global ISSB standards are intended to elevate sustainability standard setting to be in line with that of financial reporting and accounting, and will promote transparency and consistency in sustainability disclosures to better inform decision-making for users of general-purpose financial reporting.

Other standard-setting entities enhancing their involvement in ESG include FASB, which has released a [staff educational paper](#) on the intersection of ESG matters with financial accounting standards; and the Commodity Futures Trading Commission, which has established a [climate risk unit](#). With the pace of the ESG developments expected to accelerate rapidly in 2022, company management and boards should be focused on enhancing governance structures and the control environment around managing, and overseeing, ESG risks and opportunities and delivering high quality disclosure. ➤



Trends in board governance of ESG

The “G” in ESG pertains to the broader corporate governance policies and practices that a company has put in place, and ESG is a significant area of focus for boards to better understand and oversee. As a starting point, the board should define its governance structure, policies, and practices that provide a framework for overseeing ESG accountability and strategic focus. This includes the structuring of board and committee oversight and the associated delegation of responsibilities.

Building on our 2020 initial research in this area, as highlighted in **figure 3**, there was a marked increase in 2021 in the percentage of S&P 500 companies disclosing in their proxies the primary committee(s) overseeing ESG relative to last year (from 72% to 86%). This trend likely is the result of companies progressing along an ESG maturity model (**figure 1**) that is more integrated into their core business strategy and risk program and defining how the board oversees such ESG efforts.

Notably, the 35 companies newly added to the S&P 500 this past year (**figure 2**) were more than twice as likely not to have disclosed the committee overseeing ESG, suggesting that company size and market expectations may have an impact on the formalization of an ESG governance framework.

When compared by industry (**figure 4**), energy, resources, and industrials (ER&I) companies continued to lead, with 94% of ER&I S&P 500 companies disclosing their governance approach in the proxy. This is not unexpected given the industry’s longstanding focus on employee health and safety and environmental matters, coupled with significant regulatory requirements. In the wake of the pandemic, there has also been strong upward movement in life sciences and health care industry proxy disclosure from 63% to 82%, and a similar trajectory has been seen in the technology, media, and telecommunications industry.

Figure 2. Board committee oversight of ESG: Companies added to S&P 500 in the past year

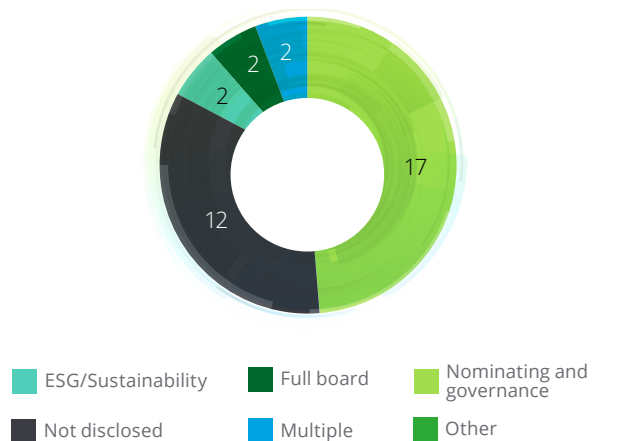
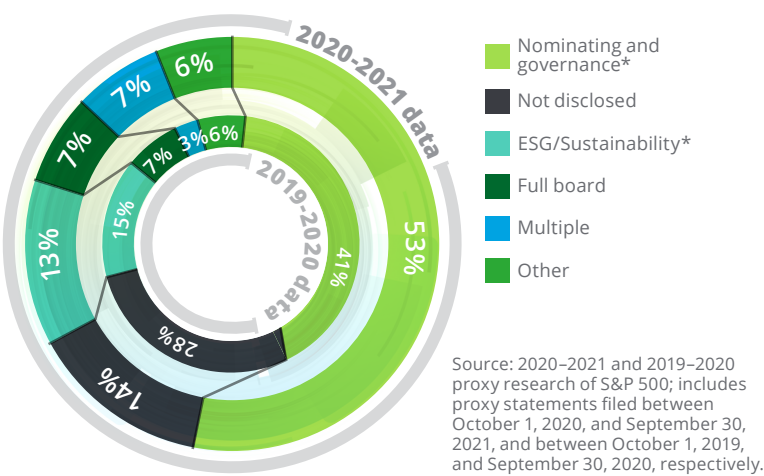
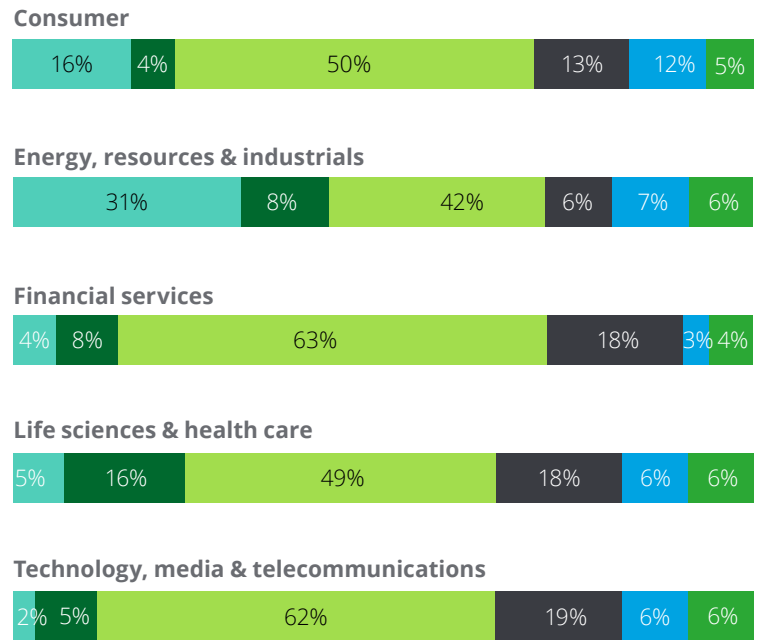


Figure 3. ESG oversight on the board and board committees in 2020–2021 and 2019–2020 for S&P 500 companies



The 2021 ESG/Sustainability category includes a remapping of companies that were previously under health and safety. The 2021 nominating and governance category includes a remapping of some companies that were previously ESG/Sustainability. If the 2020 data was recast for such companies, the nominating and governance category would have increased by 1% and the ESG/Sustainability category would have decreased by 1%.

Figure 4. Board committee primary oversight of ESG by industry – S&P 500



Sample ESG/Sustainability committee names

(Note: Includes health and safety-categorized committees)

- ESG Committee
- Safety, Environmental, Technology and Operations Committee
- Environmental and Social Responsibility Committee
- Sustainability and Corporate Responsibility Committee
- Corporate Responsibility, Sustainability, and Safety Committee
- Environmental, Health, Safety, Quality, and Public Policy Committee; ESG Council
- Environment, Health, and Safety
- Inclusion and Social Impact Committee
- Compliance, Health, Environmental, Safety, and Security
- Safety, Sustainability, and Corporate Responsibility Committee

Sample Nominating and governance committee names

- Governance and Nominating Committee
- Nominating, Corporate Governance, and Social Responsibility Committee
- Corporate Governance Public Responsibility Committee
- Governance, Sustainability, and Corporate Responsibility Committee
- Corporate Governance, ESG, and Sustainability
- Nominating, Environmental, Social, and Governance Committee
- Nominating, Governance, and Public Affairs Committee
- Governance and Sustainability Committee

Despite the overall increase in proxy disclosure, there continues to be significant variation in the committee(s) that oversee ESG. The percentage of boards utilizing their nominating and governance committee for primary oversight has grown significantly. Not surprisingly, several companies have changed the nominating and governance committee's name to be more transparent about the broader committee purview. In the callout boxes to the left, we provide a sampling, from S&P 500 proxies, of some of the tailored committee names within the general nominating and governance category as well as some name variations with the ESG/Sustainability category.

Another trend and shift from last year's research is an increase in the number of companies disclosing that the full board and a committee or multiple committees have a role in overseeing ESG elements (categorized as "multiple"). As ESG programs evolve and specific elements of the "E" and "S" are defined, a shared governance model whereby certain committees are delegated a specific ESG remit evolves. As an example, for many companies, human capital management initiatives, including diversity and inclusion initiatives, may fall under the "S" category and be allocated to the compensation, management development committee, or its equivalent talent committee, while corporate responsibility initiatives may be overseen by the governance committee. The trend for companies to disclose how the full board or committees are delegated certain ESG oversight responsibilities can effectively enable the board to execute on its fiduciary responsibility.

Only 1% of S&P 500 companies reported that the audit committee was the primary committee overseeing ESG for both years. While this is not surprising, following the shared governance model, the audit committee has certain important roles in ESG efforts, including the following:

- Audit committees should understand whether there are appropriate internal and disclosure controls and procedures for the metrics disclosed, whether in an SEC filing or a separate sustainability report. This includes working closely with other committees to understand how ESG risks are identified and prioritized and how materiality is defined.
- The audit committee should understand the companies' ESG program—its interconnectedness across the pillars of "E", "S", and "G" and the related goals and metrics—and how management considers ESG strategies and the impact they may have on the financial statements.
- As the development of companies' integration of ESG into strategy and disclosure objectives continues to evolve and marketplace standards become more established and authoritative, the role of internal audit and the value of assurance as a tool to drive trust and confidence in ESG performance will become central. Assurance can provide a strong signal to investors and other stakeholders regarding the quality and reliability of disclosures. Audit committees should take the lead in overseeing the assurance engagement. The committee may consider inquiring with management about engaging with public company auditors on how to evolve and mature its ESG programs to meet the increasing demands of the market and regulators. ➤

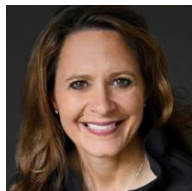
Conclusion

ESG's integration into reporting and disclosure continues to proceed rapidly, and having a defined ESG plan and governance structure is increasingly an expectation rather than an exception, particularly for large public companies. Accordingly, boards will likely need to recalibrate their oversight to accommodate these changes and meet the requirements of regulators, investors, and other stakeholders. Given growing scrutiny and market expectations, companies are realizing value and identifying opportunities more quickly and confidently through a more rigorous ESG governance and data measurement and reporting process. Audit committees should consider adding ESG matters as a standing agenda item in 2022, understand the company's disclosure process, and regularly assess the company's progress, risk oversight, financial statement implications, and the integration of ESG considerations into the core business strategy.

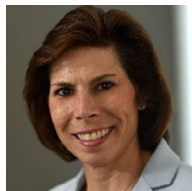
ESG questions for audit committees to consider

1. Where does the primary ownership and oversight responsibility for ESG reside on the board, both overall and in terms of its various components (e.g., climate, diversity, talent, cyber)? Does the full board understand where and when these elements are being discussed at the board and committee level?
2. How does the company identify and assess ESG risks and opportunities and evaluate its materiality to the business?
3. For ESG risks that are material to the business, how are they integrated into enterprise risk management?
4. How is the company remaining informed of developments in ESG legislation and regulations in all the relevant jurisdictions for the business? And how is the company preparing for anticipated shifts in regulatory requirements (i.e., SEC rulemaking)?
5. How is progress against ESG commitments measured and monitored?
6. How confident are management and the board in the company's ability to anticipate disruptive environmental and societal trends?
7. What processes and controls are in place to address evolving ESG risks and related disclosures?
8. Has the audit committee reviewed the company's sustainability report prior to issuing and has management walked through the key assumptions made and the basis for the metrics and goals disclosed?
9. Have management and the audit committee considered the potential impacts of climate-related or other ESG events or conditions on the financial statements? If the company discloses climate-related information in the annual report that contains or accompanies the financial statements (such as in the MD&A) are those disclosures consistent with the audited financial statements?
10. Has management engaged with public-company auditors on how to evolve and mature its ESG program to meet the increasing requirements of the market and regulators?

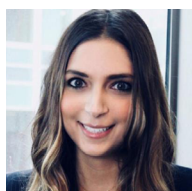
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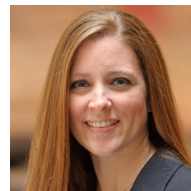
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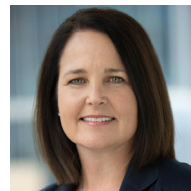
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