

European Audit Committee Leadership Network

January 2022

EACLN

VIEWPOINTS

ESG Governance

In a recent EY survey, 66% of top executives and board members of large European companies agreed that “the COVID-19 pandemic has increased expectations from stakeholders that our company will drive societal impact, environmental sustainability, and inclusive growth.”¹ Strong performance in handling environmental, social, and governance (ESG) issues and accurate, transparent reporting of that performance have become increasingly important to outside constituents; good ESG leadership can significantly influence a company’s ability to raise capital, to attract talent, and even to enhance customer demand. Regulators around the globe are insisting that climate risk and ESG be incorporated into public company disclosures. Governance of ESG is now a priority for every board.

Members of the European Audit Committee Leadership Network (EACLN) said that ESG governance at their organizations is evolving. One said, “*We are currently looking at all the reporting requirements, and we need to put a structure together, but it is not easy.*”² Another noted that her company has been a leader on ESG reporting, but added, “*That doesn’t mean that we’re perfect. I am always looking to learn anything we can do to improve.*”

On 30 November, EACLN members met virtually for a members-only discussion on ESG governance.

A list of participants is provided in Appendix 1 (page 8).

Executive summary

Members discussed how ESG is governed at their companies, what ESG oversight requires of boards and audit committees, and the importance of collaboration.

- **Oversight of ESG reporting should be within the remit of audit committees.** Members said that audit committees are experienced in overseeing disclosures and regulatory compliance. They expect the regularity and frequency of reporting on ESG metrics to increase to match that of financial data. In an integrated reporting system, nonfinancial and financial data could not be separated and would thus need to be overseen by the audit committee. One member observed that his audit committee took over ESG reporting oversight because at a prior EACLN meeting investors had made it clear that they would hold boards to the same standards for nonfinancial reporting as for financial reporting.
- **Audit committees will need new policies and capabilities.** A member noted that audit committees will have to look at their policies and be explicit about the scope of committee oversight of nonfinancial reporting. The policies should state what will be assured and to what degree, and they should be made available to outside stakeholders. Many members agreed that audit committees will need to upskill; some said that they are already conducting ESG training with internal and external experts. One member suggested that

financial experts will have to become nonfinancial experts, too, as reporting becomes more integrated and as ESG reporting becomes an increasingly significant risk for organizations. Members also agreed that audit committees will likely have to prioritize issues to ensure a manageable workload and will have to think strategically about committee composition.

- **Coordination and collaboration among committees are vital.** Members agreed that ESG oversight will vary across companies and sectors. They emphasized the need for coordination and communication between the different committees and groups involved. One member described a model of cross-committee membership, where the audit committee chair also sits on the sustainability committee and vice versa. She noted that the two committees regularly coordinate their agendas to ensure that there is no duplication and no items are dropped. Another member described a joint executive committee that brings together people from other committees responsible for ESG for regular discussions. Still another said that she and the secretary of her board take the list of ESG topics, ensure that they are updated, and then work on distributing the topics across board committees, taking into consideration the committees' time constraints and available resources.

For a list of reflection questions, see Appendix 2 (page 9).

Oversight of ESG reporting should be within the remit of audit committees

Members agreed that audit committees should be responsible for the oversight of ESG reporting. They explained why audit committees are best positioned for the task.

- **Audit committees are experienced in oversight of disclosures and controls.** One member emphasized that companies should think of ESG reporting as a source of disclosure risk because, in the member's words, *"we are dealing with new metrics with very limited track record ... We've got units in our management teams defining, creating, calculating the metrics, and reporting them who don't have a lot of experience in external reporting and an understanding of assurance."* This member also pointed to *"the fluid environment—what might look like a stable framework today might look very different tomorrow."* He sketched a scenario that keeps him up at night: *"Some corporate communications person thinks this is a great story to tell, great PR story, and a year later we realize that we didn't have the right approach and we are dealing with greenwashing or shareholder litigation."*

Members said they consider the controls around ESG data to be a serious issue. One noted that much of the data is in Excel spreadsheets, the result of manual efforts of people in different areas of the company who are not necessarily consistent in their input. The director emphasized that audit committees are experienced in oversight of disclosures and can create stronger controls for ESG data and *"a stable, auditable process for nonfinancial data"* more broadly.

- **Audit committees have the tools to ensure accurate and consistent ESG reporting.** A member observed that in the past, ESG reporting was the responsibility of his company's sustainability committee. But top management realized that *"without the rigor that was being brought by the audit committee, we were making statements and issuing reports that*



actually we didn't feel had the same assurance and the same credibility." This member noted that *"the tools that the audit committee has under it, including the direct reporting line of the internal audit function,"* can strengthen the assurance and credibility of ESG reporting. He said that audit committees *"could direct and influence and charge [internal audit] with actually doing some of the verification process and the assurance process."*

- **Audit committees are usually in charge of "regulated elements."** A member observed that audit committees will always be in charge of outside communications that are regulated. As the European Union sharpens ESG regulations, corporate ESG disclosures move into regulated filings, and therefore, this member opined, ESG compliance oversight will fall on audit committees.
- **Audit committees can assure consistency in financial and nonfinancial reporting.** One member noted there is *"mounting pressure"* for consistency in reporting, not only from regulators but also from investors. Another agreed, saying that investors have made it clear that they will hold boards to the same standards for nonfinancial reporting as they do for financial reporting. This member's audit committee took over ESG reporting oversight after the member attended an EACLN meeting at which investors drove that point home.
- **Audit committees should oversee integrated reporting.** Members noted that evolution toward integrated reporting will make financial and nonfinancial data inseparable, and that oversight of integrated reports would naturally fall to the audit committee. One member noted that integrated reporting will be a significant undertaking: *"With all the new standards coming up—with the taxonomy in Europe, for instance—with all the issues on disclosure, with the questions of consistency and accessibility of nonfinancial reporting, this is really something which will need a lot of work and then of course there is the consideration of climate related financial risks."*
- **Regularity and frequency of ESG reporting will increase.** One member noted that regularity and frequency of reporting on ESG metrics and data *"need to increase and will increase."* In addition to this creating more work, audit committees are already used to working on a regular process of financial reporting.

Audit committees will need new policies and capabilities

Members discussed how audit committees will have to change as they take on these additional responsibilities.

- **Promulgating clear policy on assurance of ESG reporting.** One member said that audit committees will have to review their policies to see what specific aspects of ESG reporting would be covered by the committee and to what degree these would be assured. He said that he has been working with his audit committee to *"have that policy available and clear to outside stakeholders so there can't subsequently be any questions like, 'We thought this was audited, but it wasn't audited.'"* This work, the director noted, will ensure that outsiders have clarity, rather than assumptions, regarding the level of audit that the company provides. He added that the new audit committee policy will be the subject of regular reviews, just like any other policy.

- **Setting priorities and becoming more efficient.** Members discussed the already full agenda of audit committees and their limited time and resources. Many agreed that if the committee takes on responsibility for ESG reporting, both the chair and members will have to prioritize work. One member opined, *“We need to prioritize; we need to be simpler or more efficient on our classic jobs of financial reporting so that there is time to do ESG reporting.”* This member thought that *“ESG reporting has a more natural place in the audit committee than cybersecurity [does] because it is about the external reporting; it’s about how we present ourselves to the world.”*

One member said that the audit committee at her organization was struggling to balance its workload. A third director commented that he finds it very hard to prioritize. He said, *“Based on my experience on both of my audit committees, there’s no waste of time, but it still is a four-to-five-hour meeting each time. And I don’t see a lot that can be taken off if we want to do our job right. Overall, we’re just getting overloaded with new responsibilities that have not been properly thought through.”*

- **Financial experts may need to become nonfinancial experts.** A member envisioned that integrated reporting and regulatory developments will mean that *“the financial expert has to also become a nonfinancial expert.”* Nonfinancial reporting will have a status similar to financial reporting, she said, which *“makes sense because the audit committee is also responsible for risk management, [the] internal control system, and ... with getting the assurance readiness for the nonfinancial reporting.”* This member noted that the transformation of finance professionals is already happening, giving as an example the exams for becoming a chartered accountant today, in which the nonfinancial piece has become an important component.

A director commented, *“You have to educate yourself, and you have to educate your group together.”* One member offered an example of board education on ESG already underway at her company: *“We need education given the breadth of the topic [ESG].”* Training sessions take place over two to four days a year, and invited guests have included ESG experts or heads of ESG at other companies.

Another director’s audit committee organizes 90-minute sessions on various ESG topics. For example, a recent session focused on raw materials like sustainable cotton. The sessions are led by internal and external experts and are recorded to allow directors to listen and learn at their own convenience. This member described a plan to bring the education to all company employees, as well as the board. The initiative, she emphasized, is driven by the audit committee. *“We felt that with risks like cybersecurity, data protection, [and] a number of new top risks, we absolutely need better education and better capabilities than the ones we felt we had today, so we started from those types of issues,”* she said.

- **The composition of audit committees may need to change.** A member said, *“I think that the audit committee needs to evolve and change to meet the changing needs and expectations of how we’re going to report, and that means [we] also [need] to have people on the audit committee that are able to contribute toward this.”* He added, *“The makeup*

and the terms of reference for audit committees need to evolve to take into account this broader expectation, this broader remit.” This member compared the audit committees’ evolution on ESG to that of risk committees—a move from more narrow focus on credit risk in banks, for example, to broader issues such as operational risk, reputational risk, and others.

Coordination and collaboration among committees are vital

Members shared models of board governance of ESG. On some boards, ESG issues are discussed by the full board. One member stressed that on ESG matters, *“Everything starts with and has to be taken care of by the whole board.”* Other members cited particular reasons for engaging their full boards on ESG strategy, risk, policy, and metrics. One said that where corporate social responsibility was once merely incidental to strategy and operations, *“the full board now needs to know, or at least understand, ESG.”* Another member shared a similar view, noting that at most of his companies, ESG is discussed as an integral part of business strategy.

At some member companies, new committees have been established or ESG responsibilities have been divided among already existing committees. In some cases, public policy and governance committees oversee the ESG work. In others, a human resources committee might focus on the social dimension of ESG and drive reporting on issues like diversity, equity, inclusion, and safety. A member said that her board has recently created an ESG committee that is tasked with sustainability strategy. This committee tracks how the company’s sustainability performance compares with that of its competitors. On another board, the ESG committee is mainly tasked with overseeing ESG reporting. A third director said that her organization is considering expanding and transforming its existing safety committee into a committee with broader ESG responsibilities.

Members agreed that ESG oversight will vary across different companies and sectors and that no single approach can work for all. Directors agreed, however, that coordination and collaboration among responsible committees are crucial.

Members offered examples of board committees collaborating to manage ESG. On one board, ESG responsibilities are shared between two board committees: policy is under the purview of a human resources, governance, and sustainability committee, and compliance is overseen by the audit, risk, and compliance committee. The member explaining this arrangement noted, *“In the beginning of this year, we did a special meeting with both committees to make sure that we were on the same page.”* In another member’s company, ESG strategy is developed by the full board, oversight of implementation is the responsibility of the ESG committee, and reporting and assurance are handled by the audit committee. Internal audit looks at the methodology and metrics. The director who described this governance model emphasized that the process is not unidirectional. The board reviews the metrics and methodology to ensure that they are consistent with the overall objectives, and these are shared with the remuneration committee to become the basis for compensation rewards. The member emphasized, *“Every day, everybody gets involved for a minute.”*



One member said that the board at her organization made the decision to create a separate sustainability committee and a new position for a chief sustainability officer. She said that the sustainability committee has already made a difference in the workload of the board and the audit committee. Strategy, communication, and staffing issues are all handled by the new committee. The member said, *“At the audit committee, we never get into such a level of detail, and we focus regularly and primarily on the quality and the substance behind the reporting.”* The committees are coordinating their agendas for the whole year in what the member described as *“a journey of real collaboration.”*

Some companies are addressing the sharing of data and information by having chairs of committees with ESG responsibilities participate regularly at each other’s meetings. One member noted that she is a part of both the audit and sustainability committees at her organization. Another member said that she also sits on her company’s governance committee. Still another described a model of wider cross-committee participation: *“It is relatively unusual, but in my company every member of the board sits on every committee.”*

One director explained that coordination on ESG at her company is assured through the work of a joint committee. She said, *“We updated our risk cartography, which looks at risks and opportunities, and we put climate in number one position.”* A joint risk committee now includes members of the internal risk management committee and two members of the executive committee: the CFO (who chairs the new committee) and the director of strategy, people, and sustainability. The joint risk committee was established to assist with the transformation of the company into a more sustainable business. The director said that the new committee has *“brought other people together that were not connected before,”* adding, *“The audit committee can’t do everything, and I think that it’s important to realize that this working together is also something that needs to be guaranteed.”* She said that her audit committee strongly supports the executive committee’s decision to bring people from various areas within the company together as those participants can bring diverse perspectives on issues and at the same time ensure that work is neither duplicated nor missed.

Conclusions

Members noted that board organization on ESG is a work in progress: their companies are reviewing reporting requirements and external pressures and using the information to determine ESG governance structures. They stressed that there is no one approach that would fit all, because risks, goals, priorities, and the maturity of individual organizations on ESG and ESG reporting vary across companies and sectors. Nonetheless, members agreed that enhanced ESG governance models require better coordination and collaboration across responsible committees and internal groups. They also agreed that audit committees are best positioned to oversee ESG reporting.



About this document

The European Audit Committee Leadership Network is a group of audit committee chairs drawn from leading European companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

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Appendix 1: Participants

The following members of the EACLN participated in part or all of the meeting:

- Horst Baier, Bayer
- Laurence Debroux, Novo Nordisk
- Hanne de Mora, Volvo Group
- Ana de Pro Gonzalo, STMicroelectronics
- Eric Elzvik, Ericsson
- Rene Hooft Graafland, Ahold Delhaize
- Dagmar Kollmann, Deutsche Telekom
- Pilar López, Inditex
- John Maltby, Nordea
- Mariella Röhm-Kottmann, Zalando
- Guylaine Saucier, Wendel
- Alan Stewart, Diageo
- Maria van der Hoeven, Total
- Gunnar Wiedenfels, SAP

The EY organization was represented in all or part of the meeting by the following:

- Marie-Laure Delarue, EY Global Vice Chair, Assurance
- Jean-Yves Jégourel, EY Country Managing Partner Germany

Appendix 2: Reflection Questions for Audit Committees

- ? What are the roles of the audit committee, nominations/governance committee, and compensation/talent committee in ESG-related policies and disclosures?
- ? How are these committees coordinating their activities?
- ? What are your views on forming a sustainability or ESG committee?
- ? Is ESG governance at your company concentrated in a single committee or more broadly distributed? What challenges have you seen?
- ? What is the role of the audit committee in ESG governance in your organization? What factors are driving change in the committee's role?
- ? To what extent is your audit committee adding ESG skills to its capabilities?
- ? What evolution do you see in the ESG responsibilities of your board committees?



Endnotes

¹ Julie Teigland and Andrew Hobbs, *Will There Be a 'Next' If Corporate Governance Is Focused on the 'Now'? EY Long-Term Value and Corporate Governance Survey* (EYGM Limited, 2021), 7.

² *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby comments are not attributed to individuals or corporations. Quotations in italics are drawn directly from conversations with network members in connection with the meeting.