Oversight of ESG, technology governance, and audit committee and board leadership

On 11 July 2023, members of the European Growth Audit Network (EGAN) convened in London to discuss:

- **Board oversight of ESG strategy and reporting** with Karina Litvack, Ambassador and Founding Chairman, the Climate Governance Initiative, and Controls and Risk Committee Member, Terna S.p.A., and Renata Greenberg Frolova-Hammer, Director and Nordic Practice Lead, BSR

- **Technology governance in the face of exponential change** with Harvey Lewis, Partner, Client Technology & Innovation, EY

- **Good practices in audit committee and board leadership** with Byron Grote, Audit Committee Chair, Tesco and AkzoNobel; Leslie Seidman, Governance and Nominating Committee Chair, Moody’s, Audit Committee Chair, Janus Henderson, and former Audit Committee Chair, General Electric; and Maria van der Hoeven, Audit Committee Chair, TotalEnergies

Below is a summary of each discussion.¹ A forthcoming ViewPoints will provide additional details on the technology governance conversation.

**Board oversight of ESG strategy and reporting**

ESG remains top of mind for many directors, with new standards and reporting requirements looming and increased pressure from investors and other stakeholders. Members met with guests Karina Litvack, ambassador and founding chairman at the Climate Governance Initiative and Renata Greenberg Frolova-Hammer, director and Nordic Practice Lead at BSR to discuss good practices for overseeing ESG strategy and reporting. Both underscored the complex nature of ESG and the need to work toward a “just transition” that factors the impact on multiple communities into decarbonization strategies. Key themes from the discussion included:

- **Integrate ESG into an overall risk framework.** ESG is no longer a gloss put over existing business, or a box-checking exercise. It is integral to a company’s strategy. “The core of it
all is no longer looking at enterprise risk management and sustainability impact separately. You must put them together,” Ms. Frolova-Hammer said. Understanding stakeholder expectations is an essential part of risk assessment, according to both guests. Ms. Frolova-Hammer added that “rights holders”—communities or social groups affected by the actions of the company—should be engaged as well.

- **Ensure an effective oversight structure is in place.** Directors play a critical role in establishing good governance for ESG. Key steps should include:
  - **Securing the right people.** “An important part of the job as a board member is to ensure the right people (the executive team) are driving the bus,” said Ms. Frolova-Hammer. “Make sure the executive board has the right skills, knowledge, and expertise.” The board of directors may need to add members or bring in advisors with specific competencies; some boards could benefit from ESG-focused training. “Knowing what questions to ask is a good start,” said Ms. Litvack, “but understanding enough to gauge what is a good enough answer can only come from better skills and training”.
  - **Determining which ESG elements are material.** Deciding on materiality enables boards to assess how ESG forms part of the company’s strategy, as well as to ask for the right data. Ms. Frolova-Hammer advised engaging a range of internal leaders in the materiality analysis: “You do not want to end up with a version designed just by the sustainability department. An effective way to conduct an impact-based materiality assessment is to engage legal, finance, sustainability, and other critical stakeholders to agree on what should be prioritized and why.”
  - **Deciding on an oversight structure.** “Ultimately, the entire board is answerable for the strategy and how it incorporates ESG,” said Ms. Litvack, “but whether or not to delegate the deeper dives to a committee, with regular reports up to the full board, is something boards must decide, based on the specific circumstances of the company.” While some boards may seek to make this decision early on, Ms. Frolova-Hammer cautioned that “trying to start with an oversight structure might be premature if you have not done your materiality assessment. Start with the right core team, establishing collaboration channels with key functions and, having identified material issues, expand accordingly.”

- **Think big picture and long-term.** It is more essential than ever for directors to adopt strategic, long-term perspectives. “Anti-woke backlash and energy security crisis notwithstanding, directors are being challenged to think in a much broader way than they are accustomed, over a much longer time horizon.” Ms. Litvack said. ESG is forcing boards to ask “some very big questions, such as ‘What is the rightful role of business in society and how should our company position itself in this changing context?’” Ms. Frolova-Hammer agreed: “Business leaders are being asked to consider what sustainability means for them
and for their product. How does your company’s strategy take the earth’s finite resources into account? How do we ensure that we do not only consume, but also regenerate and conserve, herewith paving the path for resource availability in the future?”

The current lack of clarity and consistency around ESG disclosure standards and regulations may cause some boards to shorten their focus and “get hung up on reporting,” Ms. Litvack said. She cautioned directors to remember that “even though the imperative of reporting on sustainability often drives boards to pay greater attention to both data integrity and performance, which is always a good thing, it should not be the tail that wags the dog. Fundamentally, ESG is about the substance of what your companies are doing; reporting flows from that.” Data collection and reporting processes are still far from perfect, but this cannot be a reason not to act with urgency. As the reporting standards or rules from the EU, ISSB, and SEC bed down and converge across geographies, companies will have the opportunity to refine them over time. Ms. Litvack’s advice for now: “Where Safe Harbor provisions are not available, such as is typically the case across Europe, we need to be absolutely transparent on the limitations of our methodology and be prepared to restate when more information comes to light. It is frustrating for everyone, but we have to do it and fix it as we go along.”

Technology governance in the face of exponential change

Keeping up to date on emerging technologies is essential for the directors of fast-growing companies, whether or not they are in technology businesses. In this session, members spoke with Harvey Lewis, Partner in Client Technology and Innovation at EY, on recent advancements in technology and the importance of strong technology governance.

Artificial intelligence (AI) is the most recent technology to disrupt economies, companies, and the work environment. Its capabilities and applications are advancing at a rate that even its developers find surprising, and investment in AI is keeping pace.

Dr. Lewis set the stage by describing OpenAI’s latest large language model, GPT-4, publicly released as ChatGPT: “The world’s most powerful large language model, it includes all the text content of the World Wide Web, plus thousands of books. The computer power needed to train these models is astonishing: GPT-4 probably required 20,000 of NVIDIA’s latest graphic processing units, running for 400-500 days, for a total cost between $200 and $300 million.”

AI is being successfully applied to problems that its developers had never anticipated. Dr. Lewis said, “I’ve worked 30 years in this space, and this is the most rapid, disruptive technology I’ve seen.” Boards need to understand the technology if they are to oversee the risks and opportunities it presents. He provided the following advice for board members:

- **Companies should build strong technology governance frameworks.** Technology governance is crucial to enable companies, particularly those that are scaling quickly, to manage the associated risks without impeding innovation or growth. But, Dr. Lewis cautioned, fast-growing companies could fall into the trap of looking ahead without taking
time to assess current capabilities, possibilities, and tools: “Technology governance starts with a solid technology strategy.” A member replied, “Small boards have small budgets. We’ve focused on discrete issues on technology and cyber risk before, but technology strategy isn’t something small boards have talked about.” It is important that boards take stock to understand their potential, he added: “A challenge for lots of organisations is legacy, not what I’m developing tomorrow, but what have I already got in my kit bag.”

Dr. Lewis recommended that boards consider building on existing frameworks: “One challenge I always see is an organisation creating new governance for what is emerging but not accounting for what is already there. New technologies bring new risks but also accentuate and exaggerate existing risks—and we have frameworks already for these.” He suggests considering, “In the context of new technologies, how do they increase the risk of things like data security and privacy?”

- **Smaller boards should add AI to the agenda.** Many EGAN members have tried out ChatGPT, but the majority at the meeting said that their boards were not discussing generative AI, or that conversations had only started recently. One member asked, “Should this be at the top of the priority list for policies, charters, and risk list? Is AI a flashing lights topic?” Considering the wide applicability and accessibility of generative AI, boards need to understand its evolving capabilities, stay informed on the latest developments, and understand the potential value of AI. Dr. Lewis said, “I guarantee some of your employees use ChatGPT. These are tools that can enhance productivity to levels not seen since the close of the industrial revolution. We’re seeing productivity increase up to 50% in some industries almost overnight. If you’re an employee looking for that advantage over your peers, why wouldn’t you use that technology?”

- **In particular, boards should consider the risks of deploying AI.** Members discussed a range of ethical, reputational, and legal concerns:
  - **The ethics around using AI are complex and evolving.** The recent surge in AI use has prompted discussions on ethical issues such as embedded biases and discriminatory outputs, data gathering and privacy, and intellectual property rights violations, both for the data used to train AI models and for the words, pictures, videos, and music that the models produce. Reflecting on the speed at which AI is developing, one member questioned how to approach determining ethical use and the longevity of any formal definition: “Are there parameters? There don’t seem to be any. How do you begin to talk about ethical behaviour and what does it look like? And is it for the next 30 days, months, or years?” Dr. Lewis replied that the AI regulations currently proposed in jurisdictions around the world are “built on a common set of principles from the OECD that are adopted by almost every country in the world. These focus on topics such as fairness, privacy, and transparency. It’s important that boards consider the same principles when putting in place policies and guidelines.”
Generative AI can provide false, but convincing, responses. Owing primarily to mismatches between queries and training data, large language models can produce not only false content but also fake references and supporting material that make the responses appear convincing. Dr. Lewis described a legal brief, produced by ChatGPT and submitted to a New York court without fact checking, which contained six completely bogus case references.

AI is being used to generate fraudulent material, pictures, and video content. AI can be a powerful enabler of fraud and other torts against organizations and individuals. New models, easily and cheaply accessible to malefactors, can generate believable documents, pictures, and videos. Early hopes of automated tools to detect fraudulent AI-produced content have been dashed. Dr. Lewis said, “It takes a few tweaks of a prompt to make faked text completely undetectable. We’re living in a world where AI is creating imagery, text, voices, and videos that are indistinguishable from that written by humans.”

Finding the balance between embracing change and moving too quickly involves “thinking fast and slow”. Although “12 months is an eternity in this field,” said Dr. Lewis, companies should be cautious about acting too quickly. One member commented on the challenge of finding this balance: “Companies need to find the balance between the dark side and the light side; what limitations I should enforce, what processes I can push to become more efficient, that’s a difficult balancing act.” While companies may be tempted to invest in the latest exciting technology, it is best to first spend time, rather than money, to understand the technology. He said, “One of the worst things to do is to have a knee-jerk reaction and invest a huge amount of time and money in something that quickly becomes obsolete or redundant. If you rush now, which I think a lot of organisations are doing, you’ll probably come up with the wrong answers. You need to do it in a way that’s informed and intelligent; that requires focus before massive investment takes place.”

Good practices in audit committee and board leadership

Byron Grote, audit chair of AkzoNobel and Tesco; Leslie Seidman, audit chair of Janus Henderson; and Maria van der Hoeven, audit chair of TotalEnergies, joined EGAN members in a dinner discussion, exchanging views on challenges and good practices in leading audit committees and boards. A number of key themes emerged:

The role of the audit chair. The chair is a leadership position, with a core mission of ensuring that the company is providing information to the marketplace that is “useful, accurate, fulsome, comprehensive, and comparable.” One of the audit chair dinner guests added that “the chair wears two hats: to support and to challenge.” EGAN members and dinner guests emphasized that the chair’s role is one of oversight, not a substitute for management. Members talked about how the chair also needs to be continually thinking ahead—especially about relationships that need to be maintained and grown.
- **Practical steps for creating an effective audit committee.** Members discussed actions that could be helpful in maintaining the effectiveness of an audit committee:
  
  o Using an annual calendar for the audit committee’s activities. One audit chair dinner guest said, “On taking up the chair role, I discovered that the committee didn’t have one. I quickly actioned the development of an annual calendar.”
  
  o Regularly holding executive sessions to discuss issues without management present.
  
  o Drawing on the strengths, talents, and competencies of all members of the audit committee.
  
  o Selectively bringing in others who have knowledge of a critical matter. Members noted that an audit committee, especially in a smaller company, probably doesn’t need many specialist members; the committee can bring in experts as needed.
  
  o Creating clarity around who—internal and external auditors, the board chair, or other directors, etc.—attend audit committee meetings. Members described different preferences around this but agreed that it was important to be explicit about the approach.

- **Board structures that support good governance.** Members discussed the importance of having a balance between maintaining a holistic view of company risks and clarifying responsibilities around specific risks. The audit committee or the board as a whole might own the full enterprise risk framework, allocating specific risks to other committees. One audit chair dinner guest emphasized the importance though of “rightsizing risk oversight for the company and for the nature of the risks.” Members also discussed the importance of an ongoing check to ensure that all risks are appropriately covered. One audit chair guest noted that “you hear about risks in the boardroom that are not showing up in the published risk factors.” One member added that this could be done through a “mapping of risks against responsibilities every year.”

- **Learning from other non-executive roles.** Guest audit chairs encouraged members to consider other non-executive roles, especially in different industries, to broaden their perspectives. This may help in spotting new risks and in balancing the makeup of the audit committee.

  EGAN members asked guests how they thought about taking on other non-executive roles:
  
  o Considering what you can contribute versus what you get back from the role.
  
  o Finding out what countries are involved—some may prefer more global companies.
  
  o Determining why they want you to join the leadership team.
  
  o Considering how much time it will take and whether you have the capacity.
• **Advancing oversight of ESG.** Although ESG can be less advanced in some high growth companies, it is still important to start thinking about measurements and targets to be ready for mandatory reporting. Guests suggested:

  o Keeping ESG on the agenda of the audit committee, which should maintain consistency of focus from period to period.
  o Thinking, early on, about the internal control systems needed for ESG data.
  o Starting the ESG journey with the most material risks to the business.
  o In Europe, considering how double materiality for ESG information will be disclosed.
  o Getting started early on ESG areas that may not be currently addressed—for example, ‘social’ disclosures that will become mandatory in time.
  o Quickly identifying clashing reporting standards or time frames. Avoiding premature or excessive disclosures, or promising disclosures that may prove difficult to deliver.
Appendix 1: Meeting participants

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

- Nadja Borisova, Audit Committee Chair, Blaize Car
- Brenda Eprile, Audit Committee Chair, Atlantic Sustainable Infrastructure, Inc., and Westport Fuel Systems, Inc.
- Christoph Hutten, Audit Committee Chair, Brockhaus Technologies
- Sandip Kapadia, Audit Committee Chair, VectivBio
- Linda McGoldrick, Audit Committee Chair, Compass Pathways, and Audit Committee Chair, Avrotech
- Carolyn Schuetz, Audit Committee Chair, OakNorth Bank

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

- François Langlois, Managing Partner, Markets and Business Development, EMEIA Assurance, EY
- Suwin Lee, Private Leader for Europe, the Middle East, India and Africa, EY
Endnotes

1 Summary of Themes reflects the network’s use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Quotations in italics are drawn directly from members and guests in connection with the meeting but may be edited for clarity.