Audit Committee Leadership Network

December 2021

ACLN

VIEWPOINTS

CFO perspectives on ESG reporting practices

Companies are facing an ever-growing demand from investors, regulators, and activist groups to incorporate environmental, social, and governance (ESG) matters in their business strategies and to provide transparency about past and planned actions. As a result, the quality, depth, and breadth of ESG reporting are under greater scrutiny, and the stakes for getting it right are high. Sustainability reports are increasingly being aligned with other corporate disclosures and subjected to more rigorous controls, and some form of ESG reporting is expected to become mandatory in SEC filings.

ESG reporting is increasingly a cross-functional effort, no longer isolated in social responsibility or sustainability departments. CFOs and finance organizations are now being asked to support or even lead on ESG reporting. Finance professionals can better translate greenhouse-gas emissions, social metrics, and other ESG data into monetary terms, and they are often skilled at regulatory compliance. A commentator observed that "the expertise of the CFO team is well suited to lead the design, operation, and maintenance of internal controls and governance over sustainability performance information."[1] With the SEC signaling the potential for tighter regulation of ESG disclosures, finance organizations are likely to increase their involvement in reporting.

On November 16, 2021, members of the Audit Committee Leadership Network (ACLN) met virtually to discuss ESG reporting practices and processes with Hugh Johnston, chief financial officer of PepsiCo; Nancy Buese, chief financial officer of Newmont Mining Corporation; and Prat Bhatt, chief accounting officer of Cisco Systems.

For biographies of the meeting guests, see Appendix 1, on page 9, and for a list of participants, see Appendix 2, on page 11.

Executive summary

The following themes emerged from the discussion:[2]

- **Guests' companies demonstrate mature ESG strategy and reporting practices.** Members noted that Newmont, Cisco, and PepsiCo are significantly more mature in their ESG reporting than most members' own organizations. A member said that the three companies have *"demonstrated the path that we're all eventually going to end up on,"* as well as *"the obstacles, barriers, problems, and opportunities"* that other companies can expect to encounter on their ESG journeys.

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- **Finance teams are playing an increasing role in managing ESG data.** The guests explained that their finance teams do not own ESG data but play a vital role in partnering with others in the organization to ensure that the right structure, processes, controls, and systems are in place to ensure reporting integrity. Mr. Bhatt said, *"I don't think that finance necessarily needs to own the data …. What finance can most readily add is structure, process, control systems, data architecture, systems—skills that finance is readily able to provide."* But one guest and a few ACLN members observed that finance's role may change as the SEC moves to demand ESG disclosures in corporate filings. One member noted that finance might become not only a supporter of ESG reporting but a customer of some of the nonfinancial data.
- **Compensation is being linked to ESG goals.** At Newmont, ESG metrics are included in both short- and long-term compensation plans for both executives and nonexecutives. Ms. Buese said that ESG metrics were about 20% of the short-term incentive program in 2020, and she expects this percentage to increase in the future. The compensation of leadership at the organization is also tied to 2030 and 2050 climate goals, Ms. Buese explained, reflecting the company's recognition that *"a huge amount of the lift will take place in the next handful of years, and it's the investments in the projects that we will build to support those goals that are just absolutely critical."* A member was impressed to hear about Newmont's linking long-term compensation plans to ESG, an unusual practice in Fortune 500 companies.
- **Training is now critical both for finance teams and other ESG data owners.** Mr. Bhatt emphasized the need to create awareness and to educate Cisco's global finance team of approximately 3,000 finance professionals on ESG issues. He described a comprehensive training program that is being developed and will include ESG learning modules in 2022. But finance is not the only area where new skills are needed. Members and other guests highlighted the need to educate ESG data owners in all parts of the organization on reporting and controls. A member noted, *"It's important to not only train and engage people in finance but the broader organization, as each company has a different focal point in the organization for ESG."*

For a list of reflection questions, see Appendix 3, on page 12.

Guests' companies demonstrate mature ESG strategy and reporting practices

The guests said that ESG strategy and reporting has a long history at their organizations.

Newmont has been reporting on nonfinancial performance since 2004. In 2019, Bloomberg's ESG disclosure score ranked Newmont as the third most transparent company in the S&P 500. MSCI rated Newmont AA on ESG and recognized it as a leader in its sector.[3] Ms. Buese said, *"We've got a very long history of taking a leading approach to ESG practices that is developed* *out of some incredibly important lessons we learned decades ago in Peru, Uzbekistan, and Indonesia."* A member of Newmont's executive team has, for a decade, led an independent global ESG group that has grown to 130 employees today. In a premeeting call, Ms. Buese also explained that while the ESG group *"creates the numbers and writes the narrative, we [finance] go and test that, in the exact same way we test the MD&A [management discussion and analysis] or any of our notes to the financial statements, and we also do our own independent work with the sites."* She added that the company's ESG reporting has evolved over the past 30 years and is now *"equivalent to an extra 10-K or an extra 10-Q every year in terms of volume and content."* Ms. Buese emphasized that ESG is embedded in Newmont's strategy and *"is a fabric of the company and quite fundamental to the way we operate."*

Cisco published its first corporate social responsibility report in 2005. MSCI has awarded it an AA ESG rating, and in 2020 Cisco received the Gold Class SAM Sustainability Award. Mr. Bhatt said that, as at Newmont, Cisco has deeply incorporated ESG concerns in its business. The company has focused on three main areas: climate change, social issues, and diversity and inclusion. Mr. Bhatt stressed, *"We're trying to drive lasting outcomes and not just something that's more superficial."* He said his presence, as Cisco's chief accounting officer, at meetings to discuss ESG matters is indicative of finance's evolution on ESG reporting. Mr. Bhatt noted that finance had been enthusiastically asked to join Cisco's ESG leadership in their reporting effort as they recognized that they *"needed the structure, the process, the systems knowledge, and the capabilities that finance professionals bring."* He emphasized that ESG is still a journey for both finance and the entire organization because *"driving change with environmental and social issues is incredibly complex and it takes a ton of time and commitment to achieve the outcomes. It's an evolution, and we're learning a tremendous amount every day."*

At PepsiCo investment in more sustainable packaging started as early as the 1990s. ESG is now one of three core elements that make up PepsiCo's corporate strategy banner: "Faster. Stronger. Better." The company's sustainability strategy aims "to use resources more efficiently, reduce GHG emissions, replenish water, improve our products and recapture packaging materials."[4] PepsiCo has created a program, pep+ (PepsiCo Positive), which Chairman and CEO Ramon Laguarta calls "the future of our company, a fundamental transformation of what we do and how we do it to create growth and shared value with sustainability and human capital at the center."[5] As a result of these efforts, PepsiCo was awarded Corporate Secretary's Best ESG Reporting and Corporate Governance Team of the Year (Large cap) at the annual Corporate Governance Awards (2020)[6] and was recognized with the inaugural Terra Carta Seal (2021) "for demonstrating a commitment to, and driving momentum towards, the creation of genuinely sustainable markets."[7]

The guests pointed to the direction of ESG reporting requirements in the United States and the European Union as another key factor for the companies' sustainability focus. A guest noted that the EU, which is ahead of the rest of the world in mandating ESG disclosures, forms a significant part of the company's business. This has further pushed the ESG agenda into an active part of its strategy. Mr. Bhatt commented that expectations of new requirements in both the US and the EU have moved Cisco's finance team from having a limited role in ESG reporting to being an active partner.

Members noted that Newmont, Cisco, and PepsiCo were significantly more mature in their ESG reporting, compared with their own organizations. A member said that the three companies had *"demonstrated the path that we're all eventually going to end up on."* He added that the conversation had helped him think about the transition and where his company is today, adding that hearing from the guests about their companies' and finance teams' evolution on ESG reporting gave him insight into *"the obstacles, barriers, problems, and opportunities"* that his organization can expect to encounter on its ESG journey.

Finance teams are playing an increasing role in managing ESG data

The guests explained that although their finance teams did not own ESG data, they played a vital role in partnering with others in the organization to ensure that the right structure, processes, controls, and systems were in place to ensure reporting integrity.

Mr. Bhatt described Cisco's ESG Reporting Hub—a library of information and data on Cisco's ESG priorities, performance, policies, and initiatives that was established several years ago—as *"a good collaborative effort with finance stepping in."* He said that as data is gathered across the organization, the finance team is an integral part of ensuring the accuracy and reliability of the information that gets included in the hub. The accuracy of the data is important not only because the hub makes it available to external stakeholders but also because, as Mr. Bhatt noted, the hub has become an internal *"road map"* that helps finance and ESG teams prioritize across the hundreds of metrics the organization reports on.

Finance, Mr. Bhatt noted, works on identifying *"the universe of ESG data"* by reviewing all the metrics and querying their sources—*"good old-fashioned walk-throughs and understanding of sources of information, what systems the data is coming from."* The data is bucketed and prioritized, with the data that is most reported and heavily relied on in the first tier—a process that enables a better understanding of what is most material for the organization and what work should take precedence. While finance does not own the data, it helps with the application of a commercial framework, with ensuring the reliability of the information, and with the application of SOX-like controls. Mr. Bhatt added that Cisco is currently reviewing finance data strategies and systems and has expanded the review's scope to include ESG. *"The reality is that our systems don't pick up this [ESG] information readily, so it'll be interesting to see how we can get down to the sources of that information and actually systematize it,"* he said.

A member wondered whether ownership of ESG data may need to be brought into finance, given the SEC's expected move to mandate some form of ESG reporting in corporate filings. In a premeeting call, another member was concerned about the accuracy of the data in voluntary reports: *"Sustainability teams, human resources, and groups like these are not always skilled in data accuracy. Frankly, when our internal audit groups went in, they were finding mistakes."* Similarly, another audit chair said that the rigor of his company's sustainability reports was not at the level of its financial reporting, observing that the sustainability report is still *"a balance of aspirations and attitude"* and that *"the aspirations are more developed than the data."* This member also noted that ESG reporting at his organization will need to rapidly change with new filing requirements.

Mr. Bhatt opined, *"I don't think that finance necessarily needs to own the data."* He emphasized that at Cisco, the role of finance is to provide *"high-level validation"* on ESG reporting that is as rigorous as the validation of financial metrics. Finance, he noted, has ownership over the validation controls and can give feedback to the particular function or business unit that owns the data. *"What finance can most readily add is structure, process, control systems, data architecture systems—things that we're pretty good at,"* Mr. Bhatt said.

Another guest agreed. He noted that some of the data in the financial report comes from the company's sustainability report and that the sustainability office is responsible for its controls. He added that if the SEC *"asks for what's being disclosed in sustainability reports right now, I feel like we're pretty comfortable with what is said in our sustainability report. It is pretty good relative to most companies."* But, the guest said, *"the big question out there is, are we going to be looked at to put SOX-level controls around all of this, or are they going to be more like 'SOX lite'?"* He added that if companies are required to disclose and follow a lot more data and to have SOX-level controls around ESG data like those applied to financial data, *"I might change my view in terms of who should own the data, what's behind that creation, and the management of the data."* He envisioned that the level of process testing and the validating will then need significant input from finance.

The guest also noted that his company has already incorporated ESG assumptions in some impairment analyses. He pointed to a specific example *"where we've evolved our supply chain plans and built new plants in anticipation of potential water issues."* Ms. Buese said that, at Newmont, ESG is *"a qualitative piece of impairment consideration"* that the company spends significant time thinking about. She noted that the company had halted a project because it had not been able to get the social license to operate, and that Newmont has learned from this experience. Today, the company focuses on *"how we are measuring our social license,"* Ms. Buese said. *"Where we haven't been able to achieve these measured goals, we would not go to full construction."*

Compensation is being linked to ESG goals

Ms. Buese said that sustainability and safety targets are an important part of the compensation plans for all employees and form a part of the annual bonus program at Newmont. This, she noted, *"helps us ensure that every single employee takes a personal role in our sustainability* *performance."* ESG metrics comprised 20% of the short-term incentive program in 2020 and she expected that this number would increase in the future.

Ms. Buese said that she is responsible for refining the ESG metrics that get incorporated in the incentives, and much of her focus has been on moving away from lagging indicators and creating leading indicators. For example, Newmont tracks the frequency of community grievances and the time it takes to resolve them as compared with other outstanding community issues. Ms. Buese explained the need for change: *"That's a lagging indicator, and one of the things that we're really struggling with and thinking about is how do you create a leading indicator for this social metric."*

Ms. Buese noted that executive compensation at the organization is tied to 2030 and 2050 climate goals. A member observed that many companies today are setting 2030 and 2050 net-zero goals, but very few Fortune 500 companies have linked ESG targets to long-term compensation; in other words, he said, *"people are writing checks that they don't have to cash."* In a premeeting call, another member shared similar concerns: *"The organizations are basically painting a story and talking about where they can be in 30 years, but not a single person in today's management team is going to be there in 2050, to be held accountable for reaching these goals."* In Newmont's case, however, the first member noted, specific steps are already being taken to drive toward the long-term ESG goals, and they are factored into compensation.

Linking ESG and executive compensation among S&P 500 companies

In a Willis Towers Watson survey of board members of large companies around the globe, the majority of the 170 board members interviewed believed that executive incentive plans should include ESG metrics.[8] The study, which also included a review of the ESG-related public disclosures of more than 2,000 companies, including S&P 500 companies and 350 of the top companies in Europe, found that the use of ESG metrics in incentive plans is more prevalent in Europe. Among companies listed on the major European indices, ESG metrics were used in 63% of annual incentive plans and 15% of long-term incentive plans, compared with 51% of annual plans and just 3% of long-term plans among S&P 500 companies.[9]

Training is now critical for finance teams and other ESG data owners

In premeeting calls, audit chairs cited the short supply of ESG skills as a challenge for their organizations. Many agreed that making their ESG reporting as robust as their financial reporting would require upskilling existing workforces. A member thought that it was unlikely that we will *"see companies hiring dozens of engineers to put in the finance organization to* *oversee ESG reporting."* Instead, he envisioned organizations leveraging existing resources and being more involved in their development.

Mr. Bhatt noted that a key to Cisco's progress on ESG reporting has been the finance team's understanding of the risks and commitments that the company has made. Cisco has encouraged finance staff to expand their skill sets in ESG in order to become finance professionals of the future. Mr. Bhatt described a comprehensive training program for finance professionals that would include ESG learning modules.

However, finance is not the only area where new skills are needed. Members and guests also highlighted the need to educate ESG data owners, from HR to operations, on reporting and controls. Ms. Buese said, *"We have worked very hard to train and support our ESG brethren in the same kinds of attestation, audit trail, and documentation controls environment that we have in our financial reporting world."*

A member noted, *"It's important to not only train and engage people in finance but the broader organization, as each company has a different focal point in the organization for ESG."* He suggested an alternative to training: embedding finance professionals in different groups responsible for ESG. The member thought that this would benefit not only the group but also the finance professional, as it could equip the individual with ESG skills and also be a great career development opportunity. The member said, *"Let's make sure that we don't make it too financial-centric or finance-centric. I think that it has to be broader and keeping with the strategic nature of this."*

Conclusions

Members and guests demonstrated different models of finance involvement in ESG reporting practices at their organizations. However, they agreed that finance's role in this area is likely to increase given the direction of new US and EU disclosure requirements. Guests also made it clear that despite their organizations' maturity on ESG reporting, they are still evolving and learning. They anticipated more work and challenges in the next year, including preparing for the impacts of new SEC filing requirements on ESG, raising ESG competence in finance, and automating data collection and processes.

About this document

The Audit Committee Leadership Network is a group of audit committee chairs drawn from leading North American 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.

Appendix 1: Guest biographies

Nancy K. Buese was appointed executive vice president and chief financial officer of Newmont effective October 31, 2016.

Ms. Buese brings 25 years of experience in finance leadership roles and joined Newmont having most recently served as executive vice president and chief financial officer for MPLX, a publicly traded energy company formed by Marathon Petroleum Corporation. Prior to MPLX's acquisition of MarkWest Energy partners in 2015, Ms. Buese served for 11 years as executive vice president and chief financial officer of MarkWest. Having worked in public accounting for 14 years, Ms. Buese is also a former partner with Ernst & Young.

She earned her degree in accounting and business administration from the University of Kansas and is a Certified Public Accountant.

Prat Bhatt is a Fortune 100 senior technology executive and a financial expert with deep experience in global operations, strategy, risk, and investor relations. He is the SVP and chief accounting officer at Cisco, leading a global team of over 1,000 finance professionals covering all countries where Cisco operates.

In his 20 years with Cisco, he has led key finance initiatives including development of operational strategies, processes, and systems in support of Cisco's digital and growth imperatives; capital allocation strategy; public debt offerings; tax strategy; deal structuring for complex offers, and sales arrangements, investment, and M&A transactions; along with pre- and post-M&A strategy and integration.

Mr. Bhatt serves as member of the board of directors of Seagate Technology and is a member of the audit and finance committee.

Mr. Bhatt is a respected and longstanding leader in the finance profession and influential in financial standard setting, with several chair roles in national finance professional organizations such as the FEI committee on Corporate Reporting as well as in advisory committees to the FASB and PCAOB. He is a regular guest speaker at the Stanford Graduate School of Business and on current financial topics in various other forums.

Prior to Cisco, Mr. Bhatt was a financial executive in a major national healthcare organization responsible for corporate financial planning and analysis, resource modeling and allocation, and performance improvement. He also was with Ernst & Young, with a focus on financial audits and advisory services.

He holds a graduate degree in accounting from the University of Southern California, an undergraduate degree in economics from the University of California, Santa Cruz, and is a CPA.

Hugh Johnston is vice chairman and chief financial officer of PepsiCo. He assumed the role of chief financial officer in 2010 and is responsible for providing strategic financial leadership for PepsiCo, including ensuring the company's strategy creates shareholder value; communicating the company's strategies and performance to investors; and implementing a capital structure, financial processes, and controls to support the company's growth and return on investment goals.

In addition, Mr. Johnston's portfolio has included a variety of responsibilities, including leadership of PepsiCo's information technology function since 2015; the company's global e-commerce business from 2015 to 2019; and the Quaker Foods North America division from 2014 to 2016. In these roles, He has focused on addressing global trends that are reshaping the food and beverage industry, including health and wellness, the rise of the digitally connected consumer, and the emergence of e-commerce as a new distribution channel.

Mr. Johnston joined PepsiCo in 1987, and has served in a variety of positions, including executive vice president, global operations, PepsiCo; president, Pepsi-Cola North America; senior vice president, transformation, PepsiCo; senior vice president and chief financial officer, PepsiCo Beverages and Foods; and senior vice president, mergers and acquisitions, PepsiCo.

Mr. Johnston is active with a number of corporate, NGO, and academic organizations, and currently serves as a member of the board and chair of the audit committee of Microsoft Corporation. Other organizations in which Hugh serves include: director for the Peterson Institute for International Economics; the University of Chicago's Booth School CFO Forum Advisory Board; and Syracuse University's Whitman School of Management Advisory Council. Additionally, he is a member of the Federal Reserve Bank of New York Second District Advisory Council and the CNBC Global CFO Council. Previously, he served as a director of AOL, Inc., where he chaired the audit and finance committee, and a director of Twitter, Inc., where he served as a member of the audit committee.

Mr. Johnston holds a B.S. from Syracuse University and an M.B.A. from the University of Chicago.

Appendix 2: Participants

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

- Eva Boratto, UPS
- Barbara Byrne, ViacomCBS
- Janet Clark, Texas Instruments
- Dan Dickinson, Caterpillar
- Sam Di Piazza, AT&T
- Dave Dillon, 3M and Union Pacific
- Bill Easter, Delta Air Lines
- Gretchen Haggerty, Johnson Controls
- David Herzog, MetLife and DXC Technology
- Charles Holley, Amgen and Carrier Global
- Michele Hooper, United Airlines
- Hugh Johnston, Microsoft
- Akhil Johri, Boeing and Cardinal Health
- Kelly Kramer, Gilead
- Nick LePan, CIBC
- Mike Losh, Aon
- Edward Ludwig, CVS
- Nancy McKinstry, Abbott
- Suzanne Nora Johnson, Pfizer
- Louise Parent, FIS
- Ann-Marie Petach, Jones Lang LaSalle
- Kimberly Ross, Cigna
- Tom Schoewe, General Motors
- Leslie Seidman, GE
- Gerald Smith, Eaton
- John Stephens, Freeport-McMoran
- Fred Terrell, Bank of New York Mellon
- Jim Turley, Citigroup and Emerson Electric
- John Veihmeyer, Ford
- Robin Washington, Salesforce.com
- David Weinberg, The Coca-Cola Company
- Maggie Wilderotter, Hewlett Packard Enterprise

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

- John King, Americas Vice Chair – Assurance, Ernst & Young LLP
- Patrick Niemann, Partner, EY Americas Center for Board Matters, Ernst & Young LLP
- Stephen Klemash, Leader, EY Americas Center for Board Matters, Ernst & Young LLP

Appendix 3: Reflection questions for audit committees

? What is your company's strategy for responding to the escalating demand for ESG reporting?

? What elements of financial and ESG reporting are being aligned or integrated? What elements are appearing in separate reports?

? How is your CFO helping to implement the company's ESG strategy? What role is the finance function playing?

? What kind of controls environment is being established for ESG at your company?

? What processes are being considered to keep up with the rapid developments from regulators and ESG standard setters?

? What kinds of organizational changes are being made within the finance function and across finance, operations, and other functions?

? What staff or skill sets are being added to the finance organization to support ESG reporting?

? What are the most significant challenges your company and your CFO have faced in ramping up ESG reporting? What challenges do you anticipate in the future?

? How is your company thinking about assurance of sustainability reports?

? What sorts of internal attestation and external assurance are you putting in place?

? Who do you think is best equipped to audit sustainability reports?

? How is your audit committee thinking about targets and forward-looking metrics?

? Is your company currently allocating funding for incremental efforts associated with internal or external audit attestation work?

Endnotes

[1] Shari Littan, "The COSO Internal Control Framework and Sustainability Reporting: The Benefits of Good Governance and Internal Controls," *CPA Journal,* July 2019.

[2] *ViewPoints* 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. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.

[3] "ESG Ratings & Climate Search Tool," MSCI, accessed December 14, 2021.

[4] "2020 Sustainability Report: Our Strategy," PepsiCo, accessed December 14, 2021.

[5] "PepsiCo Positive," PepsiCo, accessed December 14, 2021.

[6] "Awards," PepsiCo, accessed December 14, 2021.

[7] "PepsiCo Positive," PepsiCo.

[8] Willis Towers Watson, *ESG and Executive Compensation: Hearing from Board Members Globally* (Willis Towers Watson, 2021), 15.

[9] Willis Towers Watson, *ESG and Executive Compensation: Hearing from Board Members Globally,* 17–18.