

Audit Committee Leadership Summit

August 2022

ACLS

VIEWPOINTS

Audit chairs discuss ESG oversight

Regulators, investors, and other stakeholders are calling for increased disclosure of environmental, social, and governance (ESG) data. But companies face many challenges as they prepare to meet evolving disclosure rules in the United States and the European Union, along with the expectations of shareholders and society at large. Beyond disclosure, board oversight of ESG remains a heightened area of focus for companies, investors, and regulators.

On June 29 and 30, 2022, members of the North American Audit Committee Leadership Network (ACLN) and the European Audit Committee Leadership Network (EACLN) met to discuss how directors of large global firms provide governance and oversight of ESG matters.¹

This *ViewPoints* summarizes three themes that emerged from the discussion:

- **Clarity on who owns each element of ESG oversight is key**
- **Evolving regulatory environments present continuing challenges**
- **Assuring ESG disclosure is difficult given a lack of common standards and frameworks**

For a list of participants, see Appendix 1, on page 6.

Clarity on who owns each element of ESG oversight is key

As one member put it, the main task in overseeing ESG is “*getting very crisp on who owns the decisions on what you disclose, where you disclose it, and who owns the quality assurance around the disclosures.*”

- **Governance is usually split between multiple board groupings.** Members reported a range of approaches; for example, the nomination and governance or public policy committee might own oversight of ESG policies, while the audit and/or risk committees oversee controls and disclosures and the compensation committee connects ESG goals to executive compensation plans. Where ESG is viewed as a strategic opportunity or requires significant capital expenditure, it may be tackled by the full board. Each board develops an approach suited to its makeup and to the challenges facing the company.
- **Shared responsibility for ESG oversight requires clear communication and delegation of responsibilities.** Members have invested effort into articulating each committee’s specific role and responsibilities. A few have updated board committee charters to reflect the aspects of ESG that each committee oversees. Some boards have considered standing up ESG or sustainability committees, but, as one member observed, “*the ESG committee’s*

work really overlaps with other committees, and there is a certain amount of work deciding and communicating which committee does what.” As more than one member emphasized, coordination and communication are key when multiple board committees are involved. Given the complexity of ESG issues, “people will have to learn to work across silos.”

- **Audit committee responsibilities center on ESG controls and disclosures.** Members agreed that the audit committee’s responsibility for accurate and transparent financial reporting positions it to do the same for ESG disclosures. A member said, *“Nothing changes on the audit side. The audit committee is responsible for what goes in the documents and the controls around that.”*
- **As new regulations contemplate incorporating ESG information into financial statements, audit chairs acknowledge that there is more work to be done.** As stakeholder expectations and reporting requirements evolve, members expressed a desire to move ESG controls and reporting to a place where they are *“consistent with what is done in regard to financial disclosures.”* But one observed that there is a long way to go: *“In most companies, very little, if any, ESG reporting currently comes through the kind of SOX [Sarbanes-Oxley Act]-certified processes and pipelines that financial reporting comes through.”* Audit chairs have found ways to move toward SOX-like processes for ESG reporting, including asking finance and/or internal audit teams to review sustainability data and reports and having management internally certify reports along the lines of SOX 302 signatures.² One member contemplated asking internal audit to *“review the company’s ESG reports as if they have to write a comfort letter for an underwriter.”*
- **ESG disclosure committees can help add rigor and structure to ESG reporting.** More than half of the audit chairs at the meeting reported that their companies have established ESG disclosure committees. These typically develop and document reporting and control processes, review and verify ESG data, and develop policies for disclosure controls and procedures. In addition to finance and internal audit, managers from engineering/environmental, human resources, legal, and/or operations teams often sit on ESG disclosure committees, and there is often overlap with existing financial disclosure committees.
- **Strengthening ESG disclosure is an iterative process.** All members agreed that it will take time before ESG disclosures are as rigorous as their financial equivalents. Therefore, noted one member, *“disclosing something reliably and with good controls can affect the timing of when you want to disclose it.”* She added, *“The process of what to disclose and how to disclose it is iterative.”* With recognition that there is still much to be done related to ESG reporting, *“the difficult question is to know how much time should audit committees spend on ESG.”*

European approaches to ESG oversight

Most members assert that European companies are further along in the ESG journey than their North American counterparts, although one European audit chair thought that European boards still had a long way to go in overseeing social issues. European audit chairs highlighted practices that had been effective in their companies' ESG governance:

- Clear delegation of ESG responsibilities to existing committees
- Adding ESG board committees when needed
- Creating a matrix showing which sustainability frameworks and/or regulations the company is applying, and updating it as regulations change or the company evolves its reporting
- Scenario planning on implications of ESG commitments (e.g., what does it mean for other products, and what will demand be for ESG-oriented products?)
- Regular ESG education sessions for the board
- Bringing in board members with ESG expertise

Evolving regulatory environments present continuing challenges

As regulatory regimes in the United States and the European Union continue to change, members on both sides of the Atlantic worry that multiple ESG reporting frameworks and standards will lead to confusion and potentially conflicting mandates.

One audit chair observed that, currently, *“there are all of these different standards, and trying to figure out which ones we should use is a challenge. We use multiple and have appendices in the back of the sustainability report that show all the different frameworks and the metrics against those frameworks.”* Members anticipated that such difficulties would remain, and some thought that they could worsen if the US and EU diverge in their ESG reporting requirements. One audit chair said, *“There is real danger that the SEC goes one way and the EU another, and if they do, it will kill companies.”*

Clashing definitions of materiality have further complicated reporting. One member noted that assessing materiality *“is still quite complex because it is different for every company and industry. Is it material to your company, to the supplier, to the outside world, or inside the company?”* There are also major differences between EU and US definitions of materiality. The proposed EU Corporate Sustainability Reporting Directive is based on a “double materiality” principle, which asks companies to disclose information that is material not just for investors

but also for society in general and for the environment, whereas the US SEC's proposed new rules on ESG apply a "single materiality" principle.

ACLN and EACLN members comment on proposed rules

In November 2021, ACLN members engaged in a dialogue with SEC chair Gary Gensler. After a follow-up discussion with SEC staff in June 2022, ACLN members submitted a comment file with recommendations on the commission's climate-related disclosures proposed rule. *The recommendations can be viewed [here](#).*

In March 2022, the European Audit Committee Leadership Network met virtually with officials from the European Commission's Directorate-General for Financial Stability, Financial Services, and Capital Markets Union: Ugo Bassi, director of financial markets; Ward Möhlmann, deputy head of the unit responsible for corporate reporting and audit; and Delia Mehedintu, policy officer. *A [ViewPoints](#) from that meeting outlines EACLN members' perspectives.*

Assuring ESG disclosure is difficult given a lack of common standards and frameworks

Evolving regulations are affecting the way audit committees and companies are thinking about ESG assurance. Currently, sustainability reports and ESG disclosures are for the most part voluntary. Members said they usually call on engineering firms to assure ESG information, and specifically flagged Scope 3 disclosures as an area where they seek outside assurance from nonaudit firms. One member noted that Scope 3 disclosures *"are so subjective and there are so many choices—for instance, do you report net versus gross?"* and said that an outside firm *"helped us benchmark against how other companies are approaching it."*

But several US audit chairs said that, given SEC proposals on climate-related disclosures, they would prefer having their financial statement auditor assure ESG reporting. One company has already asked its auditor for a readiness review of its ESG reporting, and most agreed that greater involvement from external auditors was on the horizon. *"Having the same firm audit financials and ESG would be my preference,"* said one member. Another said that if ESG moves to the financial statements, *"it makes sense to have a financial auditor assure that information too."*

Members agreed, however, that until there are clear and uniform standards, there will be a variety of ways that companies go about having ESG information assured. One said, *"What are they going to audit against? There are still too many choices for how you report."*

About this document

The European Audit Committee Leadership Network (EACLN) and Audit Committee Leadership Network (ACLN) are groups of audit committee chairs drawn from leading European and North American companies committed to improving the performance of audit committees and enhancing trust in financial markets. The networks are 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 ACLN members participated in all or part of the meeting:

- Joan Amble, Booz Allen Hamilton
- Judy Bruner, Applied Materials and Seagate Technology
- Jeff Campbell, Aon
- Janet Clark, Texas Instruments
- Pam Craig, Merck
- Ted Craver, Wells Fargo
- Dan Dickinson, Caterpillar
- Bill Easter, Delta Air Lines
- Lynn Elsenhans, Saudi Aramco
- Tom Freyman, AbbVie
- Gretchen Haggerty, Johnson Controls
- Bob Herz, Fannie Mae and Morgan Stanley
- Akhil Johri, Boeing and Cardinal Health
- Lori Lee, Emerson Electric
- Arjun Murti, ConocoPhillips
- Louise Parent, FIS
- Ann Marie Petach, Jones Lang LaSalle
- Peter Porrino, AIG
- Kimberly Ross, Cigna
- Tom Schoewe, General Motors
- Leslie Seidman, GE
- Cindy Taylor, AT&T
- Fred Terrell, Bank of New York Mellon
- Tracey Travis, Meta
- Jim Turley, Citigroup

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

- Julie Brown, Roche
- Marion Helmes, Heineken
- Pilar Lopez, Inditex
- Benoît Maes, Bouygues
- John Maltby, Nordea
- Marie-José Nadeau, ENGIE
- Karyn Ovelmen, ArcelorMittal
- Ana de Pro Gonzalo, STMicroelectronics
- Jon Erik Reinhardtsen, Telenor Group
- Guylaine Saucier, Wendel
- Maria van der Hoeven, TotalEnergies

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

- Julie Boland, EY US Chair and Managing Partner, and Americas Managing Partner
- John King, EY Americas Vice Chair—Assurance
- Patrick Niemann, EY Americas Leader, EY Audit Committee Forum

Appendix 2: Questions for audit committees

- ? How do you ensure coordination between the committees responsible for ESG?
- ? What are the challenges with multiple committees sharing ESG responsibilities?
- ? How do you see ESG committee responsibilities evolving in the near term?
- ? To what extent is your board adding ESG skills to its capabilities?
- ? How much time does your audit committee spend on ESG matters?
- ? What controls environment is being established for ESG data at your company?
- ? How is your company preparing for new ESG disclosure rules? What have you observed that might be helpful to other businesses gearing up their ESG reporting?
- ? What sorts of internal attestation and external assurance are you using? Do you anticipate this change in the future?
- ? What are the most significant challenges your company has faced in ramping up ESG reporting?
- ? What challenges do you anticipate with the new rules and in general?

Endnotes

¹ *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.

² Section 302 of the 2002 Sarbanes-Oxley Act requires top company executives, usually the CEO and CFO, to personally attest, in writing, that disclosed financial information is accurate and reliable. These attestations are included in the 10-K (annual) and 10-Q (quarterly) reports filed with the SEC.