Finance, the Audit Committee and the Climate Disclosure Journey

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To guide companies toward their ESG goals, audit committee members should understand their company's strategy for climate risk and sustainability.

Finalization of the widely publicized climate disclosure regulation proposed by the SEC is expected this year. Interest in what will be included in the final SEC rule is high. The SEC received thousands of comment letters about the proposal, and climate disclosure moved onto the list of top 10 topics in SEC comment letters to registrants, as the EY Center for Board Matters reported in *What Audit Committees Should Prioritize in 2023.*

SEC Chairman Gary Gensler, upon announcing the proposed mandatory climate risk disclosure rule in March 2022, said he was "pleased to support … the proposal because, if adopted, it would provide investors with consistent, comparable and decision-useful information for making their investment decisions and would provide consistent clear reporting obligations for issuers."

Audit committee members need to ascertain whether the company they advise has the necessary controls and procedures to comply with the finalized SEC climate disclosure rules, including any potential need for third-party assurance. No doubt, most organizations will need to establish robust processes and a technological framework to support collection of verifiable data to comply with what is expected.

New Compliance Requirements Create Opportunities

Although the journey to achieving

climate disclosure compliance will be informed by the SEC disclosure rule, the path each company takes will be unique and affected by the capabilities it has. While companies redesign processes and adopt technology to help them capture the required data, corporate management also has an opportunity to consider what other data to collect that could benefit the business — if they had access to it — to create further long-term value.

To do so, they should consider answers to the following:

- What is material to their company as it relates to climate risk and sustainability?
- What is the business’s overall strategy for climate risk and related objectives?
- What is important to the company’s stakeholders (e.g., customers, employees, investors and regulators)?
- What processes and controls will businesses need to gather verifiable data for SEC climate disclosure compliance and to inform other business decisions?

Those organizations with international operations will also want to consider other regulations, such as the European Union’s Corporate Sustainability Reporting Directive, adopted in 2022.

Materiality

While U.S. finance professionals and regulators generally follow an agreed definition of materiality, sustainability professionals usually consider a broader set of stakeholders and prioritize outcomes, as opposed to making determinations that adhere to the legal definition of materiality.

Double materiality, an ESG reporting concept embedded in EU regulations that could impact multinational organizations, combines the legal definition with sustainability professionals' broader view to include performance on ESG issues as they relate to a company's financial performance and how the issues impact one another and the broader stakeholder audience.

A materiality or priority assessment is a helpful first step when a company begins its ESG journey, as it affords an opportunity to identify and align on priority issues for a reporting framework. The results of this effort will most likely provide the backbone for the company's ESG strategy and can ensure the company focuses on the most relevant ESG topics for its business.

Setting the ESG Strategy

Organizations should have a materiality or priority assessment to anchor their ESG strategy as the business identifies gaps and efficiencies. A solid ESG strategy can contribute to improved business performance, increase competitiveness and generate cost savings while realizing ESG benefits.

Given the increasingly critical role that S&P 500 board committees play in a host of management areas, including environment, sustainability, climate and the broader ESG focus, management may find it useful to discuss their ESG strategy with their directors to keep them informed and tap into their experience.

Understanding Your Stakeholders

While the materiality assessment and ESG strategy development should shed light on the stakeholders, it is important to understand their diverse set of interests and to consider how to balance those beyond compliance.

For instance, more than three-quarters of investors participating in the *EY Global Corporate Reporting and Institutional Investor Survey* think companies should make investments that address ESG issues that are relevant to their business, even if it reduces short-term profits. However, just 55% of the surveyed finance leaders shared their view.

Furthermore, 80% of the investors agreed that "too many companies fail to properly articulate the rationale for long-term investments in sustainability, which can make it difficult to evaluate the investment." Additionally, 78% of them think

companies should make investments that address ESG issues relevant to their business, even if it reduces profits in the short term.

Processes, Controls and Verifiable Data Collection

The ESG strategy will inform a company’s data management and governance strategy. ESG data can be quantitative and qualitative, as it encompasses metrics that cut across ESG issues, ranging from human capital to greenhouse gas emissions to executive compensation.

Depending on the company’s reporting framework and jurisdictional reporting requirements, it may need a comprehensive strategy for tracking, measuring and reporting metrics, using a method that can meet reasonable assurance requirements.

From there, the team needs to work out processes and controls for the nonfinancial information. If the final SEC climate disclosure regulation is not significantly changed from the proposal, all disclosures would be subjected to disclosure controls and procedures, and disclosures within the audited financial statements will be subject to internal control over financial reporting, requiring robust internal controls for reporting.

Given that most companies have up until now only performed ad hoc reviews of emissions data or other sustainability information before their inclusion in reports or other communication channels, there could be gaps in the collection and processing of this information, or even miscalculations that will necessitate information updates. With the establishment of a more structured control environment, data reliability can increase, if it is investment grade.

Ultimately, to complete this journey requires a smart, connected reporting function that executives can use to access reliable, robust data to create compliant, focused reports for stakeholders. They also need a finance team with the ability to move beyond the traditional finance function to leverage the technology and approach this work in an innovative, value-driven culture.

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