



The Future of Finance | KPMG IMPACT

# The role of finance in environmental, social, and governance reporting

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# Introduction

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How well a company performs on environmental, social, and governance (ESG) issues is becoming an increasingly critical performance metric for investors, consumers, and management.

Investors and rating agencies are demanding ESG reports. Investors believe that companies with a strong ESG program perform better and are more stable—better at retaining customers and employees, for example.<sup>1</sup> On the other hand, poor ESG practices pose environmental, legal, and reputational risks that can damage the company and its bottom line. And while ESG reporting remains voluntary in the U.S., the Securities and Exchange Commission is studying ESG reporting requirements.<sup>2</sup>

Consumers say they want to buy from companies that are environmentally sustainable, take a stand on social justice issues, and demonstrate good governance. And they say they are even willing to pay more to help companies address ESG issues.<sup>3</sup>

And CEOs are realizing that they'll be measured on their commitment to ESG. In a recent KPMG survey, 65 percent of top leaders said that managing climate change-related

risks will play an important part in determining whether they keep their job.<sup>4</sup>

Even so, companies still struggle with how to measure ESG outcomes and how to report metrics on ESG priorities and performance. Many organizations haven't yet defined a corporate-wide strategy for ESG. Others have made broad commitments but haven't established programs to act on them or measure results. More importantly, even among companies that have made a start, many fail to connect ESG performance to their business strategy or link ESG metrics to other quantitative performance measures

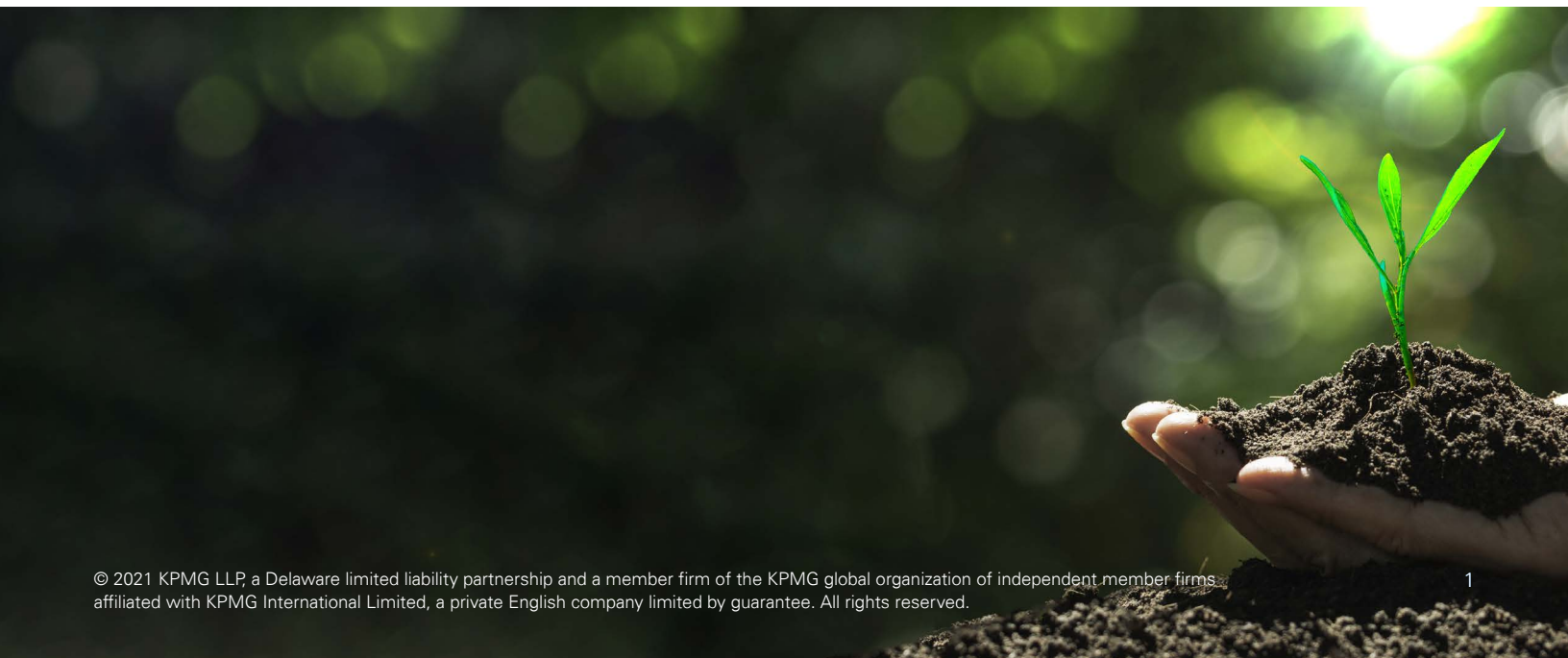
KPMG IMPACT believes that finance is ideally positioned to help organizations carry out ESG reporting efficiently and weave ESG into strategy and operations. In this paper, we describe how finance can drive success in ESG and, in the process, enhance the strategic role of chief financial officers (CFOs) and chief accounting officers (CAOs).

<sup>1</sup> Source: Strong ESG Practices Can Benefit Companies and Investors: Here's How, Nasdaq.com, June 5, 2018.

<sup>2</sup> Source: 2021 Outlook: Why, and how, the CFO should lead ESG efforts, CFO Dive website, January 12, 2021.

<sup>3</sup> Source: Two-Thirds of North Americans Prefer Eco-Friendly Brands, Study Finds, Barron's website, January 10, 2019.

<sup>4</sup> Source: [KPMG 2020 CEO Outlook COVID-19 Special Edition](#). KPMG initially surveyed 1,300 CEOs in January and February, before many markets were beginning to feel the full impact of lockdowns. Then, in July and early August, we conducted a follow-up survey of 315 CEOs to understand how thinking has evolved.





## ESG basics

Environmental, social, and governance (ESG) issues represent the non-financial factors used to evaluate a company's practices around the conservation of the natural world, the consideration of people and relationships, and the standards of running a company.

Consumers and investor expect companies to take positive action on issues such as climate change, social justice, diversity and inclusion, and exploitation of workers. For example, 70 percent of consumers in the U.S. and Canada think it is important that a brand is sustainable or eco-friendly, and 69 percent of environmentally conscious buyers said they are willing to pay a premium for recycled products. Younger Americans, in particular, say they consider social and environmental practices when they are choosing brands or companies to work for.

In this paper, ESG refers to those topics that are important to stakeholders and are commonly cited in corporate responsibility and sustainability reporting (Exhibit 1).

### Exhibit 1: ESG topics



# Finance: the right place for ESG



As ESG issues become more prominent, the role of CFO and CAO will become increasingly critical. The CFO, CAO, and the finance team are the organization's "reporting gatekeepers" and their roles are expanding to more than reporting financials.<sup>5</sup>

ESG reporting needs to be translated into finance language and financial metrics. And finance, as the fiduciary leader in the organization, has the experience compiling and reporting on metrics to stakeholders and shareholders.<sup>6</sup> CAOs and CFOs also have deep experience in other forms of regulatory and compliance filings.

Additionally, finance is ideally positioned in the organization to track the information needed for ESG strategies and reporting. Finance sees data on sales, supply chain, customers, and other types of information that help assess ESG performance. Finance also works across functions and business units, and is in a position to lead an organization's ESG reporting and data management programs. The financial planning and analysis organization can connect ESG information, drive insights, and report on progress.

As CFOs and CAOs begin to address issues around ESG, they may be asking, "How do I prepare for this? What do I need to know? What do I have to be ready for?" At a fundamental level, finance can help drive an organization's ESG agenda in four specific areas.



## Advantages of finance management of ESG

Finance can leverage its existing skills and framework to drive the organization's ESG agenda.

- Internal and external reporting
- Cross functional integration
- Financial management
- Governance and risk management
- Process efficiency
- Investor relationships

**Corporate Strategy:** Although reporting is essential, metrics only show where an organization has been, not where it intends to go. Business must also demonstrate progress. Therefore, successful ESG efforts must align with the overall corporate strategy. Incorporating ESG into strategy and value management involves establishing sustainability guiding principles that will steer investment decisions to create value; prioritizing strategic initiatives by incorporating ESG drivers into business cases and quantifying sustainability impacts; and driving ownership, accountability, and organizational influence across the business.

**Investments:** Companies that can demonstrate a commitment to ESG are in a better position to secure capital investments. For example, BlackRock has used its proxy votes against management, when it finds that companies aren't doing enough about ESG topics, such as climate risk.<sup>7</sup> And Goldman Sachs has said it will deploy \$750 billion across investing, financing, and advisory activities by 2030 "to help our clients accelerate climate transition and advance inclusive growth."<sup>8</sup> This ESG investment can drive value through several factors—increasing top-line growth, reducing costs, and decreasing investor, regulatory, and legal interventions.

**Reporting:** Organizations will need to demonstrate to stakeholders that their ESG efforts are producing results. Delivering on ESG promises requires an iterative process—reporting continuous progress to stakeholders. Finance can enable non-financial metrics to carry the same weight as financial results when evaluating ESG progress. Common ESG metrics include air quality, such as greenhouse gas emissions; water management, such as total water withdrawn from sources and consumed; and environmental footprint, such as total energy consumed and percentage of renewable energy use.

**Risk:** Since risk management often falls under finance's oversight, CFOs and CAOs should understand the financial and non-financial risks around ESG issues but also be aware of the opportunities that come with recognizing and managing ESG risks successfully. ESG should be a part of an organization's overall enterprise risk management (ERM) strategy, so ESG risk can be monitored, mitigated, and addressed.<sup>9</sup>

<sup>5</sup> Source: For more on the expanding role of the CAO, see KPMG reports on "[CAO of the future](#)."

<sup>6</sup> Source: ESG to transform CFO role, CFO Dive website, October 18, 2020.

<sup>7</sup> Source: BlackRock Investment Stewardship's approach to engagement on climate risk, BlackRock Commentary, January 2020.

<sup>8</sup> Source: Goldman Sachs to spend \$750 billion on climate transition projects and curb fossil fuel lending, CNBC.com, December 19, 2019.

<sup>9</sup> Source: CFOs Play a Key Role in ERM and ESG Oversight, FEI Daily website, February 25, 2019.



## Evolving ESG standards

Guidelines for what ESG metrics should be reported are still evolving. However, the momentum toward standardizing ESG reporting is becoming stronger and more urgent.<sup>10</sup>

- **The Sustainability Accounting Standards Board (SASB):** Provides industry-specific standards used to identify risks and opportunities most likely to affect a company's financial condition, operating performance, or risk profile.
- **Global Reporting Initiative:** Provides a framework, supporting standards, and contributions towards sustainable development.
- **Taskforce on Climate-Related Financial Disclosures:** Provides voluntary, consistent climate related-risk disclosures.

As these standards continue to be refined, some companies have already begun to report their ESG activities in their sustainability reports, integrated reports, 10Ks, and 10Qs.



## ESG reporting and strategy: How to begin

CFOs and CAOs looking to create an ESG strategy and reporting mechanism can begin by asking these questions:

- What ESG topics and concerns are your stakeholders most interested in understanding?
- What are the company's material ESG topics?
- In what part of the organization can you make the largest ESG impacts? Do they align with the company's material focus areas?
- How can you integrate ESG into the value identification and measurement processes?
- Is your finance department adequately integrated into on-going and potential ESG initiatives? Is finance

involved in project design to ensure initiative meet both financial and ESG goals?

- Do you possess the required data and reporting capabilities to track and report ESG impacts, including measuring successes and identifying gaps?

In general, organizations can start with an assessment of their operations regarding ESG and begin by choosing three to five areas to focus on. It may be that the organization's reporting systems can't accurately capture the data needed. So, moving forward with this commitment may require an investment to acquire the tools, technology, and professionals to understand, capture, analyze and report on relevant ESG data, metrics, and KPIs.



## How we helped clients with ESG problems

### Helping a retailer improve its ESG reporting

A leading retail fashion company sought independent assurance to enhance the credibility and reliability of its sustainability report. A KPMG team with in-depth knowledge of the company and industry (and familiarity with the Global Reporting Initiative reporting framework) worked with the client's CFO and CAO. The team identified key areas for improvement in the company's data collection and reporting processes. Leveraging experience and knowledge gained from similar engagements, KPMG provided practical suggestions to improve the way data is collected and how it is analyzed and communicated to enhance overall reporting. These new protocols enabled the company to adjust policies and procedures and implement better practices to ensure future reporting is more accurate and substantial.

<sup>10</sup>Source: ESG to transform CFO role, CFO Dive website, October 18, 2020.

# How KPMG IMPACT can help



KPMG IMPACT has developed a framework for organizations to quickly understand where they are on the ESG maturity scale. Exhibit 2 is an example of an ESG maturity model that looks at five key areas of consideration starting from the foundational reporting requirements through more calculated integration of stakeholder expectations for ESG into corporate strategy and goal setting

**Exhibit 2. An ESG maturity model**

	Beginning	Proficient	Leading	
<b>Stakeholder Engagement</b> 	Stakeholder engagements are typically tactical and reactive	Consideration of stakeholder issues and concerns, but not prioritized according to materiality; Key stakeholders are engaged in strategic, proactive initiatives	Formal and documented materiality testing to identify stakeholder issues; Complex stakeholder partnerships are regularly developed and monitored	
<b>Strategy &amp; Objective-setting</b> 	There is no ESG vision or goals; No financial or resource commitments to ESG; No materiality testing or identification of issues undertaken	There is a clear ESG strategy with specific, measurable, and targeted goals; General understanding of material issues	ESG vision is integrated into overall enterprise mission statement; Formal process to review goals on a regular basis; Integrated thinking to understand ESG impacts and dependencies	
<b>Governance, Culture, &amp; People</b> 	There are no defined roles, responsibilities, or processes for managing ESG impacts; There is no board awareness or executive buy-in of ESG impacts	The board is aware of a selection of ESG impacts; Cross-functional collaboration on ESG impacts; No clear organization or ownership over ESG initiatives	Leadership has designated a corporate-level sustainability leader, as well as, BU or functional-level leaders; Clear ownership and PMO structure for all ESG initiatives; ESG included in Board Charter	
<b>Risk Assessment &amp; Infrastructure</b> 	There is little or no quantitative or qualitative assessment of ESG risks; There is a lack of dedicated systems/ tools	Risks are defined with goals & KPIs; Infrastructure in place with mostly repeatable processes; Only ad-hoc systems to meet specific demands	ESG risk criteria include adaptability and speed; Business cases include ESG risk context; ESG processes are integrated into core planning and key business processes	
<b>Communication &amp; Reporting</b> 	No reporting and communication oversight structure in place; No results are communicated internally or externally; Unidentified data quality gaps	Some communications about ESG impacts to stakeholders; Processes in place to enhance the quality of data for ESG disclosures	Formally documented and approved reporting and communications strategy; ESG disclosures are provided to stakeholders and customers on a timely and regular basis; ESG data is verified and assured	

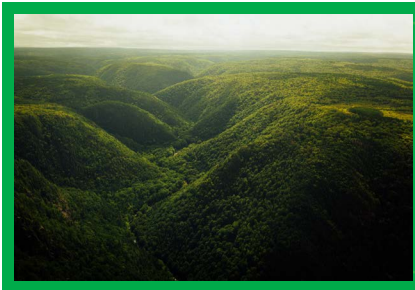
KPMG professionals have the experience and knowledge to help companies define their ESG strategy, fulfill their ESG commitments, and establish a framework to report on ESG activities.

Building on its wealth of industry-specific experience and knowledge, KPMG is working with clients in a range of industries to develop and integrate ESG and operational strategies.

KPMG can help you define appropriate data collection systems, metrics, and targets to monitor, manage, and report on ESG risks. We can provide advice on how best to disclose your ESG-related risks in your financial disclosures and provide good practice examples to guide your reporting.

KPMG professionals can help you:

- Understand the ESG issues that are material for your organization and your stakeholders
- Align your corporate activities with the United Nation's Sustainable Development Goals and assess your contributions to achieving the goals
- Choose the right reporting approaches and framework for your business
- Integrate financial and non-financial information in your reporting
- Report information for specific purposes, such as sustainability indices
- Benchmark the quality of your reporting against industry peers
- Gain independent assurance for your internal and external reporting systems and your sustainability reporting
- Assess sustainability risks of your suppliers

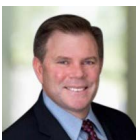


### About KPMG IMPACT

KPMG IMPACT can help your business create a more sustainable future while driving measurable growth today. Find out more about how our insights, capabilities and solutions can simplify your ESG journey. Sign up for ESG Alerts at <http://visit.kpmg.us/IMPACT>.

## Contact us

To learn more about how KPMG IMPACT could help with your ESG reporting needs, please contact us.



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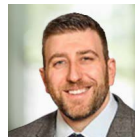
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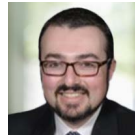
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