Q&A

Getting Into the ESG Weeds

An interview with Gregg Anderson

Smart decisions. Lasting value.™

Environmental, social, and governance (ESG) investing has increased in the past decade. More than $12 trillion in U.S. assets under management and tied to the strategy, which is also known as sustainable, responsible, and impact investing.[1] Along with growth in the supply of capital is a corresponding growth in the demand for ESG disclosures from corporate filers.

Financial Executives International (FEI) spoke with Gregg Anderson, managing director at Crowe, about the growth of ESG investing and how senior-level financial executives can translate their reporting practices to a new set of criteria.

FEI: A lot of people know about the E in ESG, but what are some specific examples of metrics for the S and the G?

Gregg Anderson: What's interesting is that ESG is an acronym that is used to talk about sustainability and social responsibility and being an ethical company. But it's not as polarizing as some of those topics might've been in the past.

When we think about environment, we're thinking of things like greenhouse gas emissions and better quality of energy management. But when we think about the S and the G, that broadens the thought process related to these topics.

Social responsibility focuses on questions like, "Am I keeping my customers' data private?" "Am I providing not only quality products but also safe products?" and "Am I appropriately and adequately disclosing to my customers what is in my products?"

From a governance perspective, questions include, "How does the governance within the organization function?" "Am I able to respond to a crisis, and how does my company respond?" "Does my company act as a 'good corporate citizen' participant in the marketplace?" "What are our business practices?" and "How has my company invested in emerging markets?"

ESG allows companies, along with their investors, customers, and suppliers, to talk about nonfinancial measures and how they are important to the companies' long-term performance.

FEI: Are those metrics fairly defined and agreed upon, or is that something that's still under debate in the ESG community?

Gregg Anderson: The ESG community loves to debate these things. But one thing that's interesting is that the Global Reporting Initiative (GRI), which is the global standard around sustainability, just hit the 20-year anniversary of its first standard. The GRI Sustainability Reporting Standards are widely used as the global benchmark for sustainability reporting. (GRI standards can be found at https://www.globalreporting.org/standards/gri-standards-download-center.)

The Sustainability Accounting Standards Board (SASB) also spent years working with investors on these topics. After six years of research, it has codified and issued a first group of standards. SASB standards differ by industry, enabling investors and companies to compare performance from company to company within an industry. SASB standards go through a rigorous process. Certainly, investors will debate whether one metric is more indicative of performance than another metric, but the standards do exist. Evaluations and research are being done on what metrics in which industry are the most material and most relevant indicators of performance and value.

FEI: What do you see as the role of the SASB in ESG?

Gregg Anderson: Initially there was a real focus on material risks. The SASB was created so that companies, in their public filings and other disclosures, can disclose these risks in a very transparent manner to investors. Through the process of working with investors, the SASB recognized that disclosures can be very complex. The SASB distills the disclosure topics down to the material ESG factors that are most important to investors.

The SASB boils disclosures down to a handful – less than a dozen – of typical issues that are most material within a given industry. So, if I'm in the food and beverage industry, I'm going to be looking at the environmental impact of my company's resources if I'm using water and livestock. I'm looking at my customers and how I carry out my labor practices. I'm looking at how I source my product, depending on from where in the world I source that product.

FEI: Beyond the SASB, what is the role of other stakeholder bodies in the financial reporting and the accounting spaces, like the American Institute of Certified Public Accountants (AICPA)? Where do they fit into the ESG framework?

Gregg Anderson: We are hearing from investors that the accounting and disclosure around ESG were lacking for quite some time. Investors were saying, "I want this information." The company was asking, "How do you want me to report it to you?" And the investors were replying, "I'll take it in whatever format you can give it to me as long as you can tell me how you use the information."

I think the SASB and the GRI have worked through a framework for organizations to report ESG. But now there's a further push to say, "Now that you're providing this information, how accurate and timely is the information?"

What do accountants do? Well, they're very good at helping look at reporting frameworks and making sure that the information is accurate – especially now that the investors say, "This is the stuff that's relevant to me. Now what I'd like to be able to do, as I'm making investments based on this data, is to understand its accuracy."

The AICPA, the Center for Audit Quality, and the International Accounting Standards Board recognize that accountants have a role to play to provide confidence in these numbers, whether it's through assurance or whether it's through helping design controls around that reporting. Looking at these things from an enterprise risk management standpoint, accountants certainly have roles to play there. I'm involved in a task force with the AICPA looking at sustainability and assurance as well as recognizing how they play into managing and reporting enterprise risk.

FEI: Given the impact ESG metrics can have on companies, how are investors making sure they are using accurate data in their analyses?

Gregg Anderson: That's a good question. You can look at the pension funds – certainly some of the largest investors working with asset managers. Also, private equity firms – especially some of the larger specialized private equity firms – are scrutinizing accuracy.

A lot of work also is being done around benchmarking. One company might be providing data, but how does that compare to others in its industry? Whether it's greenhouse gas emissions, diversity on the board, or looking at gender pay differences, data is available, and you can look at that within industry sectors and within the size of companies. Investors are doing that, just as they would, for example, in an assessment of working capital.

FEI: What is the role of the finance profession? What should CFOs and financial analysts be doing today?

Gregg Anderson: The roles of CFOs and financial analysts include providing information that is useful for decision-making, whether it's for the management of the company, for investors, or for customers. That's what the finance profession has excelled at in the past.

The folks with the discipline that we're talking about here haven't necessarily been involved in sustainability and ESG reporting, with many organizations managing this reporting from their marketing, communications, or human resource departments. In Europe and other places, we're seeing an emergence of integrated reporting where the annual report and the sustainability report are one and the same. The discussion around this blends together. It's critical that financial professionals apply their disciplines and skills to these metrics and this type of reporting.

One of the things that's emerging now is seeing the credit rating agencies including ESG factors in their determinations. In many cases it's not the primary driver, but they'll conduct the analysis in the traditional way and then go through a process of tweaking the rating either upward or downward based on ESG factors. For example, a rating agency might identify that tightening global emissions legislation remains a pivotal issue for the auto industry or that adoption rates of electric vehicles are uncertain and depend on factors outside of carmakers' control, such as the development of charging infrastructure. These factors might influence some of the credit ratings of companies in the auto industry.

FEI: Do you think ESG investing has gone beyond just the specialist ESG investors and that it's been adopted by the broader institutional investors?

Gregg Anderson: One of the interesting trends is that large, passive investors realized that for them to continue to grow and to provide growth and value, they need to be looking at ESG factors. The larger funds of the world are looking at these things – not just in their specialized ESG niches, but in all their investments.

FEI: What are the biggest challenges companies face when implementing ESG reporting and management?

Gregg Anderson: Hundreds of GRI metrics or the different factors that are reported across all industries exist. One of the biggest challenges is understanding which ESG factors are truly relevant to your organization and your stakeholders. The key to that is something that's near and dear to financial professionals: looking at the materiality of those factors and at how that ties to the strategy and the measurements of financial performance.

I work for a professional accounting firm. Although we think we use a lot of paper and some raw materials, the usage of paper is probably not the most material thing that can affect our overall performance. But how we hire people and how we make sure we get diverse viewpoints as we work with a more and more diverse client base – that's probably an important and material factor for our long-term performance as an accounting firm. So, the challenge is getting down to identifying and addressing the factors that make a difference.

Then the challenge becomes getting everybody on board to say, "Now these are the things that are relevant. These are things that we are going to report on because we're going to manage them and invest in these areas and act upon them, just like anything else." You've got to pick and choose what you're going to do and why you're going to do it, and make sure it moves the needle.

FEI: You have a lot of discussions going on right now in the policy realm about climate change. You have discussions about pay equity. How can you, when you're implementing an ESG program, keep focus on what is most material to a company and avoid getting sidetracked?

Gregg Anderson: If you follow the news daily, it's almost like there's the issue of the day and how a company responds to the issue of the day. Both can influence public companies and their stock prices. I think what it comes down to is you need to be strong in your strategy and stand behind what you've chosen to do as a company.

A lot of the ESG factors reflect on a company's values and its reputational goodwill. If you're not true to those things, in today's environment, people see through that. You can't just make a claim without being able to back it up. One company learned this when it issued its first corporate social responsibility (CSR) report in 2010. In an article on child slavery in Ivory Coast, an investigative reporter called the CSR report a "classic example of the practice of greenwashing – a PR effort to mislead the public into thinking a company's policies and products are socially responsible, when in fact they are not."[2]

Finance professionals have the skepticism, the training, and the background and should be playing an active role in reporting, disclosure, and management of ESG.

Learn more

Gregg Anderson
Managing Director
+1 630 586 5142
gregg.anderson@crowe.com

[1] "US SIF Foundation Releases 2018 Biennial Report on US Sustainable, Responsible and Impact Investing Trends," US SIF Foundation, Oct. 31, 2018, https://www.ussif.org/blog_home.asp?display=118

[2] John Robbins, "Is There Child Slavery in Your Chocolate?" HuffPost, Sept. 24, 2010, https://www.huffpost.com/entry/is-there-child-slavery-in_b_737737

crowe.com

AUDIT-19002-007D