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Got ESG? Current developments in ESG disclosure

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An article by Matthew Schell, CPA, CFA, and Mark Shannon, CPA

Executive summary

As investors and other stakeholders increasingly engage with entities on how management and others involved in governance are driving long-term value through environmental, social, and governance (ESG) efforts, some entities are seeking to increase their understanding of ESG disclosures.

Introduction

In recent years, institutional investment firms have placed increased focus on ESG matters, including how an entity's ESG activities drive long-term value. Other stakeholders have suggested entities with poor ESG policies could experience a higher cost of capital. Certain Securities and Exchange Commission (SEC) commissioners have stated current disclosure rules do not go far enough on ESG matters. President Joseph Biden recently nominated Gary Gensler to serve as the 33rd chair of the SEC, and with the change in leadership comes a change in priorities, which might involve more focus on ESG matters.

Crowe observation: Certain investors and stakeholders are emphasizing ESG factors as a part of their investment decisions. In response, there is an uptick in both public and nonpublic entities evolving their processes and disclosures to tell their long-term value story. Topics discussed include issues such as climate change, resource scarcity, employee diversity and inclusion, board qualifications and diversity, executive pay, talent management, cybersecurity, product safety, and business ethics. However, entities should be cognizant that, at times, a dichotomy can exist between investor or stakeholder expectations and the entity's narrative.

Current public company disclosures and interpretations

Although written from the perspective of capital formation and investor protection, certain SEC disclosure rules and interpretations also touch on certain ESG topics. For example:

- **Human capital disclosures.** When material to an understanding of the entity's business, Item 101(c) of Regulation S-K requires a description of a registrant's human capital resources, including any human capital measures or objectives that the registrant focuses on in managing the business.

Crowe observation: The final rule requiring human capital disclosure became effective on Nov. 9, 2020. We have observed registrants using a variety of methods, including both qualitative and quantitative disclosures, to meet the disclosure principle of Item 101(c). We expect disclosures will evolve over time as they are evaluated and refined.

- **Board qualification disclosures.** SEC rules require disclosure of "the specific experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director,"[1] and how a company's board (or nominating committee) implements policies that consider diversity in identifying director nominees.[2] In addition, in 2019, SEC staff provided guidance on these disclosure requirements, stating a registrant should[3]:
    - Discuss how any self-identified diversity characteristics, if the individual who self-identifies the characteristics consents to such disclosure, were considered in determining the experience, qualifications, attributes, or skills of an individual for board membership.
    - Describe how the board considers self-identified diversity attributes of nominees, including any other qualifications the company's diversity policy covers.

- **Cybersecurity.** The SEC issued interpretive guidance in 2018 that assists public companies in preparing disclosures about cybersecurity risks and incidents.

- **Climate change.** In 2010, the commission issued interpretive guidance addressing how existing SEC disclosure requirements might prompt disclosures related to climate change. On Feb. 24, 2021, acting Chair Allison Herren Lee announced she was directing Division of Corporation Finance (Corp Fin) staff to enhance their focus on climate-related disclosure in public company filings. The directive indicates Corp Fin staff should "review the extent to which public companies address the topics identified in the 2010 guidance, assess compliance with disclosure obligations under the federal securities laws, engage with public companies on these issues, and absorb critical lessons on how the market is currently managing climate-related risks."

Rule proposals and recommendations

As investors and stakeholders continue to increase focus on ESG topics, regulators and other stakeholders in the financial reporting process have responded through rule proposals. On Dec. 4, 2020, Nasdaq proposed changes to its listing rules related to board diversity. Previously, in May 2020, the SEC Investor Advisory Committee encouraged the SEC to develop a framework for ESG reporting in SEC filings. Future proposals and rulings may be influenced by the global regulatory environment as the European Union and others evaluate the need for standards.

Disclosure location considerations: Integrated versus stand-alone reporting

Disclosures related to ESG topics, including human capital and board qualification disclosures, appear in SEC filings when required by the form (for example, Form 10-K, proxy statement, registration statement). Some entities elect to voluntarily disclose information exceeding the minimum disclosure requirements. Voluntary disclosures typically appear in the entity's proxy statement or in a separate report such as a corporate social responsibility report or sustainability report, which often is posted to an entity's website. Entities electing to provide voluntary disclosures typically focus those disclosures on factors that management views as important to managing the business in their industry and building long-term value for investors.

> **Crowe observation:** Entities should consider the consistency of any voluntary disclosures with disclosures provided in SEC filings. As the focus on voluntary disclosures increases, entities might consider establishing a robust governance process over voluntary ESG disclosures, including disclosure controls and procedures. Entities also might want to consider the communication medium used to ensure that the information meets its objectives.

Disclosure content considerations: Voluntary reporting frameworks

Entities preparing voluntary ESG disclosures have various reporting frameworks available,[4] which are meant to allow for greater standardization and comparability among entities. However, the wide variety of available frameworks has sparked debate about comparability, and various stakeholders, including standard-setters and business organizations, have expressed the need for further convergence.

In September 2020, five ESG-related framework and standard-setting institutions – CDP, the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC), and the Sustainability Accounting Standards Board (SASB) – copublished a paper, "Statement of Intent to Work Together Towards Comprehensive Corporate Reporting," to summarize their shared vision. Ultimately, by working together with key stakeholders, including the

International Organization of Securities Commissions (IOSCO),[5] the International Financial Reporting Standards (IFRS) Foundation, the European Commission, and the World Economic Forum International Business Council, the standard-setters intend to drive toward a comprehensive corporate reporting system by providing:

- "Joint market guidance on how [the] frameworks and standards can be applied in a complementary and additive way;
- "A joint vision of how these elements could complement financial generally accepted accounting principles (Financial GAAP) and serve as a natural starting point for progress towards a more coherent, comprehensive corporate reporting system; and
- "A joint commitment to drive toward this goal, through an ongoing programme of deeper collaboration between [standard-setters], and a stated willingness to engage closely with other interested stakeholders."

The standard-setters request feedback on ideas expressed in the joint statement and engagement from stakeholders in all parts of the reporting ecosystem to encourage active support to achieve the vision. Meanwhile, two of the standard-setters already have taken meaningful steps toward convergence, and the IFRS Foundation has begun to explore the need for global standards:

- In November 2020, the IIRC and the SASB announced an intent to merge into a unified organization, the Value Reporting Foundation. The merger advances the work set out in the joint statement by simplifying reporting, and other entities eventually could be integrated. According to the announcement, the Value Reporting Foundation and the CDSB have jointly signaled interest in joining together.

- On Dec. 31, 2020, the comment period closed on the "Consultation Paper on Sustainability Reporting" issued by the IFRS Foundation, which sought to understand whether global sustainability standards are needed, whether the IFRS Foundation should play a role, and what the scope of that role could be.

On Feb. 17, 2021, the Association of International Certified Professional Accountants (AICPA) and the Center for Audit Quality (CAQ) issued a joint publication, "ESG Reporting and Attestation: A Roadmap for Audit Practitioners." Although written from the perspective of audit practitioners, it contains a number of data points preparers also might consider when developing their understanding of ESG disclosures.

Crowe observation: Current ESG standard-setting activity is significant, and the likelihood of further evolution is high. Globally, the announcements of joint visions, mergers, and the involvement of groups such as the IOSCO, which includes the SEC, signal significant advancement toward building a comprehensive system of corporate reporting. Regardless, existing frameworks differ in form and purpose, and an entity electing to follow reporting framework(s) should consider the appropriateness and sufficiency of the framework(s) selected for the entity's disclosure objectives.

Learn more

Matthew Schell
Partner
+1 202 779 9930
matthew.schell@crowe.com

Mark Shannon
Partner
+1 202 779 9921
mark.shannon@crowe.com

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

Daniela Arias
+1 415 590 3912
daniela.arias@crowe.com

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[1] Item 401(e)(1) of Regulation S-K.
[2] Item 407(c)(2)(vi) of Regulation S-K.
[3] See Question 116.11 and 133.13 of the Regulation S-K Compliance & Disclosure Interpretations.
[4] Examples include frameworks from the Sustainability Accounting Standards Board's Task Force on Climate-Related Financial Disclosures and the Global Reporting Initiative.
[5] The IOSCO is an association of the world's securities regulators and is recognized as the global standard-setter for the securities sector. Members include financial regulators such as the SEC.

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