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# How ESG disclosures may expand the nature of the CFO's role

At a recent finance conference, the CFO of a manufacturing company expressed some misgivings about attending a breakout session about the US Securities and Exchange Commission's proposed rules for climate disclosure. "I'm violating my own rule by being here," he said. "I said I wasn't going to spend any time on this until I know what the rules are."

He clarified that his own organization had taken a few early steps toward climate-disclosure preparedness—assigning the finance function responsibility for collecting climate data as well as making plans to add resources to aid with data collection. But otherwise, he said, "we are waiting on the final rules." Those proposed rules, otherwise known as the Enhancement and Standardization of Climate-Related Disclosures for Investors, could be finalized as early as this spring.

Based on the findings of Deloitte's Sustainability action report on preparedness for environmental, social, and governance (ESG) disclosures, the CFO and his employer are hardly alone. The Deloitte report, published in December 2022, included an online survey of 300 senior executives at publicly owned companies with annual revenues of $500 million or more, as well as interviews with senior executives from a range of industries. The result: 57% of executives report that their companies have established a cross-functional ESG council or working group for the purpose of driving strategic attention to ESG.[1] That figure represents a marked increase from the 21% who reported having gotten that far when Deloitte conducted its first ESG survey in late 2021.[2]

Still, 45% of surveyed companies have yet to lay the cross-functional groundwork required to integrate ESG strategy into both business operations and long-term strategy, according to last year's survey.[3] "While most companies are beginning to take meaningful steps toward enhancing their ESG disclosures, some challenges remain," the December report concluded.

A significant share of those ESG-related challenges could fall under the purview of CFOs, given their responsibility for companywide data and oversight over budgetary matters.

In this edition of *CFO Insights*, we'll explore some issues for CFOs to consider as they prepare for the SEC's final disclosure rules and the challenges they may encounter.

## Ready—or not

It's not just regulators pushing for ESG disclosure. It's also shareholders, employees, and customers. Stakeholders increasingly expect a company's business strategy to align with its broader ESG commitments such as sustainability, equity, diversity. As a result, ESG disclosure isn't just about compliance. Across industries, preparations companies make now will likely drive business performance and value in the future.

But the survey raises important questions about where progress is being made, how it's being made, and what obstacles remain.

It's clear, for example, that ESG readiness is far from uniform across all industry groups. The survey found that many financial services executives lag behind (only 44% of financial services executives say their companies have established cross-functional ESG teams), while consumer products companies include the largest proportion of surveyed companies showing ESG leadership (66%).[4]

The fact that a greater proportion of consumer products companies are making progress probably reflects the shifting demands of customers. According to a 2021 Deloitte report on how stakeholder demands are driving regulation, there has been a tectonic shift in consumer purchasing habits. "In the past, companies created products for 'consumers' who had little to no knowledge of how businesses were being operated and resources consumed in the development, use and, ultimately, disposal of those products," the report concluded. But in the digital age, "there is nowhere to hide."[5]

Increasingly, consumers want to purchase products they view not only as sustainable but also as supporting equity and equality. They want assurance that their consumption habits won't negatively affect the environment—both natural and social.[6] According to the Deloitte Global 2022 Gen Z & Millennial Survey, 90% of Gen Z and millennials are making an effort to reduce their personal impact on the environment. And 64% of Gen Z consumers say they will pay more to purchase an environmentally sustainable product over a cheaper one that is less sustainable.[7]

## A talent for driving change

In the 2021 ESG preparedness survey, executives addressed which stakeholders had the most influence over ESG reporting and disclosure policy. Employees came in last at 19%. On top, at 39%, were the ESG rating agencies that influence which stocks get included in socially responsible investing (SRI) funds and accounts.[8]

One year later, executives have reordered their priorities. According to the 2022 Gen Z and Millennial survey, executives now consider "talent attraction and retention" as a top benefit of ESG disclosure. According to the survey, 40% say they have rejected a job or assignment because it did not align with their values. And workers from both generations say they are more likely to quit jobs before two years if they don't think their employer is committed to equity and sustainability. They are also more likely to remain in their current jobs longer than five years if they think the employer is committed to their values. "Gen Zs and millennials want to make their voices heard and to drive change." according to the report. "The Great Resignation has made this even more critical for employers to pay attention to."[9]

## CFOs' sustained efforts

Many companies are taking steps to help enhance internal governance and control environments to prepare for greenhouse gas (GHG) emissions and climate-related disclosures through the annual financial reporting process. In Deloitte's 2022 survey, 45% of responding executives reported that those changes included implementing new systems, with 40% saying that their companies were hiring new staff. Not far behind, 37% said they were implementing new controls.[10]

Among respondents, 37% said that such efforts were most commonly being led by CFOs—slightly behind the 42% of businesses where chief sustainability officers led such activities. Another 29% of companies involve the oversight of a chief strategy officer. This strategic attention emphasizes how important

ESG disclosure is—to drive not only preparedness for changing stakeholder expectations and pending regulation but also business performance and value.[11] The involvement of the CFO or chief sustainability officer is a strong signal that businesses are integrating ESG reporting into business strategy.

Company size appears to make a difference. At companies with 5,000 or fewer employees, CFOs are more likely to have responsibility for managing ESG disclosure. Such companies, however, may be less likely to have hired chief sustainability officers. It's worth noting that typically a top CFO deputy, the head of investor relations, was tasked with ESG disclosure at 24% of companies—which means that, overall, ESG responsibility is most likely to reside within the finance function.[12] (See figure 1.)

## Processing data

While companies may not yet have all the data they will need to comply with climate disclosure rules, they appear to be making progress. According to the survey, 61% of respondents report being ready to report Scope 1 greenhouse gas emissions, which are those that emit from sources directly controlled or owned by an organization, such as factories and vehicles.[13] That figure is up from 58% in 2021.[14]

There's been even more progress with companies' preparedness for reporting on Scope 2, which covers indirect emissions from the purchase or generation of electricity, heat, or cooling. The percentage of respondents ready to report Scope 2 rose from 47% in 2021 to 76% in 2022.[15]

The problem area may be Scope 3 emissions, which are difficult to track accurately.[16] Scope 3 covers emissions throughout the value chain—including those tied to transportation costs, the extraction of raw materials, the sourcing and production of components, and how a consumers use and dispose of end products. Only 37% of respondents were ready to report Scope 3 emissions, up from 31% in 2021.[17] One of the challenges with Scope 3 is it relies on information provided by customers or suppliers that may not be public companies—and thus may not be required to produce climate data. As a result, Scope 3 disclosure is more likely to be based on estimated data than actual data. (For more on how companies can better manage third-party risks, see accompanying story, "ESG's Achilles heel: third-party risks").

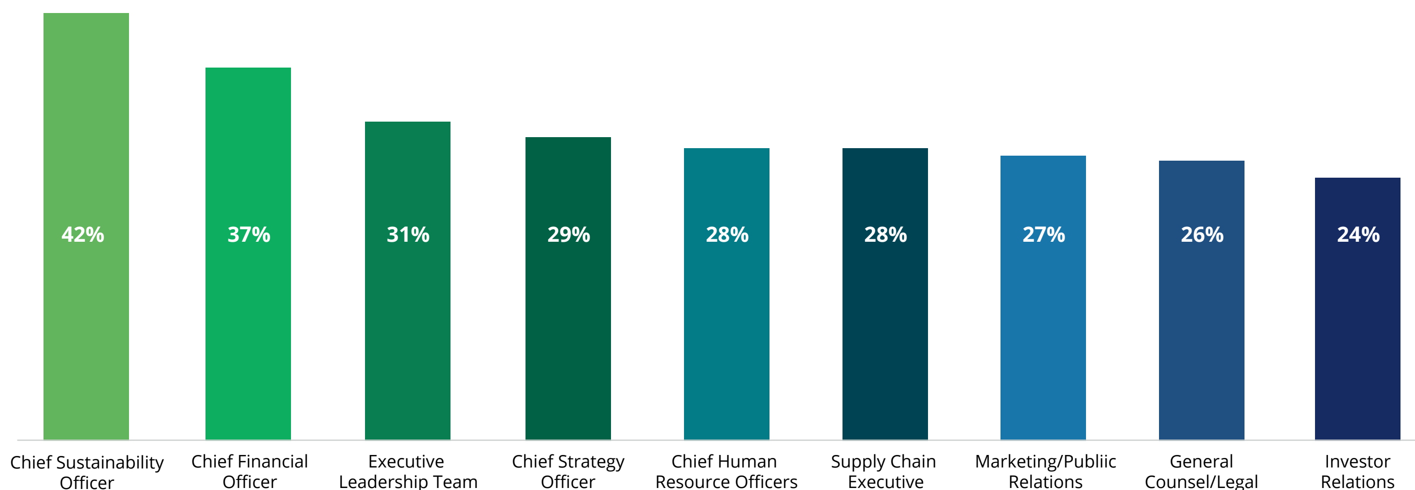
The welcome news for public companies—and for CFOs who must certify SEC filings—is that the proposed rules include a safe harbor provision for Scope 3 disclosures. The proposed safe harbor would mean that a disclosure of Scope 3 emissions by or on behalf of the registrant would not be considered fraudulent unless it is shown that such information was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.[18]

## ESG preparedness: what's next?

In Deloitte's fourth quarter 2022 CFO Signals survey™ 49% of CFOs said their companies will increase their investments in ESG initiatives.

In the ESG preparedness survey, more than one-third of executives (35%) cite data quality as their biggest ESG preparedness challenge, while 25% cite access to data. Investments in new technologies can help—which is probably why 99% of executives say their company is somewhat likely or very likely to invest in ESG data technologies or tools. These include everything from ESG dashboards to centralize ESG data in one location to energy-monitoring systems that track energy usage and carbon output. According to our survey, more than one-third of

**Figure 1. ESG disclosure management responsibility, based on 300 respondents**




Source: "Sustainability action report: Survey findings on ESG disclosure and preparedness," Deloitte Development LLC, December 2022.

executives (35%) cite data quality as their biggest ESG preparedness challenge, while 25% cite access to data.[19]

Ultimately, access to timely and higher-quality data, as well as greater discipline and ESG preparedness, can help unlock transformation and value-creation opportunities for a diverse range of stakeholders.[20]

## ESG's Achille's heel: third-party risks

Poor visibility into climate risks is a major challenge for companies seeking to build resilient supply chains. According to Deloitte's Global 2022 Third-Party Risk Management (TPRM) Survey, 58% of respondents consider climate change a major third-party risk.

Regulatory requirements, combined with net-zero and other commitments made by organizations, have heightened the focus on third-party climate risk. Yet due to Scope 3, organizations may not be able to meet emissions targets or fully comply with disclosure requirements unless the impact of third-party ecosystems is considered. Unfortunately, that impact is hard to quantify: Due to lack of reliable internal and external data, only 18% of surveyed global companies report that they have established quantitative scoring methods to assess third-party risks tied to ESG.

Some other ESG-related findings from the TPRM survey:[21]

- The majority of respondents (82%) reported that their organizations had moderate to very high levels of awareness and focus on ESG issues and related regulatory requirements.
- Forty-one percent believe they have a low level of organizational capability at present when it comes to assessing and prioritizing third-party ESG risk dimensions. Even more concerning, only 16% believe that the quality of internal and external data measuring third-party ESG risk is high or very high.
- Despite the lack of trust in ESG-related data, 64% of respondents regularly communicate ESG-related risk information to stakeholders.

Some organizations are realizing that they need a greater understanding of the data required and how to obtain it from sources internally and externally. Here are two suggestions from the Global TPRM survey:

1. **Map the various activities and processes that involve third parties.** Such inherent risks are typically driven by the nature of the activity or process. An end-to-end view of all relevant third-party relationships is a prerequisite to identifying these data-related needs and addressing leading ESG considerations effectively across much organizational activity.
2. **Graduate from ad hoc and subjective assessments into more insight-driven, formalized quantitative processes**. Organizations need to continue their investment in technologies that integrate the collection and processing of ESG data from internal and external sources that inform better decision-making.

## End notes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