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Governance Insights Center
ESG Series

Sustainability and ESG oversight: the corporate director's guide

Boards can lead the way on sustainability. Here's how to get there.

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Table of contents

Introduction	**3**
Part 1: Understanding the sustainability landscape	**5**
The investor landscape	5
The broader stakeholder landscape	8
The sustainability regulatory landscape	8
Part 2: Understanding the board's role in overseeing sustainability	**9**
Purpose and strategy	9
Risks	10
Disclosures	11
Materiality	12
Reliability of sustainability information	13
ESG standards and frameworks	14
Where to disclose sustainability information	17
Measuring and monitoring progress	19
Using compensation to create incentives	20
Part 3: Mapping sustainability to oversight	**21**
Allocating sustainability oversight responsibility	22
Making time for sustainability on the board agenda	25
Conclusion	**25**
Appendix A: A deeper dive into materiality	**26**
Appendix B: Summary of board considerations	**29**

Introduction

Conversations around the environmental, social and governance (ESG) topics that impact the sustainability of a company's business operations have become increasingly complicated.[1] Amplified by the fact that much of the language used in dialogue is undefined. Put company leaders, regulators, investment analysts, portfolio managers, activists and retail investors in a room and they will quickly realize they might be talking past each other. According to our investor survey, 78% of investors believe that companies should embed ESG directly into strategy, while just over half (54%) of directors think ESG issues are linked to strategy. When you add in regulated reporting and the political discourse that has emerged, the board's role in ESG oversight has never been more difficult.

Part of the complication also lies in the wide set of topics that can fall under the ESG umbrella, which will have varying impacts on companies over varying timeframes. ESG topics present real risks — and potentially even bigger opportunities. Examples of forces include physical elements like biodiversity, regulatory developments like mandated reporting and shifting business environments like changing consumer preferences. By understanding how and when the risks and opportunities will materialize, directors can start to sort through where to prioritize their efforts.

Identifying the issues that can be credibly linked to driving sustainable value creation involves expanding the lens when a company is developing long-term strategic plans, identifying and mitigating material risks, recognizing emerging growth opportunities to their businesses, and the boards' oversight of all of it. If that sounds a lot like an approach to strategy and risk oversight more generally, that is the point.

ESG forces will impact nearly all companies in big or small ways. It is more important than ever that boards consider how that translates into a sustainability strategy that focuses on those factors that are most important for the company. Equally important is the development of governance structures that support effective oversight. Increasingly, this looks like spreading responsibilities across standing committees and in some cases, tasking a committee with specific oversight for the most material sustainability topics for the company.

> "Market integrity and disclosure help protect investors and build trust in capital markets. Such trust helps lower the cost of capital for issuers and enhance returns for investors. It also helps increase participation in the capital markets. This is good for those investing for their future and for issuers. Integrity and disclosure facilitate what can be the best of capital markets and guard against the worst."
>
> - SEC Chair Gary Gensler

At the same time, there has been a momentous shake up in the sustainability disclosure space, with mandatory reporting required in many jurisdictions and looming in others. Regulators and standard setters around the world have finalized new disclosure requirements triggered by investor demand and, in some cases, designed to inspire efforts to combat climate change. The sustainability reporting landscape is dominated by the "big three" proposals released in 2023 and 2024: in the European Union (EU) as part of the Corporate Sustainability Reporting Directive (CSRD), internationally by the International Sustainability Standards Board (ISSB), and in the United States (US) by the Securities and Exchange Commission (SEC). Also to note are two California bills signed into law in October 2023 are poised to change the landscape of climate reporting in the US.

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[1] ESG and sustainability are frequently used interchangeably. In this guide we generally use "ESG" when referring to market trends and "sustainability" when discussing internal activities related to those trends.

Most companies are expected to be subject to one or more of these rules, and some may be impacted by all of them. Private companies are also likely to need to report in some form whether to investors with enhanced expectations, companies in their value chain or mandatorily in jurisdictions like the EU. As a result, boards should be interested in compliance. But they should not lose focus on the bigger question of value. There is more to sustainability than just reporting.

This guide captures the practices that have emerged, and questions that boards should consider when determining the governance structure that is most appropriate for overseeing sustainability given the company's industry, size, growth trajectory and strategy.

A view of the ESG landscape

Environmental Conserving the natural world				**Social** Investing in people & relationships			**Governance** Building trust in society		
Climate	**Pollution**	**Waste**	**Resource use**	**Employee**	**Customer**	**Business model**	**Business practices**	**Transparency**	**Leadership**
Carbon emissions	Air	Packaging	Water stress	Basic needs & wellness	Product safety and quality	Operations resilience	Ethics	Tax	Board & management profile
Physical asset resilience	Water	Electronic	Energy management	Diversity & inclusion	Selling practices	Product design & lifecycle management	Competitive behavior	Accounting	Executive pay structure
	Soil	Hazardous	Biodiversity & land use	Hiring & advancement	Privacy & data security	Supply chain management			Purpose and values
	Other	Wastewater	Other	Worker experience		Accessibility			Risk and opportunity
		Other				Community investment			

Part 1: Understanding the sustainability landscape

Directors have a responsibility to oversee company risk, ensuring material risks are identified, assessed and mitigated. This includes sustainability risks. The board also plays a role in challenging management to think creatively about strategic alternatives and opportunities — including sustainability topics.

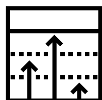
In our most recent *Annual Corporate Directors Survey*, 54% of directors say that ESG is linked to their company's strategy, and 59% say ESG is part of their board's enterprise risk management (ERM) discussions. But what exactly does board oversight in these areas look like? Management teams need a strategic plan that takes advantage of market opportunities and addresses material risks. The board is responsible for considering if the company's strategy is appropriate, takes account material risks and is likely to deliver sustainable value. Because sustainability is grounded in risks and opportunities, the sustainability lens is often a more comprehensive way of packaging existing work and analysis.

The investor landscape

Investors tend to view sustainability through the lens of long-term risks and returns. The range of investors incorporating sustainability into their processes has quickly expanded to include institutional investors; hedge fund, fixed income, private equity fund investors; and more. In addition, a growing population of investors limit their investments to companies they identify as sustainable or take positions in laggard companies to improve their sustainability practices.

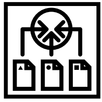
Long-term institutional shareholders

Some institutional investors are urging companies to build ESG considerations into their strategies, bringing it up during engagements and sometimes, using shareholder proposals to encourage companies to act. Some of the world's largest asset managers have used their votes against directors at companies that, in their view, lag on one or more ESG topics. These investors are leading the call for more disclosures from companies, both qualitative and quantitative, so that they can better assess how each company is addressing risks and opportunities. In addition to stewardship-related activities, fundamental analysts at buyside institutions are continuing to expand their consideration of these factors when quantifying the embedded multiple in a company's valuation. Across many different roles, these investors want transparent, comparable reporting that demonstrates where companies are today and the goals they are striving to achieve in the future.



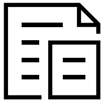
Fixed income investors and creditors

These investors are important sources of capital for many companies. In addition to using ESG factors to assess default risk, a market has developed for products that offer a lower interest rate so long as certain ESG key performance indicators are met (or a higher rate if they are missed).



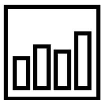
Hedge funds

Increasingly, hedge funds and other activists are incorporating ESG factors into their investment strategies. Their focus can range from areas where they believe a company has failed to set or meet goals, lags its peers' practices or has failed to adequately account for sustainability in its strategy. While we do not expect many public campaigns and proxy fights entirely based on ESG factors, ESG is likely to feature in attempts to influence management and other investors.



Private equity funds

ESG is making it into due diligence and valuation models used by private equity firms impacting the cost and access to capital. Almost all (95%) of the respondents to a recent PwC survey say they integrate highly-material ESG issues into commercial due diligence when making investment decisions.



Impact investors

These investors, who may use any of the strategies above, focus on nonfinancial factors related to ESG topics as part of their analyses to identify risks and growth opportunities. They might focus on sustainability risks along with financial performance, or specifically eliminate or select investments based on ethical guidelines. They may also track for positive impact that will benefit society or the environment

Pushback on ESG investing

Recently, some criticism of ESG investing has emerged. In many cases, the commentary focuses on whether investors are using nonpecuniary factors in their investment decisions, at the risk of not delivering on their duty to maximize returns for their clients. Of the investment approaches described here, only impact investing would use factors in investment decision-making that might not be linked to maximizing value for clients, and this would be clearly disclosed.

In general, companies with articulated sustainability strategies are well positioned to access lower cost of capital, for instance through preferential rates, as more investors look to invest in companies that think broadly about risks and opportunities.

Companies must also consider how investors obtain sustainability information. Some investors obtain the information directly from the company, while others use sustainability data compiled by aggregators or determined by rating agencies (such as proxy advisory firms, ESG raters and credit rating agencies). Other investors may use the data from these third parties to support their own independent analyses.

Investors and third parties rely on these ratings and data aggregation tools. As a result, a company's access to capital and debt as well as their brand perception may hinge on its sustainability disclosures.

Analyzing data and third-party raters

Rating agencies: Rating agencies gather data about a company's ESG efforts through direct surveys or the company's publicly available disclosures. They then provide ESG scores based on their views of companies' risk exposures versus their industry peers.

Qualitative and quantitative data inform these ratings: Rating agencies also guide investors through the publication of benchmarking data. And some use their ratings to create ESG indices that might be licensed to asset managers and others to serve as the underlying benchmarks for ESG funds and other financial products. MSCI, Institutional Shareholder Services (ISS), Sustainalytics and S&P Global are examples of established raters and rankers. The methodologies used by these agencies vary and the resulting ratings may not consistently align with a particular sustainability disclosure framework or set of standards; therefore, they may not meet the needs of all institutional investors.

Data aggregators: Data aggregators compile and present public ESG data, making it easier for investors to access the data in one place. Aggregators include Bloomberg and Refinitiv. There are also new entrants into this space that use enhanced technologies, such as artificial intelligence, to gather and analyze information and present it in data visualization tools. Examples of these companies are Clarity AI and ESG Book.

Investor ratings: Some investors have their own proprietary mechanisms for scoring ESG risks and opportunities. An investor may frequently draw on multiple data sources to generate an ESG score for a listed company that may or may not be shared with the company or public.

The broader stakeholder landscape

The push by shareholders for more and better sustainability information has been a catalyst for action by management and the board. But a company's customers, employees, communities and suppliers are also typically looking for management to drive value creation, while balancing broader obligations that impact the bottom line. For example, consumer decisions can shape practices. Half of consumer-packaged goods growth between 2015 and 2019 came from sustainability-marketed products. During that time, products marketed as sustainable grew seven times faster than those that were not.

Employees can also impact company decisions. Companies looking to attract and retain top talent from the next generations have felt this impact as Generation Z and Millennials (who will make up 72% of the global workforce by 2029) show greater concern about where their employers stand on environmental and social issues.

The sustainability regulatory landscape

Mandatory reporting is here or looming from both an international and domestic perspective. The role of the board, among other things, is to understand how prepared the company is for these mandatory disclosures. Given the large proportion of the world with disclosure requirements or proposals and their potential to encompass a broad spectrum of value chain contributors, most companies are expected to be impacted in some way.

The sustainability reporting landscape is dominated by the recently released "big three" proposals or frameworks: in the EU as part of the CSRD, internationally by the ISSB and in the United States by the SEC. Nearly all public companies are expected to be subject to one or more of these rules, and some may be impacted by all three.

> "Today's investors are looking for consistent, comparable and decision-useful disclosures around climate risk, human capital and cybersecurity. Companies and investors alike would benefit from clear rules of the road. I believe the SEC should step in when there's this level of demand for information relevant to investors' investment decisions."
>
> - SEC Chair Gary Gensler , September 2021

Companies are in the process of assessing the scope and applicability of the various proposals so that the appropriate planning can begin now. An SEC registrant that has a subsidiary listed in the EU and a subsidiary in a jurisdiction that requires ISSB™ reporting, for example, may be subject to the requirements in all three frameworks. With equivalency — that is, whether disclosures for one reporting framework can satisfy some or all of the requirements of another — not yet determined, companies captured in multiple reporting regimes have a vested interest in understanding which reporting applies. Further, understanding where the frameworks align and diverge will help companies develop the requisite reporting strategy, data gathering processes and related controls, providing for a streamlined process and effective deployment of resources.

For a comparison of the international and domestic regulations, see *Navigating the ESG landscape*. In addition, see *ESG Reporting: Preparing for tomorrow's rules today*, to understand the steps companies can take to prepare for mandatory disclosures. For a deeper dive on board considerations on the SEC's final climate rules, see How boards can prepare for the SEC's climate-related disclosures.

Part 2: Understanding the board's role in overseeing sustainability

Companies that embed sustainability into their strategies are better positioned for success. They can spot growth potential in identifying and managing ESG issues. They can also shape the narrative of their brands and practices while expanding their investor bases. So, as companies are telling their sustainability stories and integrating ESG into their strategies, it's important to think through the "how" of implementation.

If the company is already providing sustainability metrics in a variety of places (such as on its corporate website or in social responsibility reports), directors may be well served to step back and consider the existing governance structures and if the messaging is clear and consistent across channels. Is it tied to the company's purpose and aligned with the business strategy? Does it focus on stakeholder needs and address material risks? This section outlines the important considerations as follows:

- Purpose and strategy
- Risks
- Disclosures
- Measuring and monitoring progress
- Using compensation to create incentives

Purpose and strategy

A company's purpose is often expressed as the reason it's in business. But it's more than that. A company's purpose needs to be aligned to the overall business strategy — how the company will achieve returns year after year. As companies attempt to serve a diverse group of stakeholders – including investors, employees, customers, suppliers and communities, it shouldn't come as a surprise that many struggle to balance all those interests. To help, the board and management need to work together to define what's important and measure progress.

The company's purpose should be reflected through its messaging and activities. And as part of its oversight role, it's up to the board to make sure these things all tie together.

Board considerations:

- Has the company clearly articulated a purpose that considers key stakeholder needs and aligns with business strategy?
- Has the company considered how its purpose compares to that articulated by its competitors?
- Are sustainability risks and opportunities integrated into the company's long-term strategy?
- How is the company measuring and monitoring its progress against milestones and goals set as part of the strategy?

Risks

A key part of board oversight is taking a broad view of risk, and that may be harder in areas where management has less muscle memory because they may have less experience thinking of topics in the context of sustainability. Environmental and social factors heavily influence some of the thorniest business challenges companies must overcome.

These include workforce dynamics, innovating and incorporating new technologies, and supply chain disruptions due to natural disasters. Sustainability disclosure standards are still evolving, and companies are likely to be in scope of more than one. There is not one single standard that boards can consider when building their risk register. Furthermore, growing mandatory reporting requirements globally, with complex applicability, increases compliance risks.

The universe of identified risks is expanding and as companies improve how they assess sustainability risks, the ERM process often needs to change as well. The probability and impact of sustainability risks should be captured in the ERM effort. As a result, management will have a structured framework to use to manage and mitigate those risks. Fifty-nine percent (59%) of directors say their boards include ESG in their ERM discussions.

Board considerations:

- Do the company's existing risk processes include identification of any sustainability risks?
- Would expanding the risk identification process lead to a broader scope of risks to be captured?
- Does the ERM process include assessment and mitigation plans for all sustainability-related risks identified?
- How does management prioritize sustainability risks and opportunities?
- Are sustainability risks and opportunities included in capital allocation decisions?

Disclosures

In addition to pending mandatory reporting regimes, stakeholders want a comprehensive, cohesive story when it comes to sustainability. Qualitative sustainability messaging should reinforce the company's purpose statement, while quantitative metrics bring that purpose to life and help companies measure their progress toward goals. These sustainability metrics also help investors compare companies across industries and companies set transparent milestones along the way to long-term goals.

To effectively oversee these disclosure efforts, forward-looking boards are focusing on materiality, accuracy and reliability of data. Materiality is a threshold criterion in deciding which metrics to disclose. But determining materiality for sustainability purposes creates its own challenge, as discussed on the next page.

Boards are also concerned with the accuracy of the information disclosed. This includes understanding the internal controls in place for both qualitative information and quantitative metrics. And when choosing to adopt a framework or standard that incorporates specific metrics, consideration is given to the feasibility of meeting the provisions of the chosen framework/ standard, including the requirement for assurance if applicable. When disclosures are mandatory, appropriate controls will be needed for the required data.

Finally, boards are looking at how they stack up against their competitors. What types of disclosures are they making? Which metrics have they adopted? How do their ratings from third-party agencies compare? Understanding the company's ratings and how they compare to peer companies could also help highlight areas for enhancement.

Board considerations:

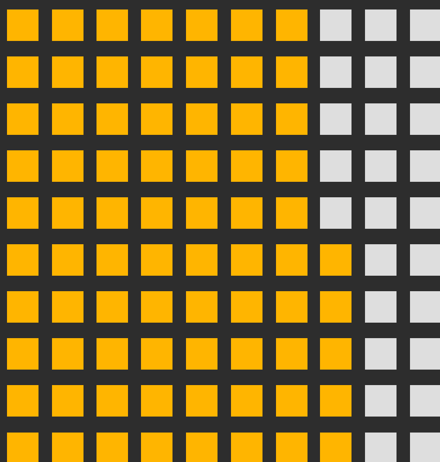
- Is the company subject to any required disclosures?
- How is the company communicating its purpose and its goals in furtherance of long-term sustainable success?
- Is the company using both quantitative and qualitative information to measure its progress?
- How does the company monitor what competitors are doing, what the rating agencies are reporting and other benchmarking data?
- Is the company transparently tracking and reporting its performance against milestone goals, as well as long-term goals, so stakeholders and others can monitor progress?
- What time periods should be presented in sustainability disclosures? For example, will the company only present current year data, or present a one or two-year comparative?
- Should the information be disclosed in the aggregate, or at a subsidiary level?

Materiality

As discussed in Part 1, investors are paying more attention to the sustainability risks and opportunities facing the companies in which they invest and are in many cases using the information available in the market to make buy, sell, hold and vote decisions. Leading companies are responding by bringing together multiple functions within the organization under close oversight by the board to identify and report on those sustainability risks and opportunities that will impact resilience and value creation for the short, medium and long term.

Recently, the vast majority of the S&P 500's market value has been tied up in intangible assets, such as human capital, customer loyalty and brand identification, on which a company's sustainability position can have substantial effects. Determining whether those sustainability risks and opportunities will have a material impact on a company's strategy, messaging, risk assessment and reporting is critical as companies compete for capital, and boards have a key oversight role to play.

Additionally, many companies have expanded the population of who they consider the stakeholders beyond investors to include employees, customers and communities. For a detailed discussion on materiality and the board's considerations, see Appendix A: A deeper dive into materiality.



How investors think about assurance

According to *PwC's Global Investor Survey 2022*, 75% of respondents say their confidence in sustainability reporting would receive the biggest boost if it were assured at the same level as companies' financial statements (i.e., reasonable assurance). The board may want to consider what sustainability data published by the company will be subject to assurance, such as the mandates in the SEC final rule and CSRD, and what level of controls are in place for data when assurance is not required. Regardless of where information is published, investors and regulators expect accuracy.

Reliability of sustainability information

Once the company has settled on the qualitative and quantitative messaging, whether required or voluntary, the board will want to oversee the process for disclosure. After all, investors will be using this information to analyze the company and make investment decisions.

This starts with understanding the policies and procedures that are in place. The board needs to understand the internal controls over sustainability disclosures. Especially because disclosures are included in financial statement footnotes, as outlined in the final SEC rule, and are subject to internal control over financial reporting (ICFR). Understanding the processes and controls in place around the scope and quality of disclosures is an important aspect of the board's oversight role. They may also want to consider stakeholder expectations for whether the company should consider obtaining some type of assurance over the sustainability information disclosed, as discussed on the previous page.

Board considerations:

- Does the company have robust policies and procedures to support the development of its disclosures?
- Do the company's disclosures adhere to the requirements of particular frameworks or standards? Are disclosures meeting investor expectations?
- What is the role of the finance/reporting function in sustainability disclosures?
- Has management found any gaps in the internal controls that support the completeness and accuracy of the disclosures? If so, how do they plan on mitigating those gaps? What is the role of the disclosure committee in the process?
- When not required, would stakeholders be confident with the accuracy of the disclosure without independent assurance? Could independent assurance serve as a differentiating factor among peers?

ESG standards and frameworks

Many companies have used standards and frameworks to make voluntary disclosures and most are preparing for regulated disclosure. As mandatory disclosure requirements evolve, investors and other stakeholders may have disclosure expectations that extend beyond what is currently being contemplated by regulators.

Using standards and frameworks to meet expanded disclosure expectations allows for consistent and comparable disclosures, aiding investors in their decisions. Companies find it helpful to have structured guidance to follow, which can also provide a benchmark in support of third-party assurance over disclosed information.

Over the past several years, the set of standards and frameworks being used in the market has expanded and contracted several times, but still leaves companies various options to choose from. To make sense of the options, it is important to first understand the difference between standards and frameworks. Generally speaking, standards, which follow a typical process (including receiving public comments), offer specific guidance for measurement and disclosure. Frameworks, on the other hand, provide general guidelines on disclosure. This distinction is important because it gives the company a sense of what level of specificity to expect when adopting a standard or framework. In addition, when deciding the standards and/or frameworks to adopt, it will be helpful to assess the following:

- The scope of the information (e.g., a focus on environmental or all ESG topics)
- Whether it is industry specific or industry agnostic
- How materiality is considered (financial versus social)
- What the target audience is

While there remains a variety of frameworks and standards in place, some have converged. Many of the following standards and frameworks represented the market prior to the current wave of consolidation. However, they remain part of the ESG lexicon and are frequently still referred to in the present tense.

The major standards and frameworks:

Name	Standard or framework	Description	Notes
Global Reporting Initiative (GRI)	Standard	Provides ESG standards that address disclosures of socially material topics affecting a company's stakeholders. It also requires that companies determine the issues that are material in consultation with stakeholders. *Their website.*	
Sustainability Accounting Standards Board (SASB)	Standard	Recommends topics and metrics for 77 different industries across all three pillars of ESG. These standards provide guidance on how organizations can align their reporting with investor needs and how companies gather standardized data. *Their website.*	In June 2021, the SASB and the International Integrated Reporting Council merged to form the Value Reporting Foundation, which subsequently was absorbed by the ISSB. The ISSB has committed to building on the industry-based SASB Standards and adopting SASB's industry-based approach to standards development.
The Carbon Disclosure Project (CDP)	Framework	Supports various stakeholders by collecting data to measure company risks and opportunities on climate change, deforestation and water security. *Their website.*	
Climate Disclosure Standards Board (CDSB)	Framework	Provides companies with a framework to disclose environmental and climate-related information at the same level of rigor as that of financial information. *Their website.*	The CDSB was consolidated into the ISSB.
The Taskforce on Climate-related Financial Disclosures (TCFD)	Framework	Provides 11 recommendations across four pillars: governance, strategy, risk management, and metrics and targets. *Their website.*	Beginning in 2024, the ISSB will take over monitoring compliance with the TCFD, effectively absorbing the organization.
The Taskforce on Nature-related Financial Disclosures (TNFD)	Framework	Provides 13 recommendations across four pillars: governance, strategy, risk management, and metrics and targets. Additionally, it has published guidance on the identification and assessment of nature-related issues: The TNFD LEAP approach. *Their website.*	

Additional disclosure guidance: A number of business associations have also developed recommendations to help members standardize sustainability disclosures within their industries. The National Association of Real Estate Investment Trusts (NAREIT), for instance, produced a guide designed to help members better understand and navigate the ESG reporting frameworks, and the Edison Electric Institute (EEI) launched an ESG template to help member electric companies provide uniform sustainability information. Separately, the World Economic Forum's International Business Council issued a white paper that outlines a common set of metrics to support consistent reporting.

Board considerations:

- Has the company leveraged various ESG standards and frameworks to help determine whether it is addressing the most significant risks and issues facing the company?
- What considerations were taken into account when deciding on the standard and/or framework to adopt? For example, were the target audience, materiality considerations and scope considered?
- How is management monitoring and responding to changes in voluntary and mandatory reporting standards and frameworks in markets where the company operates?

Where to disclose sustainability information

Once a company has decided on its purpose, messaging, metrics, and which standards and frameworks to use (both mandatory and voluntary), it will have to consider where to disclose the information. Among the most common platforms are proxy statements, CSR/sustainability reports, company websites and annual reports. These choices are informed by stakeholder preferences and peer practices, as well as the liability risk associated with information being filed, furnished or otherwise voluntarily disclosed.

Disclosure platforms

Proxy statements: More companies are including sustainability information in their proxy statements as a way to communicate directly with investors. This disclosure often includes discussion of:

- the sustainability risks and opportunities identified by the company, and their areas of focus,
- the governance and management operations structures (for example, whether a committee or a specific person is responsible for developing and executing the company's sustainability strategy and frequency of reporting to the board),
- how and how often the topic is discussed with various stakeholders, such as whether the topic was specifically targeted for shareholder engagement,
- progress against implementation goals, including the company's current state, periodic milestone goals and other long-term goals, and
- links to the company's other sustainability information, including reports or materials on the company's website.

CSR/sustainability reports: A sustainability report has been the historic channel for many companies to communicate sustainability performance and impact — whether positive or negative. If a company is planning to use its CSR report to deliver sustainability disclosures, the company should consider whether it includes the sustainability risks and opportunities that would be considered relevant to investors and other stakeholders. Also, think about whether the sustainability activities described link to the company's purpose and overall business strategy.

Websites: Companies often house sustainability information on their websites, with pages dedicated to their sustainability goals and efforts. The websites often include links to additional sustainability information, such as ESG score cards.

SEC annual and quarterly reportings: When material, companies may be required to disclose sustainability matters in the risk factors, MD&A or other sections of their SEC reporting.

96%

of companies in the S&P 500 publish a sustainability or ESG report

Source: Governance & Accountability Institute, Inc., *2022 Sustainability Reporting in Focus*, November 2022.

Earnings calls: Some companies are using their earnings calls to showcase their sustainability efforts. This approach allows them to improve corporate communication with investors on material sustainability issues and demonstrate how their sustainability efforts are embedded in their overall value creation plan.

Investor/analyst day: Some companies are incorporating their sustainability efforts into their investor/analyst day presentations to demonstrate how the issues addressed are connected to the company's strategy. Alternatively, a few companies are holding a separate day to focus on sustainability efforts and performance exclusively.

Board considerations:

- Do the company's disclosures address various stakeholder preferences? For example, a customer or an employee will most likely refer to the company's website for sustainability information, while an investor would more likely refer to either corporate responsibility reporting or annual reports.
- Are disclosures consistent across various platforms and appropriate for the different audiences of each? For example, are material risks disclosed in a corporate responsibility report aligned with those identified in the company's Form 10-K filing?
- Is the messaging being incorporated in operational discussions, such as quarterly analyst calls?
- Has the company considered its legal liability when including sustainability information in SEC filings?

Measuring and monitoring progress

Initially, investors and other stakeholders were simply looking for data from companies on relevant sustainability factors. Then the emphasis shifted to higher quality data and increased types of information. Aligning disclosures with one or more frameworks or standards was sufficient. Today, shareholders are looking for companies to set specific goals and milestones when developing their sustainability strategy and to track and report their progress against these goals and milestones. Further, they want to understand the governance structures, especially board oversight, that underpin the metrics, goals and milestones.

Board considerations:

- How does the company determine which metrics, frameworks and standards will be used for disclosure in mandatory and voluntary reporting?
- What sustainability commitments has the company made publicly, what is the strategy to achieve the commitments and how is management monitoring performance?

Using compensation to create incentives

Many investors are focused on the connection between sustainability goals and executive compensation. By tying incentive plan metrics explicitly to the company's sustainability strategy, a company is not only encouraging the achievement of those sustainability goals, it is also signaling the importance of those issues. A growing number of shareholder proposals are asking companies to link the two. And a number of large companies have already taken steps to do so.

As boards work to integrate sustainability concerns into discussions of company strategy, many are also considering how to create the right incentives for achievement of sustainability-related goals. Incentive plans have long been driven primarily by traditional financial goals. That often means quantitative goals related to things like revenue, cash flow, units sold, EBITDA, earnings per share or total shareholder return. But at many companies, a shift is underway as sustainability goals become more common. In 2022, nearly three-quarters of companies in the S&P 500 have adopted ESG metrics.

Board considerations:

- How do the company's compensation practices benchmark against peers as it relates to tying sustainability to executive compensation? Do peer companies use sustainability metrics, and if so, what metrics do they use?
- Which goals are important for the company? What are the interim and long-term goals? And therefore, which metrics make sense for the company to use?

For additional considerations on tying ESG metrics to executive compensation, see *Purpose-driven leadership: the evolving role of ESG metrics in executive compensation plans*.

Part 3: Mapping sustainability to oversight

Given how broad and complex sustainability can be, how exactly does the board go about overseeing this area?

Over the past decade, practices have evolved organically as sustainability has evolved from text-heavy corporate social responsibility reports to the investor-grade data and concrete strategies that are expected today. Poor controls over sustainability information creates risk for companies, and that risk calls for new controls. More recently, regulatory changes and stakeholder pressure are pushing even more shifts. The board can play an important role in driving the maturity of these governance processes.

Corporate governance or operational governance?

The concept of combining environmental, social and governance issues into an ESG wrapper often causes confusion. Does “governance” refer to the traditional corporate governance topics like shareholder rights, board leadership, compensation and ethics? Or does it refer to the governance systems in place to manage environmental and social risks and opportunities (operational governance)? Both answers can be correct, depending on the circumstances.

The nominating and governance committee is the traditional home for corporate governance matters. Operational governance discussions are likely to be split between the audit committee and the full board. Overseeing the policies, procedures and controls necessary for accurate public communications is a core competency of the audit committee, whereas discussions of reporting lines, strategy ownership and execution are more suited for the full board or a standalone sustainability committee.

Allocating sustainability oversight responsibility

Because sustainability strategy should align with business strategy and focus on material risks and business drivers, the full board will want to understand how those risks and opportunities are being addressed. The board will also be interested in how management is using sustainability to differentiate the company in the market. If this is a new area of focus for the board and the company, directors may need to assign detailed oversight to specific committees to help the sustainability strategy launch smoothly. Ultimately, though, sustainability issues will be relevant to all committees.

Equally important to the board oversight structure is how the board and management will interact and where accountability lies within the management team. According to PwC's *Global investor survey*, 66% of investors say that they are more confident that companies are on top of ESG risks and opportunities when someone in the C-suite is accountable. But the scope of sustainability topics does not lend itself to a single reporting line. This makes it more important for the board and management to articulate how ownership and accountability is established inside the company. Once they are identified, the board will need regular access to the individuals responsible for developing and executing the sustainability strategy.

Board considerations:

- Do we have a committee with the capacity, interest and skills to take the lead on overseeing the company's overall sustainability efforts? If not, will the full board take on this responsibility? Or should we create a new committee or add directors to the board/committee to fill the skills gap?
- How will the committees stay aligned on sustainability? Have committee charters and proxy statement disclosures been updated to clearly communicate the board's allocation of sustainability oversight responsibility?
- Is it clear how management is governing sustainability strategy development, execution and sustainability reporting?

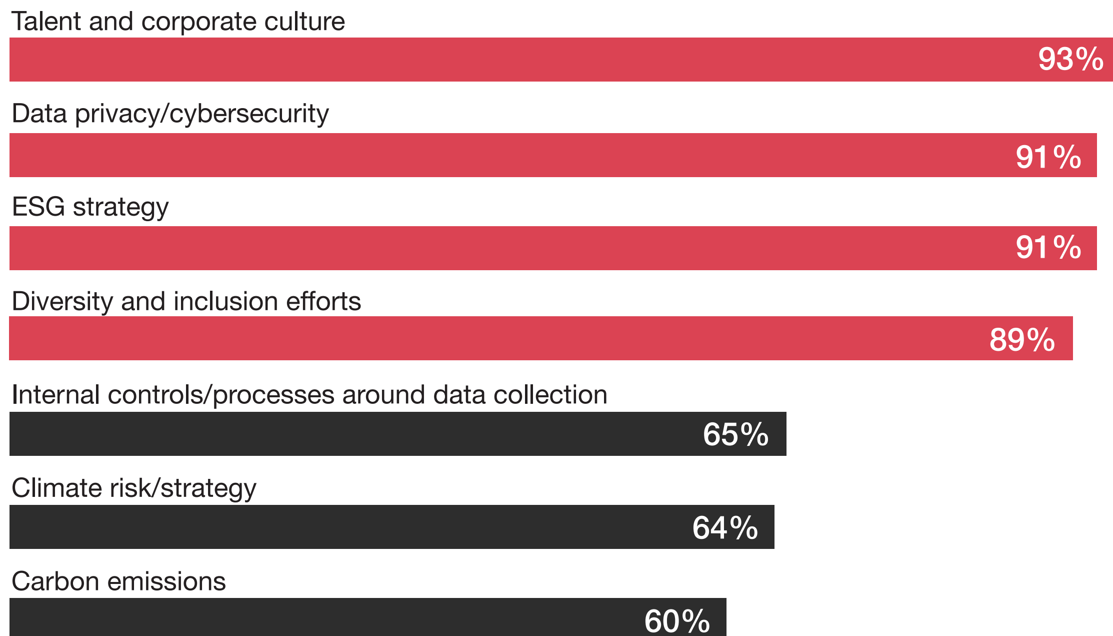
Getting the message across on board oversight

Investors are continuing to expect more transparency from boards in how they oversee particular topics, including sustainability. In fact, some shareholders may vote against directors if oversight responsibilities are not explicitly disclosed. Boards can find a number of ways to provide shareholders with the information they seek:

- Robust disclosure in the proxy statement describing the board's oversight efforts
- Updates to board committee charters to address committee oversight responsibilities related to sustainability
- Additional information about directors' skills that enhance their contribution to sustainability oversight efforts

Directors are confident about sustainability

Percentage of directors who think their boards understand the following:



Q: How well do you think your board understands the following as they relate to your company?
Responses: Very well and somewhat well
Base: 512-560
Source: PwC, *2023 Annual Corporate Directors Survey*, October 2023.

Integrating sustainability into board oversight responsibilities

Full board

Oversee:

- **Strategy:** Are sustainability risks and opportunities integrated into the company's long-term strategy? How is the company measuring and monitoring its progress against milestones and goals set as part of the strategy?
- **Messaging:** Do sustainability messaging and activities align with the company's purpose and stakeholder interests?
- **Risk assessment:** Have material sustainability risks been identified and incorporated into the ERM? Has the board allocated the oversight of these risks to the full board or individual committees?
- **Reporting:** What is the best communication platform to use for the company's sustainability disclosures?

Audit committee

Oversee:

- **Disclosures:** Is the company or any of its subsidiaries subject to mandatory reporting? For voluntary reporting, which ESG frameworks and/or standards is the company using and are the disclosures (both qualitative and quantitative) investor grade?
- **Processes and controls:** Are there processes and controls in place to support high quality data collection and reporting?
- **Assurance:** If not required, should independent assurance be obtained to enhance reliability?

For more information on ESG and the audit committee see: *The audit committee's role in sustainability/ESG oversight*.

Compensation committee

Oversee:

- **Accountability:** Are the sustainability goals and milestones effectively integrated into executive compensation plans?
- **Talent and culture:** How is management organized to execute the sustainability strategy? Are the right people and processes in place? Does the company have a culture that embraces sustainability efforts?

For more information on ESG in executive compensation see: *Purpose-driven leadership: The evolving role of ESG metrics in executive compensation plans*.

Nominating and governance committee

Oversee:

- **Engagement:** Is the company's sustainability story being effectively communicated to investors and other stakeholders?
- **Board composition:** Does the board have the necessary expertise and skills to oversee sustainability risks and opportunities?
- **Education:** Does the board understand why ESG is important to investors and other stakeholders? Is the board appropriately educated on ESG and the company's sustainability?

For more information about shareholder engagement and board composition see: *Board composition: The road to strategic refreshment and succession* and *Director-shareholder engagement: getting it right*.

Making time for sustainability on the board agenda

In the past, sustainability topics and data may have been reviewed by the board on an ad hoc basis, perhaps centered around the publication of proxy materials and a sustainability report. However, sustainability is now a recurring topic at most board meetings and sometimes in every committee meeting, as 52% of directors say ESG is a regular part of their agendas.

Given the demands and expectations for board involvement in sustainability oversight, it is important to create the right cadence. The board needs to regularly hear from management on sustainability strategy, reporting progress against goals and challenges that have arisen. Some topics, such as human capital during a labor crunch, may need frequent updates. By taking a considered approach to spreading responsibilities across the full board and appropriate committees, and setting expectations for management reporting, the board can ensure sustainability topics receive the attention they need without putting undue pressure on their time.

Additionally, high-performing boards and directors are always embracing educational opportunities. Because sustainability topics are wide-ranging and can be very complex, it's an area well-suited to different types of director education. Many boards engage outside experts to provide the board with briefings and specific training on sustainability. Others send directors to intensive programs focused on specific areas of sustainability.

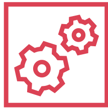
Board considerations:

- Which topics have a direct impact on near-term performance or capital allocation decisions? Are there topics the board needs to monitor but may not require direct input?
- Can performance be monitored using a dashboard or does it require time for discussion on the agenda?
- Are there any skills or abilities identified during the board evaluation process that should be prioritized for more intensive board education programs?

Conclusion

Companies have made rapid strides in unlocking the business value of sustainability in recent years. The sustainability issues a company faces vary widely by industry and company maturity, and there is no one-size-fits-all solution. The rapidly evolving regulatory environment, including the final SEC rules on climate-related disclosures and the laws instituting California disclosure requirements for companies doing business in California, means companies should act now to reduce the burden of future disclosure requirements. Directors have a big role to play in guiding management to allocate the appropriate resources and attention. Forward-looking companies value being a frontrunner on sustainability issues because they see the connection to the company's long-term success.

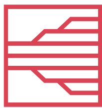
Appendix A: A deeper dive into materiality



Background

As discussed in Part 1, investors are paying more attention to the sustainability risks and opportunities facing the companies in which they invest and are in many cases using the information available in the market to make buy, sell, hold and vote decisions. Leading companies are responding by bringing together multiple functions within the organization under close oversight by the board to identify and report on those sustainability risks and opportunities that will impact resilience and value creation for the short, medium and long term.

Recently, the vast majority of the S&P 500's market value has been tied up in intangible assets, such as human capital, customer loyalty and brand identification, which can be substantially affected by a company's sustainability position. Determining whether those sustainability risks and opportunities will have a material impact on a company's strategy, messaging, risk assessment and reporting is critical as companies compete for capital. Boards have a key oversight role to play. Additionally, many companies have expanded the population of whom they consider stakeholders beyond investors to include employees, customers and communities.



Materiality in the context of sustainability information

When materiality is considered in the sustainability context, it often has a broader lens than investor-focused federal securities laws and may consider the environmental and social impacts of a company's activities. Companies will need to understand each of the definitions in the required and voluntary frameworks and standards that they are using.

In performing a materiality assessment, it is helpful to think about where a company might disclose and/or communicate sustainability risks and opportunities, and the corresponding regulatory requirements, when applicable. Regardless of where it is presented, the information should be developed under a system of processes, policies and procedures on measurement and reporting to support its completeness, accuracy and reliability.

In financial statements

For some companies, sustainability risks and/or opportunities may have a material impact on the financial statements under the US GAAP financial reporting framework or another framework they may be using. For instance, a company may be executing a plan to reduce emissions, which may result in a significant change in how certain of its physical manufacturing assets will be used. This could lead to a material impairment which would need to be disclosed in the financial statements.

In documents filed or furnished to the SEC

Because the time horizon over which sustainability-related risks and opportunities will impact a company vary by company and industry, certain risks may exist that do not yet have a material impact on the financial statements but have the potential to be material. Management may choose to disclose these risks in SEC filings because they view them to be important to the company's strategy and/or operations, even if not otherwise required to include them as risk factors. While there is significant judgment in determining what constitutes material disclosure that should be included in an SEC document, federal securities laws provide the context for management to make those decisions.

In other company communications

Reporting on financially material sustainability risks and opportunities in financial statements and SEC documents is targeted at investors and done within the construct of securities laws and US GAAP. There is, of course, other sustainability-related information that could be of interest to a broader set of stakeholders that the company may decide to actively monitor, manage and report on in a sustainability report, for example.

The factors that influence the financial impact of and investor interest in different sustainability risks and opportunities are evolving, and as such, something disclosed in the risk factors section of the Form 10-K today may impact the financial statements tomorrow. Further, the regulatory requirements for reporting are evolving quickly, as shown by publication of the SEC's final rule on climate-related disclosures and the EU's adoption or proposal of various sustainability reporting requirements.

Over the past several years, strong investor interest has shifted the analysis of how both climate- and diversity-related actions must be assessed for materiality. As such, the assessment of financial and nonfinancial impacts of sustainability issues should not be static. So that materiality assessments reflect the dynamic nature of investor and broader stakeholder concerns and remain current in this evolving landscape, companies should have a robust process for regularly reviewing their sustainability materiality assessments, the factors covered in those assessments (including the applicable regulatory requirements), and decisions about what to disclose and where.

The board's role

Not all sustainability risks and opportunities need to be discussed at the board level. Given the strong interest of institutional investors, the impact of certain sustainability matters on risk assessment, talent recruitment and retention concerns, regulatory changes, and the potential impact on brand value, overall sustainability strategy is an appropriate topic for a board to discuss regularly. The level of detail and the balance of time committed to sustainability issues will vary by company. Management's judgment about which of the issues to bring to the board should be informed by a materiality analysis. The board should understand management's process for identifying the sustainability issues relevant to the company, assessing those issues for materiality, and deciding what to disclose and where. The board should understand and challenge management's materiality assessment process.

The board may want to consider asking management the following questions:

- How has management determined those sustainability risks and opportunities that could have a material impact on strategy, operations or financial performance under each of the definitions in the required and voluntary frameworks and standards that they are using?
- Beyond investors, to which groups of stakeholders is the company accountable? Is the company considering the interests of employees, customers, suppliers and communities? Has there been an assessment of how the broader group of stakeholders could impact long-term value?
- How has management assessed what sustainability-related information is relevant for each of its stakeholder groups?
- Has management engaged with investors and other key stakeholder groups about sustainability to inform the company's materiality analysis? For example, have the sustainability concerns of institutional investors been considered? Have employees been consulted on which sustainability issues are most likely to affect their decisions about employment?
- Is the materiality analysis used as a strategic business tool — to identify both risks and opportunities arising from sustainability issues — as well as to guide disclosure decisions, considering regulatory and reporting requirements?
- How does management determine the sustainability matters to be discussed with and reported to the board?
- What is the process to oversee that communications are aligned with the company's purpose and the messaging is consistent across financial and other company reporting?

Appendix B: Summary of board considerations

Topic	Question	Page
Purpose and strategy	• Has the company clearly articulated a purpose that considers key stakeholder needs and aligns with business strategy? • Has the company considered how its purpose compares to that articulated by its competitors? • Are sustainability risks and opportunities integrated into the company's long-term strategy? • How is the company measuring and monitoring its progress against milestones and goals set as part of the strategy?	9
Risks	• Do the company's existing risk processes include identification of any sustainability risks? • Would expanding the risk identification process lead to a broader scope of risks to be captured? • Does the ERM process include assessment and mitigation plans for all sustainability-related risks identified? • How does management prioritize sustainability risks and opportunities? • Are these sustainability risks and opportunities included in capital allocation decisions?	10
Disclosures	• Is the company subject to any required disclosures? • How is the company communicating its purpose and goals in furtherance of long-term sustainable success? • Is the company using both quantitative and qualitative information to measure its progress? • How does the company monitor what competitors are doing, what the rating agencies are reporting and other benchmarking data? • Is the company transparently tracking and reporting its performance against milestone goals, as well as long-term goals, so stakeholders and others can monitor progress? • What time periods should be presented in sustainability disclosures? For example, will the company only present current year data, or present a one or two-year comparative? • Should the information be disclosed on the aggregate, at a company or subsidiary level?	11

Topic	Question	Page
Reliability of sustainability information	• Does the company have robust policies and procedures to support the development of its disclosures? • Do the company’s disclosures adhere to the requirements of particular frameworks or standards? Are the disclosures meeting investor expectations? • What is the role of the finance/reporting function in sustainability disclosures? • Has management found any gaps in the internal controls that support the completeness and accuracy of the disclosures? If so, how does management plan on mitigating those gaps? What is the role of the disclosure committee in the process? • When not required, would stakeholders be confident with the accuracy of the disclosure without independent assurance? Could independent assurance serve as a differentiating factor among peers?	13
ESG standards and frameworks	• Has the company leveraged various ESG standards and frameworks to help determine whether it is addressing the most significant risks and issues facing the company? • What considerations were taken into account when deciding on the standard and/or framework to adopt? For example, were the target audience, materiality considerations and scope considered? • How is management monitoring and responding to changes in voluntary and mandatory reporting standards and frameworks in markets where the company operates?	16
Where to disclose sustainability information	• Do the company’s disclosures address various stakeholder preferences? For example, a customer or an employee will most likely refer to the company’s website for sustainability information, while an investor would more likely refer to either corporate responsibility reporting or annual reports. • Are disclosures consistent across various platforms and appropriate for the different audiences of each? For example, are material risks disclosed in a corporate responsibility report aligned with those identified in the company’s Form 10-K filing? • Is the messaging being incorporated in operational discussions, such as quarterly analyst calls? • Has the company considered its legal liability when including sustainability information in SEC filings?	18

Topic	Question	Page
Measuring and monitoring progress	• How does the company determine which metrics, frameworks and standards will be used for disclosure in mandatory and voluntary reporting? • What sustainability commitments has the company made publicly, what is the strategy to achieve the commitments and how is management monitoring performance?	19
Using compensation to create incentives	• How do the company's compensation practices benchmark against peers as it relates to tying sustainability to executive compensation? Do peer companies use sustainability metrics and if so, what metrics do they use? • Which goals are important for the company? What are the interim and long-term goals? And therefore, which metrics make sense for the company to use?	20

How PwC can help

To have a deeper discussion about how this topic might impact your business, please contact your engagement partner or a member of PwC's Governance Insights Center.

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