BOARD OVERSIGHT: REQUIRED ESG FOR PUBLIC COMPANIES IN EUROPE

Hugh Grove *, Maclyn Clouse **, Tracy Xu ***

* Daniels College of Business, University of Denver, Denver, USA
** Reiman School of Finance, Daniels College of Business, University of Denver, Denver, USA
*** *Corresponding author,* Reiman School of Finance, University of Denver, Denver, USA
Contact details: Reiman School of Finance, University of Denver, 2101 S. University Blvd., 80210 Denver, Colorado, USA

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Abstract

Boards of directors now have a powerful monitoring guidance from the European Sustainability Reporting Standards (ESRS) to assess the required environmental, social, and governance (ESG) reporting and performance of their European public companies. Boards can now assess whether their companies are committed to ESG efforts or just greenwashing, i.e., just making commitments or pledges without any substantial subsequent performance. The main purpose of this paper is to examine and propose how boards of directors can oversee and facilitate this sustainability transition toward mandatory European ESG reporting. In the existing literature, there are currently no research papers that address this topic which is developing so rapidly. Boards of directors could also help assess if such ESG sustainability requirements are aligning with and delivering value to shareholders, customers, employees, communities, and other stakeholders. Future research could investigate these board responsibilities with case studies or empirical studies, especially to see if ESG reporting is becoming relevant and valuable.

Keywords: Board Governance, ESG, Environmental, Social, Governance

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1. INTRODUCTION

In January 2023, the European Union (EU) adopted the Corporate Sustainability Reporting Directive (CSRD), which requires both EU and non-EU companies with significant operations in the EU to file annual sustainability reports alongside their financial statements. This CSRD applies to EU-listed companies with more than 500 employees and net revenues of over EUR40 million, or a balance sheet total of over EUR20 million. These reports must be prepared in accordance with European Sustainability Reporting Standards (ESRS). On July 31, 2023, the European Commission (EC) adopted the first set of ESRS which will apply directly to all 27 EU member states. Companies will need to report in compliance with these new ESRS in the 2024 reporting period. The standards are notable for their breadth and granularity, going well beyond the reporting requirements in other mandatory and voluntary environmental, social, and governance (ESG) reporting frameworks. Companies and their boards of directors need to start getting ready to report these new ESRS now (Sasfai et al., 2023).

In April 2022, the European Financial Reporting Advisory Group (EFRAG) had previously released 13 exposure drafts in accordance with an EC proposal. The EC's CSRD requires companies to report on sustainability and climate-related information. This now-adopted CSRD mandates the development of a set of reporting standards (ESRS) with which companies in the EU are required to comply. These EU requirements also extend to large non-listed entities (Sullivan et al., 2022).

According to the CSRD, sustainability reporting, aligned with the ESRS, would be required through management reporting, e.g., management disclosure and analysis. Initially subject to limited assurance, such sustainability reporting would move toward reasonable assurance as the reporting framework evolves. In the future, this CSRD will specify a timeline for this migration to reasonable assurance. The ESRS requirements resemble those of the Task Force on Climate-Related Financial Disclosures (TCFD), requiring climate-related disclosure alongside and within annual financial filings (Sullivan et al., 2022).

For the 2024 reporting period, EU authorities are gearing up to enforce these new rules on sustainability reporting. They have estimated that more than 50,000 European public companies will have to issue ESRS reports for fiscal year 2024 to be published in 2025. Also, these changes will affect 10,400 foreign companies that also have an EU stock listing per Refinitiv, part of the London Stock Exchange Group PLC. This Refinitiv analysis has identified these foreign companies as about 33% American, 13% Canadian, and 11% British. These EU rules take effect starting in 2024 in a regulatory effort to boost ESG visibility on everything from companies' greenhouse gas (GHG) emissions to workforce disclosures. Country-level regulators will enforce the rules and penalties can vary, but listed companies that don't comply may be fined a percentage of their annual revenue in the EU bloc (Holger, 2023; Marks, 2023).

Sustainability reporting will need additional time and resources to mature to a level comparable to financial reporting when it comes to meeting this 2024 reporting timeline, enhanced corporate governance, and data management. The integration of financial metrics and nonfinancial disclosure across corporate governance, risk management, and ESG strategies can help companies drive better organizational communication, improved stakeholder connection, and accountability (Sullivan et al., 2022).

What makes these new developments even more significant is the direct impact on corporate control. The CSRD and ESRS expand the scope of control to encompass sustainability and ESG aspects. Boards of directors and management now have the task of navigating a complex regulatory environment that demands stringent control mechanisms to meet reporting requirements and ensure accountability. These developments underscore the critical role that control plays in corporate governance, where sustainability reporting is now an integral component of the control framework, essential for both regulatory compliance and organizational transparency.

The main research question of this paper is:

RQ: How can boards of directors oversee and facilitate the sustainability transition towards ESG reporting in light of the ESRS?

Our paper examines and proposes the methods and best practices based on the ESRS to help boards effectively manage this transition and fulfill the ESG disclosure requirements.

The structure of this paper is as follows. Section 2 reviews the relevant literature. Section 3 describes the research methodology. Section 4 presents the results. Section 5 discusses the results and prospects in ESG governance. Section 6 concludes the study.

2. LITERATURE REVIEW

Grove et al. (2022) focused on the challenges for boards of directors in helping their companies manage, assess, and track performance with ESG measures. At the time of this paper before the ESRS ESG requirements for Europe, there were no required ESG measures, just a variety of choices that make comparisons and analyses very challenging for boards, management, and other stakeholders. A measurement theory perspective, which focuses on valid, reliable, and operational measurement techniques, was advocated for use by management and boards in applying and assessing various ESG measures. If ESG measures are eventually required by national jurisdictional securities regulatory authorities, such as the new European ESRS ESG requirements, then boards would have specific benchmarks, targets, and reports to meet the challenge of managing ESG pledges and measures (Grove et al., 2022).

Grove and Clouse (2021) developed board corporate social responsibilities for renewable energy commitments, especially in response to activist investors. Since many companies are making renewable energy commitments, boards of directors have responsibilities to monitor such commitments for enhanced corporate governance. This paper investigated whether boards of directors were making significant efforts to monitor their companies' commitments to renewable energy and whether were boards satisfied with their companies' just greenwashing, i.e., making commitments or pledges without any substantial subsequent performance.

Velte (2022) summarized the results of archival research on corporate governance determining firms' financial consequences of corporate social responsibility (CSR) performance and reporting and concluded that effective corporate governance as a monitoring tool should increase CSR reporting and performance. Mamun (2022) used regression analysis to show that CSR reports have a connection with companies' performance and that only economic and social performance disclosures of sustainability reporting significantly influence companies' performance. Agbata et al. (2022) reviewed the impact of corporate governance on financial sustainability, environmental sustainability, and social sustainability in Nigerian firms from 2012 to 2022 and found that corporate governance had a significant effect on environmental sustainability but mixed effects (significant and not significant) on social sustainability and financial sustainability.

Professor Bob Garratt is the Director at Good Governance Development Ltd, a London External Examiner at the Gulf Cooperation Council Board Development Institute. He recommended the following research paper as an important and wise caveat that all boards need to consider as an antidote to easy ESG rhetoric and accounting. This paper by three environmental scientist professors at United Kingdom universities is *Climate Scientists: Concept of Net-Zero is a Dangerous Trap* (Dyke et al., 2021).

The three climate scientist authors, who have more than 80 years of climate change experience, criticized the current consensus that if we deploy mass tree planting, high-tech direct air capture devices, and other carbon dioxide removal techniques at the same time as reducing our burning of fossil fuels, we can more rapidly halt global warming and achieve net-zero by 2050. Unfortunately, they concluded that in practice such consensus helps perpetuate a belief in technological salvation and has diminished the sense of urgency surrounding the need to curb emissions now. They have arrived at the painful realization that the idea of net-zero has licensed a recklessly cavalier "burn now, pay later" approach which has seen carbon emissions continue to soar (Dyke et al., 2021).

Raghunandan and Rajgopal (2023) studied the Business Roundtable (BRT) companies that had signed the stakeholder-focused Statement of the Purpose of a Corporation when it was issued in August 2019. The research empirically tested whether these signatory firms exhibited superior treatment of the environment and employees, relative to non-signatory peer firms within their industries. The research found that signatory firms had higher rates of environmental and labor violations per various United States (U.S.) regulatory agencies. Also, these signatory firms were found to have higher levels of carbon emissions. Thus, these BRT companies appeared to be greenwashing their own various stakeholders with the acquiescence of their boards of directors.

Gelmini and Vola (2021) investigated integrated reporting and environmental disclosures for the impact on natural capital where a new geological era, the Anthropocene, or the Age of Humans, has been entered. They analyzed the extent and type of information that can be provided on natural capital with integrated reporting and its efficacy to really enhance sustainability practices.

Longo and Tenuta (2020) assessed sustainability at different levels of environmental, economic, and socio-institutional dimensions, using the triple bottom-line approach. They developed a Sustainable Irrigation Index to monitor and assess the sustainability of irrigation activities and policies and was applied successfully in a case study. Firmansyah and Estutik (2020) found that environmental responsibility and social responsibility disclosures were negatively associated with tax aggressiveness. However, corporate governance failed to strengthen these negative influences.

Another empirical study examined the relationship between the firms' environmental and economic performance. Hayami et al. (2015) employed the input-output methodology to study the generation of waste material and GHG in the manufacturing supply chains in Japan. They found that assemblers with suppliers producing less waste and GHG had better economic performance. The results suggest that encouraging suppliers to reduce waste output can lead to internal green products, increase cost savings, and enhance competitive advantage.

Recent studies have extended the literature on ESG disclosure and sustainability reporting. Mari et al. (2019) investigated the impact of religiosity on ESG disclosure at a cross-country level. They found that religiosity, as a country-level determinant related to general contextual factors, may improve ESG disclosure levels. Saviano et al. (2019) employed a Sustainability Helix Model to analyze ESG disclosures of a sample of Italian-listed companies. They emphasized the importance of open dialogue and shared actions to enhance companies' awareness about sustainability and ESG disclosures. Shima and Fung (2019) showed that a firm's voluntary disclosure is positively related to the adjustments in environmental performance following regulatory change. Fatemi et al. (2018) found that ESG disclosures help mitigate the negative effect of a firm's weaknesses while enhancing the positive effect of its strengths.

Peloso and Schmergel (2022) examined how the evolving ESG landscape is influencing corporate governance, particularly in terms of board oversight and disclosure requirements. It highlighted the challenges faced by boards in adapting to these changes and the need for enhanced expertise and strategic focus in ESG-related areas. Sheehan et al. (2023) discussed how corporate boards are adapting their risk management strategies to effectively oversee and address the increasing materiality and complexity of ESG risks. The 2023 global survey by a consulting firm, Heidrick & Struggles International, captured insights from 879 respondents from more than 25 countries and 19 industries. It offered a comprehensive analysis of board viewpoints on various ESG issues, highlighting how sustainability initiatives are influencing and transforming board activities (Heidrick & Struggles International, 2023). The results showcased the ways in which boards are modifying their composition, governance, and processes, achieving varied levels of success in aligning with their organizations' sustainability goals and meeting stakeholders' expectations.

The existing literature has largely focused on the various aspects of ESG measures, the financial implications of CSR, and the theoretical frameworks of corporate governance in sustainability. However, there is a lack of research addressing the direct application of the new ESRS in corporate governance and its practical implications for boards of directors. This paper contributes to the literature by examining and proposing methods for boards of directors to effectively oversee and facilitate the transition to mandatory ESG reporting in Europe. It provides a detailed analysis of the ESRS, bridging the gap between theoretical understanding and practical application, and offers valuable insights for boards navigating this new regulatory landscape.

3. RESEARCH METHODOLOGY

Boards of directors have been called upon to navigate the challenges presented by ESG that are fundamental to the success and sustainability of their companies. However, there remains a dearth of guidance to assist directors in their duty to understand and provide oversight to ESG reporting until the ESRS European ESG requirements. This paper studies these recent requirements in European ESG reporting and provides related guidance from the European ESRS disclosure requirements to enhance boards' competence in providing ESG oversight by analyzing such requirements. Specifically, our paper analyzes how boards of directors can effectively oversee and facilitate this sustainability transition toward mandatory European ESG reporting standards. We present a framework that provides guidance for boards to assess their own companies' ESG activities and performance. An alternative research method would be to draw on prior literature and develop an analytical framework on the role of boards in ESG oversight (Short, 2009).

In addition, boards of directors are now responsible for ensuring that the organization complies with the ESRS standards and that adequate controls are in place to validate the accuracy and completeness of the sustainability data reported. First, non-compliance can result in direct financial consequences for businesses, underscoring the importance of control mechanisms in ensuring compliance and accountability. Second, the integration of financial metrics with nonfinancial disclosures, as mandated by ESRS, highlights the need for controls to ensure data accuracy and consistency across various reporting dimensions. As companies aim for higher levels of assurance, they are expected to establish control procedures and data verification processes that are akin to those used in the sustainability reporting domain.

4. RESEARCH FRAMEWORK

4.1. ESRS 1: General requirements

The objective of ESRS 1 is to establish the general requirements that companies shall comply with when preparing and presenting sustainability-related information under the CSRD. The company shall disclose, in accordance with applicable ESRS, all the material information regarding impacts, risks, and opportunities in relation to ESG matters. The information shall enable the understanding of the company's impacts on those matters and how they affect the company's financial development, performance, and position. The company shall present material sustainability-related information as part of its management report. Sustainability-related information shall cover the following reporting areas, subject to materiality (Sasfai et al., 2023; EFRAG, 2022a):

- *Governance:* Provide the governance processes, controls, and procedures used to monitor and manage impacts, risks, and opportunities.
- *Strategy*: Describe how the company's strategy and business model(s) interact with its material impacts, risks, and opportunities, including the strategy for addressing them.
- *Impact, risk, and opportunity (IRO) management*: Report on the processes(es) by which the IRO management are identified, assessed, and managed through policies and action in the company's own operations, those of its group, and those of its upstream and downstream value chains.
- *Metrics and targets:* Provide such metrics and targets for material sustainability topics and connect these to the financial reports of the company, including progress towards the targets it has set.
- *Materiality:* Perform assessments on each sustainability topic, applying the double materiality principle to work out which information should be reported, i.e., for double materiality, companies must report if sustainability information is material from either a financial or an impact perspective, taking account of people and the environment.
- *Audits:* Have the company's sustainability disclosures audited by an independent third-party auditor before they are filed with the relevant authority.

Qualitative characteristics of information presented in sustainability statements are:

- *Relevance:* Sustainability information is relevant when it may make a difference in the decisions of users under a double materiality approach as subsequently elaborated.
- *Faithful representation:* To be useful, the information must not only represent relevant phenomena, but it must also faithfully represent the substance of the phenomena that it purports to represent. Faithful representation requires information to be complete, neutral, and free from error.
- *Comparability:* Sustainable information is comparable when it can be compared with information provided by the company in previous periods and can be compared with information provided by other companies, in particular those with similar activities or operating in the same industry. A point of reference for comparison can be a target, a baseline, an industry benchmark, or comparable information from other companies or from an internationally recognized organization.
- *Verifiability:* Verifiability helps to give users confidence that information is complete, neutral, and accurate. Sustainability information is verifiable if it is possible to corroborate either such information itself or the inputs used to derive it.
- *Understandability:* Sustainability information is understandable when it is clear and concise. Understandable information enables any reasonable knowledgeable user to readily comprehend the information being communicated.

Concerning the relevance characteristic, double materiality has two interrelated dimensions: impact materiality and financial materiality. A sustainability matter is deemed material from an impact perspective when it pertains to the company's material actual, or potential, positive, or negative, impacts on people or the environment over the short-, medium-, or long term. On the other hand, a sustainability matter is considered material from a financial perspective if it triggers or may trigger material financial effects on the company's development, including cash flows, financial position, and financial performance in the short-, medium-, or long term.

Concerning materiality for impacts on people, there are two main groups of stakeholders:

a) Affected stakeholders: Individuals or groups whose interests are affected or could be affected — positively or negatively — by the company's activities and its direct and indirect business relationships across its value chain.

b) Users of sustainability statements: Primary users of general-purpose financial reporting (existing and potential investors, lenders, and other creditors, including asset managers, credit institutions, and the company's insurance providers), as well as other users, including the company's business partners, trade unions, and social partners, civil society, and non-governmental organizations, governments, analysts, and academics.

4.2. ESRS 1: Structure of ESRS sustainability statements

As part of the management report, the ESRS sustainability statements start with general disclosures of market position, strategy, business model(s), and value chain(s). For EU-listed companies with more than 500 employees and net revenues over EUR40 million, or a balance sheet total of EUR20 million, the corporate sustainability reporting period for the 2024 fiscal year begins for such reports being published in 2025 (Deloitte the Netherlands, 2022). This topical ESRS covers 10 ESG topics with materiality assessment as the starting point. If a given sustainability matter is material from either a financial or impact perspective, the company must disclose it against the relevant topical ESRS. Companies still will be required to gather sustainability information from their value chains even if, once assessed, they ultimately conclude that the information is not material enough to require reporting (Sasfai et al., 2023).

There are three categories into which the 10 ESG topics are grouped as follows (EFRAG, 2022a):

1. *Environmental information*: Climate change; pollution; water and marine resources; biodiversity and ecosystems; resource use and circular economy.

2. *Social information:* The company's own workforce; workers in the value chain; affected communities, consumers; and end-users.

3. *Governance information:* Business conduct.

Each of these 10 ESG areas must report the IRO management plus metrics and targets as follows (Sasfai et al., 2023):

1. Environmental:

• *Climate change:* Disclosures on climate change mitigation, climate change adaptation, and energy consumption. Disclosures on climate change mitigation relate to the company's efforts to limit global warming to 1.5 degrees C in line with the Paris Agreement. Disclosures on scopes 1, 2, and 3 GHG emissions and transition risks.

• *Pollution:* Disclosures on pollution of the air, water, soil, living organisms and food resources, as well as the use of substances of concern and microplastics. This standard covers pollutants generated or used during the production process and those that leave facilities as emissions, products, or as part of products or services.

• *Water and marine resources:* Disclosures on consumption, withdrawal and discharge from and into water (including ground and surface water) and marine resources. This standard also requires consideration of the extraction and use of marine resources.

• *Biodiversity and ecosystems:* Disclosures covering areas such as the drivers of biodiversity loss, impact on species, and impacts and dependencies on ecosystems.

• *Resources use and circular economy*: Disclosures on resource inflows, outflows, waste, resource optimization and the risks of the transition to a circular economy. A circular economy is one in which the value of products, materials and other resources in the economy are maintained for as long as possible, enhancing their efficient use in production and consumption, thereby reducing the environmental impact of their use, minimizing waste and the release of hazardous substances at all stages of the product life cycle.

2. Social:

• *Own workforce:* Disclosures on the company's own workforce, including freedom of association, working conditions, access to equal opportunities and other work-related rights.

• *Workers in the value chain:* The standard is similar to the previous one in content but requires consideration of the workers in the company's value chain(s).

• *Affected communities:* Disclosures on the impact of a company's own operations and value chain, including its products and services, impact on indigenous rights, civil rights, and social and economic rights, including water and sanitation, among others.

• *Consumers and end-users:* Disclosures on the impacts of a company's products and/or services on consumers and end-users, including access to quality information, privacy and the protection of children. Companies are not required to consider the unlawful use or misuse of products or services.

3. Governance:

• *Business conduct:* Disclosures on anti-corruption and anti-bribery practices, the protection of whistle-blowers, political lobbying and the management of relationships with suppliers, including payment practices.

4.3. ESRS G1: Business conduct

The governance aspect of ESG reporting is sufficiently important to be covered in the separate ESRS G1 document. When disclosing leadership on business conduct, the company shall cover the role of the administrative, management, and supervisory bodies related to business conduct and their expertise on business conduct matters. Supervisory bodies would include the board of directors. The objective is to specify disclosure requirements which will enable users of the company's sustainability statements to understand the company's strategy and approach, processes, and procedures, as well as its performance in respect of business conduct. In general, the actions of a company cover a wide range of behaviors that support transparent and sustainable business practices to the benefit of all stakeholders. The following practices specified by the CSRD are indicated as business conduct matters (EFRAG, 2022b):

1) corporate culture;

2) management of relationships with suppliers;

3) avoiding corruption and bribery;

4) engagement by the company to exert its political influence, including lobbying;

5) protection of whistle-blowers;

6) animal welfare;

7) payment practices, specifically with regard to late payments to small and medium enterprises (SMEs).

Specific information on key business conduct or governance practices is provided as follows:

• *Corporate culture:* Corporate culture expresses goals through values and beliefs. It guides the company's activities through shared assumptions and group norms, such as values mission statements or a code of conduct. For disclosure purposes, the company may consider the corporate culture subjects that are taken into consideration and discussed by the administrative, management, and supervisory bodies and with which frequency. Additional disclosures may include corporate culture subjects that are promoted, the communication of the business conduct culture and/or values, the company's related leadership, and specific incentives or tools for its own workers to foster and encourage corporate culture.

• *Management of relationships with suppliers:* Disclosures may include activities to avoid or minimize the impacts of disruptions to the supply chain, training of the supply chain workforce, screening and evaluation of ESG performance of suppliers, communication, and relationship management with supply chain targets and actions.

- *Avoiding corruption and bribery:* Disclosures may include high-level details about risk assessments, monitoring programs, internal control procedures to detect corruption and bribery, training programs, and communication tools and channels, such as newsletters, dedicated websites, social media, and face-to-face interactions.
- *Political influence and lobbying:* Political contribution means financial or in-kind support provided directly to political parties, their elected representatives, or persons seeking political office. The company may provide the following information on its financial and/or in-kind contributions in regard to its lobbying expenses: the total monetary amount of such internal and external expenses, and the total amount paid for membership to lobbying associations.
- *Payment practices:* Information about the standard terms per main categories of suppliers or country or geographical region may be disclosed.

4.4. ESRS 2: General disclosures

ESRS 2 lists all the mandatory process and governance disclosures that all companies must report, irrespective of materiality. This standard includes disclosures on how sustainability-related performance is integrated into the company's incentive schemes, statements on its due diligence processes and descriptions of the processes used to identify and assess materiality. Disclosures on key performance indicators (KPIs) prescribed by the EU taxonomy regulation are also required. The objective of this standard is to specify disclosure requirements which will facilitate users' understanding of the sustainability statements (EFRAG, 2022c; Sasfai et al., 2023).

The EU taxonomy requires that non-financial undertakings report on the KPIs. Financial undertakings, such as banks and investors, need to report on their proportion of investments in companies with taxonomy-aligned activities. There are three KPIs for the EU taxonomy regulation that need to be reported (Celsia, 2023):

1. *Turnover:* Net turnover, meaning the amounts derived from the sale of products and the provision of services after deducting sales rebates value-added tax and other taxes directly linked to turnover. For most companies, the total turnover used in taxonomy reporting is the same as stated in the revenue statement in the financial reporting.
2. *Capital expenditures (CapEx)*: Total investments in tangible and intangible assets during the financial year considered before depreciation, amortization and any re-measurement associated with the taxonomy-eligible activities. The taxonomy refers to the CapEx covering costs based on certain international financial reporting standards (IFRS) such as property, plant and equipment, intangibles, etc.
3. *Operational expenditures (OpEx):* This OpEx differs from what most companies report in their financial statements. It could be thought of as an inclusion of parts of the OpEx. This KPI aims to capture non-capitalized costs (those costs not captured by the CapEx KPI) which relate to investments in assets and processes. This OpEx is thus a category of costs which complements CapEx.

If estimations are used, the company shall indicate the standard, sectoral study, or sources, which are the basis used in estimating its missions, as well as the possible degree of uncertainty, and the range of estimates reflecting the measurement uncertainty. For pollutant-related disclosures (air, water, and soil), they can be presented in a tabular format by each row as follows: measure type, actual reported value, unit, reporting year, reporting comparative, base year, target, target date, and calculation methodology. If available, benchmarks may also be used. For example, local air quality indices or information from the TCFD requirements might be used (EFRAG, 2022c).

5. PROSPECTS IN ESG GOVERNANCE

Since the EU adopted the CSRD in 2023, EU and non-EU companies with activities in the EU must file annual sustainability reports alongside their financial statements, starting with the 2024 reporting year. These reports must be prepared in accordance with ESRS. Since it may take some time for companies to perform materiality assessments and set up systems to gather the audit-ready data needed for their reports, key ESG elements or concepts for businesses and their boards of directors to consider are outlined here (Sasfai et al., 2023):

1. *The centrality of materiality assessments:* Companies will need to front-load work in this area to determine the scope of their reporting requirements under each of the ten topical ESRS. Outside advisers likely will play a key role in helping companies design relevant processes, which must include an analysis of value chains and double materiality, and likely will differ substantively from companies' existing sustainability reporting frameworks and risk management systems.
2. *The process cannot be neglected:* The ESRS are very detailed on what companies must report on and how they should report. This means that most companies will need to assess whether their existing sustainability diligence and reporting practices comply with the CSRD, even if they already report on some or all the areas covered by the ten ESG topics. The ESRS also has a significant focus on disclosures related to the governance of sustainability matters. Companies should be attentive to preparing for the mandatory process and governance disclosures in ESRS 2.
3. *Importance of climate materiality:* A notable feature of the current ESRS is the move away from the prior proposed mandatory reporting on very specific detailed aspects of climate change, such as the seven types of GHG, the eleven types of air pollutants, and the seven types of water pollutants. However, companies will still need to report on general aspects of climate change, such as disclosures of scopes 1, 2 and 3 GHG emissions and the pollution of air and water, given the breadth of the double materiality framework. Also, there is the need to justify any materiality decision to exclude climate reporting and have that justification pass audit. At the same time, there are increased investor and customer demands for climate data, meaning many companies will be making climate disclosures anyway.

4. *Greater consistency with other ESG reporting frameworks, but gaps remain:* The ESRS differ from the SEC's current and proposed climate rules. The ESRS also are broader than just climate disclosures and extends well beyond the current limited SEC requirements related to human capital and governance matters. For companies already aligning voluntarily with climate reporting frameworks, such as the Global Reporting Initiative, the Sustainability Accounting Standards Board, or the TCFD, the ESRS contains numerous significant differences in subject matter and methodology.

The governance component of ESG reporting is sufficiently important that it is covered in the separate ESRS G1 document named Business Conduct. Boards of directors' responsibilities for overseeing their companies' ESG reporting are included as supervisory bodies in the ESRS G1 Business Conduct. When disclosing leadership on business conduct, the company needs to cover the role of the administrative, management, and supervisory bodies related to business conduct and their expertise on business conduct matters. Boards of directors should review the disclosure requirements which enable users to understand the company's sustainability strategy, approach, processes, and procedures, as well as its performance with respect to business conduct. Such a board of directors' review should cover a wide range of the company's behaviors that support transparent and sustainable business practices to the benefit of all stakeholders.

For example, boards of directors could create a review checklist of key ESG items, based on the ten topical ESRS, like an auditor's internal control questionnaire. The board could assign such ESG responsibilities to its audit committee or establish a separate ESG board committee. Also, the following behavioral practices specified by the CSRD are relevant business conduct matters to review: corporate culture, management of relationships with suppliers, avoidance of corruption and bribery, company engagement to exert its political influence and lobbying, protection of whistle-blowers, and payment practices, especially regarding late payment to small and medium enterprises.

Also, boards of directors should review the general reporting requirements for their companies in ESRS 1, concerning ESG governance: strategy, impacts, risks, opportunities, metrics, and targets, along with the qualitative attributes of ESG information: relevance, faithful representation, comparability, verifiability, and understandability. ESRS 1 specifies that sustainability reporting begins January 1, 2025, for the 2024 fiscal year, including breakdowns of total revenue in upstream and downstream value chains. Concerning the environmental and social categories of ESG, reports must include IRO management, metrics, and targets. As previously listed, five and four specific information topics are also required for the environmental and social categories, respectively. Also, as previously listed, the governance area of ESG has seven business conduct reporting matters. Thus, boards have significant, emerging corporate governance responsibilities.

Boards of directors now have powerful monitoring guidance from ESRS disclosure requirements to assess their companies' ESG reporting and performance. Boards can now assess whether their companies are committed to ESG efforts or just greenwashing, i.e., just making commitments or pledges without any substantial subsequent performance. What is also challenging besides greenwashing is the emergence of "greenhushing" where U.S. companies do not tout their green efforts and credentials in response to many U.S. politicians now taking a strong stand against corporate environmental activities and targeting companies that publicize their climate change-related goals. An analysis by Swiss consultancy South Pole in 2022 revealed that one in four of the 1,200 U.S. companies initially planning to embrace green initiatives subsequently chose to "go dark", i.e., keep their green goals under the radar (Visram, 2023). Such greenhushing would not be possible for those 3,400 U.S. public companies that also have EU stock listings and, thereby, must follow ESRS disclosure requirements, starting for the 2024 fiscal year.

Warren Buffett, chairman of the board, chief executive officer (CEO), and the largest shareholder at 31.6% of Berkshire Hathaway do not worry about either greenwashing or greenhushing. He downplays ESG with the message that profitability is a social good, demonstrating too often an unrecognized financial partnership between government and business. While many boards of directors are now assembled like political platforms, with consummate attention to satisfying multiple "politically correct" interests, Berkshire chooses directors based on business savvy and owner, not stakeholder, orientation. Buffett remains an emphatic believer that boards exist to represent shareholders (Lowenstein, 2023).

Grove et al. (2018) analyzed ESG activities for energy and other companies in the U.S. and found there were not yet any required regulations for ESG reporting for public companies by the U.S. Securities and Exchange Commission. However, Duke University's Climate Risk Disclosure Lab concluded that a standard, robust, and mandatory disclosure framework would benefit investors and issuers alike. It would have broad market and social benefits, spurring greater productivity and creating more resilient economies. A mandatory framework would benefit investors by allowing easy company comparisons, promoting greater capital allocation, decreasing search costs, making it easier to hold companies accountable, and protecting the reputation of institutional investors. Such a framework would benefit firms by minimizing shareholder and stakeholder information requests. It would also encourage firms to identify adaptation measures and emerging opportunities and make it easier to communicate that information to investors (Climate Risk Disclosure Lab, 2021). These new European-required ESG disclosures will reflect such benefits.

U.S. company voting proposals by shareholders targeting ESG issues are declining. The environmental aspect of ESG accounts for about 30% of all such votes, with investors calling for increased transparency on phasing out fossil fuels and specific near-term targets for lowering emissions. Although the number of votes on climate-related resolutions had increased in the past three years with the support of such proposals climbing to almost 40%, up from 29% in 2019, this year 2023 may see retrenchment. Havelock (2024) showed that big investors like Vanguard significantly reduced their support for environmental proposals last year, backing less than 10% of them. While social issues continued to garner strong shareholder support in 2023, only one diversity-related proposal passed among the 140 filed. BlackRock, the largest asset manager in the world, and JPMorgan Chase, the largest U.S. bank, are both some of the biggest investors and financiers of Big Oil companies, and they are prime examples of such softening ESG support in the U.S. (Quinson, 2023a).

Also, the 2023 PricewaterhouseCoopers (PwC) annual survey of board directors (83 members from Fortune 100 and private companies) found that there is a growing disconnect between ESG and strategy; 54% of these directors said their corporate strategy was linked to ESG concerns, down from 64% last year. This drop comes amid increasing scrutiny of ESG, including pressure from U.S. states' general attorneys and Republican presidential candidates (Parsley, 2023).

It's important to note that such climate-related ESG shareholder proposals would not be relevant for those 3,400 U.S. companies that also have an EU stock listing since they must follow ESRS disclosure requirements, starting for the fiscal year 2024. Also, European investors are still focused on environmental-related investment funds. At the end of June 2023, there was $447 billion of European climate-focused funds, compared to only $44 billion in China and $32 billion in the U.S. per Morningstar. Hortense Bioy, Morningstar's global director of sustainability research, said: "The global picture shows the U.S. is clearly behind its biggest, competing markets. […] regulation has played a prominent role in the proliferation of actively run and passively managed climate-transition funds in Europe. […] The bottom line is the US has a lot of catching up to do as it pertains to providing investors with solutions to manage climate-related risks and opportunities in investment portfolios" (Quinson, 2023c, paras. 3–11).

Kroll, a financial advisory firm that focuses on governance, risk and transparency, published a report indicating that companies with higher ESG ratings tended to outperform those with lower ratings over a nine-year period, ending on December 31, 2021. Kroll examined 13,000 companies across a variety of geographies and industries around the globe. It focused on the relationship between a company's total stock returns (dividends plus capital appreciation) and the ESG ratings issued by MSCI Inc. over the 2013–2021 period. Globally, ESG leaders generated an average return of 12.9%, compared to 8.6% for the so-called laggard companies. In the U.S., the ESG leaders earned an average annual return of 20.3%, compared to 13.9% for the laggard companies. Carla Nunes, managing director and global leader of Kroll's valuation digital solutions group, said: "With all the new regulations coming in, assessments of financial materiality are critical and analyzing ESG factors is part of that process" (Quinson, 2023b, para. 4). Although there is politization of ESG, "investing simply involves the consideration of "risks and opportunities" and that includes issues that may arise from various environmental, social or governance trends. […] While time will tell whether the ESG label ultimately prevails, it doesn't really matter because the premise behind the strategy isn't going away" (Quinson, 2023b, paras. 12–14). For representing investors and other stakeholders in their companies, boards of directors should pay attention to such strategic ESG trends.

6. CONCLUSION

The EU's CSRD and its accompanying ESRS represent a pivotal moment in the journey towards more sustainable and responsible corporate governance. As the landscape of corporate sustainability continues to evolve, so too must our understanding and approach to governing and reporting in this critical domain. This paper addresses the complexities and challenges brought forth by these regulations, offering a roadmap for boards of directors to navigate this new terrain. By focusing on the role of boards in ensuring ESRS compliance and analyzing the impact on corporate governance mechanisms, the paper provides new perspectives into this rapidly evolving field.

Our study revealed the extensive scope of the CSRD and ESRS, which necessitates a significant overhaul in how large companies report on sustainability. The directive introduces rigorous compliance requirements, emphasizing transparency in ESG aspects. The findings underscore the expanded role of corporate boards in overseeing and integrating these ESG components into their governance structures, highlighting a shift towards more accountable and sustainable corporate strategies.

In particular, the implications of this shift are profound for companies operating within the EU. They necessitate a proactive approach to materiality assessment, climate reporting, and aligning corporate strategies with sustainability goals. Additionally, the paper identifies challenges such as greenwashing and greenhushing, practices that the ESRS aims to mitigate, demanding more robust and transparent ESG commitments and disclosures. Our findings offer valuable guidance for boards and management teams to navigate this complex regulatory environment, ensuring not only compliance but also leveraging these standards to enhance corporate reputation and stakeholder trust.

While this paper offers an in-depth examination of the CSRD and ESRS within the EU framework, it's important to note that these are recent regulations, and their long-term impacts and overall efficacy are yet to be fully understood. Moreover, our analysis is constrained by the dynamic nature of global ESG standards and the diverse approaches adopted by different jurisdictions. Future research can extend to comparative analyses across different regulatory environments, providing insights into best practices and potential areas for harmonization of global ESG standards. In addition, research into how these evolving standards influence investor behavior and market dynamics would further enrich our understanding of the broader economic impacts of ESG compliance.

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