



# The ESG disclosure spectrum

Robust governance and transparent stakeholder communication are key to boards' effective year-round oversight and reporting

*In discussion with KPMG and Joele Frank's ESG practice*

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# Introduction

With growing investor attention on climate change; diversity, equity, and inclusion (DEI); and employee engagement and retention, it is critical for companies to present a consistent environmental, social, and governance (ESG) message across all reporting channels, including the 10-K, sustainability report, and, perhaps most significantly, the proxy statement.

Investors are increasingly focused on ESG: sustainable investment funds are driving most new money growth, with the amount invested in ESG increasing tenfold from 2018 to 2020.<sup>i</sup> Investment firms are supporting this push, with some quadrupling their support of ESG resolutions in 2021.<sup>ii</sup> Even though proxy resolution voting results through August 2022 show that investors seem a bit more discerning in their support, there has still been a significant increase in resolution support and votes against directors in the past few years.

As the current proxy season came to a close and we look forward to the next one, the KPMG ESG Impact team sat down with leaders from Joele Frank's ESG practice to discuss how boards should oversee and disclose on ESG risk management. This paper focuses on the key questions discussed.



## What are the expectations for board oversight around ESG?

Companies with robust board oversight over ESG priorities are distinguished by transparent and consistent disclosure around ESG governance, including roles and responsibilities of the assigned board committee, relevant director qualifications, management roles, and a year-round cadence of ESG oversight, reporting, and assurance processes.

It is important to remember that reporting on ESG is not a “one and done” proposition. Shareholders are keenly interested in the board’s perspective on the company’s key ESG priorities; how they align with the long-term growth strategy; ESG performance goals set for management; and whether specific, quantifiable targets have been met.

Boards are expected to be mindful of a broad range of company stakeholders, assess the impact of the company’s operations and products against changing societal expectations, review data and proof points on a regular cadence, and present it all through strategic reporting.

## How should the board prepare for shareholder proposals related to ESG?

Although discussions may intensify right before and after the proxy season, the board should establish a regular cadence for receiving ESG strategy and performance updates throughout the year so they can maintain a regular dialogue with shareholders. For any company, large or small, receiving a shareholder proposal should not be a surprise. Rather it should fall within an area where the company is already working on enhancing its practices to address performance gaps. This preparedness, particularly during the current era of rising ESG shareholder activism, is a critical part of the board’s effective oversight of the company’s ESG risks and strategy.

## Should we integrate ESG into executive compensation decisions?

Since ESG performance is widely considered to have an impact on an organization’s financial performance, there is an increasing focus on linking ESG progress to executive compensation. According to recent research by Semler Brossy, 70 percent of S&P 500 companies that filed their proxy statements between April 2021 and March 2022 included an ESG measure in executive compensation program design, which is nearly a 23 percent increase compared to 57 percent prevalence a year ago.<sup>iii</sup>

A carefully considered strategy with aligned metrics can motivate substantial cultural change across an entire organization and drive long-term strategic performance results. That said, it is important not to act hastily on tying ESG to executive pay. Instead, take the time to ensure that selected ESG performance metrics create meaningful and transparent incentives without undermining the effectiveness of the overall compensation program.

When thinking about whether your organization is ready to move in this direction, consider the following questions:



Is your organization far enough along on its ESG journey to align ESG strategy with compensation?



Does the board have a clear idea of which ESG issues are core to the business strategy?



Which ESG issues do investors—as well as customers, suppliers, and other internal and external stakeholders—view as key to the company’s long-term strategy?



Can you regularly measure and track performance progress against selected metrics?



What are the broader risks of performance results falling below the pre-set ESG targets?

Although your organization may not necessarily have specific ESG performance metrics, it is important for the compensation committee to ensure that the company's executive compensation is aligned with not only financial considerations, but also broader ESG performance and societal impact issues (environmental incidents, diverse representation across the workforce, significant layoffs, product recalls) to avoid surprises and shareholder vote-no campaigns before the annual meeting. [For more on this topic, please click here for KPMG's thought leadership piece "[Implementing ESG Incentives: How soon is too soon?](#)"]

### **How should boards address evolving climate risk expectations, especially considering the newly proposed reporting rules from the SEC?**

In March of this year, the SEC released a proposed rule change detailing potential new carbon data reporting requirements, including greenhouse gas emissions and the impact of climate risk on organizations' financial statements. Although scrutiny will be significantly higher after the SEC rules are codified, shareholders are already assessing whether the companies they invest in are ready for a shift from voluntary to mandatory disclosures. Clearly, climate change is a priority ESG issue on investors' minds. Already, some investment advisors have indicated they will vote against directors at companies that don't disclose emission-reduction targets or how boards are managing climate-change-related risks, as required under the Task Force on Climate-related Financial Disclosures (TCFD) framework.

Companies are taking heed. In the 2022 proxy season, the number of environmental proposals increased by 129 percent, driven by the SEC rules that limited the ability of companies to exclude shareholder proposals from company proxy statements. Support for proposals to set greenhouse gas emission targets averaged 54 percent, with proposals receiving support above 90 percent in all instances where management recommended shareholders vote "For" or did not make a specific vote recommendation. As we move forward, it is likely that the audit committee will need to get more involved in climate disclosures, since it is not only an annual 10-K disclosure, but potentially a quarterly 10-Q, as well.

### **How can boards keep the momentum going on diversity, equity, and inclusion (DEI), not only at the board level, but also across the organization?**

Some asset managers have pledged to vote against compensation committee chairs at S&P 500 companies that do not disclose meaningful DEI data. In the short term, this may keep the number of related shareholder proposals coming to a vote relatively low. However, in the longer term, public companies should pay attention to evolving investor expectations regarding human-capital reporting issues. In addition, board members need to shine a light on their own structure to ensure that they are aligned with expectations and DEI is an integral part of the regular board refreshment process.

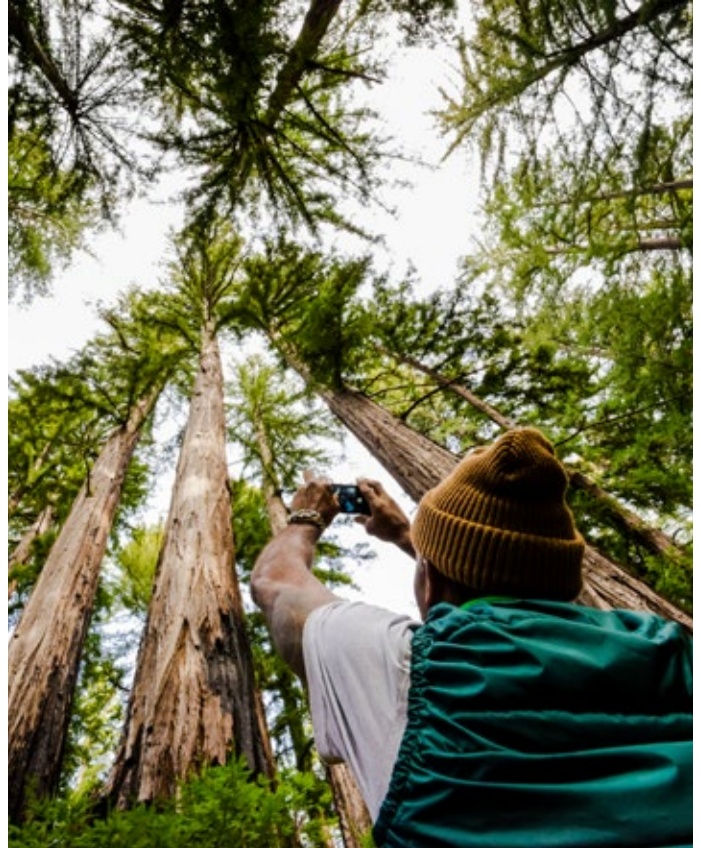
## How should boards decide what ESG data to collect and analyze?

It is critical that management develops a strong understanding of the company's ESG risks and priorities. This is achieved through strong ESG risk assessment, which should be communicated to the board for their own evaluation. Across all ESG reporting, it has become increasingly important to move beyond public statements and back up all assertions with metrics, as well as controls and procedures to help ensure accuracy and consistency. On the human capital side, it is important to collect diversity data across the organization to track equity of opportunity. On climate risk, boards should focus on risk assessment and reporting aligned with the TCFD and Sustainability Accounting Standards Board (SASB) disclosures.

ESG data sets often stem from multiple sources and sometimes require complex calculations. To this end, boards need to pay close attention to governance over data quality, assurance, reliability, and repeatability, as detailed in KPMG's recent thought leadership piece ["One size fits one."](#)

## What is the best way to report on ESG issues in the proxy?

Proxy summaries are a great place to highlight the company's ESG accomplishments over the course of the most recent fiscal year, including: (1) proactive environmental initiatives to combat climate change, such as aligning with the Paris Agreement and progressing toward Net Zero carbon emissions and interim targets; (2) social and DEI milestones, such as increased gender and racial diversity on the board and EEO-1 U.S. employee diversity data disclosures; and (3) governance initiatives such as aligning ESG programs with the business's strategy and increasing accountability, e.g., through connections between ESG progress and executive compensation. Additionally, ESG governance disclosures should be incorporated into corporate governance, and relevant ESG experiences should be taken into consideration for each board member, as well as for relevant committee selections.





## Dos and Don'ts for ESG Reporting

### ✓ Do

- ✓ Be consistent in how you tell your ESG story across all reports and communications.
- ✓ Keep a pulse on evolving investor, regulator, and other stakeholder priorities.
- ✓ Collect ESG performance information and data throughout the year, not just for annual reporting.
- ✓ Take the time to act on ESG issues that can be addressed in the short term.
- ✓ Establish a reporting assurance process as you would for any corporate financial reporting.

### ✗ Don't

- ✗ Rush to link ESG to executive compensation before you do your internal due diligence.
- ✗ Wait for SEC final rulings or other regulatory changes before initiating ESG-related efforts.
- ✗ Neglect to turn the spotlight on the board from a diversity and capability perspective.
- ✗ Forget that ESG reporting is a year-round proposition.
- ✗ Neglect to prepare for an integrated ESG discussion during shareholder engagement.



# Conclusion

As ESG likely impacts the entire corporate value chain, it is a broad and complex topic requiring board oversight. Early board engagement with management is critical to allow for shared understanding of the ESG strategy, its integration into the corporate strategy, defining ESG priorities, the accountability and reporting structure, and how governance will ensure reliable and repeatable reporting. Most important, remember to maintain a succinct, consistent message across all channels, as regulator and investor scrutiny will likely only become more intense in the current climate.

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<sup>i</sup> Talib Visram, ESG investing continued to soar in 2021. The government could boost it even more, *Fast Company*, December 28, 2021.

<sup>ii</sup> Jessica DiNapoli and Ross Kerber, New blood at Wall Street's old guard rattles Corporate America, *Reuters*, June 3, 2021.

<sup>iii</sup> Semler Brossy, ESG + Incentives, 2022 Report, *semlerbrossy.com*, July 2018, 2022.

<sup>iv</sup> Meridian Study on Use of ESG Metrics in Incentive Plans, *meridiancp.com*, May 25, 2021

<sup>v</sup> Skadden, Arps, Slate, Meagher & Flom LLP and Affiliates, *Matters To Consider for the 2022 Annual Meeting and Reporting Season*, December 2021.

# Start the conversation



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