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Oversight of EESG Disclosure

In her regular column on corporate governance issues, Holly Gregory explores the board's role in overseeing disclosure about employee, environmental, social, and governance (EESG) issues and reviews key developments with respect to mandated and voluntary disclosure.



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In a recent speech to the Society for Corporate Governance, Securities and Exchange Commission (SEC) Commissioner Allison Herren Lee emphasized the need for boards to attend to the significant challenges that environmental, social, and governance (ESG) issues present to the long-term success of companies, financial markets, and the economy. She noted that understanding of their "short-, medium- and long-term relationship to financial performance has evolved to the point that the principal debates are about when, not if, these issues are material." (Allison Herren Lee, *Climate, ESG, and the Board of Directors: "You Cannot Direct the Wind, But You Can Adjust Your Sails"* (June 28, 2021), available at [sec.gov](https://www.sec.gov).)

In the past two years, ESG has shifted from being perceived as a matter of corporate social responsibility to a business and corporate governance imperative that requires fiduciary attention to employee considerations, as well as environmental, social, and governance matters (referred to as EESG). Leo Strine, former Chief Justice of the Delaware Supreme Court, recently described the need for board attention to EESG matters as consistent with the board's duty to

implement and monitor a compliance program under *Caremark* (Leo E. Strine, Jr. et al., *Caremark* and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective *Caremark* and EESG Strategy, 106 Iowa L. Rev. 1885 (2021)).

Growing recognition of the importance of EESG issues has added to the pressure on US public companies to provide more EESG-related disclosure. This pressure has outpaced regulatory requirements, resulting in significant growth of voluntary reporting outside of the SEC disclosure framework, often in response to targeted initiatives by private actors. Mandatory disclosure of EESG matters remains grounded in materiality considerations and specific line-item disclosure requirements, and the SEC has not mandated a uniform framework to ensure that disclosure of EESG information is consistent and comparable, in effect ceding this territory to a growing set of voluntary standard setters. However, the SEC has significantly increased its focus on EESG topics in 2021 and is likely to expand requirements and guidance around EESG reporting requirements.

Against this background, this article discusses:

- The board's responsibility for oversight of EESG issues and disclosure.
- SEC requirements and guidance related to mandated EESG disclosure.
- Key standards for voluntary EESG disclosure.
- Practical guidance for boards with respect to oversight of EESG activities and disclosure.

EESG OVERSIGHT RESPONSIBILITY

The board's responsibilities for corporate activity in the sphere of EESG is related to its oversight of strategy, risk management, internal controls, ethics, and corporate disclosure. These responsibilities are grounded in fiduciary duties of care and loyalty, including the duty of good faith, which generally requires attention to known risks, as well as information and compliance systems, under the laws of the state of incorporation (for more information, search [Fiduciary Duties of the Board of Directors](#) on Practical Law). The overlay of federal securities laws and regulations for US public companies requires board attention to compliance with disclosure obligations and oversight of corporate disclosure. Specifically, as noted by Commissioner Lee, given that directors need to address red flags that may suggest legal violations or other risks of harm to the company, directors may need to analyze EESG matters, such as climate change, as the regulatory landscape evolves.

Consistent with its oversight role, the board should understand how corporate strategy implicates EESG matters and what risks may affect that strategy. The board should also have visibility into the system of controls (including enterprise risk management, information and reporting systems, disclosure controls and procedures, and compliance programs) that relate to EESG. Many boards will find it most efficient to delegate authority for aspects of EESG activity to one or more board committees.

SEC REQUIREMENTS AND GUIDANCE

SEC rules and regulations currently do not broadly mandate a specific framework for public company reporting of EESG matters. However, disclosure may be required if the information is material (meaning there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision in the context of the total mix of available information), even in the absence of a specific line-item requirement identifying a particular EESG-related risk.

While not all material information must be disclosed, disclosure of information may be required to the extent material to an understanding of the company's business, and where necessary to make the statements made not misleading. Using these standards, public companies must consider whether and the extent to which disclosure of EESG-related risks and effects may be necessary in their annual and quarterly reports, proxy statements, and other SEC filings.

The SEC disclosure mandates that are the most relevant to EESG matters include:

- **The business description (Regulation S-K Item 101).** Companies must provide a description of the business, which, depending on the circumstances, may need to address certain EESG matters. For example, a company must disclose, in each instance, to the extent material to an understanding of the company's business as a whole:
 - the material effects that compliance with governmental regulations, including environmental regulations, may have on the company's capital expenditures, earnings, and competitive position; and
 - its human capital resources, including any human capital measures or objectives that the company focuses on in managing the business, such as measures or objectives that address development, recruitment, and retention of personnel.
- **Legal proceedings (Regulation S-K Item 103).** Companies must disclose information relating to material pending legal proceedings to which they or their subsidiaries are a party, including proceedings in which their property is the subject of the litigation. Similar actions that, to the company's knowledge, are contemplated by governmental authorities must be disclosed. Item 103 includes specific disclosure requirements for certain types of environmental proceedings.
- **Risk factors (Regulation S-K Item 105).** Companies must disclose the material factors that make an investment in the company's securities speculative or risky. The SEC discourages disclosure of boilerplate risk factors that could apply to any company (such as climate change or acts of terrorism or war) unless the company explains how each disclosed risk would specifically impact the company's operations and financial condition. If a risk has materialized and prior disclosure characterized it as theoretical, the company should update its disclosure to describe specifically what has occurred and the risks going forward.

■ **Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) (Regulation S-K Item 303).**

Companies must disclose information relevant to assessing their financial condition, changes in financial condition, and results of operations. If the company knows of events that are reasonably likely to cause a material change in the relationship between costs and revenues, such as known or reasonably likely future increases in labor or material costs, price increases, or inventory adjustments, disclosure is required of the reasonably likely change in the relationship. This requires assessment of the likelihood that an event will occur, balanced with a materiality analysis regarding the need for disclosure about the event, in the interest of helping investors understand the potential material consequences. This rule can drive disclosure of EESG matters that are known trends, demands, commitments, events, or uncertainties that are not remote.

■ **Financial statements (Regulation S-X).** Companies must issue financial statements that comply with US GAAP issued by the Financial Accounting Standards Board (FASB). The SEC's Acting Chief Accountant recently advised companies that they should review FASB guidance discussing the intersection of EESG matters with financial accounting standards, including topics such as risks and uncertainties, inventory, impairments, loss contingencies, environmental obligations, asset retirement obligations, and tax.

■ **Board oversight of risk (Regulation S-K Item 407(h) and Item 7 of Schedule 14A).** Companies must disclose the extent of the board's role in the risk oversight of the company, including a description of how the board administers its risk oversight function. To the extent EESG-related risks are material to a company's business, the discussion should include the nature of the board's role in overseeing the management of those risks, including information about how the company perceives the board's role and the relationship between the board and senior management in managing the material risks facing the company. Companies are increasingly discussing in their proxy statements whether the full board or a board committee has responsibility for oversight of EESG-related matters.

■ **Director diversity characteristics (Regulation S-K Items 401(e) and 407(c)(2)(vi)).** Companies must disclose information about the experience, qualifications, attributes, or skills that led to the selection of a director and whether, and if so how, the nominating committee (or the board) considers diversity in identifying nominees. If there is a diversity policy related to identifying nominees, the company should describe how this policy is implemented and how the effectiveness of the policy is assessed. If certain self-identified diversity characteristics (such as race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background) were considered when determining a candidate's experience, qualifications, attributes, or skills, the company should disclose those characteristics and how they were considered in the nomination process. This disclosure should be provided if a director or nominee self-identified with a particular characteristic and consented to the company's disclosure of that characteristic. SEC guidance

also recommends that a company disclose how its diversity policy, if any, considers nominees' self-identified diversity attributes and any other qualifications (such as diverse work experiences, military service, or socio-economic or demographic characteristics).

■ **Other EESG matters.** The SEC's 2010 interpretive release on climate change disclosure (Climate Change Release) emphasized that disclosure about the potential impact of global climate change may be required in SEC filings under existing disclosure requirements discussed above relating to the business description, legal proceedings, risk factors, and MD&A if a company's business is likely to be materially affected by global climate change. The release provides examples of climate-related issues that a company should consider when determining whether disclosure is required. In addition, companies must disclose, if applicable, information regarding their use of conflict minerals and any business activities involving Iran, specially designated nationals, and blocked persons.



Search [Form Check Guide: Form 10-K Checklist](#), [Form Check Guide: Form 10-Q Checklist](#), and [Form Check Guide: Annual Meeting Proxy Statement Checklist](#) for more on SEC disclosure requirements.

VOLUNTARY EESG DISCLOSURE

Voluntary disclosure by US companies of EESG information has become far more prevalent in the last several years as pressure from investors and others to make this disclosure has intensified. The emergence of numerous disclosure frameworks with overlapping and sometimes conflicting standards has posed challenges for both companies and investors. These challenges are compounded by the voluntary nature of the standards and the lack of a requirement for third-party assurance of the accuracy of the information.

To help companies provide more reliable, standardized, and comparable EESG information, global efforts are underway to develop a more coherent and comprehensive reporting system. In particular, companies should monitor:

- The various standards for voluntary reporting of EESG information.
- The prevalence of voluntary reporting and usage of voluntary standards.

EESG REPORTING STANDARDS

Several organizations have issued standards for voluntary reporting of EESG information related to climate change and sustainability, such as:

- The Climate Disclosure Standards Board (CDSB) (formerly the Carbon Disclosure Standards Board), an international consortium of business and environmental non-governmental organizations established in 2007. The CDSB issued its first framework in 2010 focused on climate change and, in 2015, published an expanded framework to include information on natural capital and cover reporting of environmental and climate change information in mainstream reports, such as

annual reports. The framework was updated in 2018 to align with recommendations by the Task Force on Climate-Related Financial Disclosures (TCFD) and includes seven guiding principles and 12 reporting requirements.

- CDP (formerly the Carbon Disclosure Project), an international non-profit organization established in 2000. CDP scores companies on environmental risks and opportunities related to climate change, water security, and deforestation based on information it collects through annual questionnaires. The questions differ depending on the company's industry. The questionnaires provide a framework for companies to make environmental information available to their stakeholders covering governance and policy, risks and opportunity management, environmental targets and strategy, and scenario analysis. In addition, CDP hosts the Secretariat for the CDSB.
- The Global Reporting Initiative (GRI), an international organization that issued widely used sustainability reporting standards (GRI Standards). The GRI Standards are a modular set and include three universal standards for use by each company that prepares a sustainability report, topic-specific standards from which a company can select to address its material topics (economic, environmental, or social), and sector standards based on industry. The topic-specific standards cover matters such as energy, emissions, water, waste, diversity, child labor, customer privacy, suppliers, anti-corruption, tax, and procurement practices.
- The TCFD, established by the Financial Stability Board in 2015 to develop recommendations for more effective climate disclosure. The TCFD released a framework in 2017 to help companies evaluate and disclose in mainstream annual filings the financial risks posed to their business by climate change. The framework's disclosure recommendations are structured around governance, strategy, risk management, and metrics and targets.
- The Value Reporting Foundation (VRF), formed in June 2021 in the merger of the Sustainability Accounting Standards Board (SASB) and the International Integrated Reporting Council (IIRC). The VRF plans to more closely align SASB and IIRC guidance, including:
 - a framework of industry-specific sustainability accounting standards for 77 industries, issued by SASB in 2018. Each standard sets forth disclosure topics and related accounting and activity metrics, which are asserted to be reasonably likely to be material to a company in that industry. The standards address sustainability-related risks and opportunities reasonably likely to affect a company's financial condition (its balance sheet), operating performance (its income statement), or risk profile (its market valuation and cost of capital); and
 - the International Integrated Reporting Framework, issued by IIRC in 2013 and updated in January 2021, which facilitates integrated reporting of sustainability information together with financial information. This framework identifies information to be included in an integrated report, such as communication about how a company's strategy, governance, performance, and

Heightened SEC Focus on EESG Disclosure

Key SEC actions related to EESG disclosure include:

- The formation by the SEC Division of Enforcement of a new 22-member Climate and ESG Task Force in March 2021, to target ESG-related misconduct and potential violations.
- A comment period (closed in June 2021) announced by then-Acting SEC Chair Allison Herren Lee on climate change disclosure, including 15 sets of questions intended to assist the SEC in considering climate change disclosure rule amendments.
- Statements by various SEC officials directing enhanced regulatory scrutiny of climate-related disclosure in public company filings, expressing support for developing an ESG disclosure system, and emphasizing increased scrutiny of company climate-related disclosure, including accounting for climate-related risks and impacts.
- The development of a new ESG landing page at [sec.gov](https://www.sec.gov/esg), which tracks various SEC developments in the ESG area pursuant to its "all-agency" approach.
- Inclusion on the SEC's Spring 2021 regulatory agenda of proposed new rules requiring disclosure relating to climate risk and human capital, including workforce diversity and board diversity.



Search [Key Developments in ESG and Climate Disclosure: 2021 Tracker](#) for more on key SEC actions in 2021.

prospects lead to creation, preservation, or erosion of value over time.

Other organizations intend to participate in the process of setting global standards relating to EESG issues, including:

- The World Economic Forum (WEF), which in September 2020 together with Deloitte, EY, KPMG, and PwC issued a set of Stakeholder Capitalism metrics and disclosures that can be used to align mainstream sustainability reporting and track contributions towards the United Nations (UN) Sustainable Development Goals. There are 21 core and 34 expanded metrics and disclosures organized under four pillars, that is, principles of governance, the planet, people, and prosperity. They are derived from existing standards and disclosures.
- The International Financial Reporting Standards Foundation (IFRSF), the body responsible for developing (through the International Accounting Standards Board (IASB)) a set of global accounting standards (IFRS) that are mandated in more than 140 jurisdictions. In September 2020, the IFRSF proposed to create a new International Sustainability Standards Board (ISSB) to issue global sustainability standards similar to IFRS. The International Organization of Securities Commissions (IOSCO) has been working with the IFRSF in developing a plan to establish the ISSB. The IFRSF intends to announce the formation and membership of the ISSB before the UN COP26 conference in November 2021. The purpose of the ISSB will be

to replace the patchwork of voluntary guidance with a single set of global norms for companies to report the impact of climate change on their businesses.

- A new Task Force on Nature-Related Financial Disclosures (TNFD), which launched in July 2021 and was developed by an informal working group comprised of financial institutions, companies, governments, regulators, multilaterals, non-governmental organizations, and consortiums from 24 countries. Its membership is to equally represent financial institutions, companies, and data and service providers from developed and emerging markets, and a diverse stakeholder group will inform its efforts. The TNFD builds on the success of the TCFD and intends to deliver a framework in 2023 for companies to report and act on evolving nature-related risks.

Work on convergence towards global sustainability reporting standards has accelerated, particularly with the recent efforts of the IFRSF to establish the ISSB, which is supported by the G7 finance ministers, IOSCO, and key institutional investors. The degree to which global regulatory convergence will occur and the role that regulators will play in aligning on standards for measurement, management, and reporting of sustainability matters remains to be seen.



Search [ESG Disclosure & Sustainability Reporting Frameworks](#) for more on EESG reporting standards.

PREVALENCE OF VOLUNTARY REPORTING AND USAGE OF VOLUNTARY STANDARDS

Most US companies that voluntarily disclose their EESG activities do so in a stand-alone sustainability report. According to a recent report by the Center for Audit Quality (CAQ), while all S&P 100 companies made some EESG information available, the vast majority reported EESG information outside of an SEC filing, typically in a stand-alone report. (CAQ, S&P 100 and ESG Reporting (Apr. 29, 2021), available at [thecaq.org](#).)

Voluntary reporting has increased in the last several years. According to a report by the Governance & Accountability Institute, Inc. (G&A), in 2019, 90% of S&P 500 companies published a sustainability report, compared to 86% in 2018 and just 20% in 2011. (G&A, 2020 S&P 500 Flash Report (July 16, 2020), available at [ga-institute.com](#).)

The increase in voluntary reporting by US public companies has been driven by a variety of factors. For example:

- Employees and consumers are focusing on EESG matters and the company's role in addressing environmental and social issues, including issues of racial and gender equality, employee health and safety (particularly during the COVID-19 pandemic), and social justice. This has underscored expanding expectations of transparency in these areas.
- Investors increasingly consider EESG to be fundamental to corporate performance and believe that companies with strong EESG profiles are likely to navigate adverse conditions more successfully than peer companies with weak EESG profiles. As a result:

- major institutional investors and pension funds, such as BlackRock, State Street, Vanguard, and CalPERS, are engaging with companies to enhance EESG disclosure and implement change. These investors also are adopting policies to vote against directors at companies that fail to address EESG matters, including with what they view as appropriate disclosure, and voting in favor of EESG-focused shareholder proposals at record levels; and
 - hedge funds and other activist investors are incorporating EESG themes into activism campaigns. EESG themes can be the main focus of an activism campaign, supplement activist investors' traditional requests (such as M&A, share repurchases, dividends, and director seats), or both. For example, in May 2021, Exxon Mobil Corp. lost three board seats to activist investor Engine No. 1 over shareholder concerns relating to Exxon's ability to create long-term shareholder value in light of climate change and Exxon's current continued focus on fossil fuels.
- Companies seek to:
 - communicate their growing commitment to and progress on EESG-focused goals, such as emissions reduction, diversity, equity and inclusion, and the UN Sustainable Development Goals;
 - ensure that their EESG-focused activities are credited in ratings issued by organizations such as Institutional Shareholder Services, Sustainalytics, Bloomberg, and MSCI, which rate companies based on publicly available information; and
 - disclose particular information that is required as a condition of inclusion in certain EESG-focused stock exchange indices or funds.

As EESG reporting has increased, so too has reliance on voluntary disclosure standards (see above *EESG Reporting Standards*). In particular, BlackRock, State Street, and Vanguard have strongly encouraged disclosing sustainability information in line with the SASB and TCFD frameworks. BlackRock's Chairman and CEO, Larry Fink, stated in his January 2020 letter to portfolio company CEOs (available at [blackrock.com](#)) that BlackRock would vote against directors when companies have not made sufficient progress on disclosing sustainability-related information in line with those frameworks by the end of 2020. During the first half of 2020, BlackRock voted against directors at 53 companies due to concerns over their management or disclosure of climate risk (BlackRock, Inc., Our 2021 Stewardship Expectations, at 19, available at [blackrock.com](#)).

Wide variations exist between companies in their use of the various standards, and no comprehensive data set for S&P 500 companies exists. However, according to the CAQ's recent report (available at [thecaq.org](#)), S&P 100 companies commonly used or referenced (to varying degrees) the following reporting frameworks and standards:

- CDP questionnaires (87 S&P 100 companies).
- GRI Standards (76 S&P 100 companies).

- SASB framework (67 S&P 100 companies).
- TCFD framework (65 S&P 100 companies).

Use of or reference to more than one set of voluntary disclosure standards is typical for large US companies. Per the CAQ report (which was issued before the IIRC and SASB merger), 88 companies in the S&P 100 rely on at least two of the sets of standards issued by CDP, GRI, SASB, TCFD, and IIRC, and 44 S&P 100 companies rely on four of those five sets of standards.

Reliance on voluntary standards in the absence of mandatory disclosure requirements has led to wide variations in the accuracy and reliability of disclosure. Third-party assurance of EESG disclosure is a focus of various accounting and auditing professional bodies, including the Association of International Certified Professional Accountants, the CAQ, and the International Federation of Accountants.

Companies should be mindful of the potential pitfalls when providing voluntary disclosure. Corporate EESG disclosure will be scrutinized closely by activist investors and the plaintiffs' bar. Companies should:


- Ensure that disclosed information is accurate.
- Be careful when making any aspirational statements. Companies need to be able to back up their statements with actions. Statements that are connected to actions, and commitments that are actionable, will have a more positive impact on a company's reputation and relations with its employees, customers, and suppliers.
- Review EESG scores and reports from the leading EESG data and ratings providers on a regular basis, because activist investors may use them to identify potential target companies.
- Consider having outside counsel review EESG disclosure (such as the sustainability report) to identify potential vulnerabilities.

PRACTICAL GUIDANCE

Consistent with its fiduciary obligations to act in the interests of the company, including the long-term interests of shareholders, the board has a responsibility to address EESG issues that affect the company's performance, operations, risk profile, and relationships with important stakeholders.

Prudent practices for boards include:

- Focusing board attention on EESG as it relates to strategy and risk by making it a regular agenda item, and discussing with management how EESG opportunities and other considerations factor into business decisions, including strategic decisions, risk assessments, and enterprise risk management.
- Considering delegation of oversight to board committees where it would be efficient to do so. For example, it is becoming fairly common to delegate:
 - general EESG oversight, including oversight of EESG engagement and disclosure, to the Nominating and Governance Committee;
 - human capital management oversight to the Compensation Committee; and

- EESG risk oversight, and monitoring of compliance and internal controls regarding EESG, to the Audit Committee.
- Ensuring that a comprehensive internal reporting process is in place relating to EESG disclosure. EESG risks should be considered as part of a company's overall risk profile and integrated into its existing risk management and financial reporting processes, including proper documentation of the company's internal analyses of these risks. A company should make and document materiality determinations with respect to EESG risks, just as it would any other business risk, even though many EESG risks may be longer term in nature.
- Ensuring that key EESG disclosure is reviewed at the board (or board committee) level, and working with management to confirm that disclosure in sustainability reports and other website disclosure is accurate (thereby avoiding "greenwashing") and consistent with SEC filings. The SEC staff increasingly comments on inconsistencies between disclosure in filed versus non-filed communications.
- Working with management to determine the content and scope of any voluntary EESG disclosure, including what and where to report, which framework and metrics to use, whether to publicly disclose EESG goals for the company, and how frequently to report on progress toward EESG goals. When making these decisions, directors should bear in mind the company's industry, strategy, shareholder base, risk of an activism campaign and litigation (for example, shareholder derivative lawsuits have been brought against companies that touted their diversity and inclusion efforts), peer company disclosure practices, and other relevant factors.
- Keeping abreast of pending legislation, SEC rulemaking and guidance, and other developments that may impact EESG disclosure through periodic briefings to the board (or relevant committee), and considering whether to be an early adopter of forthcoming mandatory EESG disclosure standards.
- Preparing for engagement with key institutional investors and other stakeholders on EESG issues, including voluntary disclosure, and staying informed of their policies and viewpoints. Directors should monitor trends regarding support for EESG-focused shareholder proposals, a record number of which have achieved majority support in 2021 (34 as of early July 2021, up from the previous record of 21 in 2020), in large part due to increased willingness by BlackRock to vote in favor of these shareholder proposals.
- Thinking like an activist investor and a plaintiffs' attorney when reviewing disclosure, including considering how the company's EESG-focused practices, risk oversight, and disclosure measure up against peer practices, best practice, and rating agency criteria. 

The views stated above are solely attributable to Ms. Gregory and do not necessarily reflect the views of Sidley Austin LLP or its clients. Portions of this column are based on the work of Ms. Gregory's colleagues, Sonia Gupta Barros, Rebecca Grapsas, and Claire H. Holland, of Sidley Austin LLP.