ARTICLE

CFOs Hold the Key to Unlocking ESG Value

ESG (environmental, social, and governance) is now a priority of many corporate leadership teams, playing an important part in a company's financial reporting, risk management and corporate messaging.

New regulations surrounding ESG-related reporting and disclosures are under consideration and review by the U.S. Securities and Exchange Commission (SEC) and within the European Union (EU). Adherence to high standards for ESG is critical for demonstrating positive corporate citizenship, appropriate risk management, resiliency and responsiveness to the investment community. While mandated reporting on ESG issues will create a baseline in terms of the quality and completeness of disclosures provided, companies have an opportunity to differentiate themselves versus peers and lower their actual and perceived cost of capital by establishing robust processes for risk identification, assessment, prioritization, the assignment of oversight, and related internal and external reporting.

Increasingly, CFOs can play a particularly important role when it comes to ESG, as finance functions have the necessary skills, systems, and processes to track and report key ESG-related metrics, and much of the information needed to track and measure ESG goals can be found in financial systems. Given the centrality of financial analysis and reporting to sound ESG programs, leadership and direction from CFOs is becoming an increasingly important factor in driving a company's successful management of data and thus target-setting and reporting. In practice, finance and accounting teams skilled in managing large data sets and tying financial metrics to non-financial measures are moving to center stage as key business partners attempt to define how and where to source necessary data for ESG strategy development and reporting. For CFOs and

their teams to successfully contribute to and empower a company's ESG strategy, they need to be well-versed in ESG metrics and related international standards and reporting frameworks. Among many other critical areas of focus, knowledge-building within finance and accounting functions and the development and continuous improvement of systematic ESG data collection, tracking and reporting processes will likely be front and center, given that:

- The SEC may soon mandate reporting of climate-related financial risks for public companies, which will be aligned with the recommendations posed by the Task Force on Climate-Related Financial Disclosures (TCFD) and guidance from the Greenhouse Gas (GHG) Protocol;
- Nine other international jurisdictions have announced adoption of TCFD-aligned reporting requirements: Brazil, EU, Hong Kong, Japan, New Zealand, Singapore, Switzerland, the UK and Canada;
- Many large asset managers such as Blackrock, Vanguard and State Street have requested that portfolio companies respond to the TCFD's recommendations and, in some cases, have threatened to vote against directors in situations where such implementation and disclosures are lacking;
- The importance of ESG-related due diligence is increasing within the M&A process, including assessing a target's ESG reporting, disclosures, transparency, commitments, and ultimately the value at risk and the cost to align the target's ESG profile with that of the acquirer;
- Credit rating agencies (CRAs) like Fitch, Moody's and S&P are beginning to roll out ESG evaluations and scores that have the potential to impact broader credit ratings and thus the borrowing terms that companies receive on their debt from banks and other lenders.

Understanding TCFD

The recommendations of the Task Force on Climate-Related Financial Disclosures have quickly become one of the most utilized and well-regarded frameworks for reporting the potential financial impacts a company may face due to risks and opportunities associated with climate change. The value in the TCFD's recommendations stems from its design, which replicates quarterly disclosures already being discussed and provided by finance and accounting functions internally: governance, strategy, risk management, and related financial metrics and targets. These same categories are the four substantiating pillars of TCFD, but through a climate-focused lens. Regardless of organizational structure, CFOs have key oversight, responsibility and partnership on each of these corporate functions. They are also responsible for communicating with investors, shareholders, creditors and supply chain partners, making them an incredibly valuable part of the process.

Figure 1 - TCFD Core Elements of Recommended Climate-Related Financial Disclosures

The TCFD recommends 11 related yet distinct disclosures across four pillars. Each disclosure from TCFD is thought-provoking in its pursuit of properly identifying climate-related risks and opportunities, establishing relevant oversight, quantifying the resilience of an organization – along with the potential financial impact of these risks and opportunities under certain scenarios – and then disclosing metrics and targets that enable stakeholders to evaluate a company's current standing and its path forward. A market shift is currently underway whereby public companies are being pressured to pivot from pure disclosure of discrete metrics to thoughtful analysis and reporting of climate

impacts on the company as a going concern. Privately held companies should be mindful of the TCFD as well, as it helps frame discussions around operational resiliency and responsiveness with investors and creditors while also preparing them for ESG discussions during due diligence. Additionally, given that many companies subject to SEC reporting requirements may ultimately report financially material indirect value chain GHG emissions (Scope 3) and any related targets, supply chain participants — even those privately held — may be pressured to begin reducing their own GHG emissions (Scopes 1 and 2) and disclosing efforts and progress accordingly. For all the reasons above and many more, CFOs will likely play a central role in responding to and implementing the TCFD's recommendations.

What Is Happening with the SEC's Climate Rule?

> The SEC proposal includes a requirement to disclose Scope 1, 2, and (possibly) 3 GHG emissions

Regulatory compliance is one of the most important areas where CFOs have significant responsibility given their oversight of financial statement reporting and disclosures. Globally, jurisdictions are increasingly aligning reporting with the TCFD's recommendations, including the SEC proposal currently under discussion, namely the "proposed rules to enhance and standardize climate-related disclosures for investors" released by the SEC in March. If finalized, these rules would require registrants to provide narrative disclosure of climate-related risks (and their governance), potential climate impacts on the firm's strategy and business model, climate-related goals (if any) and GHG emission metrics, among other disclosures. Additionally, in the notes to a registrant's financial statements, the company would be responsible for providing detail on how climate change is impacting financials, capital expenditures and forward forecasts. As mentioned above, CFOs are responsible for helping to manage communications and flow of information to the investment community, and this proposed rule would add another layer to the financial metrics that must be managed, reported and verified.

Within U.S. politics, the SEC's proposed rule on climate reporting is yet another contentious issue among many other topics open for debate. Recently, the SEC was forced to reopen its public comment window on the climate rule due to a technical glitch that occurred earlier this year. This could push any formalized ruling into 2023 (existing target is December 2022), at which point the rule is almost certain to be challenged in court by conservative lawmakers and others. As investors, lenders and other stakeholders are increasingly asking for decision-useful climate-related disclosures from both public and private companies alike, CFOs need to be ready for TCFD-style reporting with or without a finalized SEC rule, given the impact that effective reporting, or lack thereof, can have on access to and cost of capital.

ESG Is the New "Must Have" for Due Diligence

Environmental, social, and governance issues have the potential to impact acquisition value, as they can shed light on previously unforeseen risks or opportunities, and thus may impact whether deals go forward. Whether CFOs are on the sell-side or buy-side of an M&A engagement, confirming that pertinent ESG information is critical when evaluating potential legal and reputational risks that may accompany the sale of an entity or acquisition of new operations and facilities[1], not to mention any capital expenditures required to maintain ongoing emissions-reduction projects. CFOs can assist in three commonly occurring ESG due diligence scenarios summarized here:

- Benchmarking the target against peers: Benchmarking is a critical exercise to perform to identify gaps between the target's ESG risks, opportunities, strategy, reporting and commitments and those of its peers. As with financial due diligence, CFOs and supporting functions can leverage publicly available data and industry-specific resources to examine exposure to and management of relevant ESG risks and opportunities, including those related to climate change, anti-bribery and anti-corruption, among many others. Key questions to consider include: Is the target an ESG "laggard," "leader," or in the middle of the pack? Does the combined entity's

ESG risk and opportunity profile change materially? If so, what implications for ESG ratings, reporting and sustainability reporting frameworks may exist?

- Assessing value and risk when a target lacks an ESG program: If the potential target does not report ESG or climate-related metrics at all, this decisive lack of action requires diligence as well. Key questions to consider include: Do we need to adjust our purchase price multiple due to any unreported or unaddressed ESG issues? What investments need to be made to collect relevant ESG data and consolidate with the acquiring company's existing analysis and visualization processes? Do accurately measured Scope 1–3 GHG emissions and realistic and quantifiable reduction pathways exist?
- Aligning the target entity's ESG initiatives with the acquiring company: When the target has reported ESG or sustainability metrics, financial due diligence can verify the sources for these metrics and calculations. Key questions to consider include: How comparable are the source data and calculations to the acquiring company's metrics? What adjustments need to be made so they can be compared on a similar basis? How will the underlying data and processes be integrated post-acquisition?

CFOs can be a natural fit for guiding and defining a company's material ESG issues and setting corporate sustainability goals where key issues and critical room for improvement exist. With oversight of and insight into personnel, systems and processes that are best able to accurately capture and analyze the metrics needed to track progress and confidently set and report on targets, CFOs ultimately have a large role to play in the provision of decision-useful and transparent disclosure to the investment community. Further, they also have influence over corporate governance, financial reporting, regulatory compliance and M&A activities, positioning them well to partner with the executive team and board of directors to ensure that strategies related to ESG issues are fully integrated into broader corporate strategy and planning discussions and models.

How FTI Consulting Can Help

FTI Consulting has experts who can partner with executive and functional teams to create a successful reporting strategy by bringing our deep experience helping clients respond to and implement the recommendations of the TCFD. Further, we know how to work side-by-side as partners to identify the metrics, targets and processes to enable effective sustainability reporting alongside a company's financial reporting. We create a tailored approach that serves the needs of a company's stakeholders, including investors, employees, customers, suppliers and policymakers, and we have numerous experts, including those with experience and advanced certifications in ESG, finance and accounting, carbon accounting, climate issues, climate scenario modeling, net-zero strategies, financial and ESG reporting, and data transformation, among others. Whether determining a company's material ESG issues, identifying relevant climate-related risks or opportunities, evaluating the issuance of green bonds or the procurement of renewable energy, or drafting TCFD disclosures and broader sustainability reports, we provide clients with unbiased and actionable advice that advances their ESG goals in the context of their larger business objectives.

1 https://www.sec.gov/news/press-release/2022-46

The views expressed herein are those of the author(s) and not necessarily the views of FTI Consulting, Inc., its management, its subsidiaries, its affiliates or its other professionals.

FTI Consulting, Inc., including its subsidiaries and affiliates, is a consulting firm and is not a certified public accounting firm or a law firm.

Authors

LINDA HABERLACH
Senior Director, Power, Renewables & Energy Transition
+1 650.801.9898
linda.haberlach@fticonsulting.com

CATHERINE MORAN
Director, Power, Renewables & Energy Transition
+1 303.689.8890
Catherine.Moran@fticonsulting.com

Contributing Authors

BEN HERSKOWITZ
Managing Director
+1 212.850.5654
Ben.Herskowitz@fticonsulting.com

BRETT HUNDLEY
Managing Director
+1 484.459.8128
Brett.Hundley@fticonsulting.com

FTI Consulting is an independent global business advisory firm dedicated to helping organizations manage change, mitigate risk and resolve disputes: financial, legal, operational, political & regulatory, reputational and transactional. FTI Consulting professionals, located in all major business centers throughout the world, work closely with clients to anticipate, illuminate and overcome complex business challenges and opportunities.©2022 FTI Consulting, Inc. All rights reserved. **www.fticonsulting.com**

FTI CONSULTING™