# ESG governance

Why it's everyone's business at your company

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# Introduction

Driven by market forces, more and more companies are committed to improving their environmental, social, and governance (ESG) performance. Customers, employees, and investors are increasingly demanding ESG transparency. Regulators are also starting to require additional disclosure to create comparability between companies. And many companies now hold top executives accountable for ESG performance, making them responsible for the governance of ESG programs.

In this paper, we explore the challenges that organizations face in creating effective ESG governance—defining ambitions, managing execution, and reporting on their ESG achievements. This isn't about Governance with a capital "G" (e.g., executive pay, board diversity) but governance with a small "g." To realize ESG aspirations, we believe it is critical that a company create an ESG-aware culture that permeates the organization so that achieving ESG targets becomes part of "business as usual" for every employee. It is the job of the company leadership to determine the right ESG strategy for their organizations (see "The essential role of the board" on page 4). But it takes a team effort by the whole organization to execute.

# What does robust ESG governance look like?

Good ESG governance will drive greater awareness of ESG performance in every facet of business operations. The goal is that, over time, everyone will adopt an ESG mindset in their daily activities to help the organization achieve its ESG goals. To see what robust ESG governance looks like and what leading practices are emerging today, KPMG LLP launched our first annual ESG survey (see "Survey methodology"). We found that forward-looking companies are putting leaders with the right skills in charge of their ESG programs, integrating ESG into their enterprise strategy, and positioning the organization to deliver superior ESG performance as long as it exists.

ESG is still in its early days, however, and many organizations are struggling to implement effective ESG programs. This is often because companies believe a whole new governance structure and business strategy are necessary to tackle ESG issues. Amid the usual pressures of running a business, such a task can seem overwhelming. But we believe it's better to integrate, to the extent possible, ESG practices into a company's unique governance structure and existing strategy. For example, most companies already have an enterprise risk management (ERM) program in place—which means they can extend the same discipline to ESG-related risks and data, such as risks to the business resulting from climate change.

Some of the more notable insights from our survey and work with clients include:

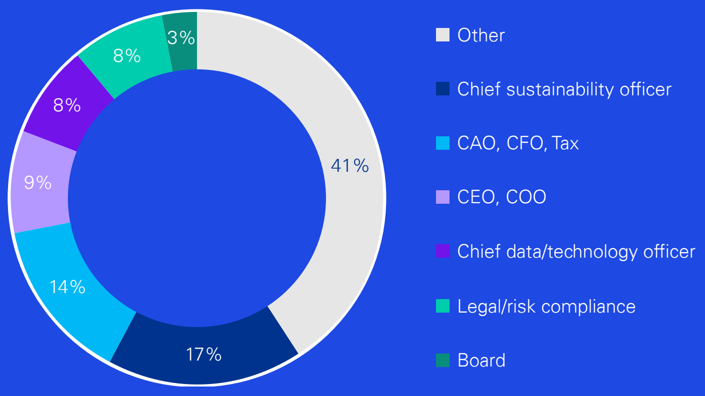
- A majority (53 percent) of survey respondents agreed that the most important skill for a company's ESG leader is collaborating cross-functionally to drive action across business functions such as finance, operations, human resources (HR), information technology, etc.
- More than 80 percent of companies that embedded ESG into their enterprise-wide business strategy consider their ESG programs a success.
- Companies recognize that making ESG an integral part of their operations is a long journey and should be seen as a program and not a project.

Well-governed companies shouldn't regard establishing good ESG governance as an extraordinary challenge. The key is to appoint the right leader to work with the existing structure and people to weave ESG into the company's business DNA so that it eventually becomes ingrained in everyday behavior for everyone in the organization.

## Survey methodology

In H1'22, KPMG surveyed 300* public and private companies (46 percent and 52 percent, respectively) in the U.S. across a wide range of industries, and government entities. Approximately 89 percent of respondents were either leaders of or have influence over ESG programs:

### By role




*Although 300 executives participated in the survey, not all participants answered every question. For some topics, only those who had given relevant answers to previous questions were asked additional, follow-up questions.

# Identify a cross-functional ESG leader

Given that ESG encompasses the entire organization, ESG must be a team effort. No individual can see it all and manage it all. Still, accountability for the overall development and progress of ESG strategy and reporting needs to be centralized. Ideally, companies would have one person who takes ownership of the ESG program. ESG leadership is not something that can be shared by several people who work on it on a part-time basis.

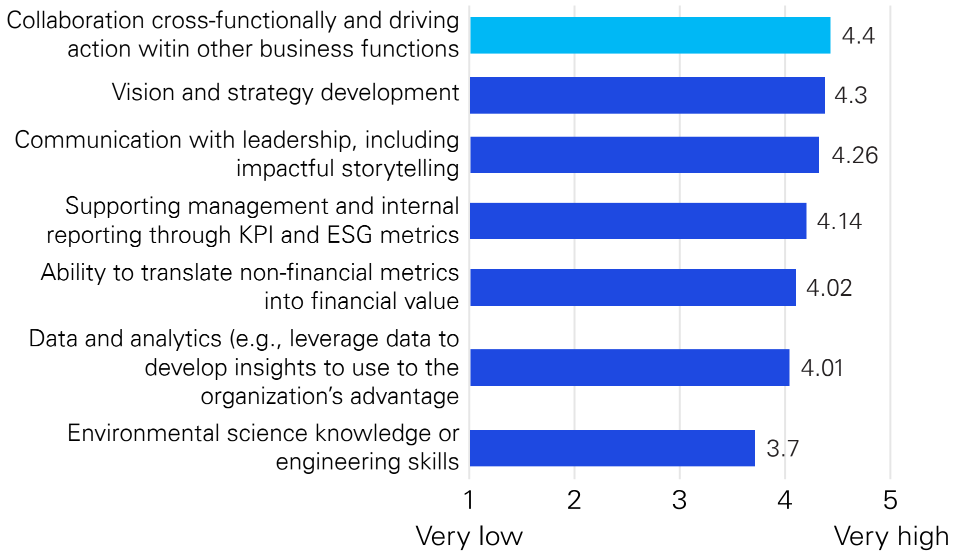
The most important strength for an ESG leader is being comfortable working with both C-suite executives and with various business unit heads—that is, the ability to work cross-functionally. The person needs to have not only ESG expertise but also the interpersonal skills to gather input from functional leaders and bridge gaps between, say, finance, HR, and legal, or operations and marketing to help them collectively carry out the company's ESG agenda.

Collaboration is key to meeting a company's ESG goals because only a cross-functional emphasis can ensure the united effort needed to improve the organization's ESG performance. For example, in order for a delivery firm to shift to an all-electric vehicle fleet, fleet management and procurement will need to enter into the contracts and track the retirement of a non-electric fleet, treasury and finance will need to budget and finance the purchases, accounting will need to record the asset additions and disposals, and operations and logistics will need to determine where and how the vehicles can be recharged.

Ideally, a common language would be spoken across the business units, and it will be up to the ESG leader to translate and connect ESG's non-financial metrics to the company's financial performance. Indeed, for an ESG leader to be successful, our survey respondents said the ability to collaborate cross-functionally to drive action is the most important skill set—more than vision and strategy development, or communication with leadership (Exhibit 1).

### Exhibit 1. Cross-functional collaboration is the most important skill set in an ESG leader

**How would you rate the importance of the following skill sets required for an organizational ESG lead to be successful?**




## The essential role of the board

To ensure proper ESG governance, the board needs to get comfortable with management's ESG priorities and strategy. If a company isn't yet mature in ESG ambitions or has a complex ESG-related value chain, then it may want to assign ESG oversight to a board subcommittee. It is also essential that the board receive integrated, reliable, and repeatable ESG reporting. This will allow more robust agenda setting and discussions.

The board may need to adjust its own governance to accommodate ESG oversight into its structure. There is, however, no single formula as each organization has unique requirements. Irrespective of how the board decides to structure its governance, one of its primary objectives is to oversee the integration of ESG into corporate strategy and operations.

In our survey, 60 percent of organizations said their boards have integrated ESG into standing committee agendas and charters. In addition, 66 percent said their boards are "engaged" in helping influence the strategy for the organization's ESG program, and another 19 percent said they are "very engaged."

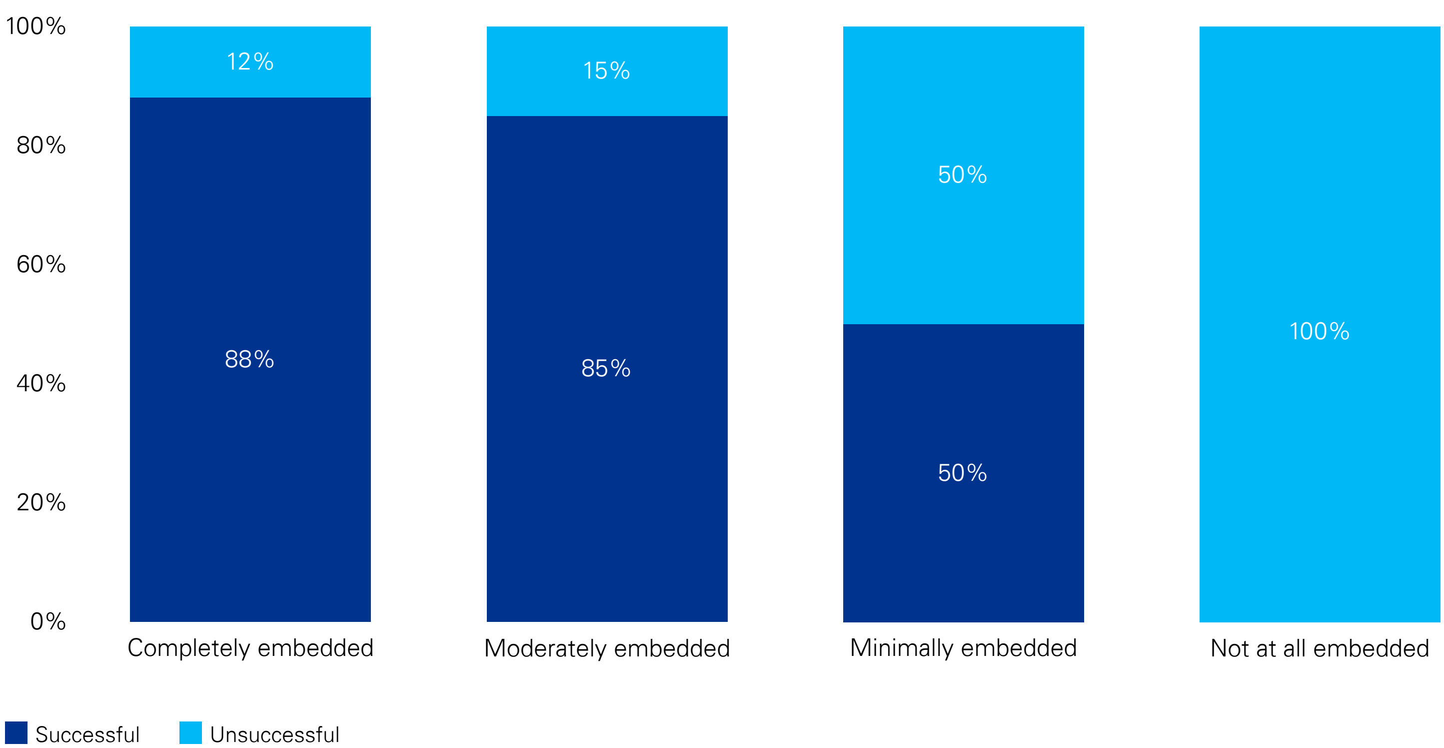
Collaboration remains a challenge for many ESG programs: 61 percent of all respondents to the KPMG survey said they saw room for improvement in collaboration in their programs. Although there are many aspects of a change-management program to consider, organizations can help expedite collaboration by examining how they drive ESG-related accountability further into the organization. This may include building ESG performance metrics into performance discussions and incorporating incentives into compensation criteria. Aligning performance metrics to ESG (e.g., recruiting for a diverse workforce) is likely to affect behavior and drive improvement.

## Make ESG a part of operations and routine reporting

After selecting the ESG leader, companies need to authentically communicate to all stakeholders how they intend to execute their ESG priorities and purpose. Leadership needs to set the right tone and build an ESG-aware culture that permeates company-wide. Start this journey by making ESG goals an integral component of business strategy.

One of the strongest insights we gleaned from our survey results is that companies which embedded ESG into their enterprise-wide business strategy were more likely to regard their ESG programs as successful than those that didn't. Of those respondents who said ESG was completely or moderately embedded into enterprise strategy, over 80 percent replied that their ESG program was a success, but of those with minimally embedded ESG, only half said so (Exhibit 2). By tying ESG strategy to business strategy, these companies made the goal of becoming a more sustainable enterprise a top priority and connected ESG targets to the outcome of day-to-day operations.

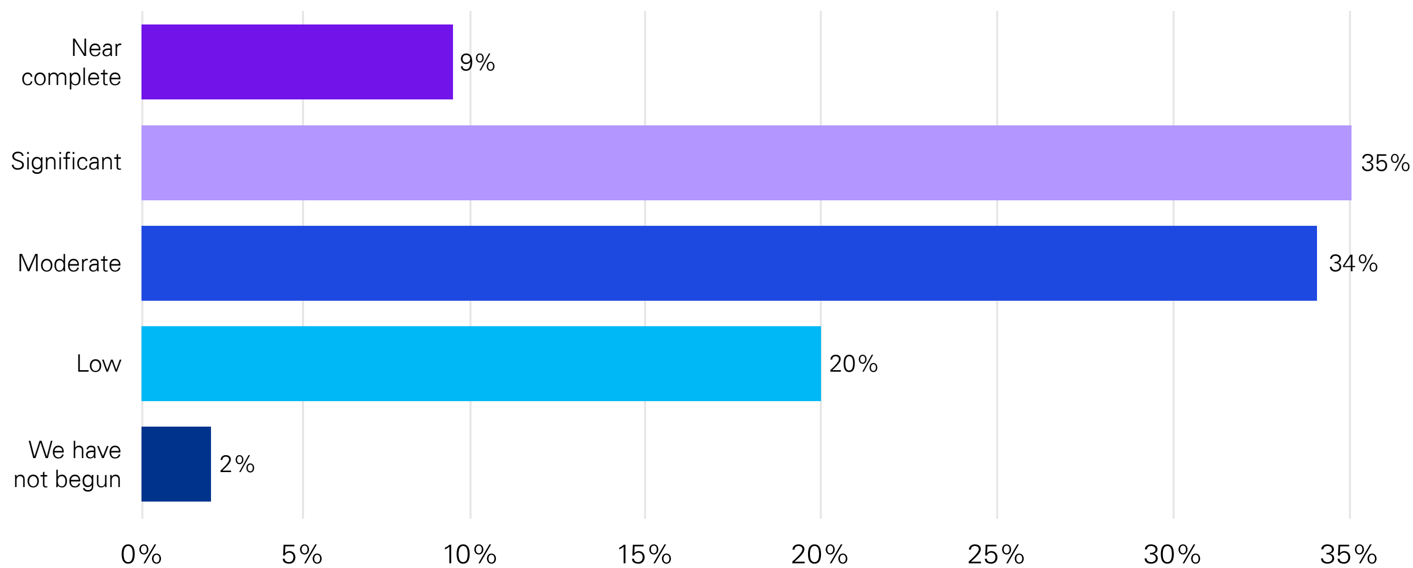
### Exhibit 2. Embedding ESG into the business strategy underpins the success of an ESG program



For ESG to be woven into the organizational fabric of the company, as well as to monitor and document progress, metrics and reporting are critical. Externally, regulators are moving to mandate transparency through detailed quantitative and qualitative disclosures vetted by an independent third party. Yet ESG reporting, at best, is in its adolescence. Less than 15 percent of our survey respondents said their program has attained maturity in timely regulatory reporting compliance, controls on ESG data, integrated ESG risk analysis, or clearly defined oversight. And only 9 percent are close to completion on implementing processes and controls to ensure the consistency of their ESG policies, activities, and reporting (Exhibit 3).

To address this challenge, many companies are naming an ESG controller who works shoulder-to-shoulder with the ESG program lead. The ESG controller often has experience addressing accounting changes or business transformation activities such as systems implementation. The ESG controller or equivalent should drive the establishment of policy, process, and the right level of internal controls over ESG information to produce investor-grade data.

**Exhibit 3. Few companies have consistent ESG processes and controls implemented**




# Plan for a long journey

Addressing so many issues will take time, and companies know it. More than two-thirds (69 percent) said ESG will be a priority for the next three to five years. Therefore, ESG is not a project but a program. What's the difference? Projects usually have limited life, but the intended outcome of a program is to be a permanent part of the organization. Given the growing importance placed on ESG by all stakeholders from customers to shareholders, a company's ESG program will continuously evolve and mature. This is why thinking long term and setting ESG targets accordingly is critically important. ESG is an enduring mission requiring continued leadership commitment.

# Conclusion

A successful ESG program must integrate existing governance disciplines and fit in with the organizational culture to truly be impactful. Every company has a unique starting point. To integrate ESG into business operations, each must ask: given its ESG strategy, what additional governance structure must be created?; what processes and technology already exist that can be leveraged?; and do roles and responsibilities need to be clarified? Answering these questions will inevitably be a "one size fits one" effort.

What is clear is that the landscape is evolving quickly, and good ESG governance is essential to not fall behind. By starting now, companies can solidify their position as a leader. Customers, employees, investors, and regulators will continue to demand transparent, reliable ESG reporting and performance. How will you meet their expectations?

# How KPMG can help

Our governance solution focuses on helping businesses leverage process and organizational structure to bolster the ESG strategy with the appropriate management and board oversight. This includes helping management create processes to enable the four major pillars of the ESG journey (assess, design, operationalize, and measure and report). Additional focus is applied to helping the board understand its responsibilities to oversee ESG, including any reporting requirements, how they should be structured, and compensation alignment. Proper execution of ESG governance gives stakeholders confidence and comfort that the strategy is being executed as designed and embedded in the overall enterprise strategy.

## Key elements of an ESG Program

**Our deep ESG experience will help guide you across the ESG journey.**

**Communications**

Support company-wide buy-in by clearly communicating goals, expectations and achievements before, during, and after the implementation of a new framework.

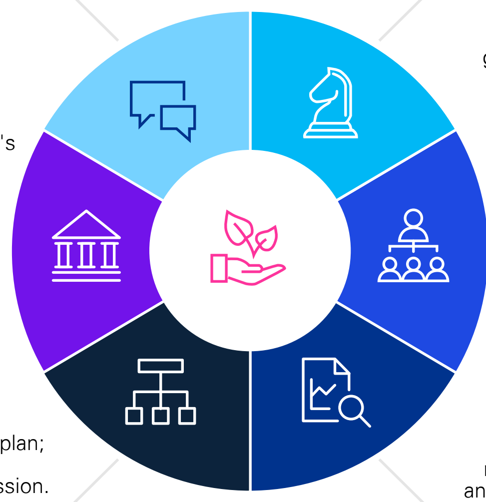
Support external communication of organization's ESG strategy to investors, customers, and suppliers.

**Governance**

Define governance model, internal controls, and role of the board.

**Process**

Implement appropriate processes within the organization's structure; operationalize strategic plan; map in detailed process flows to help ensure programmatic goals align with organization's mission.



**Strategy**

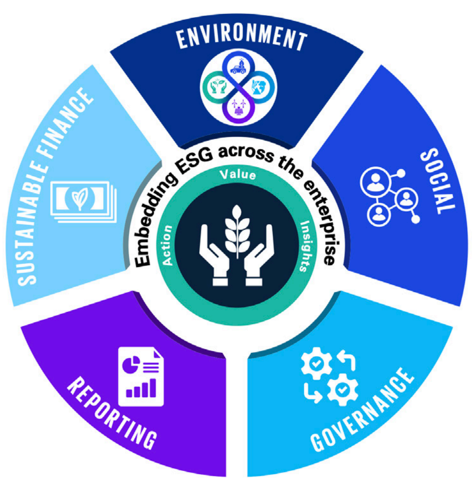
Provide the basis for effective implementation of given framework; establish guidelines for mission and vision, define objectives, and set the tone of new ESG framework.

**Organizational structure**

Identify and define key components of the ESG framework, assessment of existing skill sets, and clear definition of key roles and responsibilities.

**Reporting**

Understand the reporting frameworks. Ensure regulatory and reporting needs are met; establish and implement strong internal control environment.




This report is part of the KPMG ESG series covering topics under Environment, Social, Governance, ESG Reporting, and Sustainable Finance. Our ESG content series demonstrates that embedding ESG across the enterprise will turn ESG aspirations into action by leveraging insights from data to create value for your organization. For other reports in this series, please visit the [KPMG ESG website](KPMG ESG website).

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Steve is a partner with the KPMG Advisory practice and has over 30 years of experience providing advisory services to clients. Steve currently serves as leader for the Internal Audit and Enterprise Risk practice's Texas Business Unit as well as the Risk Services ESG practice. His ESG experience has included assessments of the Securities and Exchange Commission's recent proposed climate disclosure guidelines, establishing ESG governance programs, evaluating ESG internal controls, and helping clients to design and operationalize a target operating model around ESG reporting requirements.


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Deon is the National Lead partner for the KPMG Board Advisory Services. As a 30-year veteran at KPMG, his last two decades have been exclusively focused on governance-related engagements with boards and management to drive improvements in performance and effectiveness. His ESG experience is primarily focused on helping organizations enable their ESG strategy by integrating good governance into their respective areas of responsibility.


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*Partner, Audit*


Maura is the KPMG ESG Audit leader. She has more than a decade of experience providing ESG reporting and assurance services, coupled with more than 15 years of experience providing audit and internal control opinions on financial information for companies ranging from venture-backed private companies to the Fortune 100. She sits at the nexus of ESG strategy and reporting and regularly speaks with the media and clients to educate and advise on practical next steps.


**We would like to thank our contributors:**

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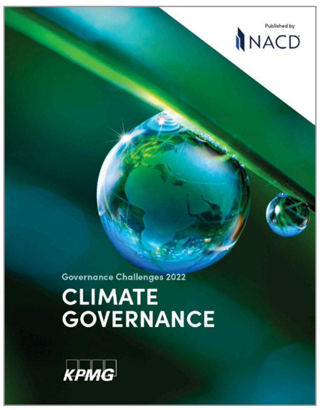


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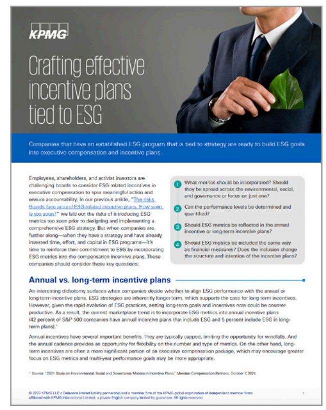


**Crafting effective incentive plans tied to ESG**

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