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Reporting on environmental, social, and governance (ESG) data has become increasingly important over the past few years and is poised to continue to increase in importance moving forward. As an` area of increasing importance, it is no surprise that the Securities and Exchange Commission (SEC) has increased their regulatory focus on reported ESG information. Although the SEC's proposal has not been released at the time of this publication in its final form, an important alignment is already occurring among ESG, digital transformation, and the finance function.

Finance professionals are poised to incorporate their expertise and experience with processes and controls, combined with new tools and technologies, to contribute to developing infrastructure that will power organizational ESG reporting efforts. To highlight this important confluence and help bridge the knowledge gap, the Financial Education & Research Foundation (FERF) partnered with Persefoni to study how finance functions are evolving in response to the SEC's climate proposal.

KEY TAKEAWAYS

- **Finance teams are laser focused on building an ESG reporting ecosystem:** Finance is working to control ESG (100%), developing oversight of ESG reporting (97%), and increasing its role in preparing disclosures related to the SEC's proposal (93%).
- **Eyes on the process:** Eight out of ten finance professionals reported being most keenly focused on building the complex processes needed to address organizational ESG reporting.
- **Climate data continues to perplex many:** Respondents named difficulties in obtaining scope 3 data (77%) and the general complexity of the climate data (58%) as the biggest challenges to meeting the SEC's climate proposal.

ABOUT THE REPORT

FERF and Persefoni collaborated to develop the survey and interview questions designed to uncover which ESG frameworks and standards organizations are increasing their focus on in the next year, preparer readiness for various components of the Securities and Exchange Commission's Climate Proposal, the biggest challenges in the proposal, how finance functions are evolving to support increased ESG reporting, and the key technological adoption trends to meet the proposal's ESG requirements.

The report and its findings are based on a survey distributed to finance professionals from US-headquartered, publicly traded companies. In total, more than 50 chief accounting officers and controllers from some of the largest US companies participated in the survey. A subset of those participating in the survey (6) also participated in more in-depth qualitative research interviews.

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VP of Strategic Finance at Persefoni 10

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A NOTE ON LAYOUT: In authoring this report, we wanted to convey the journey that finance functions are on as they work to support increased ESG reporting capabilities. Although each company is on its own journey as it relates to ESG reporting, we were struck by the methodical approach companies were utilizing. As you read through the report, you may notice the use of hexagonal tiles to create a mosaic which is completed on the cover and deconstructs throughout the report, until the tiles again reconstruct the forest image.

We opted to use the hexagonal tile and mosaic theme to symbolize data, which is the carbon of the reporting ecosystem – i.e., the building block upon which all information is composed. Again, we were struck by the considerate approaches financial leaders described as they discussed the importance of data, especially in these, the early stages of their ESG transformation journey.

BUILDING FROM THE GROUND UP

"We'll get working on controls when we know what we are reporting on and the accompanying requirements," said one controller at a large public company. What a difference a year makes. This sentiment, when given, was shared among many with whom FERF spoke to when conducting its research study, How finance professionals are helping to advance ESG reporting.

Now, financial leaders are thoughtfully considering the interplay between finance and ESG and are actively applying lessons learned from the world of finance and accounting to ESG reporting, from data collection to external reporting. Also, finance professionals are rapidly working to upskill and reskill their teams, leading to an evolution of roles and responsibilities unseen since the codification of Sarbanes–Oxley into law more than 20 years ago. In this transition, finance professionals are at the forefront, helping to lead and participate in cross-functional efforts to collect, collate, analyze, and control ESG data in a way that promises to transform the finance function and the value it brings to the organization.

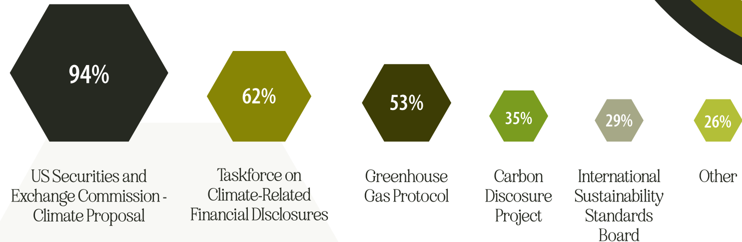
For those whose organizations have already begun their ESG reporting transformation, many in interviews discussed the importance of using what their ESG reporting function has already done, whether that be the purview of corporate communications, legal, or any other function, or the focus on addressing the gaps between where the firm's ESG reporting is and where it will need to be when reported ESG information must be included within SEC filings.

Who is reporting, and where?

	Total S&P Companies by Industry	Average Date of Public Support for TCFD	Percentage of S&P Companies Supporting TCFD	Percentage of Near-term SBTi Target
Communication Services	25	10/31/20	16%	48%
Consumer Discretionary	58	6/11/21	17%	47%
Consumer Staples	33	12/8/20	12%	76%
Energy	21	2/15/21	5%	10%
Financials	66	1/25/19	9%	29%
Health Care	65	11/15/20	11%	45%
Industrials	71	9/10/20	10%	34%
Information Technology	76	7/26/21	8%	43%
Materials	28	3/23/21	7%	54%
Real Estate	31	2/12/21	10%	68%
Utilities	29	9/5/20	14%	21%

The data to the left illustrates the nascency of ESG reporting in the United States as of December 2022. Moreover, that only 11% of S&P 500 companies are signatories of the Taskforce on Climate-related Financial Disclosures (TCFD) is unsurprising. Similarly, that 42% of those in the S&P 500 have committed to a short-term target under the Science- Based Targets initiative (SBTi) speaks to the importance companies are placing on measuring and – ultimately – reducing their carbon emissions moving forward. Of note, the chart below depicts the responses from a subset of the S&P 500, with the majority of responses coming from a segment of companies that are more advanced in their ESG reporting journey than the average S&P 500 member. Moreover, the chart below asks specifically about the degree to which companies are working to bolster their reporting efforts over the next year.

Which frameworks or standards is your organization preparing for/planning on placing increased emphasis within the next year?



When surveyed on their organization's plans to increase their focus on the disparate standards, there was clearly a heightened focus on the SEC's climate proposal and the standards and frameworks from which it draws inspiration – namely the TCFD and Greenhouse Gas Protocol (GHG Protocol). Moreover, additional factors that companies are weighing up as they increase their prioritization assigned to reporting under these frameworks are that the regulatory bodies – both US-based and international – are increasing their own focus on climate-related metrics while stakeholders are also becoming more climate cognizant.

> "With sustainability reporting, we're reporting on metrics that are just as important to the value of the organization as the financial information."
>
> \- FINANCE PROFESSIONAL AT A LARGE PUBLIC COMPANY

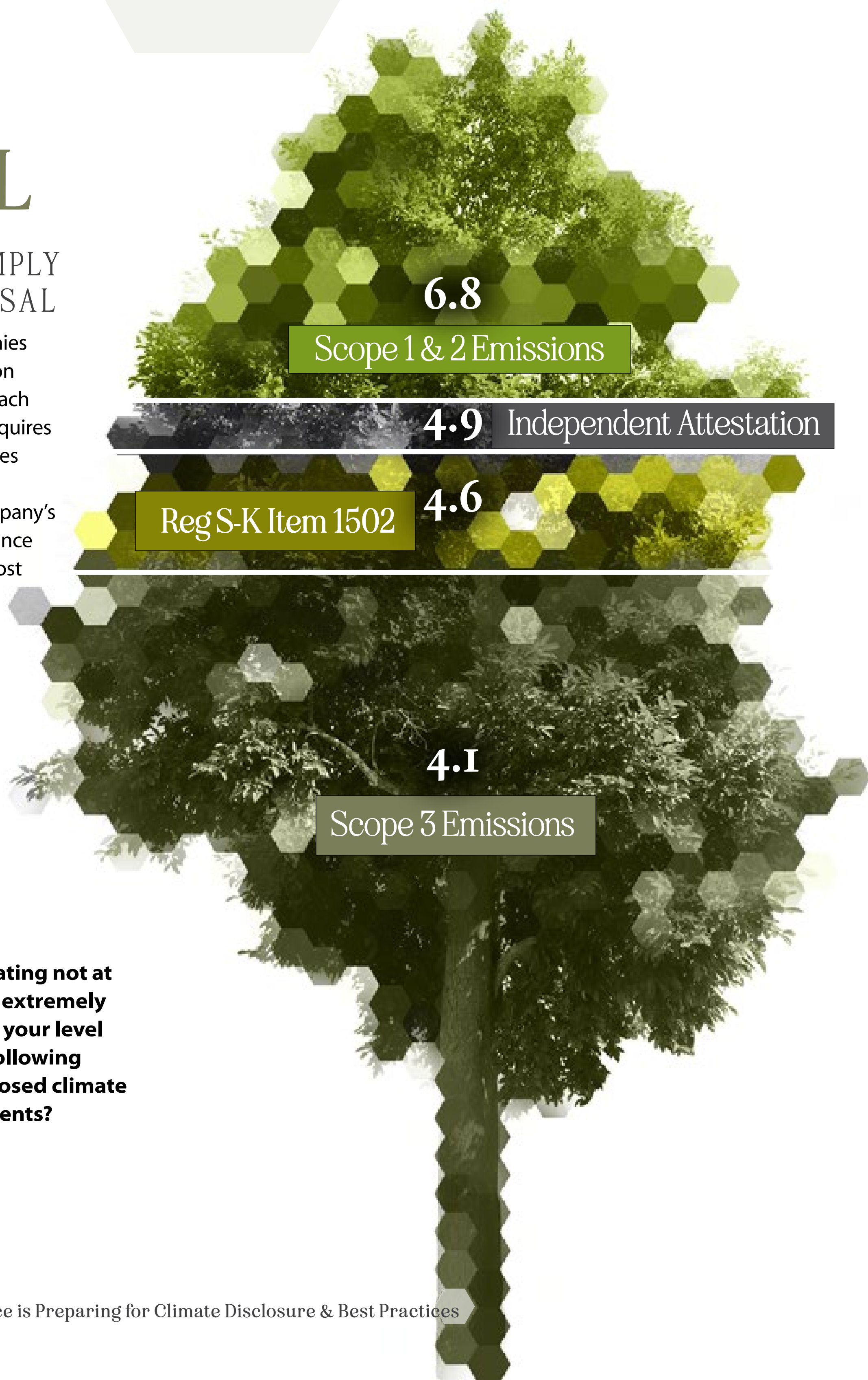
The nascently formed International Sustainability Standards Board (ISSB) is reportedly being emphasized by only a minority of preparers (just under 30% according to the graphic above). That said, preparers will be keenly monitoring the ISSB's standard setting activity moving forward.

Interestingly and consistent with previous FERF research on the subject of ESG reporting, we are seeing a diversity of practice with regard to the different frameworks and standards companies are using in their ESG reporting efforts, and that companies are planning to continue to report utilizing a plurality of standards and frameworks. Even after the SEC's climate proposal goes into effect, the research participants indicated that they expect their companies to continue to report under multiple standards, as they report on the metrics that are important to their company and its stakeholders.

THE SEC CLIMATE PROPOSAL

PREPAREDNESS TO COMPLY WITH THE SEC'S PROPOSAL

As noted in the previous section, companies are devoting significant time and attention to the SEC's climate proposal. That said, each element of the Commission's proposal requires different levels of investment as companies work to achieve compliance. Given the imperative placed on reporting on a company's GHG emissions, it is unsurprising that finance professionals indicated that they were most prepared to comply with reporting on scope 1 & 2 emissions, as opposed to scope 3 emissions, Reg S-K Item 1502, and independent attestation.



On a scale of 1-10, with 1 indicating not at all prepared and 10 indicating extremely prepared, how would you rate your level of preparedness to meet the following components of the SEC's proposed climate disclosure reporting requirements?

In speaking to the challenges presented by reporting on scope 3 emissions, one finance professional said, "the other big data challenge comes into play with financed emissions and scope 3, so category 3.15, and that's an area where you are very dependent on upstream reporting from your clients, so we're getting client data and we're using third-party informational sources to get the information we need."

> "To report on scope 3 at the level we need to would need more than 12 months of data collection."
>
> \- SURVEY RESPONDENT

As it pertains to independent attestation, the 2022 Annual Public Company Audit Study revealed how public companies are approaching assurance for climate-related disclosures, with 42% unsure of the approach they will take, 40% using their financial statement auditing firm, 9% using a public company auditing firm different from their financial statement auditor, and 9% using other assurance providers (i.e., a GHG emissions advisory service).

> "Reporting on scope 1 and 2 will be a recurring thing that ends up in a filing, so we are figuring out how we get almost an ICFR-level process around it to make sure we are comfortable."
>
> \- ESG CONTROLLER AT A LARGE PUBLIC COMPANY

Persefoni's Kristina Wyatt, Deputy GC, SVP Global Regulatory Climate Disclosure, gives a practitioners note.

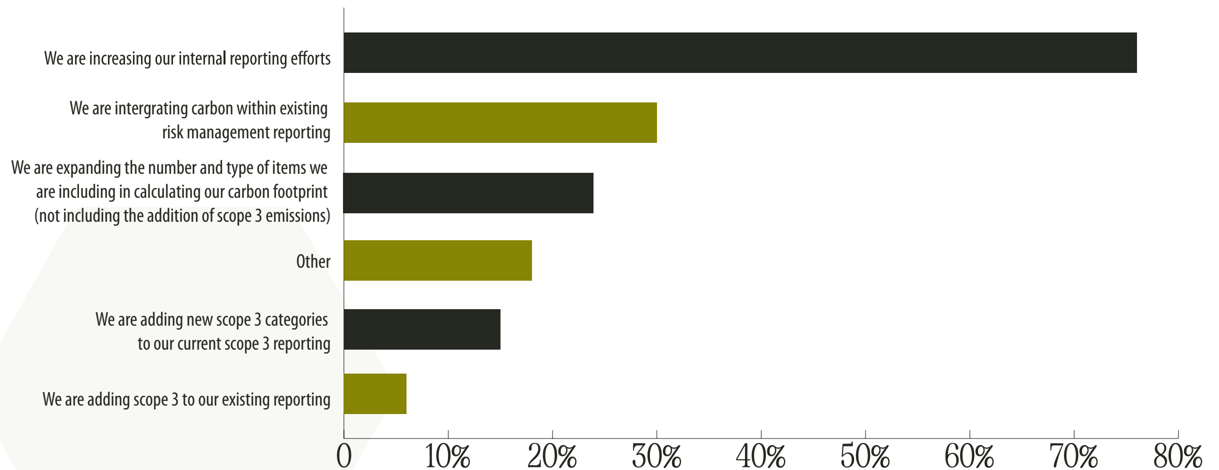
A common misconception is that companies must obtain emissions data directly from all of their suppliers in order to calculate and report their Scope 3 emissions. The Greenhouse Gas Protocol states in its Scope 3 Technical Guidance, "collecting data directly from suppliers adds considerable time and cost burden to conducting a scope 3 inventory, so companies should first carry out a screening to prioritize data collection and decide which calculation method is most appropriate to achieve their business goals."

One acceptable method to calculate Scope 3 emissions is to use spend-based formulas that multiply the amount of money spent, or the number of goods purchased, by emissions factors that use industry averages. Companies using this approach do not have to obtain data from their entire value chain to ensure compliance. For example, some food manufacturers have hundreds of thousands of small farms around the world in their supply chains. It would be a monumental feat to get emissions data from all of those suppliers. Similarly, professional services firms with the majority of Scope 3 emissions from air travel can simply use data they already have in travel management systems (mileage, cost, etc.) to calculate business travel emissions.

The SEC's proposal specifically endorses this as an acceptable methodology: "when calculating Scope 3 emissions from purchased goods or services, a registrant could determine the economic value of the goods or services purchased and multiply it by an industry average emission factor (expressed as average emissions per monetary value of goods or services)." Over time, particularly with technology tools that facilitate reporting, more granular supplier data will surely become available. For now, it is important to keep in mind that there are alternative ways for companies to calculate and report their carbon footprints that don't involve "more than 12 months of data collection".

REPORTING

How do you anticipate your reporting externally and to management around the SEC's recent climate proposal will change within the next year? *(Multiple responses permitted)*



The graph above depicts the areas in which organizations are prioritizing efforts around the SEC's climate proposal over the next year.

Given the recent regulatory focus ESG reporting has received and its import within corporate strategy, it is relatively unsurprising that organizations are looking to increase their internal reporting efforts. As corporate and stakeholder understanding of ESG topics continues to mature within the US, we anticipate that each item listed in the graphic above should receive increased prioritization.

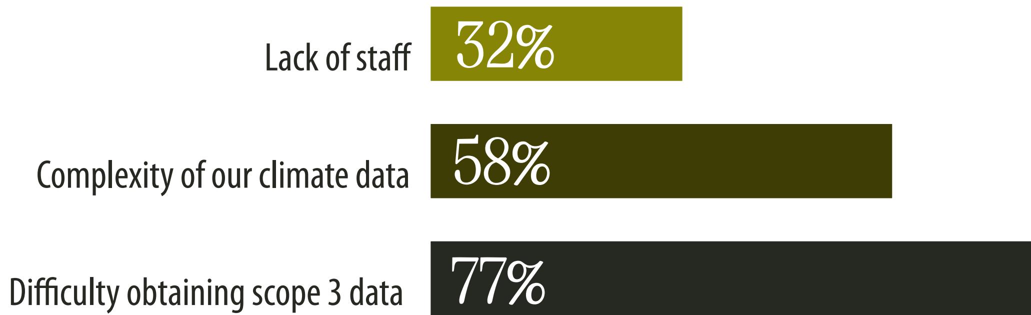
For example, many will look to increase their reporting on scope 3 if it is included in the SEC's final regulation; many will also increase their scope 3 reporting efforts as upstream companies increase their own efforts to report on scope 1 and 2, thereby increasing the availability of data to be used when calculating scope 3 emissions.

Moreover, many will look to increase the number and types of items included in calculating their carbon footprint as customers increasingly request this information – something several interviewees noted they are already asking of their suppliers, and using to evaluate the suppliers from whom they source materials moving forward.

When describing why her organization is looking to increase internal ESG reporting and seeking increased finance function involvement, one controller said, "every time you sit with someone, you help them make a business decision." Whereas these conversations have largely focused on the financial implications of various decisions, she posits that these conversations could soon evolve to include discussing whether the company should pursue digital marketing or a mailer strategy based on not only the potential financial implications but also the impact on the company's carbon footprint and their roadmap to net zero.

BIGGEST CHALLENGES

As your organization makes changes to meet the reporting requirements from the SEC's climate proposal, which of the following do you anticipate representing the biggest challenge(s)?



Overall, the biggest challenge associated with meeting the reporting requirements from the SEC's climate proposal as reported by respondents was the difficulty of obtaining scope 3 data. In a follow-up question, one survey respondent noted, "One specific scope 3 related challenge we're facing relates to the use of assumptions, third-party data, and other material that we take at face value that may be outside our control. We anticipate this challenge to remain until the related processes mature." In response to this same question, others pointed to challenges related to collecting scope 3 data, the availability of such data, the complexity inherent within their industry, the variety of end-of-use applications for downstream emissions, and various supply chain evaluation issues.

In speaking broadly to the challenge that climate data represents – selected second most common among the biggest challenges to meeting the SEC's climate proposal – one controller at a large public company said, "we're looking at data in a way that we've never looked at it before – it's different cuts, it's different places and I think everyone is struggling with climate data."

Moreover, it is not simply that ESG data is comparatively novel, bespoke, or highly manual that makes it challenging – each of these difficulties can be remedied. For example, the novel will soon become ordinary, the bespoke can become uniform, and the manual automated; each of which will require careful investments of time and change management. The challenge, put simply, is for finance professionals to steer the structure and processes professionals will follow as organizations embark on an ESG digital transformation journey. One such example pertains to ESG data quality. Many interviewees noted that creating a digital infrastructure and process that reinforces the integrity of ESG data should improve the quality of reported data in the short-term and increase the automatability of ESG data and processing in the long-term.

A Q&A WITH JOE CAVANAUGH, VP OF STRATEGIC FINANCE AT PERSEFONI

When you are onboarding new companies, what are their biggest pain points as it relates to maintaining a rigorous structure to extract, capture, and analyze their climate data?

"Data management in the context of producing disclosure-grade climate management and accounting data is a challenge. Compared to financial accounting, enterprise carbon accounting – driven by the Greenhouse Gas Protocol (i.e., GHGP) – is a newer discipline with diffuse data sources and types, and generally with less-developed internal systems and resources behind it. For companies in the midst of implementing a carbon accounting solution – whether doing it for the first time or upgrading to a higher level of sophistication and management – it is critical that they keep in mind their end goals (e.g., public disclosure, auditability, and compliance with prevailing standards) and ensure that all of their data sources and approaches to data management are aligned in support of those goals. Data sources may need to be replaced or upgraded, or processes refined, in the pursuit of developing enterprise-grade answers that will inform a company's management strategy."

How should finance professionals think about auditability as they make and implement changes to the systems that capture, store, and analyze climate data?

"Auditability must be a core tenet of any company's GHG data management process and strategy – no different than in financial accounting. First, the audit and assurance requirements included in the initial SEC proposal provide a strong indication of where we are headed from a regulatory perspective. Second, as the market evolves from the question of "what is your GHG emissions baseline?" to "what are you doing to reduce it?", companies need to ensure comparability across systems and calculations for various time periods in support of monitoring and demonstrating progress to stated goals and targets. As climate data informs the contextualization of risks and investment decisions at the executive and board levels, potential restatement due to adjustments in calculation methodology or the systems used will be problematic. Those companies that are thinking about these processes and requirements today are setting themselves up for success given the potential lead time for the development and implementation of a sound reporting process from the perspectives of data management, auditability, and controls."

How has the conversation around climate data changed over the past few years? How do you think the conversation around climate data will change as finance professionals continue to enter into the conversation in a more significant way?

"The conversation around "climate data" has evolved rapidly – where previously sustainability offices led the charge with a focus on discretionary reporting and reductions, the center of climate discourse is quickly moving toward the CFO's office. With the SEC's proposal and investors' desire to see standardization of the reported data, we are moving closer and closer to the obvious analog – financial accounting – to see how corporations will need to align their internal systems and controls to support data management and reporting that will be truly disclosure-grade. The core expertise that the finance function holds in these areas will be critical to implementation and management in the face of the evolving regulatory and shareholder landscape, so it is a very natural evolution to see this discussion push into the realm of the CFO's office and the Audit Committee. We do believe, however, that the conversation will remain multi-disciplinary, involving not just finance but also legal, strategy, sustainability, operations, supply chain, and human resources."

What is the most impactful part of the SEC's climate proposal that people haven't talked about enough?

"Given that the proposal draws on the framework of the Taskforce on Climate-related Financial Disclosures (TCFD), it connects the measurement and reporting of GHG emissions with the identification of risks and the development of business strategy. Financial professionals at companies that will directly or indirectly fall under the purview of the SEC's proposal will play a central role in analyzing the financial risks and opportunities related to a company's GHG emissions, and in developing the strategies that will allow those companies to both mitigate those risks and pursue the most attractive opportunities."

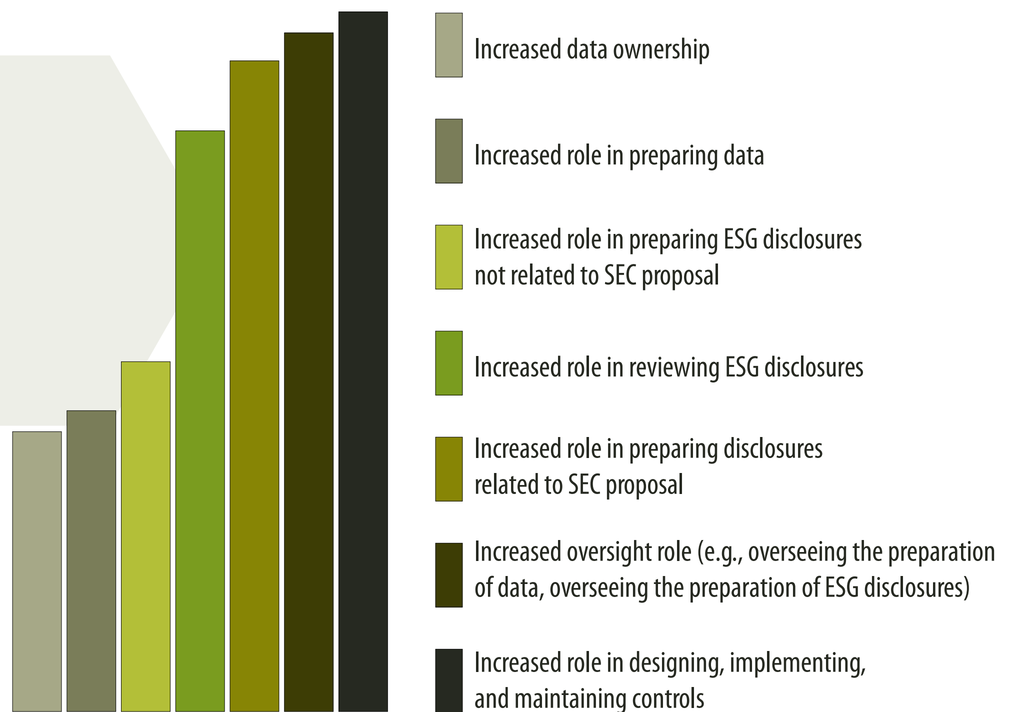
BEST PRACTICES

> “You have a broad array of metrics companies use to issue metrics, disclosures, or goals against. But I don’t have a historical process today – there’s no ESG ledger or ESG SOX-like controls.”
>
> \- ESG CONTROLLER AT A LARGE PUBLIC COMPANY

This graphic below speaks to an infrastructure problem facing companies seeking to comply with the SEC’s proposal. This infrastructure will come in time, but for now, the lack of historical precedent leaves many managing as best they can as they lead their organizations forward. Yet the lack of historical precedence upon which to refer and the diversity of practice hinder, somewhat, the development of best practices. In the meantime, finance professionals will have to work tightly with those in-house who have been leading the sustainability reporting efforts and work together with them to apply best practices from the world of finance to constructing a robust ESG reporting process.

> “I think most of us are working within an as-best-as-we-can basis as opposed to the rigorous, controlled financial-regulated standard processes.”
>
> \- CONTROLLER AT A LARGE PUBLIC COMPANY

How do you expect the finance function’s role at your organization will evolve as a result of the SEC’s climate proposal? *(Multiple Responses Permitted)*



The above chart depicts the magnitude of change that ESG represents for the finance function. While the approaches finance functions are taking with regard to ESG reporting differ somewhat at the micro level, the data displays some emergence of practices at the macro level.

Namely, with regard to finance functions taking an increased role on controls, oversight (e.g., preparation of data, ESG disclosures), preparing disclosures related to the SEC's proposal, and in reviewing ESG disclosures. It's unsurprising that finance is taking an increased role in these areas given the competencies finance professionals have obtained in these areas, albeit with financial data.

As one finance professional noted, "who better knows our data, our data systems, our platforms, and how they all merge together than finance?"

That said, the dearth of finance professionals with ESG acumen is a significant challenge for companies. On this topic, one Senior Director, ESG Reporting commented, "What we were talking about is having enough people and in-house expertise to understand what kind of data you need and how it will be used before you can even go in and figure out what's available, what's not available, right?"

The work in the short term then is to reskill and upskill finance professionals with regard to ESG topics, especially those who are most critical based on the companies' goals as it pertains to their internal and external reporting. All this amounts to a functional ESG upskilling strategy, in which the organization and deployment thereof will have significant, long-term impacts at the employee level with regard to the obtaining of competencies and the evolution of finance and ESG roles moving forward.

> "There's just not enough people in finance who understand how to create a GHG inventory and the methodologies, the assumptions, and how it applies to your individual organization."
>
> - CONTROLLER AT A LARGE PUBLIC COMPANY

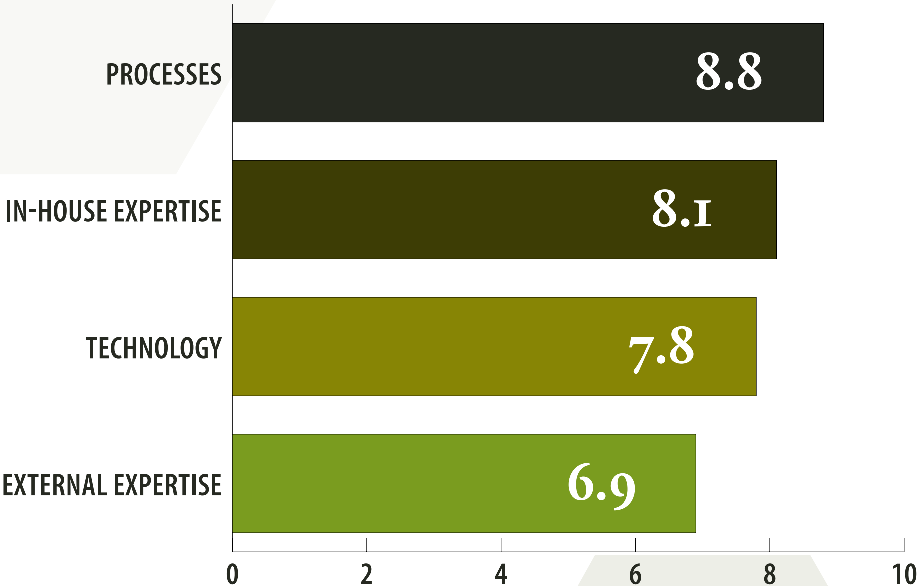
THE ESG CONTROLLER

With finance functions starting to increase their efforts to support organizational ESG reporting, many have determined that someone from the controllership needs to own its involvement with ESG reporting, and that the ESG controller has become that person for many finance functions. Relatedly, one controller at a large public company noted, "some teams may need new ESG controllers that help oversee and shepherd the processes, because you have got a lot of non-finance people who are in the process that haven't been taught to think about things in the way that we have. These people will need to focus on training, documentation, and that everyone knows the end goal."

One Senior Director, ESG Reporting explained that his organization evaluated the ESG metrics on which they reported and determined that they wanted to implement SOX-like controls around at least those metrics that were rated as tier one. Conversations like this led to the development of his role and created new roles and new people on his team to put systems and processes in place to support the ability to report on tier-one ESG metrics, with a SOX-like control providing the desired levels of accuracy and rigor.

> We need a new class of finance professionals – someone who has the control mindset that comes from audit, but also someone who is able to apply their intellectual abilities to really understand how you can advance sustainability reporting. You want someone who can look at this information where you are using new metrics to measure dimensions of value that we weren't before. Given their skillset, finance professionals are a natural fit. Take our head of sustainability accounting policy for example; she has a fantastic audit and technical accounting background, in addition to the logical and analytical skills we see in really sharp finance professionals. It is the combination of these skills that make her successful in understanding the broader notions of sustainability and applying her control expertise, her accounting expertise in a logical way as it relates to TCFD standards or the greenhouse gas protocol.
>
> - ESG CONTROLLER AT A LARGE PUBLIC COMPANY

On a scale of 1 to 10, how important are each of the following categories as it relates to addressing your organization's ESG reporting? *(A ranking of 10 indicates that it is extremely important and a ranking of 0 indicates that it is not at all important)*

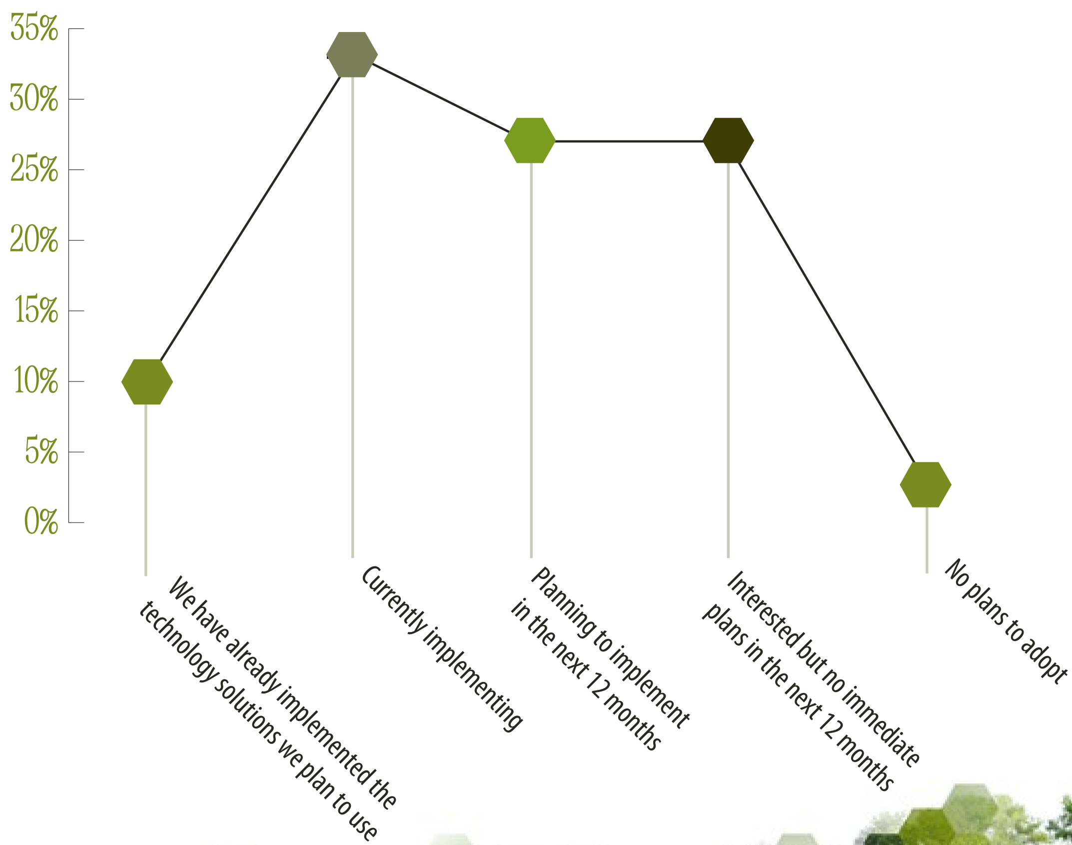


With an 8.84/10 rating, finance professionals rated the processes as the most important item as it related to addressing their organization's ESG reporting, with several interviews echoing a common refrain that they needed to get the right processes in place, then everything else would follow.

In speaking about her organization's ESG digital transformation journey, one controller said, "We moved quickly to get our full team in place, but we're still developing processes and systems, and we are certainly supplementing these with consultant resources, so it's not all internally supplied." This controller further explained that they have brought on more headcount than they expect to retain in the long-term given the lift associated with building processes and controls; once these processes and controls are established and documented, there won't be as much of a need when it comes to maintenance and incremental adjustments. Moreover, her team is leveraging external consultants to fill the gaps as her team works to document processes, identify controls, and implement systems.

With the importance of in-house expertise and the key challenges to addressing the finance-ESG talent gap described above, technology, with a 7.84/10 rating, is rated as the third-most critical category. As depicted in the chart below, 70% of organizations are at least planning to implement technology solutions to meet the increased reporting requirements from the SEC's climate proposal. Interestingly, the data in the chart closely tracks the technology adoption curve, with 10% of companies ahead of the game, representing the early adopters, 33% representing the early majority, 54% planning to implement within the next 12 months, representing the pragmatists and conservatives, and 3% with no plans, representing the laggards

What are your firm's plans to adopt technology solutions to meet increased reporting requirements from the SEC's climate proposal?



Those who participated in the research interviews were seeking different attributes and had different perspectives on ESG digital transformation, which is to be expected given the relative nascency of ESG reporting and the diversity of approaches in other areas of ESG reporting. One assistant controller noted that her team is currently searching for a broader ESG tool that can aggregate all of their ESG data as well as provide the controls and reporting functionalities.

> "For technology, we are certainly adding to our ESG environment, in particular with regard to the climate calculator-type space."
>
> - CONTROLLER AT A LARGE PUBLIC COMPANY

For now, her team is taking a portfolio approach to ESG systems that complement one another and augment what her organization already has in place. Still, others are addressing climate data first and seeking to ensure that their climate data possesses the qualities of accuracy, auditability, completeness, and repeatability by seeking to create a single source of truth for their ESG data.

In the meantime, one controller at a large public company reported looking at ESG platforms that can manage workflows and house the data in one source, in order to ensure that all internally and externally reporting on metrics of one type (e.g., scope 2 emissions) would be derived from the same source. Relatedly, leveraging existing platforms (e.g., shared calendars) that promote inter- and cross-functional collaboration represents a promising solution to visualize and reduce bottlenecks and ensure that all the relevant professionals are working together toward the organization's ESG reporting goals.

CONCLUSION

The SEC's climate proposal represents a generational undertaking. While some see it merely as a compliance exercise, there are many whose careers have already been profoundly impacted. Beyond the creation of ESG-related finance roles, we are seeing finance professionals having the opportunity to elevate and broaden the type of business conversations they take part in as they elucidate new measures of value. As it stands now, one controller explained, "so we are going to be in charge of finding that data, helping to ensure that it's controlled, that it is auditable, and that it is more easily accessible. But it is going to be quite a journey.

APPENDIX

CHART PAGE 4

	Number of Companies	Average Beginning TCFD Reporting Date	Percent of Companies Reporting on TCFD	Percent committed to a short-term SBTi
Communication Services	25	10/31/20	16%	48%
Consumer Discretionary	58	6/11/21	17%	47%
Consumer Staples	33	12/8/20	12%	76%
Energy	21	2/15/21	5%	10%
Financials	66	1/25/19	9%	29%
Health Care	65	11/15/20	11%	45%
Industrials	71	9/10/20	10%	34%
Information Technology	76	7/26/21	8%	43%
Materials	28	3/23/21	7%	54%
Real Estate	31	2/12/21	10%	68%
Utilities	29	9/5/20	14%	21%
Total	***503***	***8/13/20***	***11%***	***42%***

CHART PAGE 9

As your organization makes changes to meet the reporting requirements from the SEC's climate proposal, which of the following do you anticipate representing the biggest challenge(s)? (Please select the top 3 most challenging)

Difficulty obtaining scope 3 data	77%
Complexity of our climate data	58%
Lack of staff	32%
Inadequate technology/software to measure emissions	29%
Lack of expertise in-house	26%
Lack of budget	16%
Lack of executive/board-level support	3%

ABOUT PERSEFONI

Persefoni's Climate Management & Accounting Platform (CMAP) provides businesses, financial institutions, and governmental agencies the software fabric for managing their organization's climate-related data, disclosures, and performance with the same level of rigor and confidence as their financial reporting systems. The company's software enables users to simplify the calculation of their carbon footprint, identify decarbonization strategies and perform climate trajectory modeling aligned to temperature rise scenarios set forth by the Paris agreement, and benchmark their impact by region, sector, and/or peer groups.

Persefoni is a proud signatory of both The Climate Pledge and Carbon Call to achieve a net zero carbon future by 2040. For more information about Persefoni, please visit https://persefoni.com/

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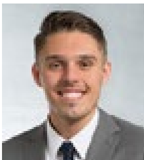
AUTHORS



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