ESG: POSITIONING A COMPANY FOR SUCCESS

By **JOHN W. CITTI, CPA, CTP**
IMPACTING NONPROFITS LLC

With recent anti-ESG (environmental, social and governance) legislative efforts in many states and backlash against diversity programs, one might think the ESG movement is losing steam. However, a closer look tells a different story.

A February 2023 survey by Ernst & Young of 500 C-suite executives at Fortune 1,000 companies found that 87% consider ESG very or extremely important to their organization. The Business of Sustainability Index found 69% of consumers say environmental impact is important in purchasing decisions.

Here's a look at ways CPAs can position their company or their clients for ESG at the state, national and corporate levels.

NEW JERSEY

The Regional Greenhouse Gas Initiative (RGGI) is a cap-and-trade program covering 11 northeastern states that has reduced the region's power sector CO2 emissions by 50% since implementation in 2008. In July 2023, Governor Phil Murphy's administration released its plan for investing New Jersey's RGGI funds for the 2023-2025 period.

The plan directs 41% of funding to decarbonize buildings, 49% to transition the state's transportation system to electric power and 10% to improve forests and coastal areas. And it focuses on lower-income and minority communities that have disproportionately suffered environmental harm.

Municipalities, for-profits and nonprofits can obtain funding for electric vehicles and charging stations, sequestering carbon, reducing building emissions, as well as enhancing urban forest canopy, water quality, coastal habitats and other projects. Information is available at dep.nj.gov.

NATIONAL

Swedish activist Greta Thunberg is not the only young person championing the environment. High school students in Montana won a landmark lawsuit this summer against Montana by arguing the state's support of the fossil fuel industry violated their constitutional right to a clean and healthful environment. Harvard Law professor Richard Lazarus says the ruling's full impact is not known yet, but it's the first time a U.S. court has ruled against a government for violating a constitutional right based on climate change. The ruling could influence the growing number of environmental lawsuits around the country.

Perhaps the starkest example of the country's political division is the divergent ESG policies by red and blue states. Several blue states, including New Jersey, have introduced or passed legislation to enhance board diversity and divest state pension funds from fossil fuel and firearms companies. Conversely, many red states prohibit their state government from doing business with financial institutions that integrate ESG into their business decisions or avoid fossil fuel or firearms companies. National companies are left wondering what to do.

The law firm Ropes & Gray advises financial institutions to avoid overstating or understating how ESG factors into their business decisions. Companies should monitor developments in states and ensure their written policies and marketing documents do not violate new anti-ESG rules.

The Securities and Exchange Commission (SEC) is expected to release its final required climate-related disclosure rules by the end of 2023. The reporting burden is on public companies, but since SEC-regulated companies may be required to report their upstream and downstream impact, the rules can affect private companies in a public company's supply chain.

While ESG initiatives and reporting are significant burdens to clients, they are also an opportunity for sales, recruitment and expense savings. For example, the Business of Sustainability Index found that 66% of consumers would pay more for

sustainable products. Benevity reports that 95% of job seekers compare employer diversity efforts and consulting firm McKinsey & Co. found that strong ESG policies can significantly reduce operating expenses.

CORPORATIONS

As companies commit to ambitious ESG targets, they wrestle with how best to manage initiatives and reporting. EY reports that 86% of companies surveyed assigned oversight to the board along with delegating responsibility to existing board committees and creating a new ESG committee. Over half of S&P 500 companies use ESG metrics in their executive compensation plans and many integrate ESG into their strategic plans. CPAs can guide their company or clients to the best governance structure for their culture and business.

After the murder of George Floyd, a Black man in Minneapolis, chief diversity officer positions grew by 169% from 2019 to 2022 as employers built their diversity programs. However, ABC News reports a reversal, as one in three diversity, equity and inclusion (DEI) professionals lost their job in 2022. Global leadership consulting firm DDI found that companies lacking DEI programs are up 33%.

Does this mean employers are pulling back from their DEI goals? Gene Marks, a speaker at the NJCPA Annual Convention & Expo, wrote in *The Hill* that employers are no less committed to diversity. Instead, they are determining the best size and structure for their programs.

Surveys validate this view. The EY survey cited above found that 87% of executives support a diverse workforce. The University of North Carolina at Pembroke reports that gender-diverse teams outperform others by up to 50%.

When it comes to financing, Green Bonds and Sustainability Linked Loans (SLL) have become popular tools in recent years. While proceeds from Green Bonds are invested in environmental or sustainability projects, SLL proceeds can be used for general corporate purposes if one or more key performance metrics relate to sustainability performance targets. Failure to meet targets does not trigger a default but can result in higher interest rates. Some loan agreements reduce the interest rate if targets are met.

These loans prove lender and borrower commitments to the environment, earning goodwill from stakeholders. Borrowers receive the added benefit of lower interest expense if metrics are met. Risks exist as well: both sides can be accused of "greenwashing" (inaccurate claims of positive environmental impact) if the metrics are not aggressive enough, which can damage reputations and trigger stakeholder litigation and regulatory scrutiny. The SEC is particularly keen on investigating potential greenwashing.

CPAs can advise their company or clients of the pros and cons of these facilities and structure appropriate metrics.

As companies position their organizations to meet the challenges and opportunities presented by ESG, they need assistance with regulatory compliance, capital allocation, risk management, projections and financing — all within the CPA skill set.

John W. Citti, CPA, CTP, is the managing member of Impacting Nonprofits LLC. He is a member of the NJCPA Nonprofit Interest Group and can be reached at john@impactingnonprofits.com.

READ MORE

ESG KNOWLEDGE HUB
njcpa.org/hub/esg

LEARN MORE

Dec. 18 and additional dates, Live Webinar
INTRODUCTION TO SUSTAINABILITY ACCOUNTING

Dec. 22 and additional dates, Live Webinar
ACCOUNTING & AUDITING FOR ESG

Dec. 28 and additional dates, Live Webinar
GETTING STARTED WITH ESG

Jan. 15 and additional dates, Live Webinar
THE IMPACT OF ESG MATTERS ON FINANCIAL REPORTING AND AUDITS

njcpa.org/events