B8027 – MBA – Fall 2022

Challenges in Measurement & Disclosure of Environmental, Social and Governance Data

Professor:

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In 2019, the Business Roundtable redefinition of the purpose of a corporation to promote "an economy that serves all Americans" created a vivid debate on whether corporations should primarily be dedicated to shareholders or stakeholders. In the post Covid-19 era, the role of firms in the debate pertaining to tackling climate change and social challenges is accelerating, with a fast-growing allocation of capital towards funds and companies promoting "ESG".

Despite the recent surge of popularity about ESG investing, little is known about firms' ESG footprints. In fact, in his 2020 letter to CEOs "A Fundamental Reshaping of Finance", Blackrock CEO Larry Fink focused primarily on sustainability and climate change, a key factor in companies' long-term prospects. A novel point of the letter was the call upon portfolio companies to improve their sustainability-related disclosures accompanied by a threat to vote against managers and directors that would fail to effectively disclose ESG elements. This echoes the statement made by Gillian Tett, the Financial Times Chair of Editorial Board and US Editor-at-large published a video on April 2020 in which she states that "as the responsible investing business continues to grow, so too will the need for financial transparency and consistency. **Auditors, rating agency experts and corporate accountants** could have a far greater impact than any activist".

Today, firms face key challenges as they need to (1) identity the relevant non-financial and financial information demanded by their stakeholders and (2) find a way to measure and disclose this information properly and credibly. To date, no universal standards exist but the industry is organizing itself around both private and public fast-changing initiatives. This course aims at providing a framework to think about the current challenges and opportunities to measure and disclose environment, social and governance information.

Course description

Broadly speaking, the goal of this class is to provide students with both the theoretical and practical knowledge to understand the current challenges in accounting for firms' ESG goals. In this rapidly evolving field, the course will be structured in four modules:

- Module #1 reviews the need for sustainability accounting and provide an overview of the providers of ESG metrics and the limits of current **aggregated ESG data**.
- Module #2 present various **market-based mechanisms** to create ESG standards
- Module #3 discusses **regulatory initiatives** to create ESG information for listed firms
- Module #4 departs from non-financial disclosure and discuss the limits of current **accounting standards** and introduce new developments to incorporate ESG characteristics into traditional financial statements.

While ESG encompasses a vast body of topics, this class will draw examples and discuss about a diverse set of issues ESG, including carbon emissions, employees pay, employees labor-safety, and the role of consumers' NGO, based on short examples or cases spanning different firms in different industries (e.g., wholesale, aviation) and different countries (e.g., USA, France, Japan). This half-term course is composed of a mix of lectures, cases and online or in-person interventions by high profile industry guest speakers. The lectures are motivated by (1) rigorous recent academic studies drawing from the accounting literature, but also borrowing from adjacent fields including economics, finance, law and strategy and (2) practitioners notes and examples.

Who should take this course?

Students should take this course if they are interested in ESG in general and/or if they expect to use disclosure of non-financial information in their career. This is particularly relevant for students who want to pursue careers in finance (e.g., investment banking) where firms' ESG footprint is becoming a scrutinized factor in M&A or investment decisions in general, as well as students going to careers in consulting where corporate decisions will more and more be benchmark against their ESG implications.

Please note that this course does not require students to have pre-existing knowledge about ESG.

Course Materials

There is no required textbook for this course. I will post all course materials on Canvas. These will include cases, handouts, and presentation slides. I will also use Canvas to post assignments and make announcements.

Evaluation Method

Your grade will consist of a final project (60%), class participation (25%), and three assignments (15%). The three assignments consist of three case submission assignments.

Here is a description of each graded category:

- Final project (60%) – In the final project, you will conduct an assessment of the ESG disclosure of a firm. Students will need to critically assess the quality of the ratings as well as the current reporting framework chosen by the firm for the reporting of non-financial information (e.g., is it following the UN guidelines and use some existing voluntary standards?), offer improvements in material elements that should be taken in consideration or better measured, and ideally contact the firm's IR department to understand the firm's position in tackling (or not) these issues in coming years. You may work on this project alone, or in a team of up to three students. The project is due exactly a week after the last day of class: I will give you additional information on this project partway through the course. It is a Type **A** or Type **B** assignment.

- The Class participation (25%) – Class participation is essential for the course to ensure that one learns from the experiences of others and meaningfully contributes to the overall discussion. Grading for class participation will be based on factors such as quality of participation, interest, level of participation, and attendance. Everyone should come to class having read the materials assigned and prepared the cases.

- Assignments (15%) – There will be case submission assignments for each case covered in the course. All case assignments are mandatory. You may work on these assignments alone, or in a team of two. The assignments are due before the class dedicated to the case has started. The case submission are Type **A** or Type **B** assignments.

In accordance with Columbia Business School's policy, all grade appeals should be made in writing.

Course Outline (Indicative – Refer to Canvas for details)

Module 1: Scoping the problem & aggregated ESG Data (Sessions 1 - 2)

Block #1: What is the problem?

Learning objectives:

- Introduce the shareholder theory versus stakeholder theory
- Highlight the assumptions behind the shareholder theory and discuss the need to account for externalities
- Define a sustainable organization and provide an "ESG" framework (United Nation framework)
- Early evidence on the performance of ESG strategies and the need for measurement

Block #2: Who provides ESG ratings?

- Introduce the main providers of ESG ratings (MSCI, Sustainalytics, CDP, DJSI)
- **Guest speaker: Michael Disabato, MSCI ESG ratings expert**

Block #3: The limits of global ESG ratings?

Learning objectives:

- Discuss the sources of disagreement between ratings agencies: measurement, scope and weight issues
- Discuss how ratings can be "gamed" by companies
- Detailed example using the reports and ratings of **Philip Morris Inc**

Module 2: Market solutions to measuring and disclosing ESG Data (Sessions 3 – 6)

Block #4: Overview of market mechanism

- Discuss the trade-off between public standards and private standards
- Overview of the accounting & information economics literature on private standards
- Overview of the different private reporting initiatives and their (partial) relations to E/S/G
    - Examples: **SASB, IIRC, GRI**
    - Example: **H&M sustainability reporting**

Block #5: Case study "Danone: Adopting Integrated Reporting or Not" (Case Assignment)

- To identify internal and external stakeholders and articulate their interests and incentives
- To illustrate the lack of effectiveness of firms internally developed carbon standards
- To identify the different frameworks available to Danone for reporting non-financial information and the decision-making to opting for one particular reporting framework.

Block #6: Case study – "JetBlue: & the adoption of SASB standards (Case Assignment)

- To illustrate the financial materiality of sustainability metrics
- Discuss how sustainability could be part of a firm's strategy
- To showcase the need for standardized metrics and how metrics can be used to drive change
- To examine the change management process leading to sustainability leadership
- To examine how disclosure strategy might drive changes in ownership structure

Block #7: Example of private initiatives: The emergence of the SASB & the Value Reporting Foundation

Guest speaker - Jeffrey Hales, Professor of accounting & SASB Chair

- Discuss the trade-off between public standards and private standards
- History and objectives of the Sustainability Accounting Standards Board (SASB)
- Introduction to the industry-specific SASB standards
- Trends in adoption of the SASB standards and future avenues
- Overview of the research on the adoption and consequences of SASB standards

Module 3: Regulatory solutions to measuring and disclosing ESG Data (Sessions 7 – 9)

Block #8: Disclosure regulation of individual ESG data at the firm level

- Discussion on regulating firms' behavior versus regulating disclosure related firms' behavior
- Discuss the role of the saliency of non-financial disclosure and more generally the conditions under which a disclosure regulation might achieve its objectives
- Discuss the role of standardization of non-financial disclosure through regulations
- Discuss the risk of reallocation from entities subject to disclosure regulation to other entities
    - Example: public firms to private firms; regulated countries to unregulated countries
- Discuss the evolution of regulations around the world, in particular the **European Union non-financial reporting directives** and the US **SEC** updates.

Block #9: Example on the use of regulatory disclosure to change firms labor behavior

- Discussion about four regulatory interventions, two on "E" and two on "S" considerations:
    - USA Federal EPA GHG Reporting Program (carbon emission)
    - UK Company Act (carbon emission)
    - USA Federal mine-safety disclosure
    - USA State: California Transaparency in Supply Chain Act
        - Discussion on the use by KnowtheChain of disclosure from the CTSC
            - From third-party scrutiny to shareholders' proposals
- For each regulation, we will evaluate the objective of the law, the reporting entity (e.g, company, plant), the target audience, the challenges to process the information and the success (or not) of the regulation using dedicated academic studies and practical examples

Block #10: Disclosure regulation of ESG data at the capital provider level

- Discussion of the benefits of reporting at the capital provider level
    - Ability for consumers / shareholders to express their sustainability preferences to a few large banks / asset managers
- Discussion of the role of disclosure regulation by banks to induce ESG changes at the portfolio firm level
- Evaluation of the pioneering 2015 French regulation - Article "173"
    - Scope, real effects, limits
- Evaluation of the EU SDFR directive

Module 4: From disclosure to financial statements (Sessions 10 – 12)

Block #11: ESG in today's financial statements

- The role of intangibles and goodwill in currently capturing firms' ESG characteristics
- How can ESG considerations hit the preparation of financial statements today, examples including:
    - Estimating the net realized value of inventory
    - Estimating the useful life of an assets
    - Estimating the fair value of non-financial assets
    - Accounting for assets retirement
- Discussion of the missing asset and liabilities pertaining to social and environmental actions

Block #12: Rethinking Financial Statements

- Environmental & Social P&L
- How to design a system that helps decision-making in assessing the consequences of corporate actions not only for financial and physical capital but also for human, social and natural capital.
    - Example of the Weighted-account initiatives
- How to use accounting standards to change firms' incentives
    - Example: rethinking the expensing versus capitalizing debate for CAPEX in order to promote the investment in uncertain "green" technologies

Block #13: Case study – "True Value at Ambuja Cement" (Case Assignment)

Block #14: The role of auditing in ESG

- From consulting to verification
- The value of voluntary audits

Guest Speaker: Elodie Timmermans, sustainability expert at EY