ESG – Risks and Opportunities for Professional Service Firms

Environmental, social and governance (ESG) issues are increasingly important to global companies, and professional service firms are not exempt. To address material ESG risks and opportunities, firms are establishing, refining and articulating corporate ESG policies and practices, while also developing specific ESG practice areas (often advisory or attestation services) for their clients. A strong ESG strategy offers opportunities for long-term sustainable growth and resilience, however, the complexity and evolving nature of these issues adds to the challenges and risks facing firms.

ESG At A Glance

ESG is the consideration of material environmental, social and governance risks and opportunities alongside traditional financial factors. It is used to assess the long-term viability, resilience and financial prospects of an organization, and is also increasingly influencing the capital and insurance markets.

ESG issues vary by industry and even by company. Several factors that are material to professional service firms and/or their clients include, among others:

- Environmental issues both at the corporate level and in the client roster;
- Social factors such as diversity and inclusion, employee engagement and retention, workplace health and wellness, and social license to operate;
- Governance issues, including board diversity and independence, executive compensation, corporate accountability, and policies and practices on bribery and corruption, lobbying and political contributions.

Reporting on ESG policies, practices and metrics communicates how well, or how poorly, a company is managing ESG risks and opportunities, demonstrates commitment to the environment and society, and manages shareholder expectations. When executed well, a company's ESG strategy should highlight an interdependent value chain among stakeholders.

ESG's Increasing Importance

Although not new, ESG has become a key focus in the last 12 to 18 months, in part driven by growing awareness of environmental and equity and inclusion issues, as well as the health and wellness impacts of COVID-19. The events of 2020 highlighted how ESG risks can become financial issues overnight.

Investors and other financial market participants are increasingly scrutinizing how companies address ESG. The rapid growth in sustainable investing, which considers the impacts of ESG factors on investment strategies while aiming to make positive environmental and societal change in the long-term, is one factor driving the development of ESG reporting.

Release Date: August 2021

As a result, demand for professional services in this area is growing as stakeholders seek to improve the availability and reliability of ESG information for decision making. There are now more than 650 voluntary and mandatory ESG regulatory and disclosure requirements globally, with more coming online in the next 12 months. This increases ESG reporting requirements and, while there has been some progress in developing a global approach to ESG reporting, at present requirements remain fragmented. Some regulators have also issued specific guidance for auditors to provide ESG-related services.

> *The overall value of assets under management (AUM) at funds leveraging environmental, social and governance (ESG) data has increased significantly over the past four years, from US$22.9 trillion in 2016 to over US$40 trillion in 2020. With ESG data integration becoming prevalent at asset managers, this growth trajectory is unlikely to slow any time soon.*
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> OPIMAS. Retrieved from http://www.opimas.com/research/570/detail/ [August 2021]

ESG Risks

While obviously a business opportunity for many firms, liability may be created as professional service firms incorporate ESG offerings into existing services (such as audit and tax work performed by accounting firms for their clients) and grow their stand-alone ESG-specific services. Disclosures can potentially become a source of litigation risk. **Accounting firms** may also face regulatory enforcement risk when providing attestation services for the ESG information that forms part of a submission under securities laws.

Professional service firms may also face scrutiny when reporting on internal ESG issues. Failure to adequately identify, address and report material ESG issues could raise the possibility of direct financial impacts as well as negative reputational consequences that could result in long-term harm to brands.

To date, climate and diversity-related claims and disputes have targeted corporations, their directors and boards. Allegations have related to fraud, misrepresentation, misleading disclosures, breach of fiduciary duties and failure of boards to adequately factor climate change risk into investment decisions. Litigation in these areas is on the rise and, although many rulings have been favorable to defendants, the potential liability, including the costs of defending and investigating such claims, is a significant risk. There is also an expectation that the cases will begin to involve other parties, including accountants, **consultants** and **lawyers**.

Aon offers a wide range of **solutions to address and manage ESG issues**. These solutions, which include consulting and advisory services, are tailored to individual needs and objectives.

Contact

If you would like to discuss any of the issues raised in this article,
please contact **Audrey Jenner** or **Rona E Davis**.

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