

# **MSCI ESG Ratings Methodology: Accounting Key Issue**

MSCI ESG Research LLC

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## Introduction

This document provides essential information on the components of the Accounting Key Issue to enable users of ESG Ratings to understand how our outputs are determined. Accounting is a Key Issue in the Governance Pillar of the MSCI ESG Ratings model. Companies are evaluated on the appointment of the external audit firm, the findings of its audit report, and on other accounting events as an indicator of potential accounting risk.

For additional details on the MSCI ESG Ratings Model, refer to Section 2, Data, ratings and scores, of “ESG Ratings Methodology.”

**Exhibit 1: MSCI ESG Key Issue hierarchy**

3 Pillars	10 Themes	33 ESG Key Issues
Environmental	Climate Change	Carbon Emissions
		Climate Change Vulnerability
		Financing Environmental Impact
		Product Carbon Footprint
	Natural Capital	Biodiversity & Land Use
		Raw Material Sourcing
		Water Stress
	Pollution & Waste	Electronic Waste
		Packaging Material & Waste
		Toxic Emissions & Waste
	Environmental Opportunities	Opportunities in Clean Tech
		Opportunities in Green Building
Opportunities in Renewable Energy		
Social	Human Capital	Health & Safety
		Human Capital Development
		Labor Management
		Supply Chain Labor Standards
	Product Liability	Chemical Safety
		Consumer Financial Protection
		Privacy & Data Security
		Product Safety & Quality
	Stakeholder Opposition	Responsible Investment
		Community Relations
	Social Opportunities	Controversial Sourcing
		Access to Finance
		Access to Health Care
		Opportunities in Nutrition & Health

3 Pillars	10 Themes	33 ESG Key Issues
Governance	Corporate Governance	Board
		Pay
		Ownership & Control
	Corporate Behavior	Accounting
		Business Ethics
		Tax Transparency

## Accounting Key Issue Score

The Key Issue Score is based on the aggregation of the following Key Metrics using the methodology described in Section 3.5.4, Calculating Governance Scores, of “ESG Ratings Methodology.”

Each Key Metric evaluates a specific aspect of a company’s governance risk profile.

Some Key Metrics are relevant only to companies with specific governance characteristics stemming from ownership type, management structure or other factors. Companies are distinguished by the type of issuer, indicated by the scope of each Key Metric below.

## Key Metrics

### Category: Accounting Events

#### Accounting Investigations Key Metric

**Definition**

Has the company announced an internal investigation into its accounting or come under investigation from a regulatory body, or been subject to fine, settlement or conviction for issues related to its accounting practices? Or has the company’s auditor come under investigation for issues related to its work on the audit of the company?

Flagged if yes. The duration of the flag is dependent on the severity assessment.

**Scope:** All issuers

**Typical Scoring Contribution:** Variable, based on event severity: Minor 0.0, Moderate 0.3, Severe 0.5, Very Severe 1.0

## Auditor Report Concerns Key Metric

### Definition

Has the company's independent auditor expressed a qualified, adverse or disclaimer of opinion, expressed concerns via an emphasis of matter paragraph, have concerns been identified in respect of the auditor's ability to present an independent opinion, or has the auditor been changed in a manner that may raise concerns for investors?

Flagged if yes within the past year.

*This metric is based on the report of the external auditor disclosed in the annual financial statements and highlights any qualified auditor opinion or concerns raised in an emphasis of matter inserted by the auditor. Purely informational emphasis of matter paragraphs are not flagged. This metric is also evaluated on the basis of news reports or regulatory filings, including those that relate to interim or quarterly financial statements in which the auditors have raised concerns.*

**Scope:** All issuers

**Typical Scoring Deduction:** Variable, based on type of auditor opinion/emphasis of matter and whether there are consecutive years of concerns.

Range: 0.5 to 3.0

Average: 0.776

## Internal Controls Key Metric

### Definition

Has there been evidence of material weakness in the company's internal control systems?

Flagged if yes. The duration of the flag is dependent on the severity assessment.

*The event tags or categories used to create this flag include the following: material weakness in internal controls or SOX 404 violations. Outside of the U.S., this metric is evaluated based on the assessment of the audit committee in relation to the effectiveness of internal control.*

**Scope:** All issuers

**Typical Scoring Deduction:** Variable, based on event severity: Minor 0.0, Moderate 0.1, Severe 0.2, Very Severe 0.4

## Restatements or Special Charges Key Metric

### Definition

Has the company had to restate previously published financial statements due to fraud, error or the mis-application of accounting standards?

Or has the company announced or reported special charges or write-offs that might raise questions as to the stewardship of the company by the board?

Flagged if yes. The duration of the flag is dependent on the severity assessment.

**Scope:** All issuers

**Typical Scoring Deduction:** Variable, based on event severity: Minor 0.0, Moderate 0.3, Severe 0.5, Very Severe 1.0

## Late Filings Key Metric

### Definition

Is the company currently experiencing a reporting delay or is it late in the filing of its quarterly, half-year (or interim) or annual reports, or its annual proxy/notice of annual meeting of shareholders?

Flagged if yes. The flag will be removed once the case is assessed as concluded.

**Scope:** All issuers

**Typical Scoring Deduction:** 0.2

## Category: Auditor Independence

### Auditor Independence Key Metric

#### Definition

Did the company pay its external audit firm less for audit and audit-related services than for other services in the last fiscal year?

Flagged if yes.

*This metric uses auditor fees schedules to flag companies where such independence may have been compromised.*

**Scope:** All issuers

**Typical Scoring Deduction:** 0.5

## Auditor Tenure Key Metric

### Definition

Is there evidence that the external audit firm has served in excess of 20 consecutive years?

Flagged if yes.

**Scope:** All issuers

**Typical Scoring Deduction:** Variable based on tenure:

0.3 if > 50 years

0.2 if > 20 years

0.1 if not disclosed

Average 0.137

## Revision History

In June 2022, three Key Metrics derived from accounting ratios (Revenue Recognition, Expense Recognition and Asset-Liability Valuation) were removed.

In June 2023, the Auditor Tenure Key Metric was revised to be more specific.

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