

# **MSCI ESG Accounting Governance Risk Methodology Summary Guide for Corporate Issuers**

MSCI ESG Research LLC

ESG Issuer Communications

**March 2021**

**Contents**

Introduction.....	3
MSCI ESG Accounting Governance Risk .....	3
Frequently Asked Questions .....	5

## INTRODUCTION

ESG Issuer Communications is the main point of contact for all companies in the MSCI ESG Research coverage universe. This guidance document provides a summary overview of the Accounting Governance Risk (AGR) methodology, and a list of frequently asked questions about this methodology. For questions pertaining to other MSCI ESG Research reports, or our company interaction process in general, please refer to our [General FAQ](#). This guidance document will be updated periodically.

## MSCI ESG ACCOUNTING GOVERNANCE RISK (AGR) OVERVIEW

The MSCI ESG Accounting Governance Risk (AGR) scores are model driven, based on purely statistical assessments, with no direct analyst input<sup>1</sup>.

The AGR ratings model is used to assess the quality and consistency of companies' financial reporting and accounting practices. They can also help identify potential accounting irregularities that may go undetected by traditional research methods. AGR Ratings are available to subscribers as an independent scoring model and has also been used to strengthen the Accounting key issue assessments included in MSCI's ESG Ratings, and in our standalone Governance Metrics reports.

**Risk assessment:** Three categories of accounting metrics and two of non-accounting metrics form the highest level of the AGR taxonomy, as listed below. A statistical process selected these metrics from hundreds examined as being potentially valuable in identifying accounting concerns. Accounting governance profiles of companies that have been subject to SEC Accounting and Auditing Enforcements are examined to analyze the financial reporting characteristics of companies exhibiting accounting irregularities. These cases are used to identify the ratios most frequently associated with accounting problems pursued by the SEC.

---

<sup>1</sup> For additional information please see the MSCI Accounting Governance Risk (AGR) Methodology, available online via ESG Manager, or by request.

- **Accounting Risks**

We look for anomalies in corporate accounting statements to help identify potential accounting irregularities or a lack of transparency. We examine about 40 metrics that we classify into three broad accounting risk categories: Revenue Recognition, Expense Recognition, and Asset-Liability Valuation.

- The most common issues we identify under the Revenue Recognition grouping are premature recognition of sales, the inclusion of one-time nonrecurring items in sales without acknowledging their unusual nature, fictitious revenues, and some related party transactions. Revenue Recognition concerns are among the most common issues cited in SEC Accounting and Auditing Enforcement actions brought against companies.
- Expense Recognition concerns include deferred expenses that improve margins and the capitalizing of expenses that should be expensed immediately.
- Asset-Liability Valuation issues involve over-valuing either short or long-term assets, understating, or even omitting liabilities, and the problematic treatment of reserves. In this category we also look at the quality of assets, and the degree of leverage and liquidity.

- **Governance Risks**

An additional 10 metrics address key aspects of corporate governance and behavior, broadening the scope of our analysis. These non-accounting metrics are classified under Corporate Governance Events and High-Risk Events for the AGR score but are not included in the accounting key issue used in our ESG Ratings Corporate Governance theme, or in our separate Governance Metrics reports.

**Metrics:** We examine each metric for unusual values along two analytic dimensions. Our metrics operations compare a company's ratios to that of industry peers within the same region, and also consider the year-over-year percentage changes. Metrics contributing to our AGR scores include many of the traditional fundamental ratios used to evaluate corporate strength and profitability, as well as forensic ratios. Outlying values along either of these dimensions, involving any of these operations, are flagged and form the basis of

the AGR score. Each metric is assigned a weight by the statistical model, which in turn define the relative importance of each metric in the overall AGR score.

## **FREQUENTLY ASKED QUESTIONS**

- 1.1 We note the following statement in the ESG Ratings report: “we have flagged this company for potential concerns regarding revenue, expense recognition and asset-liability valuation ratios (based on our quantitative assessment).” What is this quantitative assessment?**

Some of the accounting metrics used in our ESG Ratings are derived from the MSCI ESG Accounting Governance & Risk (AGR) ratings model. In general, companies are flagged by AGR for potential accounting concerns whenever certain ratios, as defined by the AGR model are considered “extreme” as defined by the AGR methodology (top or bottom 20% of peer group). While the full AGR model is not included in our ESG Ratings, you may access your company’s AGR report directly on the ESG Issuer Communications Portal. More information about the AGR methodology is included in these reports. Please note that there is no direct analyst input included in these reports – they are based on a purely quantitative, statistical model. The AGR product provides statistical ratings, which are not the result of a subjective analysis, and there is no opportunity for the overriding of specific AGR model flags. We will, however, address any factual errors that can be identified.

- 1.2 There are several events listed in the AGR report – what are the impact of these on our ESG assessments?**

In a recent update to the AGR methodology, M&A, Divestiture, and Restructuring events no longer influence the AGR score. For the moment, we will continue to show these items on the “AGR Events” page as they support past flagging for recent scores. Please note, however, that these events were never part of the AGR-derived inputs that flow into the Corporate Governance portion of our *ESG Ratings*, which use only the AGR accounting ratios.

**1.3 You note that the financials used in the report come from Refinitiv (formerly called Thomson Reuters.) Can you provide more details?**

We use Thomson Reuters Fundamentals (Knowledge Direct product) for accounting items, and their Significant Developments and Officers & Directors feeds for several of the non-accounting metrics.

## Contact us

esgclientservice@msci.com

### AMERICAS

Americas	1 888 588 4567 *
Atlanta	+ 1 404 551 3212
Boston	+ 1 617 532 0920
Chicago	+ 1 312 675 0545
Monterrey	+ 52 81 1253 4020
New York	+ 1 212 804 3901
San Francisco	+ 1 415 836 8800
São Paulo	+ 55 11 3706 1360
Toronto	+ 1 416 628 1007

### EUROPE, MIDDLE EAST & AFRICA

Cape Town	+ 27 21 673 0100
Frankfurt	+ 49 69 133 859 00
Geneva	+ 41 22 817 9777
London	+ 44 20 7618 2222
Milan	+ 39 02 5849 0415
Paris	0800 91 59 17 *

### ASIA PACIFIC

China North	10800 852 1032 *
China South	10800 152 1032 *
Hong Kong	+ 852 2844 9333
Mumbai	+ 91 22 6784 9160
Seoul	00798 8521 3392 *
Singapore	800 852 3749 *
Sydney	+ 61 2 9033 9333
Taipei	008 0112 7513 *
Thailand	0018 0015 6207 7181 *
Tokyo	+ 81 3 5290 1555

\* = toll free

## About MSCI

MSCI is a leading provider of critical decision support tools and services for the global investment community. With over 50 years of expertise in research, data and technology, we power better investment decisions by enabling clients to understand and analyze key drivers of risk and return and confidently build more effective portfolios. We create industry-leading research-enhanced solutions that clients use to gain insight into and improve transparency across the investment process.

## About MSCI ESG Research Products and Services

MSCI ESG Research products and services are provided by MSCI ESG Research LLC, and are designed to provide in-depth research, ratings and analysis of environmental, social and governance-related business practices to companies worldwide. ESG ratings, data and analysis from MSCI ESG Research LLC. are also used in the construction of the MSCI ESG Indexes. MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc.

To learn more, please visit [www.msci.com](http://www.msci.com)

## Notice and disclaimer

This document and all of the information contained in it, including without limitation all text, data, graphs, charts (collectively, the "Information") is the property of MSCI Inc. or its subsidiaries (collectively, "MSCI"), or MSCI's licensors, direct or indirect suppliers or any third party involved in making or compiling any Information (collectively, with MSCI, the "Information Providers") and is provided for informational purposes only. The Information may not be modified, reverse-engineered, reproduced or redisseminated in whole or in part without prior written permission from MSCI. All rights in the Information are reserved by MSCI and/or its Information Providers.

The Information may not be used to create derivative works or to verify or correct other data or information. For example (but without limitation), the Information may not be used to create indexes, databases, risk models, analytics, software, or in connection with the issuing, offering, sponsoring, managing or marketing of any securities, portfolios, financial products or other investment vehicles utilizing or based on, linked to, tracking or otherwise derived from the Information or any other MSCI data, information, products or services.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information. NONE OF THE INFORMATION PROVIDERS MAKES ANY EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION (OR THE RESULTS TO BE OBTAINED BY THE USE THEREOF), AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, EACH INFORMATION PROVIDER EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.

Without limiting any of the foregoing and to the maximum extent permitted by applicable law, in no event shall any Information Provider have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits) or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not be applicable law be excluded or limited, including without limitation (as applicable), any liability for death or personal injury to the extent that such injury results from the negligence or willful default of itself, its servants, agents or sub-contractors.

Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.

The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons.

None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), any security, financial product or other investment vehicle or any trading strategy.

It is not possible to invest directly in an index. Exposure to an asset class or trading strategy or other category represented by an index is only available through third party investable instruments (if any) based on that index. MSCI does not issue, sponsor, endorse, market, offer, review or otherwise express any opinion regarding any fund, ETF, derivative or other security, investment, financial product or trading strategy that is based on, linked to or seeks to provide an investment return related to the performance of any MSCI index (collectively, "Index Linked Investments"). MSCI makes no assurance that any Index Linked Investments will accurately track index performance or provide positive investment returns. MSCI Inc. is not an investment adviser or fiduciary and MSCI makes no representation regarding the advisability of investing in any Index Linked Investments.

Index returns do not represent the results of actual trading of investable assets/securities. MSCI maintains and calculates indexes, but does not manage actual assets. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the index or Index Linked Investments. The imposition of these fees and charges would cause the performance of an Index Linked Investment to be different than the MSCI index performance.

The Information may contain back tested data. Back-tested performance is not actual performance, but is hypothetical. There are frequently material differences between back tested performance results and actual results subsequently achieved by any investment strategy.

Constituents of MSCI equity indexes are listed companies, which are included in or excluded from the indexes according to the application of the relevant index methodologies. Accordingly, constituents in MSCI equity indexes may include MSCI Inc., clients of MSCI or suppliers to MSCI. Inclusion of a security within an MSCI index is not a recommendation by MSCI to buy, sell, or hold such security, nor is it considered to be investment advice.

Data and information produced by various affiliates of MSCI Inc., including MSCI ESG Research LLC and Barra LLC, may be used in calculating certain MSCI indexes. More information can be found in the relevant index methodologies on [www.msci.com](http://www.msci.com).

MSCI receives compensation in connection with licensing its indexes to third parties. MSCI Inc.'s revenue includes fees based on assets in Index Linked Investments. Information can be found in MSCI Inc.'s company filings on the Investor Relations section of [www.msci.com](http://www.msci.com).

MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc. Except with respect to any applicable products or services from MSCI ESG Research, neither MSCI nor any of its products or services recommends, endorses, approves or otherwise expresses any opinion regarding any issuer, securities, financial products or instruments or trading strategies and MSCI's products or services are not intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Issuers mentioned or included in any MSCI ESG Research materials may include MSCI Inc., clients of MSCI or suppliers to MSCI, and may also purchase research or other products or services from MSCI ESG Research. MSCI ESG Research materials, including materials utilized in any MSCI ESG Indexes or other products, have not been submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body.

Any use of or access to products, services or information of MSCI requires a license from MSCI. MSCI, Barra, RiskMetrics, IPD and other MSCI brands and product names are the trademarks, service marks, or registered trademarks of MSCI or its subsidiaries in the United States and other jurisdictions. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of MSCI and Standard & Poor's. "Global Industry Classification Standard (GICS)" is a service mark of MSCI and Standard & Poor's.

MIFID2/MIFIR notice: MSCI ESG Research LLC does not distribute or act as an intermediary for financial instruments or structured deposits, nor does it deal on its own account, provide execution services for others or manage client accounts. No MSCI ESG Research product or service supports, promotes or is intended to support or promote any such activity. MSCI ESG Research is an independent provider of ESG data, reports and ratings based on published methodologies and available to clients on a subscription basis. We do not provide custom or one-off ratings or recommendations of securities or other financial instruments upon request.

For information about how MSCI collects and uses personal data, please refer to our Privacy Notice at <https://www.msci.com/privacy-pledge>.