# Update on the ESG Landscape

**And the Impact to Internal Audit** 



## **Speakers**





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### **Overview of Today's Discussion**





# **ESG Trends**



### The ESG Landscape

Here are some market developments that support our need to move ahead in this area:



External pressures from investors and from other businesses for **ESG disclosure and performance** have and will continue to increase.

**Sustainability organizations (Standard setters and Frameworks)** are collaborating to align standards and will only become **more influential** in this collaboration.

**86%** of employees prefer to support or work for companies that **care about the same issues they do**.

Customers are becoming more interested in **buying from companies** that are focused on sustainability.

Potential for **decreased costs** through better resource usage. Better stewardship of natural resources can decrease spend.

Sustainability **disclosure requirements** are **evolving** around the world. Sustainability related disclosures are becoming more common in both separate reports and in SEC filings.



- The OCC, federal agency that oversees the execution of laws relating to national banks, announces Chief Climate Risk Officer
- SEC proposes mandatory climate-related disclosure.
   CSRD finalized in January of 2023 which will have implications here in the states
- Third party assurance of ESG reporting gaining traction
- Legal and litigation risk rising for inaccuracies and fund labeling
- It is predicted that this year, there will be increased scrutiny over these generalized statements and stricter litigation will be created and enforced. There will be a legal crackdown on Net-zero pledges, the wording in advertisements, and risk disclosure failures
  - Keurig fined \$3 million and ordered to change the misleading recycling claims on its packaging
  - A class-action lawsuit was filed against Hefty Recycling Bags for the claim that its bags are "designed to handle all types of recyclables".
- Stakeholder Engagement, Materiality Assessment and Industry lens is key
- Ultimately must become part of strategy



### ESG: Other Relevant Updates



### **Poll Question #1**

### What is your level of knowledge of ESG?

A.	Very familiar,	I live for ESG
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- B. Somewhat familiar
- C. Not familiar but eager to learn
- D. ESG??



### **Poll Question #2**

### What is the current state of your organization's ESG journey?

- B. We just got started discussing ESG
- C. We have made progress and now reported publicly
- D. We have reported for multiple years
- E. Don't know



# Regulatory Landscape for ESG



### **SEC Proposal: Climate-Related Disclosure\***

- Expands and revises Regulation S-K (registration statements and annual reports) and Regulation S-X (annual audited financial statements).
- Creates new Subpart in Form 10-K on climate-related matters, following the 4
  Pillars of TCFD-Governance, Strategy, Risk Management and metrics and targets.
- Requires disclosure of Scope 1 and 2 emissions evolving from unaudited to limited to reasonable assurance over a three-year period, with selected requirements on Scope 3 emissions.
  - Creates new audited financial statement footnote on certain disaggregated climate-related financial statement metrics.





#### **CSRD**

#### The proposed rule would apply to the following:

- · EU companies that fall into one of the three categories:
  - (i) Large Companies (>250 Employees, Turnover of €40 Million, Total Assets > €20 Million),
  - (ii) Parent of a "Large Group",
  - (iii) Listed SMEs
- Non-EU Companies that:
  - (i) have generated a net turnover of more than €150 million in the EU for each of the last two consecutive years and have an EU subsidiary that falls into the "large" company category or the listed SME category applicable to EU companies as set out above or an EU branch that generated a net turnover of more than €40 million in the preceding financial year;
  - (ii) Non-EU companies listed on an EU-Regulated Market

#### **Timeline for Impacted Undertakings**

January 2023 – CSRD entered into force

2025 - EU undertakings that meet the criteria for large undertakings but whose securities are not admitted to trading on an EU regulated market. Non-EU undertakings whose securities are admitted to trading on an EU regulated market and who meet the criteria for large undertakings but have less than 500 employees. Report Due 2026

2028 - Non-EU undertakings who do not have securities listed on an EU regulated market, but which have (i) a turnover at group level of over €150m in the EU and (ii) a subsidiary that is a large undertaking or a branch having a net turnover of at least €40m in the EU

January 2023

2024

2025

2026

2028

2024 - EU and non-EU undertakings whose securities are admitted to trading on an EU regulated market and that satisfy both: >250 employees, net turnover that exceeds €40m. Report Due 2025

2026 All other EU and non-EU undertakings whose securities are listed on an EU regulated market (i.e. those who are neither large nor micro undertakings – see above).

#### **Key Takeaways**

Applies to Large Companies:

- >250 Employees
- Turnover of €40 Million
- Total Assets > €20 Million

Applies to Parent of a "Large Group"
Listed SMEs

Reporting Requirements - Information must be clearly identifiable in a section of the management report and will cover sustainability matters

Undertakings will be required to report on sustainability according to mandatory reporting standards

Mandatory requirement for review of disclosures and assurance by a statutory auditor or independent assurance services provider that there has been no material misstatement in company's disclosures

Issuers are required to make public the annual report, at latest, four months after the end of each fiscal year and continue to make available for at least 10 years

Requirement to prepare annual financial reports in XHTML format and mark sustainability information in financial statements and management reports with a digital 'tag' so that it is machine readable

Non-EU undertakings subject to the CSRD will be permitted to report on sustainability matters using 'equivalent standards' to those set out under the CSRD



# Regulations – What Corporate Finance Should Be Doing

Performing a gap analysis against existing disclosures

**Evaluate internal and external resourcing** 

**Evaluation of your internal controls** 

Revisit climate-related risk oversight and management practices

**Evaluation of your board on climate expertise** 

Materiality assessment with climate as a focus

**Coordinate with your external auditor** 

Look at Scope 1, 2 & 3 and how much effort that could be





### **Poll Question #3**

### Our ESG reporting process is...

- B. Combination of spreadsheet and existing ERP data
- C. Leverages a specific ESG reporting application or module
- D Utilizes an ESG data metrics/hub center, data warehouse or data lake
- E. Don't know



# Internal Audit's Role in ESG



### **Establishing a Sustainability Program**

Organizations need to know **relevant sustainability & ESG topics** and analyze their **impact on the organization and of the organization**. This comprises their impact on impact on society and the environment and the risks and opportunities related to sustainability & ESG. In order to get a holistic view and have a real value according to your unique business and purpose, six activity areas must be considered.



#### **STRATEGY & PLANNING**

Understand the organization, its sustainability maturity, context, competitors and stakeholders, and identify material topics.



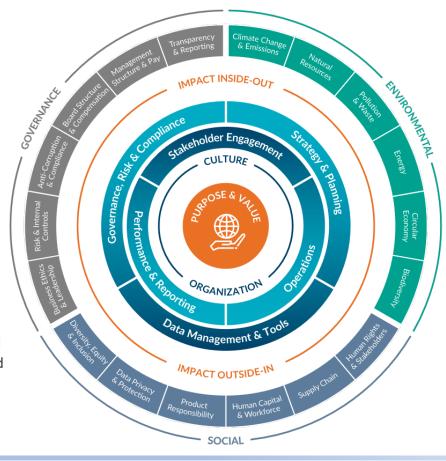
#### STAKEHOLDER ENGAGEMENT

Define communication and interaction with external and internal stakeholders. Continuously engage with the relevant stakeholders and meet their expectations.



#### **DATA MANAGEMENT & TOOLS**

Identify relevant data & tools for the analysis and management of material sustainability topics and build the data collection, aggregation, and validation processes.





#### **GOVERNANCE, RISK & COMPLIANCE**

Ensure your organization manages its risks, complies with all relevant regulations and provides insights for improved decisionmaking.



#### **PERFORMANCE & REPORTING**

Define and implement an infrastructure to monitor your sustainability performance; provide comprehensive and transparent reporting; and excel in ESG indices, ratings and rankings.



#### **OPERATIONS**

Assess, design, and implement capabilities that improve your operations and support the achievement of value chain sustainability.



### **Internal Audits Over Sustainability**





### **Data Validation**

Procedure Procedure	Tier-1	Tier-2	Tier-3	Tier-4
Review data for reasonableness via inquiry and/or inspection	٧	٧	٧	٧
Fie-out of data point to supporting documentation	Х	٧	٧	٧
Test supporting documentation for clerical accuracy / reperformance	Х	٧	٧	٧
Verify information disclosed is appropriately presented	X	٧	٧	V
Reconcile supporting documentation to underlying source file(s)	X	Х	٧	V
/erify completeness and accuracy of source files through sample testing	X	Х	X	٧



### **Applying COSO**

ACHIEVING EFFECTIVE INTERNAL CONTROL OVER SUSTAINABILITY REPORTING (ICSR):
BUILDING TRUST AND CONFIDENCE THROUGH THE COSO INTERNAL CONTROL—INTEGRATED FRAMEWOR

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**Control Environment** 

**Risk Assessment** 

**Control Activities** 

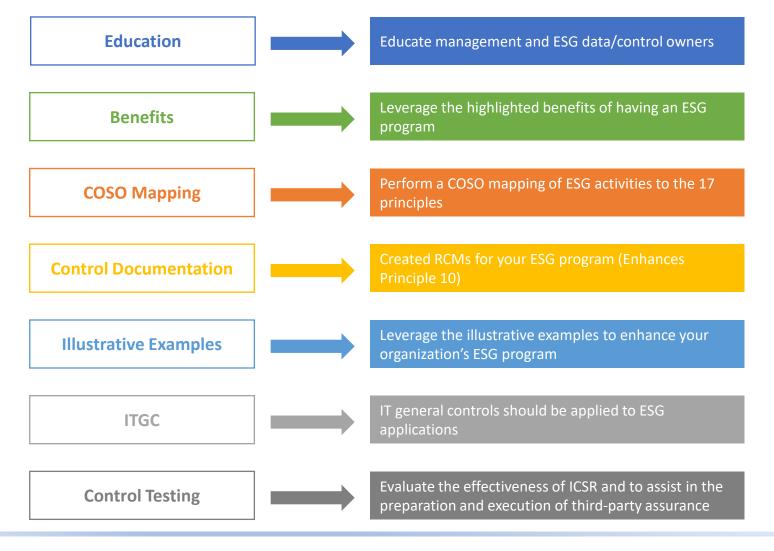
Information & Communication

**Monitoring Activities** 

- 1. Demonstrates commitment to integrity and ethical values
- Exercises oversight responsibility
- 3. Establishes structure, authority and responsibility
- 4. Demonstrates commitment to competence
- 5. Enforces accountability
- 5. Specifies suitable objectives
- 7. Identifies and analyzes risk
- 8. Assesses fraud risk
- 9. Identifies and analyzes significant change
- 10. Selects and develops control activities
- 11. Selects and develops general controls over technology
- 12. Deploys through policies and procedures
- 13. Uses relevant information
- 14. Communicates internally
- 15. Communicates externally
- 16. Conducts ongoing and/or separate evaluations
- 17. Evaluates and communicates deficiencies



### Seven Practical Uses for the COSO ESG Guidance





### **Approach to Internal Controls**

A similar approach used for Internal Controls over Financial Reporting can be applied to ESG performance data and reporting



#### **Determine Objectives**

Establish, document, and communicate internal and external ESG reporting objectives, as well as establish accounting principles for specific ESG factors to ensure that they are implemented, and risks in preparing the ESG data are assessed.





#### **Identify Risks and Key Control Activities**

Determine the scope of control by assessing the relevant qualitative and quantitative risk factors for key material topics that could endanger the achievement of ESG reporting goals. Identify and document key control activities in the form of an ESG RCM





#### **Implement Control Activities**

Implement specific control activities to manage or mitigate risk of misstatement of key material topics. These procedures will support data measurement, management, and integrity of data used in reporting.





#### **Evaluate Effectiveness**

Once internal controls over ESG data are established, design and operational effectiveness should be evaluated on a regular basis to confirm that the documented procedures are operating as intended.





### **Poll Question #4**

#### What is the state of your ESG internal controls?

- B. Just getting started
- C. Completed with documentation and design
- D. Completed design and operational effectiveness testing
- E. Wait... what?



### **Types of ESG Internal Controls**

#### **Entity Level**

- Annually, the ESG Steering Committee reviews the metrics that will be managed for the year to verify that the subjects meet the organizational goals and strategies. Review is evidenced via sign off on the ESG Steering Committee Annual meeting minutes.
- Annually, an ESG materiality assessment is performed by the Steering Committee to evaluate and understand if there are material subjects that are relevant and impact the organization.
- The company has a formal ESG policy. When there are significant changes to the ESG policy, a communication notice is sent to all employees and managers.



#### **Transactional**

- As needed, the data owner performs a review of all metrics and disclosures contained in the report to supporting evidence. This tie-out is reviewed by the manager and evidenced via tick marks, comments and sign-off of respective preparers. Materiality thresholds for allowable variances in reconciliations are defined, and reconciliation materiality values are reviewed by appropriate management.
- Quarterly, all KPIs are prepared by the designated KPI preparer. ESG KPIs are reconciled to source data and approved by the KPI owner. Approval is explicitly evidenced via signature or email approval.

# \$

#### Monitoring

- Metrics to be presented in public ESG reports, on company websites, or in company marketing materials are reviewed and approved by the ESG Committee. The rationale is documented and maintained.
- ESG report designs are reviewed and approved and align with business objectives and requirements. A checklist is prepared by the manager and reviewed to verify presentation in accordance with these objectives.
- As needed, ESG Disclosures, including KPI data, are independently prepared and reviewed prior to issuance. Prior to disclosure, significant disclosures are discussed with the ESG Committee.



### **Commitments**

Microsoft will be carbon negative by 2030

### Walmart Pledges Zero Emissions By 2040

Bank of America Announces \$1 Billion/4-Year Commitment to Support Economic Opportunity Initiatives

#### The Climate Pledge

This is Amazon's commitment to be net-zero carbon by 2040. In addition, we are on a path to powering our operations with 100% renewable energy by 2025.

#### **OUR ENVIRONMENTAL FOOTPRINT REDUCTION GOALS**

INDICATOR	TARGET	TARGET YEAR	2021 TOTAL PERFORMANCE	LEGACY HUNTINGTON 2021 PERFORMANCE
GHG Emissions (Scope 1 & Scope 2 location- based) 1,2,3,4	31% reduction 41% reduction	2027 2037	35% reduction 35% reduction	46% reduction 46% reduction
Renewable Energy	50% of electricity usage	2035	1% of electricity usage	1% of electricity usage



# **Challenges Auditing ESG**



### Challenges

#### **ESG Program Management**

Executive support and tone at the top

ESG strategy aligning with business objectives

Data quality and availability, including system management

Regulatory landscape

#### **Internal Audit**

Guidance for metric calculations

Frequent changes to metrics and goals

Information and control owners are new to formalization needed for external reporting

Documented risks and controls



Q&A



