



Update on the ESG Landscape

And the Impact to Internal Audit



The Institute of
Internal Auditors

August 2023

Speakers

Anthony Chalker



**Managing Director,
Protiviti**

Steve Wang



**Managing Director,
Protiviti**



Overview of Today's Discussion

1

ESG Trends

2

Regulatory
Landscape for
ESG

3

Internal Audit's
Role in ESG

4

Challenges
Auditing ESG

5

Q&A



ESG Trends



The Institute of
Internal Auditors

The ESG Landscape

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



- 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
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?

- | | |
|-----------|--|
| A. | ESG is not on our agenda, yet |
| 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



The Institute of
Internal Auditors

SEC Proposal: Climate-Related Disclosure*

1

- Expands and revises Regulation S-K (registration statements and annual reports) and Regulation S-X (annual audited financial statements).

2

- 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.

3

- 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.

4

- 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

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

Timeline for Impacted Undertakings

January 2023 – CSRD entered into force

January 2023

2024

2025

2026

2028

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

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).

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...

A.

Primarily manual with spreadsheets

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



The Institute of
Internal Auditors

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.



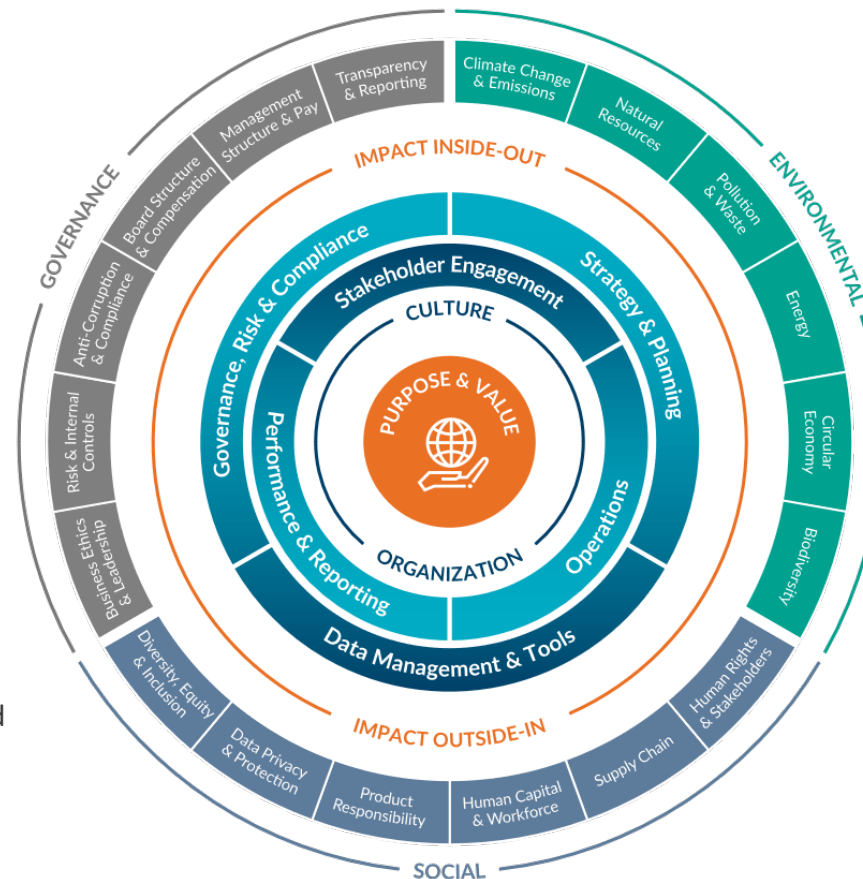
STAKEHOLDER ENGAGEMENT

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 decision-making.



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.



The Institute of
Internal Auditors

Elevating Impact

Internal Audits Over Sustainability



Data Validation

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



Applying COSO

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

TABLE OF CONTENTS

Nonauthoritative, Interpretative Publication.....	4
Preface by COSO Chairs: The Call to Action.....	5
Executive Summary.....	7
Acknowledgements.....	9
Recommendations: Building Trust and Confidence in Sustainable Business Information.....	10
Background.....	15
What Is COSO?.....	20
CIF-2013: The Basics.....	22
Applying ICIF-2013 to Nonfinancial Information.....	24
Sustainable Business Information: Goals and Users.....	25
Regulatory Bodies and Standard Setters that Oversee Sustainable Business Information.....	29
Delivery of ESG Reporting.....	33
Differences between Conventional Financial Reporting and ESG Reporting.....	34
Applying the ICIF-2013 Principles to Sustainability: Building Internal Control over Sustainability Reporting (ICSR).....	40
Component: Control Environment.....	43
1. Demonstrates commitment to integrity and ethical values.....	33
2. Exercises board of directors' oversight responsibilities.....	37
3. Establishes structures, authority, and responsibilities.....	41
4. Demonstrates commitment to competent human resources.....	44
5. Enforces accountability.....	46
Component: Risk Assessment.....	49
6. Specifies suitable objectives.....	49
7. Identifies and analyzes risks to meeting sustainable business objectives.....	55
8. Assesses fraud risk.....	60
9. Identifies and analyzes significant changes and emerging trends.....	64
Component: Control Activities.....	68
10. Selects and develops control activities.....	68
11. Selects and develops general controls over technology.....	71
12. Deploys oversight through policies and procedures.....	77
Component: Information and Communication.....	81
13. Uses relevant information.....	81
14. Communicates internally.....	85
15. Communicates externally.....	88
Component: Monitoring Activities.....	92
16. Conducts ongoing and/or separate evaluations.....	92
17. Evaluates and communicates deficiencies.....	95

Control Environment

1. Demonstrates commitment to integrity and ethical values
2. Exercises oversight responsibility
3. Establishes structure, authority and responsibility
4. Demonstrates commitment to competence
5. Enforces accountability

Risk Assessment

6. Specifies suitable objectives
7. Identifies and analyzes risk
8. Assesses fraud risk
9. Identifies and analyzes significant change

Control Activities

10. Selects and develops control activities
11. Selects and develops general controls over technology
12. Deploys through policies and procedures

Information & Communication

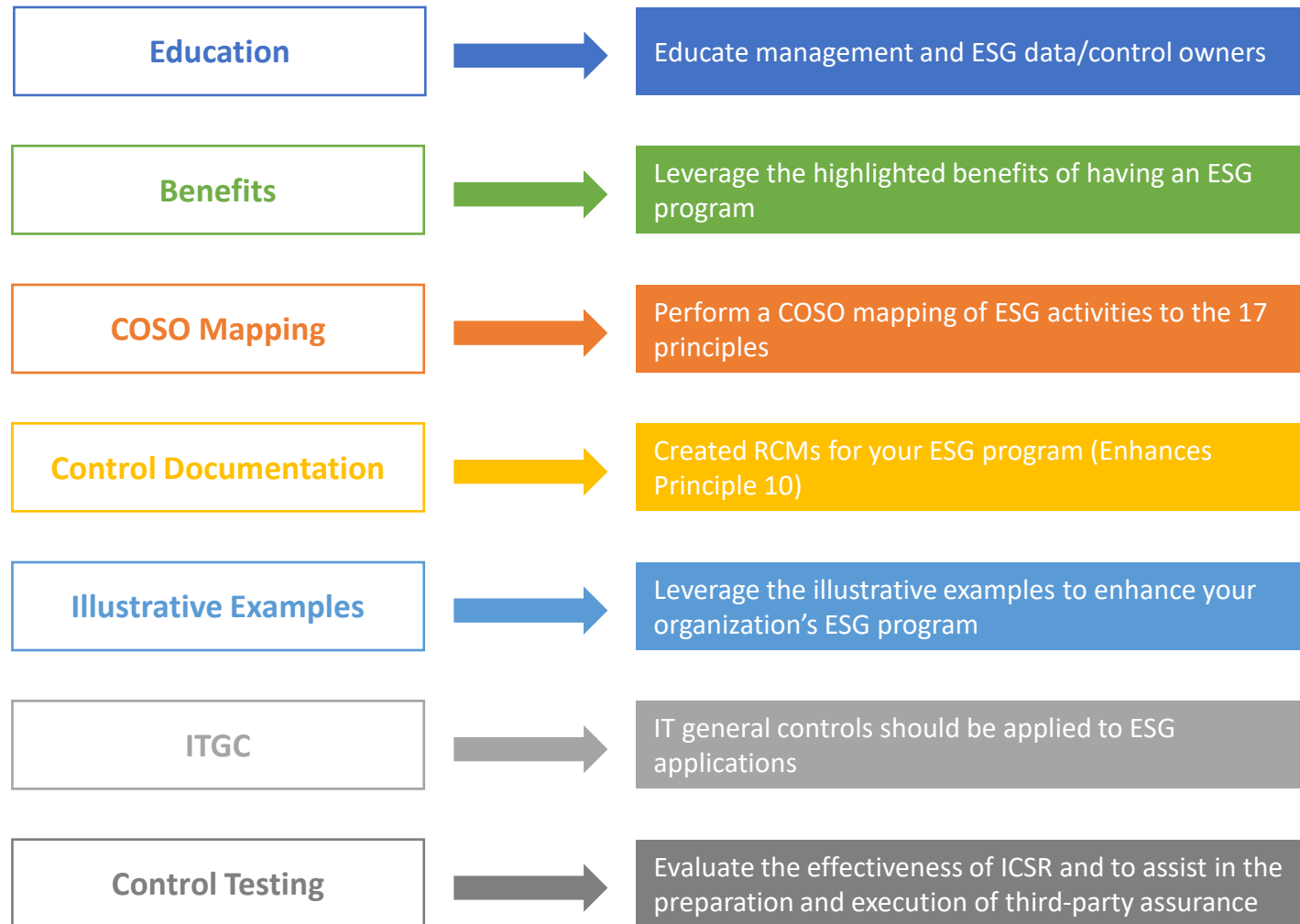
13. Uses relevant information
14. Communicates internally
15. Communicates externally

Monitoring Activities

16. Conducts ongoing and/or separate evaluations
17. Evaluates and communicates deficiencies

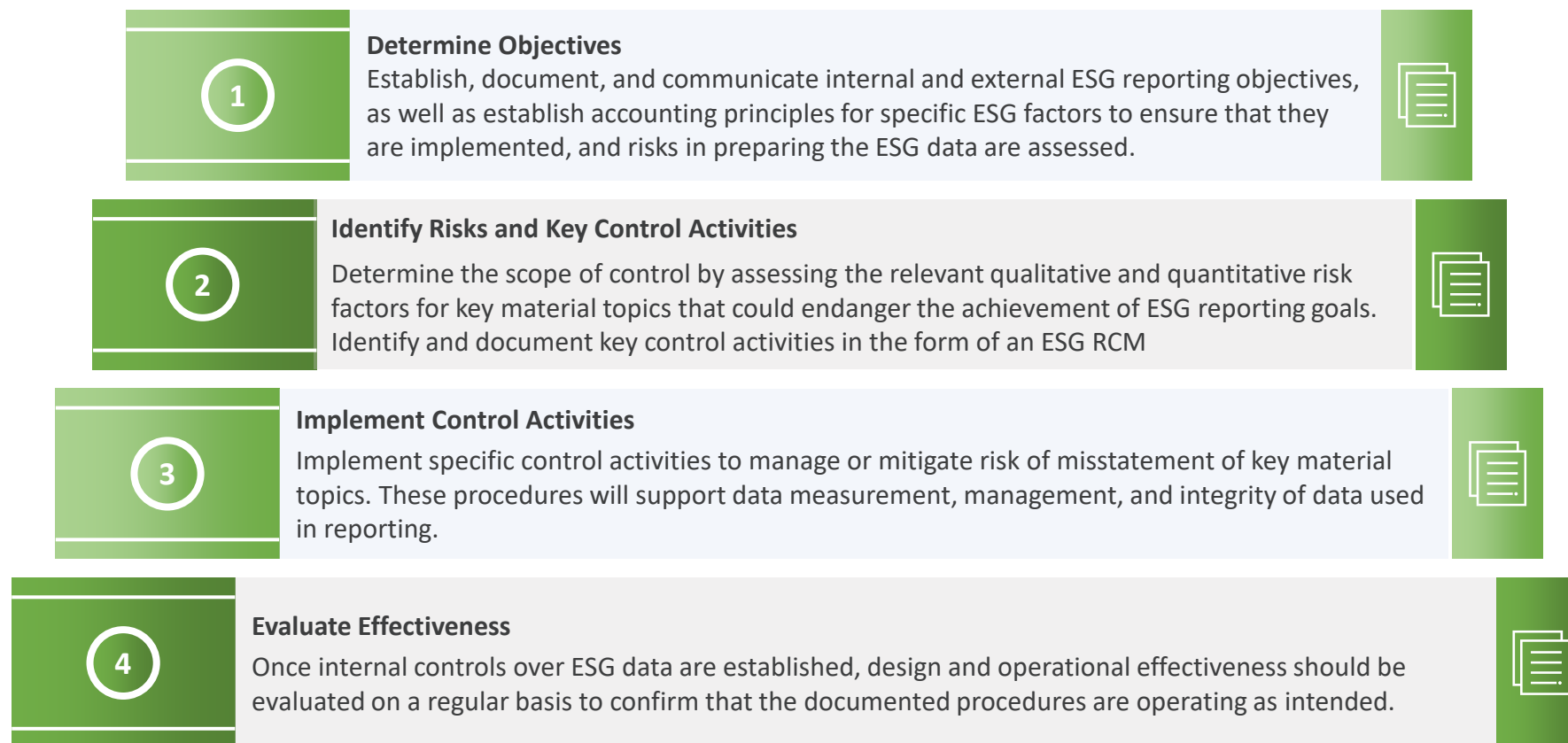


Seven Practical Uses for the COSO ESG Guidance



Approach to Internal Controls

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



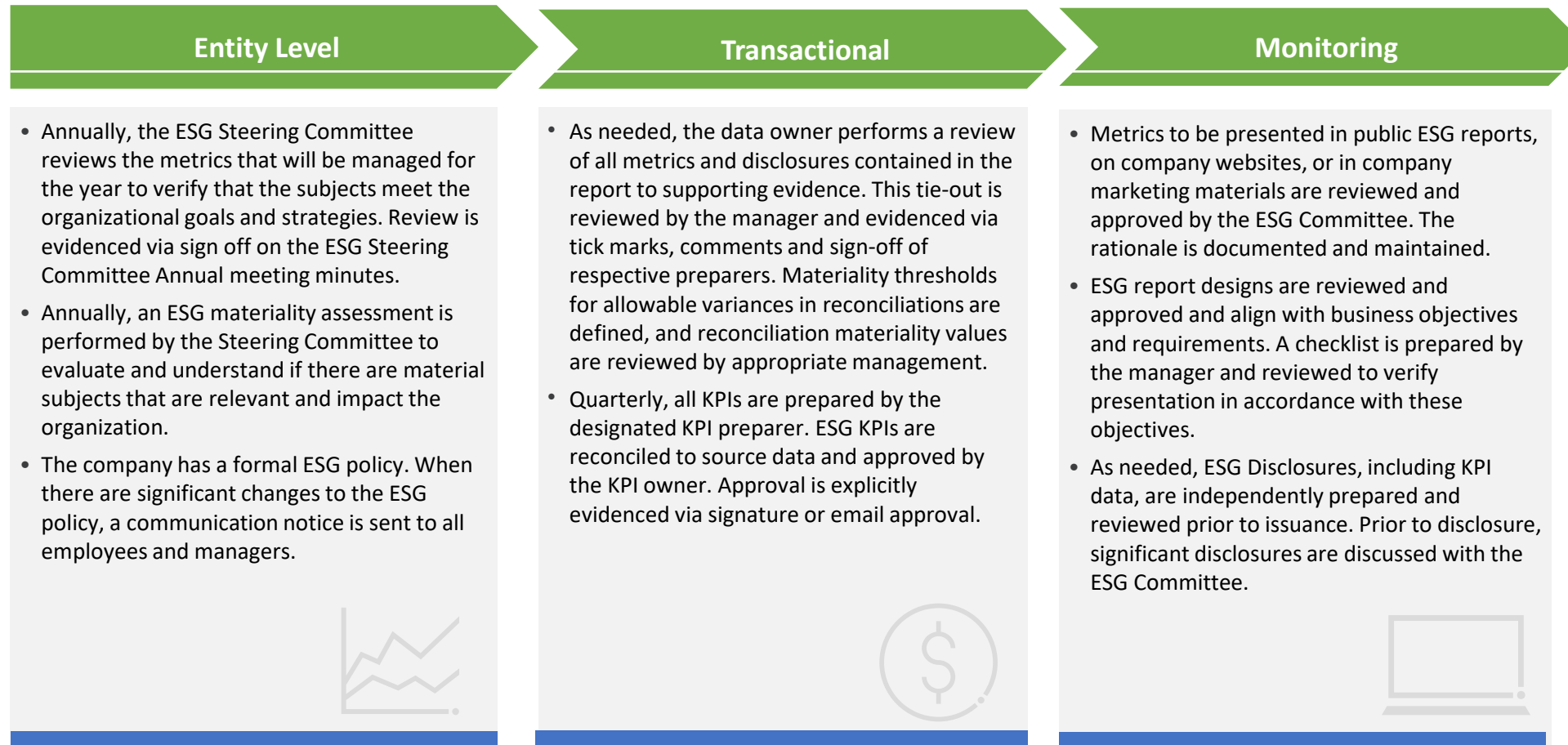
Poll Question #4

What is the state of your ESG internal controls?

A.	Not yet started on the formalization
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



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



The Institute of
Internal Auditors

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



The Institute of
Internal Auditors