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Environmental, Social, and Governance (ESG) Landscape Overview

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ESG Landscape Overview

The ESG Landscape

Environmental, Social, Governance (ESG) is framed as the universe of topics that reflect areas of performance management around impacts and dependencies of the business on society and the environment.

Environment

- Greenhouse gas (GHG) emissions
- Air quality
- Energy management
- Water and waste management
- Waste and hazardous materials management
- Ecological impacts

Business model & innovation

- Product design and lifecycle management
- Business model resilience
- Materials sourcing and efficiency
- Supply chain management
- Physical impacts of climate change

Human capital

- Labor practices
- Employee health and safety
- Employee engagement, diversity, and inclusion

Social capital

- Human rights and community relations
- Customer privacy
- Data security
- Access and affordability
- Product quality and safety
- Customer welfare
- Selling practices and product labelling

Leadership & governance

- Business ethics
- Competitive behavior
- Management of the legal and regulatory environment
- Critical incident risk management
- Systemic risk management

Source: SASB Materiality Map

Included within ESG are climate-related matters that could lead to potential impacts on an entity's financial statements from physical and transition risks or opportunities.*

- Inventory
- Property, Plant, Equipment
- Climate Change Commitments
- Risk and Uncertainty Disclosures
- Going Concern
- Goodwill, Intangibles
- Loss and Gain Contingencies
- Income Taxes
- Financial Instruments

**For additional information, see the IASB Educational Material Effects of climate-related matters on financial statements and Deloitte's Closer Look Investor demand for corporate reporting in line with the Paris Agreement on Climate Change.*

Drivers of ESG Acceleration

Rapid pace of change: Shift from voluntary to authoritative ESG and climate disclosure

01

Regulators

Rulemaking around required climate-related and other ESG disclosures

02

Investors

Accelerating action and transparency around the financial impacts of climate and ESG

03

Corporations

Accountable to ambitious commitments and providing enhanced climate-related and other ESG disclosures

04

Standard-setters

Accelerating acceptance of authoritative climate-related and ESG standard-setters and a common baseline

Regulatory Landscape Overview

The global ESG disclosure and regulatory landscape is evolving rapidly

Recent developments from government regulators and international sustainability standard setters show signs of convergence

North America:

- **SEC:**
  - **Proposed climate change disclosure rule** and **cybersecurity**
  - Pending rules on **human capital** and **board diversity**
- Proposed bills in **California requiring data accountability, divestment from fossil fuels**, and **climate-related** financial risk disclosure
- Proposed disclosure rule for **US federal contractors to report GHG emissions** and **set SBT**

UK

- **Mandatory TCFD reporting** for large companies in the UK beginning April 2022
- **UK** announced intentions to **mandate ISSB**

EU

- **The European Parliament** adopted the **Corporate Sustainability Reporting Directive (CSRD)**
- **The European Commission** approved 12 **European Sustainability Reporting Standards (ESRS)** which cover the full range of ESG issues, including climate change, biodiversity, and human rights
- **The European Parliament** voted in favor of the draft **Corporate Sustainability Due Diligence Directive (CSDDD)**

APAC

- **Hong Kong, Singapore, Japan** and **Malaysia** announced **mandatory TCFD climate disclosures**
- **ASEAN** Taxonomy Board (ATB) released the **ASEAN Taxonomy for Sustainable Finance** (ASEAN Taxonomy)
- **China, Hong Kong Stock Exchange, Japan, Australia, New Zealand, Malaysia** and **Singapore** are considering **using the ISSB Standards**

SEC 2023 Regulatory Agenda

On June 13th, 2023, the Office of Information and Regulatory Affairs released the Spring 2023 Unified Agenda of Regulatory and Deregulatory Actions[1], which includes updates on the SEC's rulemaking priorities for the next year. The below showcases four of the ESG—related items.

CLIMATE CHANGE DISCLOSURE

*Abstract: The Division [of Corporate Finance] is considering recommending that the SEC **adopt** rule amendments to enhance registrant disclosures regarding issuers' climate—related risks and opportunities.*

Notice of proposed rulemaking released March 2022; comment period closed June 17, 2022, after initial 60—day comment period was extended with over 14,000 comments received; comment period reopened October 7, 2022, for 14 days due to a technological error; **final action anticipated October 2023**.

CYBERSECURITY RISK GOVERNANCE

*Abstract: The SEC **adopted** rules to better inform investors about a registrant's cybersecurity risk management, strategy and governance, and to provide timely notification of material cybersecurity incidents.*

Final rule adopted in July 2023. Registrants must provide such disclosures beginning with annual reports for fiscal years ending on or after December 15, 2023[2].

HUMAN CAPITAL MANAGEMENT DISCLOSURE

*Abstract: The Division is considering recommending that the SEC **propose** rule amendments to enhance registrant disclosures regarding human capital management.*

Notice of **proposed rulemaking anticipated October 2023.**

CORPORATE BOARD DIVERSITY

*Abstract: The Division is considering recommending that the SEC **propose** rule amendments to enhance registrant disclosures about the diversity of board members and nominees.*

Notice of **proposed rulemaking anticipated April 2024.**

1. Unified Agenda of Regulatory and Deregulatory Actions *US Office of Information and Regulatory Affairs. 2023.*
2. *Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure, SEC, 2023.*

Source: U.S. General Services Administration — Office of Information and Regulatory Affairs

SEC Proposal: Enhancement and Standardization of Climate-related Disclosures

Call to Action: What this means for your organization

Today…

- Oversight of ESG is often not clearly established or defined, though governance and organizational capacity are critical to managing climate-related efforts.[1]
- Timeliness for data collection and reporting typically extend beyond current 10-K filing deadlines.[2]
- Data processes and controls over climate-related information are generally not as mature as financial reporting processes and controls.[1]
- Climate-related disclosure is voluntary. Companies use a variety of sustainability reporting frameworks and standards, and disclosure outlets.[2]
- Assurance – an avenue to quality, accurate, and reliable disclosure – is currently not required.[1]

Under the proposed rule, registrants would be required to disclose[3]…

1. **Governance of climate-related risks,** how identified climate-related risks have or are likely to have a material impact on a company's strategy, business model, outlook over short-, medium-, or long-term, and risk management processes.
2. **Climate-related financial statement metrics** (e.g., disaggregated climate impacts on financial statement line items) and **impact of climate-related physical events and transition activities** on estimates and assumptions.
3. **Greenhouse gas (GHG) emissions,** including Scope 1 and 2 (and Scope 3 phased in if material or if registrant has Scope 3 target).
4. **Information about climate-related targets** and transition plans.

Obtain reasonable assurance, phased in for accelerated and large accelerated filers over certain GHG emissions disclosures; limited assurance precedes.

1. *2022 Deloitte CxO Sustainability Report. Deloitte. 2022.*
2. *ESG Reporting and Attestation: A Roadmap for Audit Practitioners CAQ. 2021.*
3. *The Enhancement and Standardization of Climate-Related Disclosures for Investors. SEC. March 21, 2022.*

SEC Proposal: Enhancement and Standardization of Climate-related Disclosures

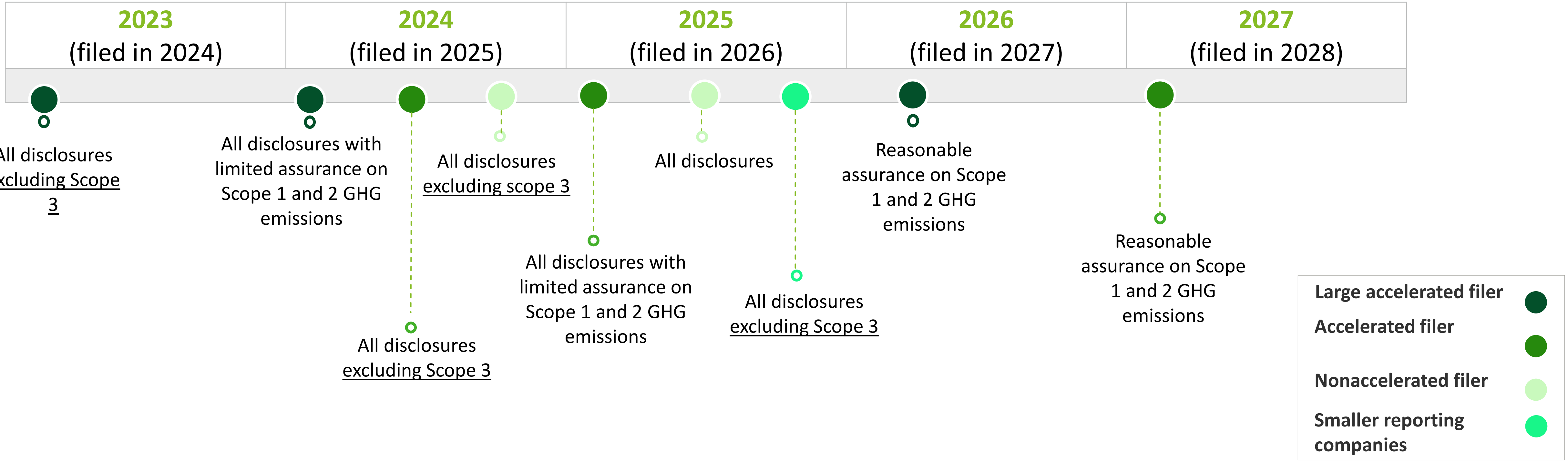
Proposed disclosure location

	Financial Statements	Outside the Financial Statements
Disclosure Required	For climate-related events and transition activities: (1) financial impact metrics (2) expenditure metrics (3) discussion of the impact on financial estimates and assumptions	(1) GHG emission disclosures for Scopes 1, 2 and 3 (2) Climate governance (3) Climate-related risks and opportunities (4) Climate risk management (5) Climate targets and goals
Controls and procedures	Subject to internal control over financial reporting	Subject to disclosure controls and procedures
Attestation	Part of financial statement & ICFR audit	Phase-in to reasonable assurance over Scope 1 & 2 GHG emission disclosures for large accelerated and accelerated filers

SEC Proposal: Enhancement and Standardization of Climate-related Disclosures

Proposed timeline

Timeline for Proposed Climate Rule* (Illustrative timeline for calendar year end filers)



*This timeline is subject to change when the final rule is issued, planned for October 2023 according to the Spring 2023 regulatory agenda.

SEC Proposal: Enhancement and Standardization of Climate-related Disclosures

Financial statement disclosure

Financial Impact Metrics

Separate disclosure for **each** line item of (1) negative impacts and (2) positive impacts related to:

- Climate-related events
- Transition activities

Proposed disclosure would be required if the **absolute value** of all impacts to the affected financial statement line item **exceeds 1%**

Expenditure Metrics

Proposed disclosure would be required if **total amount expensed** on the event/activity **exceeds 1%** of total expenditures

Proposed disclosure would be required if **total amount capitalized** on the event/activity **exceeds 1%** of total capitalized costs

Separate disclosure of (1) total amount expensed and (2) total amount capitalized related to:

- Climate-related events
- Transition activities

Illustrative disclosure:

Financial Statement Line Item	Climate-Related Events		Transition Activities	
	Positive Impact	Negative Impact	Positive Impact	Negative Impact
Cost of Sales	$X	$X	$X	$X

Illustrative disclosure:

Expenditures	Climate-Related Events	Transition Activities
Expensed	$X	$X
Capitalized	$X	$X

ESG developments in the E.U. and the impact on U.S. based companies

Scope

	Reporting for calendar year end filers:			Enterprise level
	2024	2025	2026	2028
Scope	Subsidiaries of U.S. companies already subject to NFRD	All **large**[2] E.U. subsidiaries of U.S. companies or U.S. companies listed on **E.U. regulated market**	**SME** subsidiaries of U.S. companies **listed** on **E.U. regulated market**	**U.S. companies with > €150M of revenues in E.U.**[4]
Required standards	ESRS (or equivalent standards[1])			ESRS, equivalent standards[1], or alternative standards to be developed
Reporting level	**Stand-alone subsidiary**[3], unless included in Parent's report prepared under ESRS or equivalent standards[1] for non-E.U. Parent.			**Consolidated group**—Including non-E.U. activity
Assurance	Yes—**Limited assurance** over **all** reported sustainability information			Yes—Limited assurance over all reported sustainability information

[1] What may be deemed 'equivalent' is yet to be determined by the European Commission, which may also exempt non-EU listed for a transitional period

[2] Large undertaking is defined by the Accounting Directive as an entity that meets 2 or more of the 3 criteria: >250 employees, >€20M balance sheet , >€40M turnover in EU

[3] May also present in scope EU subsidiaries with common non-EU parent in one consolidated EU report under ESRS (until 2029)

[4] EU large and listed subsidiaries (or branches where there is no EU large or listed subsidiaries) of a non-EU ultimate parent with > €40 million net turnover will need to publish a sustainability report of that parent at the consolidated level if that parent has a net turnover in the EU of > €150 million in each of the last two financial years

ESG developments in the E.U. and the impact on U.S. based companies

Scope—European Sustainability Reporting Standards

Cross-cutting standards

ESRS 1	ESRS 2
General requirements	General disclosures

Environment

ESRS E1	ESRS E2	ESRS E3	ESRS E4	ESRS E5
Climate change	Pollution	Water and marine resources	Biodiversity and ecosystems	Resource use and circular economy

Social

ESRS S1	ESRS S2	ESRS S3	ESRS S4
Own workforce	Workers in the value chain	Affected communities	Consumers and end-users

Governance

ESRS G1

Business conduct

Governance and Internal Controls

The ESG Landscape

ESG risks and opportunities are business risks and opportunities. As the pace and impact of societal and environmental disruption continues to intensify, organizations should work to build capacity to drive ESG performance and resilience.

Strategy

Integrate ESG factors to drive innovative and brand-enhancing strategies, including strategic choices across the value chain

Communication

Optimize strategic communications to stakeholders to navigate changing expectations and credibly demonstrate prioritization and management of ESG risks and opportunities

Human resources

Invest in leading practices around employee health and safety, diversity, equity, and inclusion, and development to attract, retain and incentivize talent to innovate, drive productivity and deliver on the business strategy

Sustainability function

Design and activate strategies to deliver on the corporate strategy, Purpose and ESG objectives to drive performance

Operations

Prioritize and measure opportunities for cost savings, risk mitigation, and reputation enhancement and implement solutions to reduce resource inputs and wasteful outputs

Risk

Identify, manage and respond to latent and emerging ESG risks; integrate ESG risk capabilities into existing risk and control frameworks

Finance

Incorporate ESG-related risks into annual reporting and regulatory filings, investor engagement, pricing, forecasting and budgeting, capital-allocation and annual reporting

Legal

Understand and manage risk and liability considerations related to ESG performance – e.g., inadequate, or inaccurate disclosure of material financial risks

Compliance

Broaden the integration of ESG performance into the existing management control frameworks to support compliance around ESG risk

Internal audit

Integrate ESG risk and compliance considerations into the internal audit plan to instill discipline and enhance controls related to material ESG risks

Deloitte's 4 Takeaways on COSO's Achieving Effective Internal Control Over Sustainability Reporting (ICSR): Building Trust and Confidence Through the COSO Internal Control-Integrated Framework

This report marks an important development at an important time in the ESG landscape to help inform and enhance organizational ESG capacity and leadership. The message is clear: governance should be at the core, customization and adaptation are important, and the time for ESG is now.

1

17 guiding principles: Organizations should assess the framework's outlined principles aligned to existing categories: *control environment, risk assessment, control activities, information and communication and monitoring activities* when implementing ICSR

2

Prioritize ICSR: Designing and implementing effective controls over sustainability related information can result in more complete, accurate and reliable disclosure.

3

Governance is central to the framework: ESG-related education, change management, collaboration across stakeholder groups and cross-functional team structures is an important step to transformation

4

Obtaining internal & external assurance: Internal evaluation of controls is an important first step prior to engaging in external assurance

Source: COSO-ICSR-Report.pdf

COSO: Components and Principles

A deeper look: a call out to the 5 components and 17 principles of ICIF-2013 to be applied to ICSR

CONTROL ENVIRONMENT

1. Commit to organizational **integrity** and **ethical** values

2. Have an **independent board** perform oversight of ICSR

3. Clearly outline **structures, authority and responsibilities**

4. Work to attract, develop and retain **personnel** that align with **organization values**

5. Hold personnel **accountable** for internal control responsibilities

RISK ASSESSMENT

6. Identify objectives with clarity to enable the identification and **assessment of risks**

7. Incorporate how risks should be **managed** into risk analysis

8. Evaluate potential of **fraud** as risks to objectives

9. Prepare for **changes and trends** that could impact internal controls

CONTROL ACTIVITIES

10. Identify and develop control activities that contribute to **risk mitigation** and the furthering of organization objectives

11. Identify and develop control activities related to **technology** that contribute to the furthering of organization objectives

12. Position oversight through **policies and procedures**

INFORMATION & COMMUNICATION

13. Use information to **support** the function of internal controls

14. **Internally communicate** key control information

15. **Externally communicate** key control information

MONITORING

16. Perform **periodic evaluations** to ensure internal controls are present and operating

17. Communicate internal control inefficiencies to personnel responsible for **corrective action**

Source: COSO-ICSR-Report.pdf

A Deeper Look: Proposed Governance and Controls considerations for Climate-Related Data

Climate-Related Governance

- Establish **board oversight & top-down accountability** mechanisms to support robust control environment
- Clearly define **data owners' roles, responsibilities, and competencies**
- **Build organization capacity and train** Board and Management
- Incorporate climate-disclosure considerations into **data management policies & procedures**

Internal Controls over Climate-Related Data

1. Define disclosure objectives

- Establish, document and communicate climate-related data timelines, aligned with financial reporting
- Review current-state of processes and controls around existing climate disclosure
- Understand existing data governance structures, to identify gaps and meet reporting requirements

2. Assess disclosure risks

- Identify potential risks that could impact climate-related reporting objectives
- Determine relevant data sources, systems and process owners
- Document end-to-end climate processes through narratives and flowcharts
- Identify and document data/IT system limitations, assumptions and estimates

3. Identify controls

- Evaluate maturity of existing controls to enhance data accuracy and completeness
- Define internal process controls and general IT controls (GITCs) to mitigate identified climate-related risks
- Document methodologies for data collection, measurement and/ or estimation

4. Evaluate effectiveness

- Regularly assess design, implementation, and effectiveness of controls
- Remediate control gaps and deficiencies and implement ongoing process improvements
- Integrate controls over climate disclosure into ERM processes and Internal Audit plans
- Engage with external assurance provider

The SEC proposed rule calls for disclosure of GHG emissions, Scope 1 and 2 (and Scope 3 phased in if material or if registrant has Scope 3 target), as well as certain financial statement disclosures, and qualitative and governance disclosures. The Scope 1 and Scope 2 GHG emission disclosures would be subject to limited assurance during a phase-in period, followed by reasonable assurance.

How to Prepare for Proposed Regulated Disclosures

Potential Challenges in the Global ESG Regulatory & Standards Landscape

Data

Data entry is disaggregated and could be happening by 100s of personnel globally, making auditability difficult. Organizations who are decentralized in nature should consider the need to think about how they will manage data with the level of auditability required.

Timeline to adoption

It can be a challenge to anticipate the data gaps. Timeline from planning to operation varies due to the size and complexity of a company’s organization.

Internal control considerations

Increased reporting requirements may necessitate internal controls over areas and systems not generally in the scope of SOX.

Technology

Technology should be able to accept automated data entry and deliver accurate reports to reduce burden on personnel. When technology is not integrated with ERP systems, it may be difficult to tie ESG data to financials.

Resources

The proposed SEC Climate Rule will encompass multiple stakeholders (e.g., legal, risk, controllership). Organizations will need to have the right people at the table.

Other operational challenges

The lack of clarity on the new rule can result in application of judgment and estimation. Timeline to prepare climate-related disclosures will need to align with the Form 10-K reporting timeline.

Assembling a Team to Prepare

Assembling a team to operationalize ESG into the company business model

Spectrum of cross-functional talent

Broad range of competencies within the global organization

Formalizing responsibilities within the organization

A steering committee or similar may help guide and enforce roles and responsibilities

Planning for near-term compliance and potential future enhancements or requirements

The overlay of governance strategy

What role will the board and senior management play?

Errors in practice may guide areas of focus

Understanding where others have been challenged allows you to avoid similar issues

The multitude of external constituencies

- Parties influencing your business objectives and disclosures
- Parties assisting you in the quality journey

Global ESG Regulatory & Standards Landscape: Next steps

Illustrative actions and timeline for CSRD and SEC readiness

Incremental CSRD readiness actions

Define boundaries
Assess impact by E.U. subsidiary to guide implementation requirements and timeline

Perform double materiality assessment
Identify the most important E, S and G issues from an impact and financial perspective

Perform steps 2–5 below on climate and GHG disclosures and evaluate readiness against 9 other topics[1], if deemed material, including:

- Pollution
- Water and marine resources
- Biodiversity and ecosystems
- Resource use and circular economy
- Own workforce
- Workers in the value chain
- Affected communities
- Consumers and end-users
- Business conduct

Obtain limited assurance
Q1 2025: limited assurance on **all** disclosures

SEC readiness actions-Large accelerated filer

1. Begin where you are, with what you have
Understand regulatory requirements and timeline implications

2. Perform disclosure gap analysis
Understand disclosure gaps, and develop strategy to address

3. Understand your control environment
Formalize and document existing controls over **climate and GHG** information

4. Remediate disclosure and control gaps
Implement changes to fill **climate and GHG** disclosure and control gaps

5. Develop disclosures
Leverage gap analysis and remediation actions to develop draft and final disclosures over **climate and GHG**

6. Obtain assurance
Q1 2024: Audit of climate metrics
Q1 2025: Limited assurance of Scope 1 & 2 GHG

Assess data processes, controls, and readiness to obtain assurance
Assess and enhance data processes and controls environment

[1]The topics identified are the 9 environment, social and governance European Sustainability Reporting Standards, excluding the climate change standard (ESRS E1) that is most closely related to the SEC's proposed rule on climate disclosures.

Leading takeaways

Disclosure readiness often requires time and resources, and many companies will likely be impacted by proposed upcoming requirements. Companies often have the tools to get started today.

01 The time to get started is now

02 Climate disclosures impact private, public, domestic and global companies

03 Requirements across CSRD and SEC overlap

04 Comprehensive disclosures need a variety of resources – people, technology and processes

Resources to get started:

- **Measure GHG emissions:** Greenhouse Gas Protocol
- **Assess risk:** Taskforce on Climate-related Financial Disclosure
- **Set targets:** Science Base Targets initiative
- **Develop transition plan:** CDP and Glasgow Financial Alliance for Net Zero

Questions

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