



ESG

Evolution & Opportunities

September 7, 2022

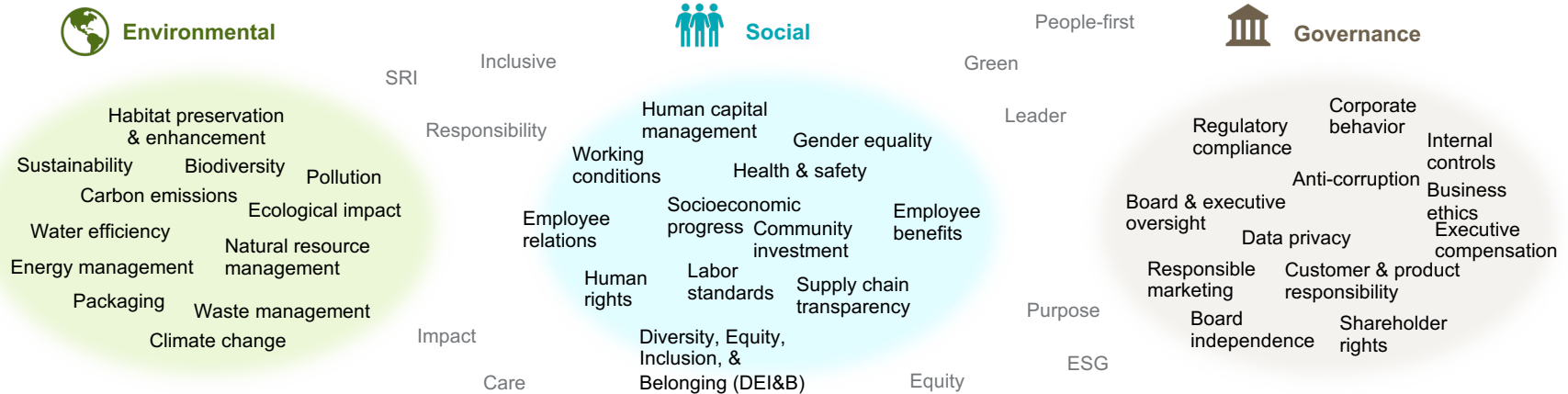
The ESG Landscape

ESG is an alphabet soup of definitions, and can mean different things to different companies and sectors...

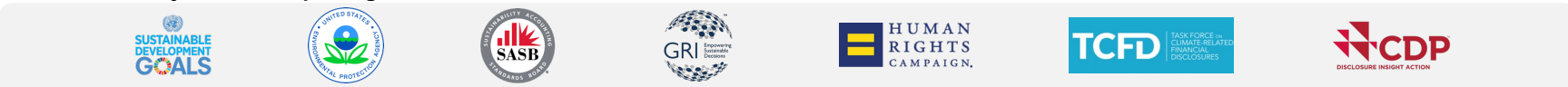
Evolution of ESG as a business practice



ESG is discussed in many different ways...



...and has many different reporting mechanisms



The Social Responsibility of Business is to Increase its Profits

There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the **rules of the game**, which is to say, engages in open and free competition without deception or fraud.

That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both **those embodied in law and those embodied in ethical custom**.

Milton Friedman, 1970, *New York Times Magazine*

Statement of Corporate Purpose (Business Roundtable)

1

Deliver value to our customers

2

Invest in our employees

- **Compensate** them fairly
- Provide important **benefits**
- Support them through **training and education** to help develop new skills for a rapidly changing world
- Foster **diversity and inclusion, dignity and respect**

3

Deal fairly and ethically with suppliers

- Serve as a **good partner** to other companies, large and small, that help us meet our missions

4

Support the communities in which we work

- **Respect the people** in our communities
- Protect the environment by **embracing sustainable processes** across businesses

5

Generate long-term value for shareholders

- Provide the capital that allows companies to invest, grow and innovate
- Commit to **transparency and effective engagement** with shareholders

Evolving as Laws and Ethical Customs Change



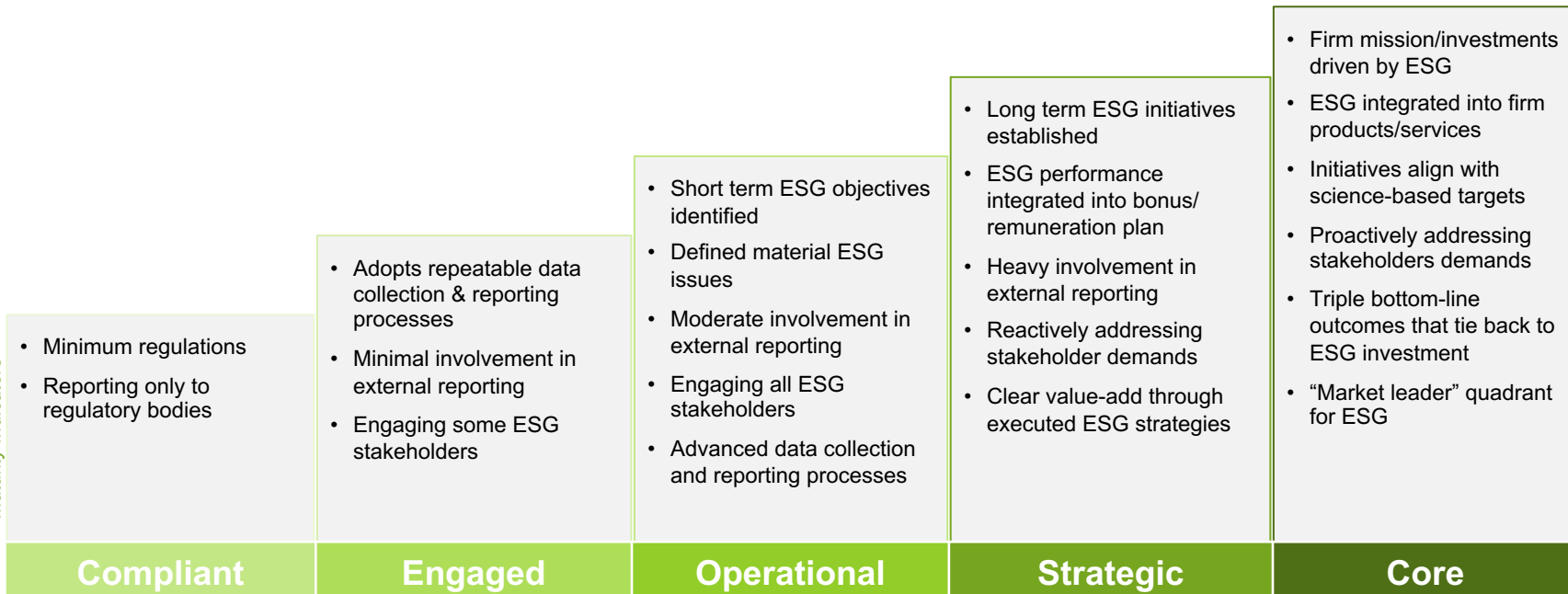


ESG Maturity

Compliance is only the beginning of ESG. Organizations can explore a variety of ways to strategically position ESG so that it becomes embedded in operations rather than having ESG serve only as a risk mitigation or “check the box” exercise.

↑ IMPACT ON BUSINESS PERFORMANCE

Maturity Indicators



MATURITY →

Polling Question 1

How would you describe your organization's ESG maturity?

- A) **Compliant** – reports only required information
- B) **Engaged** – repeatable data collection and processes, minimal reporting
- C) **Operational** – advanced data collection/processes, more reporting, appealing to stakeholders
- D) **Strategic** – heavy reporting & engagement, linked to bonus/remuneration
- E) **Core** – integrated into products/services, reporting, a recognized leader
- F) **Not sure**



Why Is This Happening?

ESG stakeholders



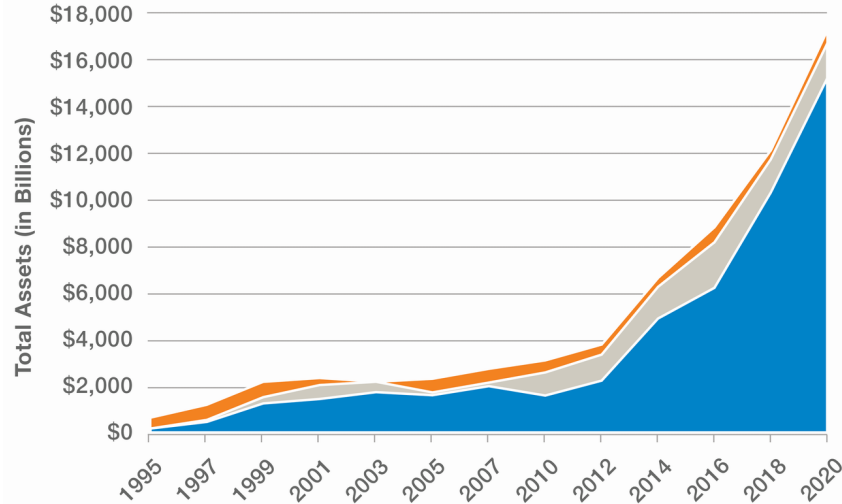


ESG & Investors

Attracting investment capital

Sustainable Investing in the United States 1995–2020

■ ESG Incorporation ■ Overlapping Strategies ■ Shareholder Advocacy



SOURCE: US SIF Foundation.



\$3.07 to \$17TN between 2012 and 2020



Performed better and recovered quicker after 2008 economic crisis



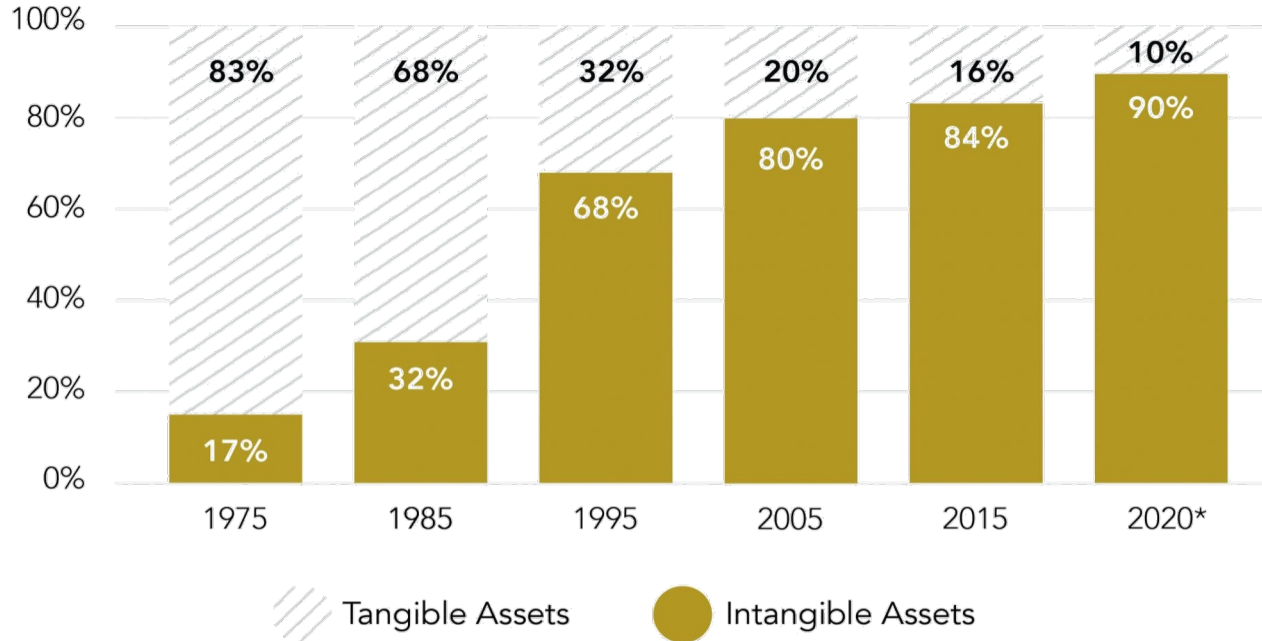
One out of three dollars under professional management in the U.S.



Growing pool of money invested in sustainable companies

What is an Organization 'Worth'?

S&P Europe 350 index - increase from 71% in 2015 to 74% in 2020.



SOURCE: OCEAN TOMO, LLC INTANGIBLE ASSET MARKET VALUE STUDY, 2020
*INTERIM STUDY UPDATE AS OF 7/1/2020

Tangible Assets

Physical Assets

Financial Capital

Intangible Assets

Intellectual
property

Brand Image

Customer
loyalty

Reputation

Employee
engagement

Analysts'
Perception

Labor
environment

Unallocated
goodwill

Community
support

Maximizing intangible assets

Effectively managing relationships with:



Customers



Employees



**Owners /
Investors**



Suppliers



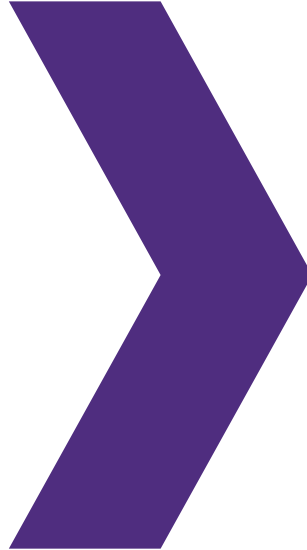
Competitors



Communities



Government agencies / regulators



**Best
accomplished
with a robust
ESG program**

SEC and Investors Are Lining Up Behind Key ESG Issues



BlackRock



	Regulators	Investors			Proxy advisory firms
Climate	✓	✓	✓	✓	✓
Board Diversity	✓	✓	✓	✓	✓
Human Capital	✓	✓	✓	✓	✓
Cybersecurity	✓				

Most stakeholders – from shareholders to employees, to customers, to communities, and regulators – now **expect companies to play a role in decarbonizing** the global economy.

Few things will impact capital allocation decisions – and thereby the **long-term value of your company** – more than how effectively you **navigate the global energy transition in the years ahead.**”

- Larry Fink, CEO of BlackRock



ESG & Regulation

SEC | Regulatory overview

The US SEC's rule-making agenda includes several proposed rules on ESG topics. Entities that have implemented ESG reporting have a head start; however, the SEC is expected to write its own requirements rather than pulling from existing voluntary standards.

Climate
change
disclosure
(Proposal
issued)

Required disclosures proposed:

- Climate-related risks
- GHG emissions

“The disclosure of this information would provide consistent, comparable, and reliable—and therefore decision-useful—information to investors to enable them to make informed judgments about the impact of climate-related risks on current and potential investments.”

- SEC proposed rule on climate-related disclosure

Other
ESG-
related
topics

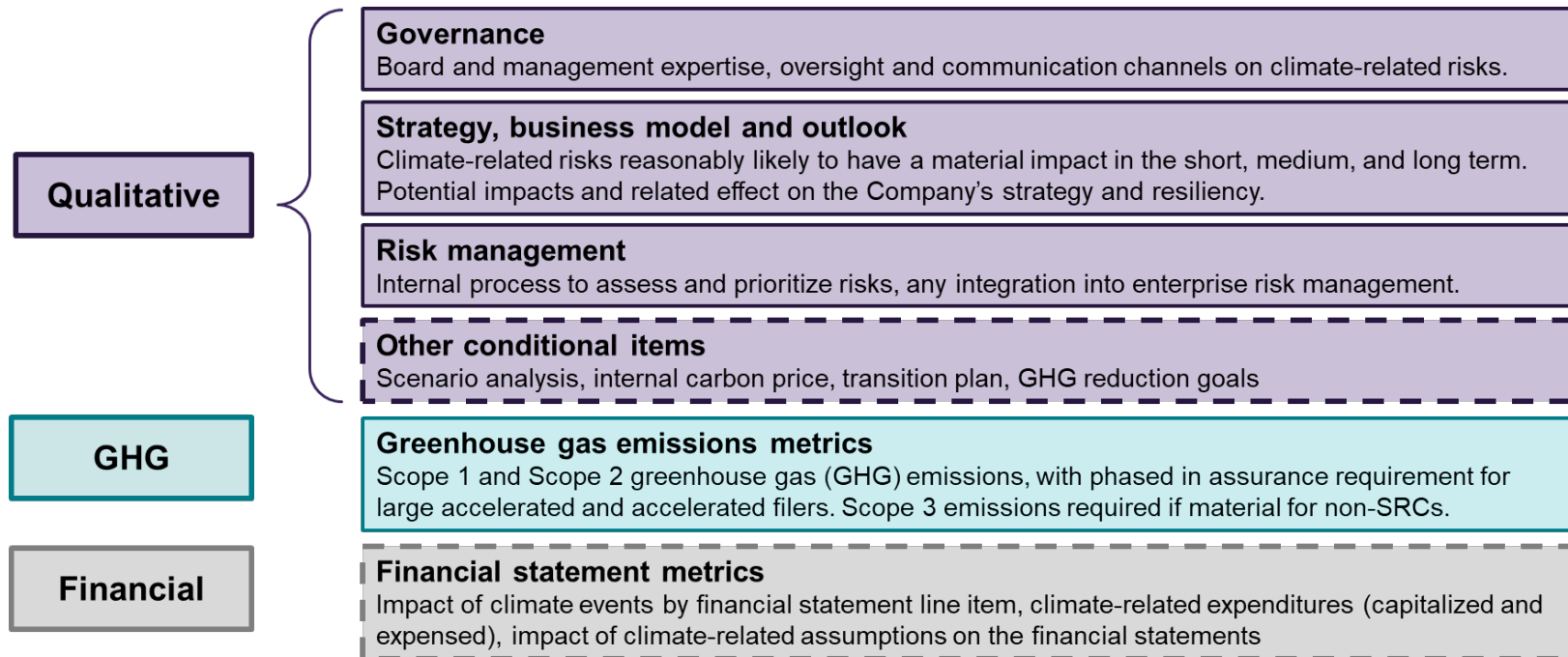
Cybersecurity Risk Governance (proposal issued)

Human Capital Management (proposal not issued)

Corporate Board Diversity (proposal not issued)

SEC climate change proposed rule overview

The SEC's proposed rule, The Enhancement and Standardization of Climate-Related Disclosures for Investors, would require all registrants to include certain climate-related information in registration statements and periodic reports.



SEC | Proposed climate disclosure timeline

The anticipated timeline for calendar year-end filers includes initial reporting in the 2024 Form 10-K, based on timelines in the proposed rule.

Fiscal year. To be filed following year	2023	2024	2025	2026	2027	Ongoing
Large accelerated filer	<ul style="list-style-type: none"> • Scope 1 & 2 	<ul style="list-style-type: none"> • Scope 3 • Limited assurance Scope 1 & 2 	<ul style="list-style-type: none"> • Scope 3 • Limited assurance Scope 1 & 2 	<ul style="list-style-type: none"> • Scope 3 • Reasonable assurance Scope 1 & 2 	<ul style="list-style-type: none"> • Scope 3 • Reasonable assurance Scope 1 & 2 	<ul style="list-style-type: none"> • Scope 1 & 2 (with reasonable assurance) • Scope 3 (no assurance)
Accelerated filer		<ul style="list-style-type: none"> • Scope 1 & 2 	<ul style="list-style-type: none"> • Scope 3 • Limited assurance Scope 1 & 2 	<ul style="list-style-type: none"> • Scope 3 • Limited assurance Scope 1 & 2 	<ul style="list-style-type: none"> • Scope 3 • Reasonable assurance Scope 1 & 2 	
SRC			<ul style="list-style-type: none"> • Scope 1 & 2 • Exempt from Scope 3 & assurance 	<ul style="list-style-type: none"> • Scope 1 & 2 	<ul style="list-style-type: none"> • Scope 1 & 2 	<ul style="list-style-type: none"> • Scope 1 & 2 (no assurance) • No Scope 3

Progression of climate disclosure



Sources of ESG data & data quality

Facilities management

Procurement

Human resources

Marketing

Finance & accounting

Third party data/utility management vendors

Franchisees / Subsidiaries

Operations

Common issues with ESG data

Source information

Quantity	Units of measure
Quality	Normalization
Accuracy	Timeliness
Completeness	Multiple, disparate sources
Relevance	Transparency
Consistency	Reliability

Control environment

<i>Internal challenges</i>	<i>Service organizations</i>
Lack of policies & procedures	Security
Lack of internal controls	Processing integrity
General immaturity vs. ICFR and COSO components	Privacy controls
<ul style="list-style-type: none"> • Tone at the top • Risk assessment • Control environment & activities • Information & communication • Monitoring 	Availability

ESG data | Emerging repercussions

Breaking news

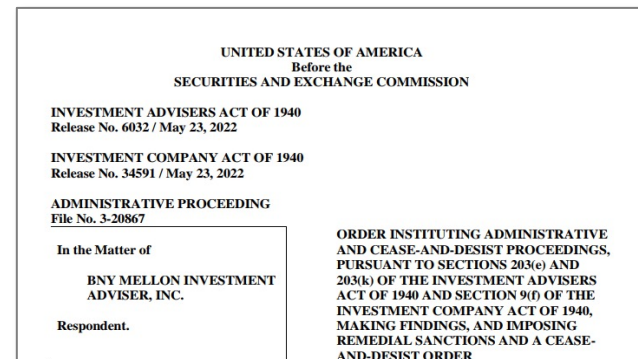
May 23, 2022:

The SEC found that BNY Mellon Investment Advisers made **misleading ESG statements** in prospectuses and even RFP statements.



1. This matter arises from material misstatements and omissions made by registered investment adviser BNYMIA concerning the consideration of Environmental, Social, and Governance (“ESG”) principles to make investment decisions for certain mutual funds advised by BNYMIA (the “Overlay Funds”).

The prospectus stated that quality review was done for all investments, and **the SEC felt it lacked appropriate policies and procedures** for those reviews.



Source: <https://www.sec.gov/litigation/admin/2022/ia-6032.pdf>

Polling Question 2



Which do you think is/will be the primary 'driver' for ESG disclosures for your organization?

- A) Regulatory requirements
- B) Investors
- C) Customers
- D) Employees
- E) Not sure



ESG & Finance

Polling Question 3

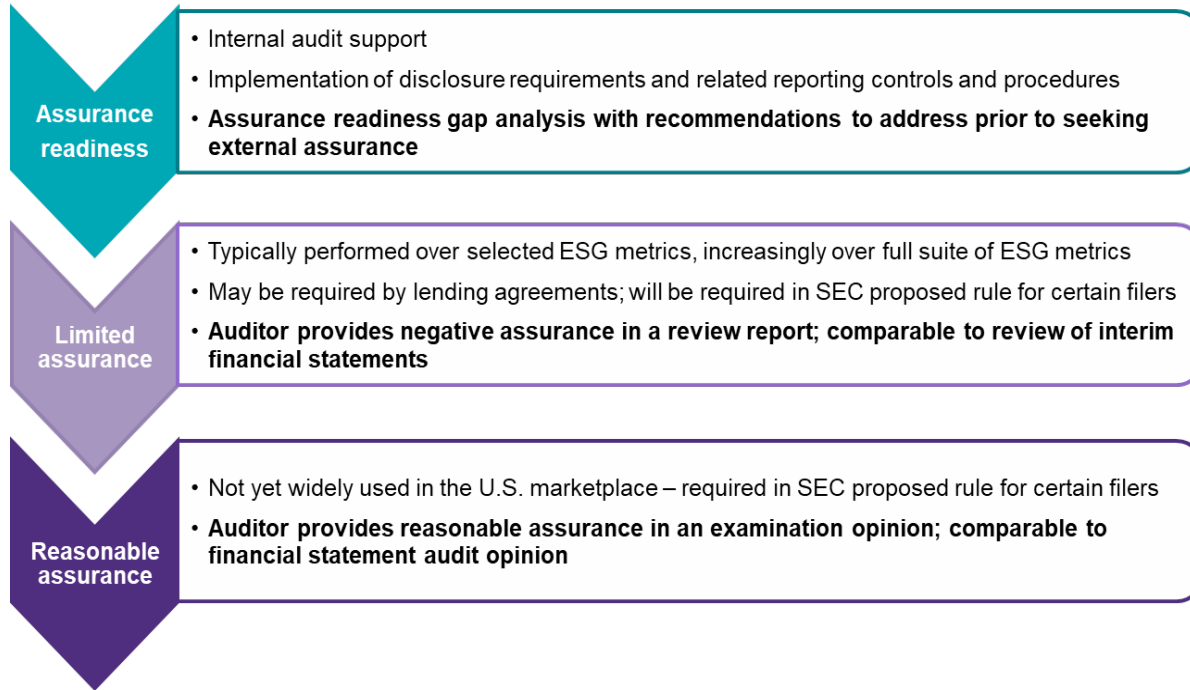


Have you or your department or role been involved with ESG data or reporting to-date?

- A) Yes
- B) No
- C) Not sure

ESG assurance overview

Assurance over ESG reporting is increasingly being used and includes varying levels of assurance based on company needs.



Assurance can be provided over selected ESG metrics prepared using suitable disclosures standards and frameworks:



Key ESG metrics:



Greenhouse Gas



Energy



Water



Waste

ESG | Increasing focus on controls

As ESG frameworks continue to evolve and merge with the growth of ESG reporting and regulation requirements, Internal Audit can leverage experience to ensure accuracy & completeness over ESG data.

Internal audit	
SOC (AICPA)	COSO Framework
Technology compliance	Internal controls
<ul style="list-style-type: none"> • Security • Availability • Processing integrity • Confidentiality • Privacy controls 	<ul style="list-style-type: none"> • Operations • Reporting • Compliance <p>5 components:</p> <ol style="list-style-type: none"> 1. Control environment 2. Risk assessment 3. Control activities 4. Information & communication 5. Monitoring activities

ESG	
GHG Protocol	Task Force on Climate-related Financial Disclosures (TCFD)
Greenhouse gas emissions calculations & reporting	Climate-related risks & opportunities disclosure
<ul style="list-style-type: none"> • Completeness • Accuracy • Relevance • Transparency • Consistency 	<ul style="list-style-type: none"> • Governance • Strategy • Risk management • Metrics & targets

Common risks with ESG data & reporting

Internal audits skills will be useful in addressing some of the common issues with ESG data and reporting, helping to validate information, processes, controls, and decisions as well as identify potential risks.

Greenwashing

False or misleading information about a company, its products or services making them seem more sustainable than in reality

Unintentional error

ESG data originates from many sources in various formats, units, and levels of quality & completeness – all which must be aggregated for reporting

Intentional misstatement

As companies make external commitments, significant incentives to overstate ESG progress exist

What can finance do?

- Process & control assessment
- Data integrity

- Independent review of materiality assessment
- Understand process to select reported topics
- Risk assessment
- Verify actual vs reported progress for public ESG goals



Opportunities for integration with ESG

Internal Audit can play an integral role in several areas of ESG.

ESG data collection, management, & reporting

- Establish controls to prevent errors that may occur with large quantities of ESG data
- Proactively advise on governance, risks, processes, and controls used in data management & reporting for ESG

ESG software controls (SOC)

- Review specifications and controls of any software system or applications used in ESG data management and reporting

Climate risk implications

- Assist board & ESG managers with managing risks around ESG strategy & implementation
- Target setting and net zero commitments – setting & consistency

External assurance assistance over GHG emissions

- Assist external auditors in review and testing of systems, controls, processes, and procedures.

Risk mitigation & management

- Ensure risk mitigation and management procedures are included in ESG
- Supply chain risks and implications on ESG data accuracy & completeness
- Compliance with regulations & requirements by jurisdictions

Polling Question 4



Do you believe your organization's ESG data is audit-ready?

- A) Yes
- B) No
- C) Not sure

ESG: Big Opportunity

88%

Of Institutional Investors Worldwide believe ESG metrics should be subject to same standards as operational and financial metrics.

60%

Percentage of people who want a career that aligns with their personal values.

Contact Us

The world is changing. We can help you change with it.



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