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The Future of Controls & Environment, Social and Governance

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Our **speakers** for today…

Dan Cane

Nicola Summers

Greg Finegan

Steph Chen

Future of Controls: Reliable ESG Reporting

Investors, banks and regulators are increasing the need for disclosures around environmental, social, and governance (ESG) reporting and therefore the reliability of reporting increases the need for better governance and internal controls.

Define. Optimise. Embed. Report.

Similar to financial reporting, ESG reporting needs to be integrated into a business' strategy and operational practices. Applying a consistent controls methodology across the broader spectrum of ESG disclosures and metrics will ensure clear responsibility and accountability and enable robust reporting.

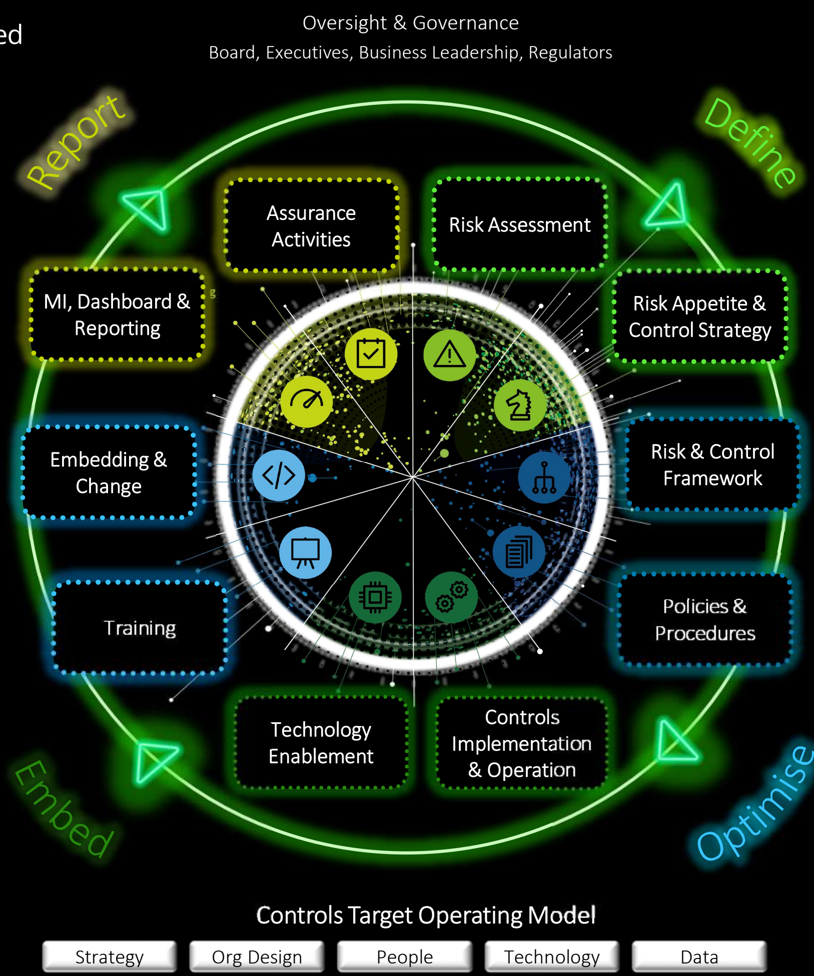
Governance. Design appropriate governance and accountability mechanisms. Define and communicate expectations. Maintain accountability and evaluate performance.

Define. Perform ESG materiality assessment to focus on what matters. Identify risks related to the achievement of ESG objectives. Continue to adapt and respond to emerging ESG risks.

Optimise. Understand ESG processes. Establish the control framework to ensure control activities address risk at the right level. Consider controls around IT infrastructure.

Embed. Utilise technology to enhance the control environment. Invest in knowledge and skills development through ESG-related training. Encourage cross-functional collaboration to drive change.

Report. Define assurance activities, including external assurance where required, to assess the effectiveness of controls. Address remediation activities and feedback into future risk considerations.



ESG Regulatory Landscape

The Global Regulatory Landscape

Below is a holistic view of regulation in various jurisdictions. Despite convergence of reporting standards, the regulatory landscape is more varied with a number of jurisdictional differences, however, it is anticipated that the ISSB will become the primary international standard.

Canada

- The Canadian Securities Administrators (CSA) has released the "Canadian Proposal", which will require federally regulated financial institutions to publish climate-related risks and disclosures aligned with the TCFD framework, starting in 2024

US

- SEC proposes climate change disclosure rule
- Proposed bills in California requiring data accountability, divestment from fossil fuels, and climate-related financial risk disclosure

International

- IFRS Foundation & VRF complete consolidation to support the work of the ISSB
- ISSB published its final climate standard and sustainability reporting framework in June 2023

UK

- **Mandatory TCFD reporting** for listed companies since January 2021
- UK announced intentions to **mandate ISSB**
- Department for Business, Energy & Industrial Strategy (BEIS) requirements to underpin economy-wide **mandatory TCFD aligned climate disclosure requirements** that started in April 2022

EU

- The European Parliament adopted the **Corporate Sustainability Reporting Directive (CSRD)**
- The European Financial Reporting Advisory Group (EFRAG) released the first set of **European Sustainability Reporting Standards (ESRS)** on climate and sustainability disclosures
- The **EU Taxonomy enforced in July 2020** is a classification system establishing a list of environmentally sustainable economic activities helping the EU **scale up the green deal**

APAC

- Hong Kong, Singapore and Japan announced mandatory climate disclosures aligned with TCFD
- ASEAN Taxonomy Board (ATB) released the ASEAN Taxonomy for Sustainable Finance (ASEAN Taxonomy)
- China announced plans to adopt ISSB

The Corporate Sustainability Reporting Directive (CSRD)

What is it?

CSRD is a cornerstone of the EU Green Deal that ultimately aims to create a sustainable economy in the European Union. The measures go far beyond reporting: from strategy and policies to performance management, technology and controls implementation to change management and audit readiness. Furthermore, implications entail decarbonisation actions and implementing due diligence processes.

REPORTING REQUIREMENTS

- Adoption of binding EU Sustainability reporting standards – ESRS cover range of E/S/G topics for disclosure
- Report according to double materiality
- Materiality assessment disclosure
- Provide qualitative and quantitative information, forward-looking and retrospective
- Reporting of green financial indicators (EU Taxonomy)
- Sustainability information needs to be reported in the management report
- Reporting format needs to be machine-readable (digital tagging)

SCOPE

- All large companies, meeting two of the three criteria:
  - Revenues > EUR 40 m
  - Total assets > EUR 20 m
  - > 250 employees
- Global non-EU firms with a net turnover of EUR 150 million and at least one significant subsidiary or branch in the EU
- Exemption for subsidiaries when (non-) EU parent undertaking complies with the obligation

FY 2024 – **Applicable for companies already subject to the NFRD** (i.e. Public Interest Companies)

FY 2025 – **Applicable for all large companies** (see scope above)

FY 2026 – **Applicable for listed SMEs, small and non-complex credit institutions and captive insurance companies**

FY 2028 – **Third-country undertakings that generated net turnover over EUR 150 million, and that have EU subsidiaries**

CSRD

European Sustainability Reporting Standards (ESRS)

The ESRS is a reporting framework under the CSRD. Companies subject to CSRD will have to report against this framework, which was developed by the European Financial Reporting Advisory Group (EFRAG).

ESRS

- **12 standards** for all sectors
- **82 Disclosure Requirements** on the information to be provided
- Around **1100 datapoints,** of which a third are quantitative

Additional standards to come

- **SME standards:** Listed and voluntary
- **40 sector-specific standards** (timeline under review due to delays in publishing implementation guidance)
- Standards for **non-EU groups**

Cross-cutting standards	**ESRS 1** General principles	**ESRS 2** General disclosures*			
Environment	**ESRS E1** Climate change	**ESRS E2** Pollution	**ESRS E3** Water and marine resources	**ESRS E4** Biodiversity & ecosystems	**ESRS E5** Resource use & circular economy
Social	**ESRS S1** Own workforce	**ESRS S2** Workers in value chain	**ESRS S3** Affected communities	**ESRS S4** Consumers and end-users	
Goverance	**ESRS G1** Business conduct				

Delegated Act published at the end of July 2023

EU Taxonomy

* As of the Commission's update in June 2023, only ESRS 2 *General disclosures* are mandatory for all organisations. All other metrics listed across topical standards are subject to the outcome of materiality assessments

CSRD

Assurance Requirements

CSRD requires *limited assurance* as soon as it comes into force. There is a progressive approach expected to eventually shift to *reasonable assurance* in the future six years after the CSRD comes into force. The EU objective therefore has a similar level of assurance for financial and sustainability reporting.

Limited Assurance readiness

Assurance readiness helps prepare you for public assurance in future reporting cycles. This is an important step and can be revisited as you progress along the journey.

Reasonable assurance readiness

Limited assurance

Limited Assurance is primarily used for metrics and disclosures, providing a "negative statement" over agreed selected information.

For limited assurance, less evidence is collected than for reasonable assurance, although sufficient for a negative form of expression of the assurer's conclusion. This is usually achieved by performing different or fewer tests than those required for reasonable assurance or using smaller sample sizes for the tests performed.

Reasonable assurance

Same level of assurance as a financial statement audit. Leading companies working towards this for ESG reporting.

Increasing level of assurance provided over the subject matter

Progressing along the above journey requires an increasing level of maturity in control environment, data collection and management processes

International Sustainability Standards Board (ISSB)

What is it?

ISSB published the two sustainability reporting standard drafts in March 2022:

- **Draft IFRS S1: General Requirements for Disclosure of Sustainability-related Financial Information**; and
- **Draft IFRS S2: Climate-Related Disclosures**

Information is considered 'material' in accordance with financial materiality i.e. information is material if omitting, obscuring or misstating it could be reasonably expected to influence investor decisions

	Aim	Link to TCFD	Specific disclosure requirements
ISSB S1	Disclosure of material information about sustainability-related risks and opportunities to meet investor information needs	Applies TCFD structure (four pillars) whenever providing information about sustainability	Requires industry-specific disclosures
TCFD **ISSB S2 (similar to ESRS E1)**	Disclosure of material information about climate-related risks and opportunities to meet investor information needs	Incorporates TCFD Recommendations fully and adds verifiability	Material information about physical and transition risks, climate-related opportunities and industry-specific metrics

March 2022 – **ISSB published two draft IFRS Standards (IFRS S1 and IFRS S2)** for consultation

Aug 2022 – **UK Government announced endorsement of ISSB**

Dec 2022 – **ISSB announces guidance and reliefs to support Scope 3 GHG emission disclosures**

FY 2023 – **ISSB expected to publish final drafts of ISSB S1 and ISSB S2 towards the end of June 2023**

ISSB S1 and ISSB S2

Reporting support

RELIEFS FOR FIRST YEAR OF APPLICATION

Disclosure of ISSB S1:
Organisations can respond to ISSB standards in a phased manner by reporting against ISSB S2 in their first year of reporting and responding to ISSB S1 in the subsequent year

Timing of reporting:
Companies do not need to provide annual sustainability-related disclosures at the same time as the related financial statements

Scope 3 disclosure:
For one year following the implementation companies do not have to disclose their Scope 3 emissions

Applying Greenhouse Gas Protocol (in specific circumstances):
Companies do not need to use the GHG protocol to measure emissions, if they are currently using a different approach. *This does not apply to Compass*

Comparative reporting:
Companies can choose to adopt the relief measure on reporting on comparative information for ISSB S1 in the first year

APPLICATION SUPPORT

In addition to the reliefs for first year of reporting, ISSB will provide guidance on:

- Scenario analysis, using TCFD Guidance
- Industry-based climate disclosure, drawing on SASB Standards
- How to identify relevant sustainability-related risks and opportunities in the value chain, using Scope 3 GHG emissions as an example
- Scope 3 GHG emission measurement
- Disaggregation of Scope 1-2 GHG emissions by consolidated accounting group and unconsolidated investees
- Potential disaggregation of GHG emissions by greenhouse gas (e.g. methane)

Double Materiality

The purpose of materiality

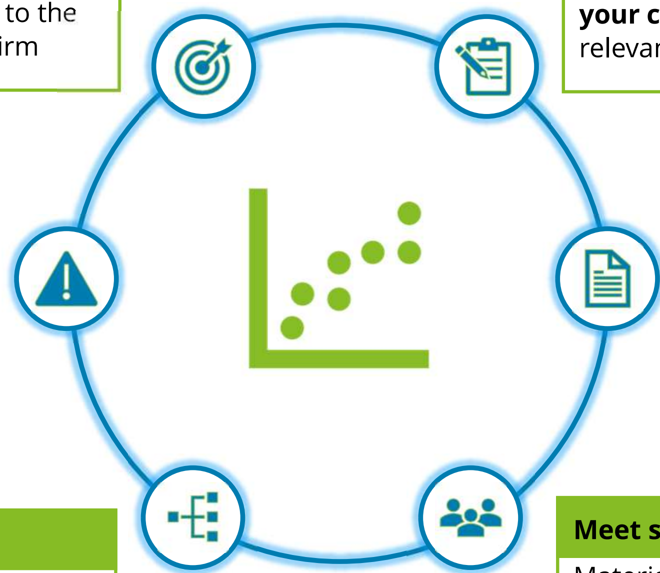
Materiality is an essential component to strategic ESG decision-making and planning. It drives necessary sustainability reporting and enables business to understand and communicate with stakeholders.

Strategic decision-making

The results will enable you to **align your ESG vision and strategy** to the most material topics for your firm

Sustainability reporting

The results can be used to **structure your communications**, improving relevance of your reporting



Risk and reputation

A materiality assessment **demonstrates your understanding of ESG risks to the business** and are taking measures to address them

Reporting requirements

Non-financial reporting expectations are increasing (such as, ISSB and CSRD) with a focus on the materiality process

Resource allocation

A materiality assessment will support in **effective allocation of resources and finance**

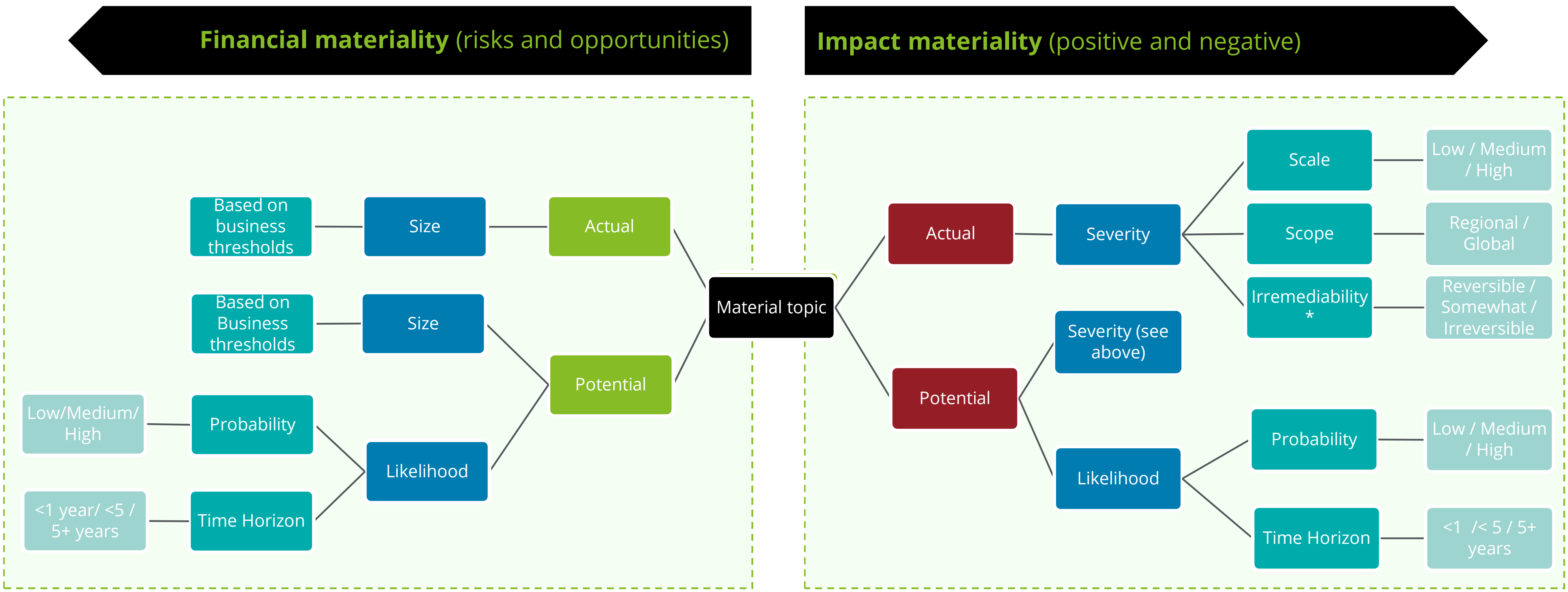
Meet stakeholder expectations

Materiality assessments give you access to **independent insights from your stakeholders**, allowing you to address their needs

Double Materiality

Navigating the nexus of materiality lenses

We approach financial materiality and impact materiality through the below system of thinking to ensure that for each topic we capture all of the lenses outlined in the CSRD.



Double materiality is the union of impact materiality and financial materiality. A sustainability topic will meet the criteria for disclosure even if it is only deemed material for either an impact perspective **or** financial perspective.

**only included when assessing negative impacts*

Glossary

Definitions

Definitions for commonly used terms throughout the activity are captured below.

Term	Definition
Corporate Sustainability Reporting Directive (CSRD)	CSRD is a cornerstone of the EU Green Deal that aims to create a sustainable economy in the European Union. CSRD aims to go beyond reporting to embed sustainability in strategy, policies, performance management, technology and controls implementation, change management and audit readiness. Furthermore, implications entail decarbonisation actions and implementing due diligence processes.
Double materiality	Double materiality is an extension of the key accounting concept of materiality of financial information. It assesses the impact sustainability issues have on a business ("outside-in") and how a business' activities impact society and the environment ("inside-out").
Impacts, Risks and Opportunities (IROs)	Sustainability Impacts, Risks and Opportunities are identified through the double materiality assessment and reflect the impacts of sustainability issues on the business, the sustainability risks that need to be mitigated and the sustainability opportunities that could be harnessed.
International Sustainability Standards Board (ISSB)	ISSB was set up by the International Financial Reporting Standards (IFRS) Foundation in November 2021, with the aim of developing a comprehensive global baseline of sustainability disclosures focused on the needs of investors and the financial markets. With two standards (on sustainability- and climate-related risks and opportunities) ISSB uses the four pillars of governance, strategy, risk management, and metrics and targets to embed sustainability and climate considerations into strategic decision-making.
Sustainability-related risks and opportunities (SRR&O)	The ISSB requires companies to assess their Sustainability-related risks and opportunities (SRR&O) over different time horizons. Companies are required to assess risks and opportunities arising from sustainability-related issues i.e. activities that affect a company's ability to deliver value for investors and impacts its stakeholders, the society it operates in, and the natural resources it depends upon.