



# ESG and internal controls: practical advice to prepare now

November 2021



# With you today



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01

# Introduction

# Introduction

## **ESG: Environmental, Social, and Governance**

Environmental, social, and governance issues represent the nonfinancial factors used to evaluate a company's practices around the conservation of the natural world, the consideration of people and relationships, and the standards of running a company.

Consumers and investors expect companies to take positive action on issues such as climate change, social justice, diversity and inclusion, and exploitation of workers.



02

# What is ESG and why now?

# ESG background and importance

The ESG categories can be broken down into dozens of subcategories, including:

## Environmental



### Conservation of the natural world:

- Climate change and emissions
- Air and water pollution
- Biodiversity
- Deforestation
- Energy efficiency
- Waste management
- Water scarcity

## Social



### Consideration of people and relationships:

- Customer satisfaction
- Data protection and privacy
- Gender and diversity
- Employee engagement
- Community relations
- Human rights
- Labor standards

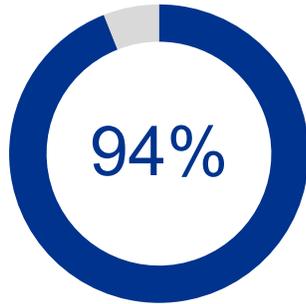
## Governance



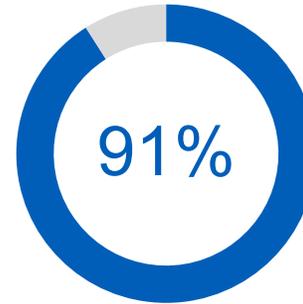
### Standards for running a company:

- Board composition
- Audit committee structure
- Bribery and corruption
- Executive compensation
- Lobbying
- Political contributions
- Whistleblower schemes

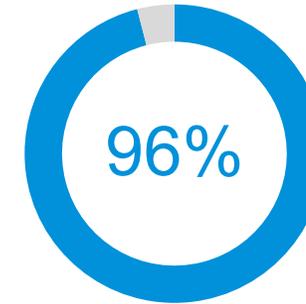
# 2021 CEO outlook pulse survey results – ESG perspectives



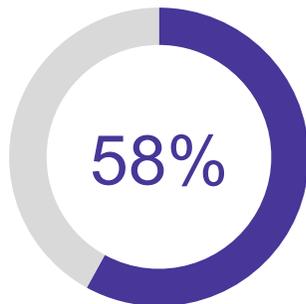
say their focus **will shift toward the social component** of ESG programs in response to the pandemic



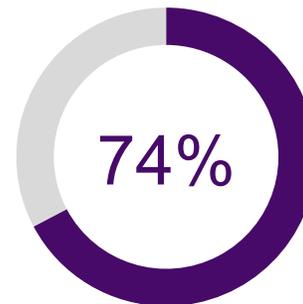
say the United States reentering the **Paris Climate Agreement** will cause their company to have more stringent ESG practices



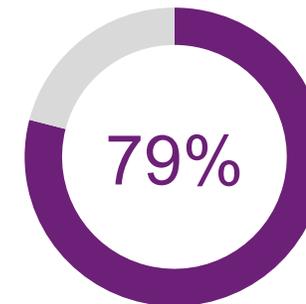
say the **scrutiny of their organization's diversity performance will continue to increase** over the next three years



say **progress on diversity and inclusion** has moved much too slowly in the business world



say there is still a huge amount to do to **build more diversity on boards**



want to **lock in the sustainability and climate change gains** they have made during the pandemic

Source: KPMG 2021 CEO Outlook Pulse

# Why is ESG important?

## Rising C-suite, board, and market attention on ESG



- Increased emphasis on management of ESG-related policies and practices from investors, employees, customers, and community at large
- COVID-19 has increased awareness and urgency on a company's response to ESG risks
- Investors want companies to be transparent about their ESG policies and want managements and the board to be held accountable
- Increase focus by investors on ESG disclosures when making investment decisions



# Why is ESG important? (continued)

## Meeting bold ESG ambitions



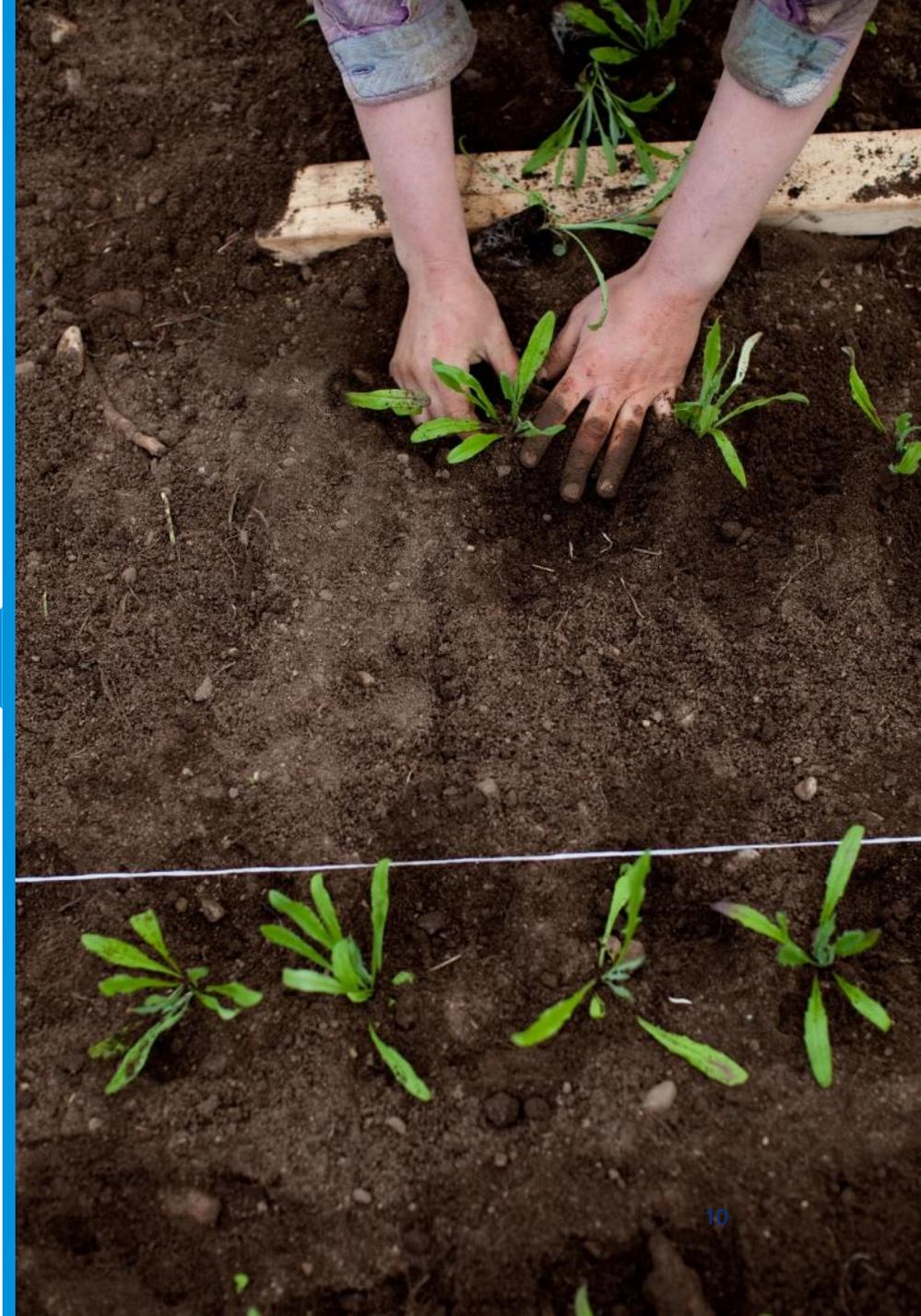
- Align sustainable growth and resiliency goals with financial ROI
- Understand fragmented and complex ESG area
- Strategize and execute upon ESG ambitions
- Design solutions to be industry-driven for diverse needs

*“We are prepared to use our proxy voting power to ensure companies are identifying material ESG issues and incorporating the implications into their long-term strategy.”*

– Cyrus Taraporevala,  
State Street Advisors,  
in a letter to SSgA board

*“By 2030 Microsoft will be carbon negative, and by 2050 Microsoft will remove from the environment all the carbon the company has emitted either directly or by electrical consumption since it was founded in 1975.”*

– Microsoft CEO Satya Nadella

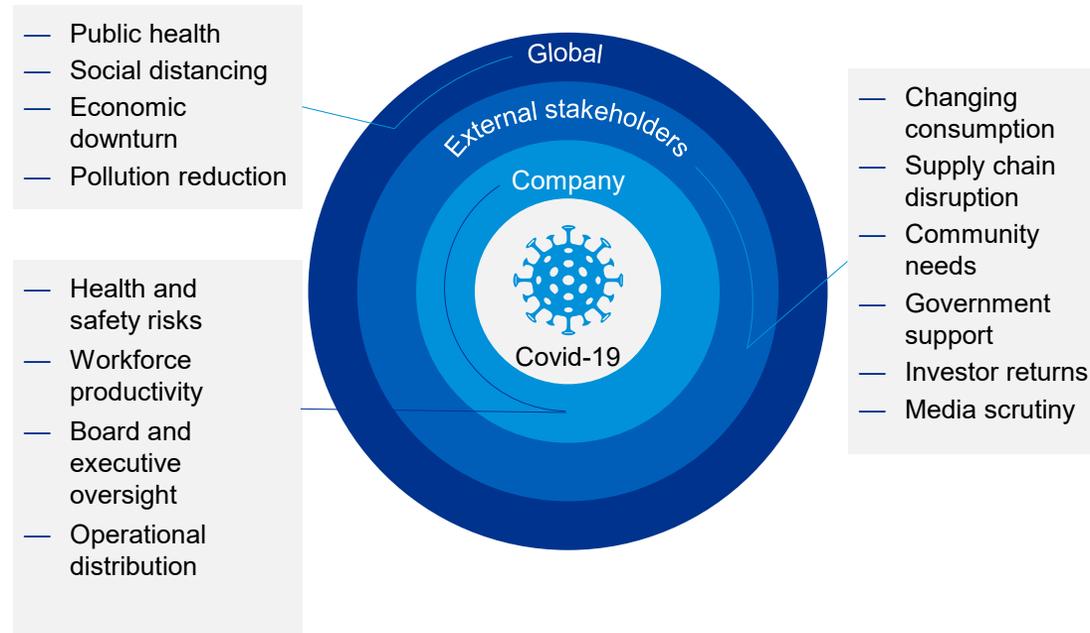


## What is ESG and why now

# Evolution of ESG in a post-COVID-19 world

Increasing materiality of environmental and social risk factors with the importance of governance in the wake of COVID-19 pandemic

### COVID-19 ESG Ripple Effect



Source: S&P Global Ratings.

### “E” Factors: Environmental Risk in a Time of Uncertainty



Greenhouse gases



Waste



Water



Land use

### “S” Factors: Social Distancing and Beyond



Workforce and diversity



Safety management



Customer engagement



Communities

### “G” Factors: A Litmus Test for Good Governance



Structure and oversight



Code and values



Transparency and reporting



Cyber risks and systems

# CPE QUESTION #1

How comfortable are you with the ESG topic as a whole?

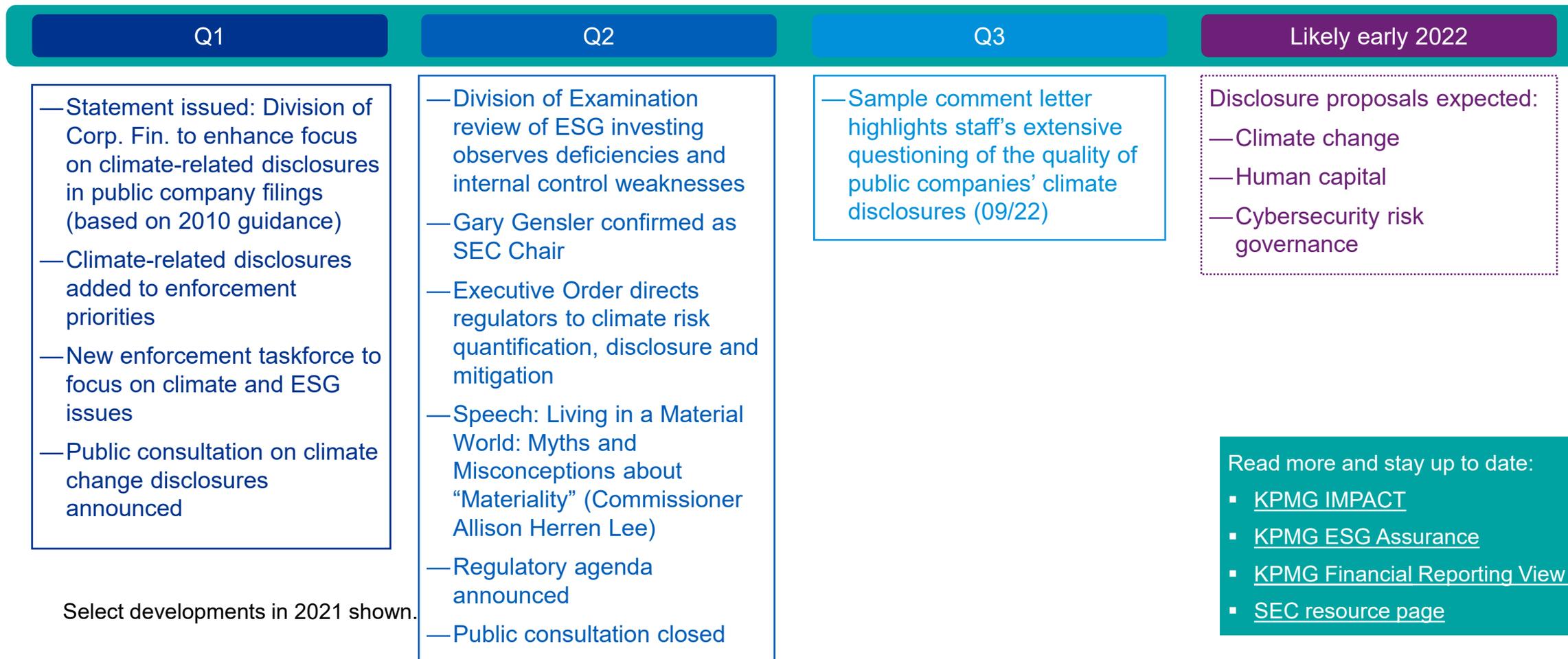
- A. Little knowledge
- B. I have been reading up on it but have a way to go
- C. I am proficient in my understanding

03

**The changing  
regulatory environment**

# SEC developments happening at pace

**Latest news:** SEC staff questions quality of climate disclosures



# Leading ESG guidance and reporting frameworks

A set of core first- and second-generation initiatives, frameworks, and guidance examples are outlined below.

	<p><b>Global Reporting Initiatives standards</b></p> <ul style="list-style-type: none"><li>— Early, broadly accepted methodology to homogenize sustainability reporting; periodically updated to improve disclosure quality and meet sector-specific needs</li><li>— Reporters identify their material focus areas and tailor reporting to cover those topics</li><li>— GRI provides E, S, and G topic-level disclosures for material focus areas, which include both qualitative and quantitative disclosures</li></ul>
	<p><b>Sustainability Accounting Standards Board</b></p> <ul style="list-style-type: none"><li>— Modeled on the Financial Accounting Standards Board (FASB); aims to create a focused, standardized reporting framework tailored to corporate needs</li><li>— The global economy is divided in 77 subsectors; for each subsector, material topics were identified, and topic-specific metrics were developed</li><li>— Rapidly growing support among investors and corporation alike</li></ul>
	<p><b>Task Force on Climate-related Financial Disclosures</b></p> <ul style="list-style-type: none"><li>— TCFD requires entities to consider and assess risk and opportunities poised by climate change to the business and its operations</li><li>— Analysis is forward looking, covering strategic and tactical considerations as well as the quality of governance and management</li><li>— Institutional asset managers are beginning to expect (but not yet require) TCFD analysis</li></ul>
	<p><b>World Economic Forum: ESG Metrics</b></p> <ul style="list-style-type: none"><li>— Newly developed ESG metrics incorporating leading practices from current reporting frameworks</li><li>— Core and expanded metrics to report on ESG performance and track their contributions toward the SDGs</li><li>— Develop in coordination with the Big Four accounting firms</li></ul>
	<p><b>Carbon Disclosure Project</b></p> <ul style="list-style-type: none"><li>— Nonprofit organization for companies and other organization to submit and disclose details of their environmental impacts—typically, GHG emissions and water</li><li>— Companies are asked to populate surveys, which capture details of emissions scope and scale, and ambitions to modify and manage emissions</li><li>— Submissions are scored for completeness, transparency, and planned mitigations. Scored survey materials are shared via a searchable, public-facing database.</li></ul>
	<p><b>Sustainable Development Goals</b></p> <ul style="list-style-type: none"><li>— Set of 17 goals to achieve “a better and more sustainable future”</li><li>— Governments and corporations can enable/support progress toward goals through their actions and support</li><li>— Wide market support and acceptance, but actions are entirely voluntary and lack tangible metrics/disclosures to evidence support</li></ul>

As ESG-related flows continue to increase, companies must integrate ESG into their policies and procedures. The noted initiatives, frameworks, and guidance offer a starting point for building and evidencing integration.

## CPE QUESTION #2

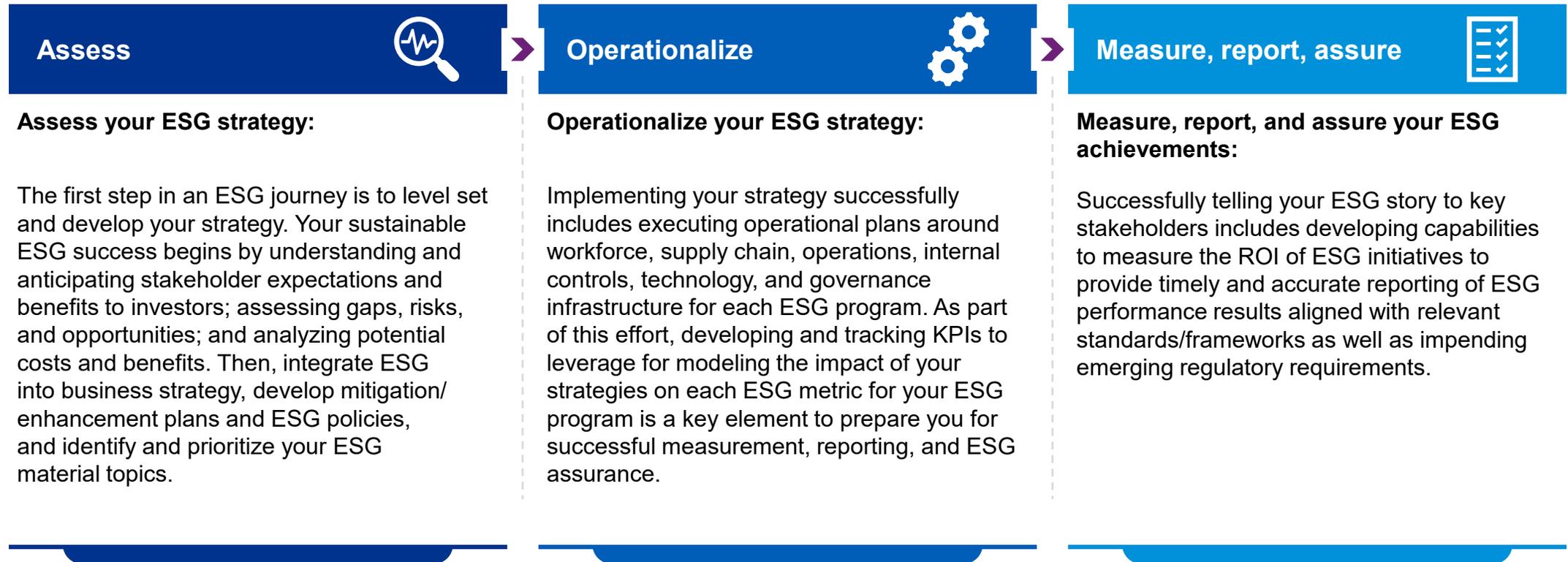
What part of ESG do you believe your company is most focused on?

- A. E – Environmental
- B. S – Social
- C. G – Governance

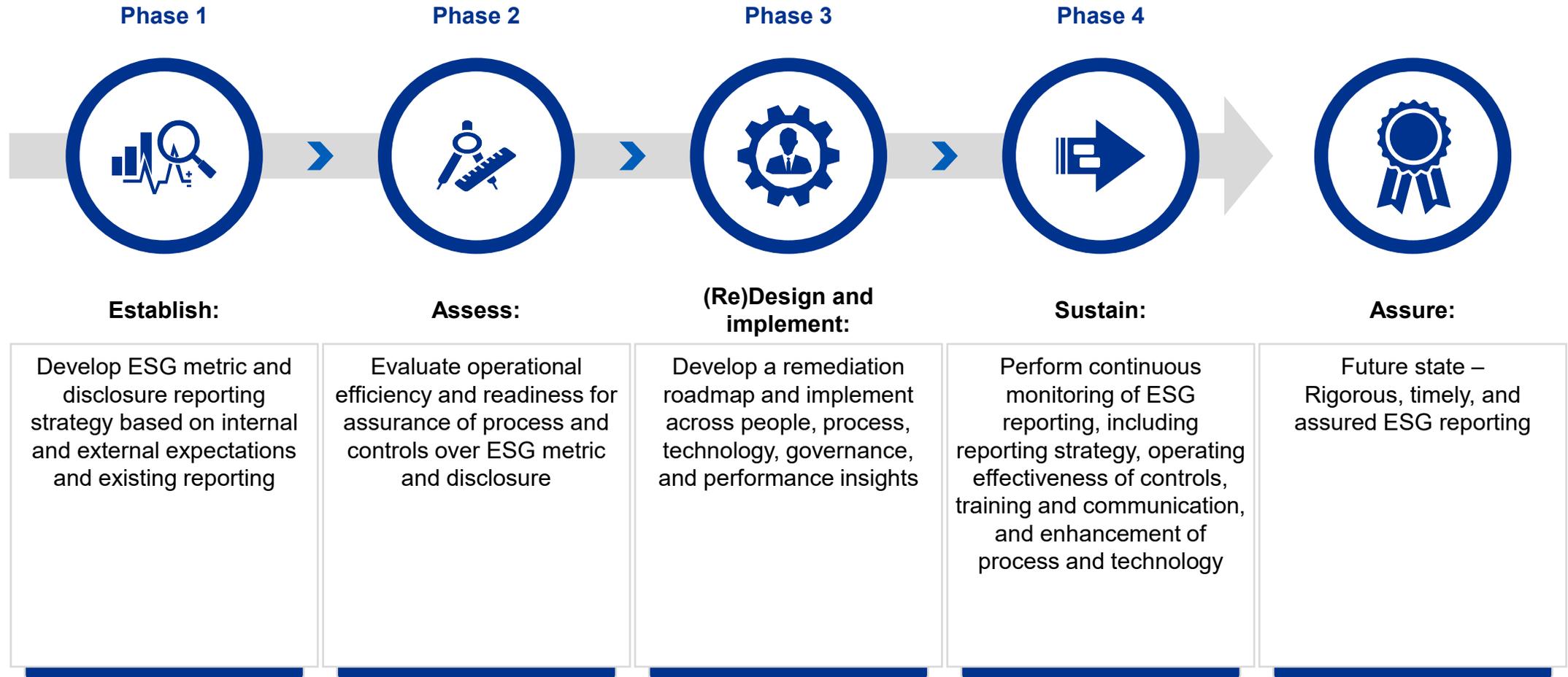
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# Implementation approach

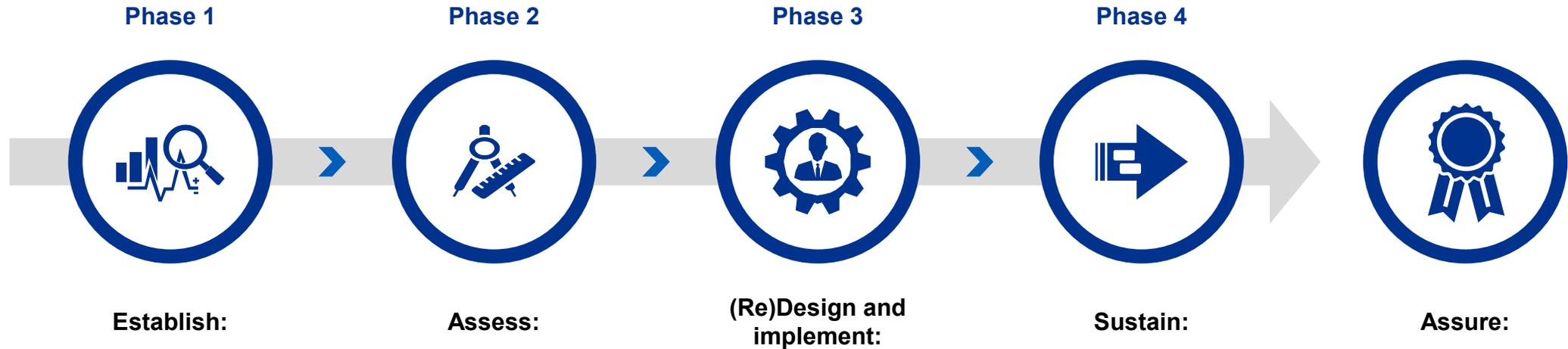
# The ESG journey



# The ESG Journey – Road to assurance



# Similarities in the SOX and ESG journeys



# Addressing key ESG measurement, reporting, and assurance questions

What is my ESG reporting strategy?	How do I embed ESG reporting in my operating model?	How do I measure ESG reporting progress and tell my ESG story?
What ESG information should I report? Am I reporting the material information?	How do I obtain the data needed for ESG reporting requirements? How do I partner with the functions I need data from?	What is rigor of reporting and review based on reporting structure (e.g., audience, alignment with standards and frameworks, sustainability reporting, proxy, 10-K, etc.)?
How am I reporting versus my peers? What is the gap between the current state and future state of successful reporting?	Which processes need to be updated/improved to properly capture ESG data?	How do I determine whether reporting goals have been achieved and continually monitor for improvement?
How do I know which standard or framework should guide ESG data reporting?	Where should internal controls be implemented to address data and reporting risk?	How do I validate that my data and reporting is complete and accurate?
How do I distinguish between ESG data needed for financial reporting versus sustainability reports?	How do we remediate gaps and process improvement opportunities identified in the current reporting structure and performance?	How do I know what and how much to include in final reporting?
What are my internal versus external ESG reporting requirements, e.g., regulatory, etc.?	How do we integrate D&A to improve our reporting?	How do I attest the accuracy and completeness of my ESG reporting to investors and stakeholders?
How do I align data ownership regarding ESG data and reporting requirements?	Which data sources, tools, and technology are needed/need to be enhanced to enable effective ESG data gathering and reporting?	
	Should certain tasks be outsourced versus internally developed?	
	Can data gathering or verification be automated?	

## CPE QUESTION #3

What role does internal audit play in the ESG space at your company?

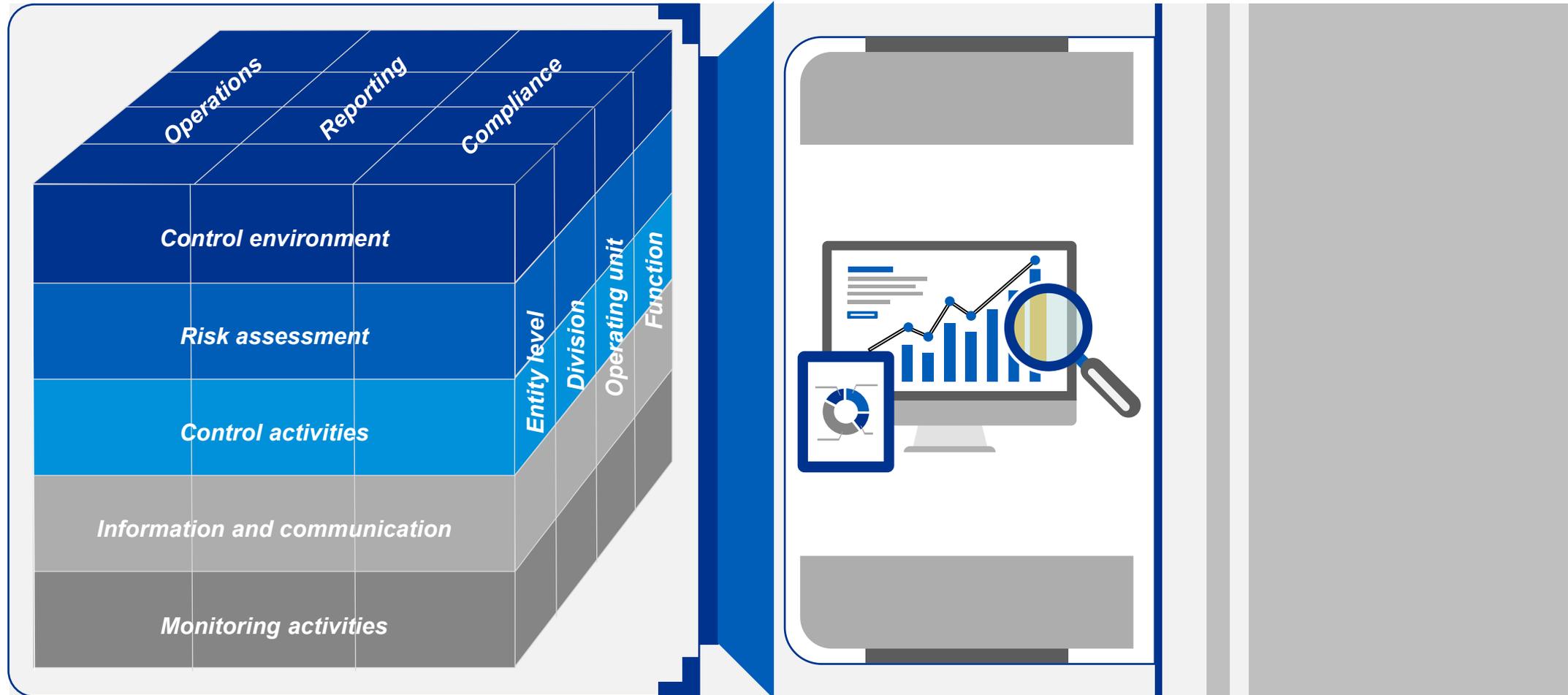
- A. None.
- B. Internal audit is defining where they fit in.
- C. Internal audit is actively auditing and supporting our efforts.
- D. I don't know.

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# Internal control considerations

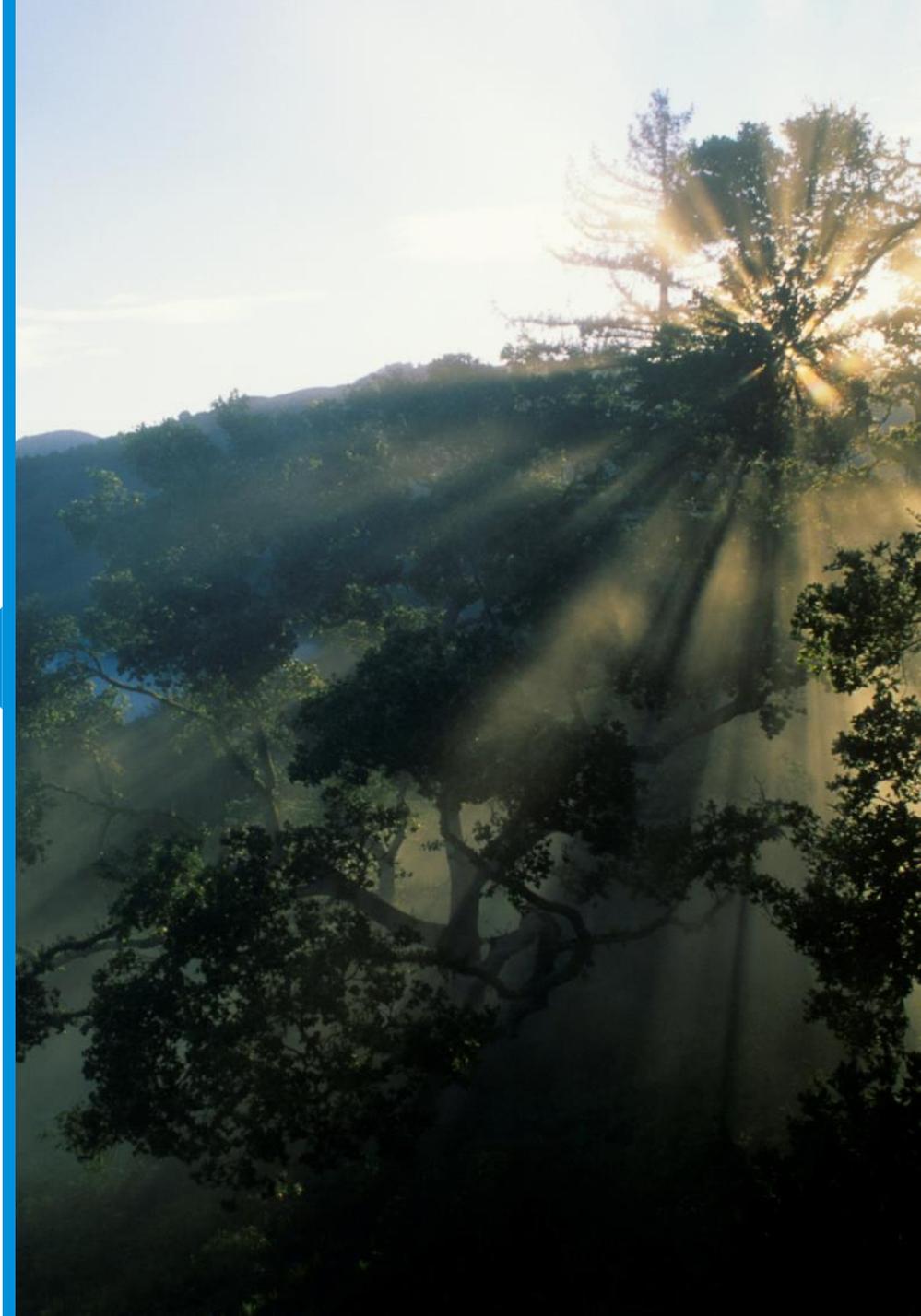
# Internal control considerations

## COSO model



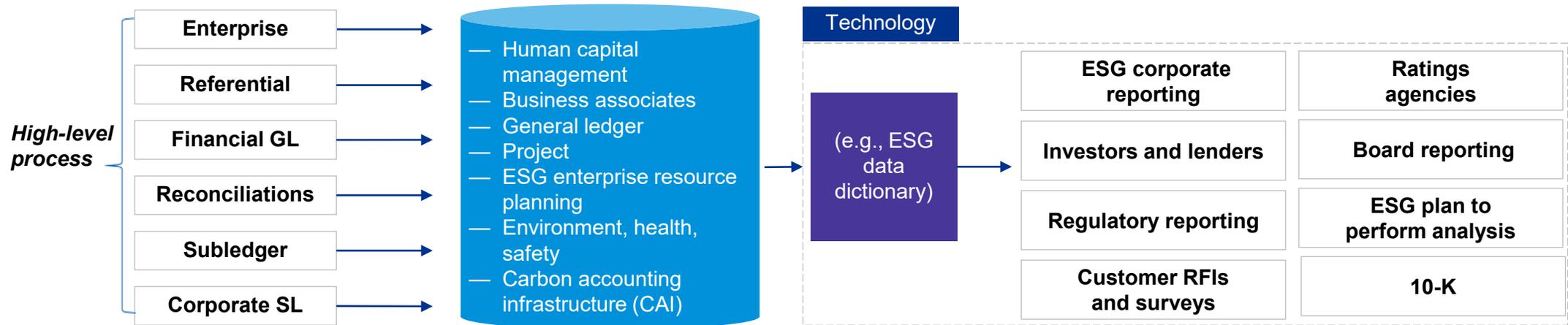
# Internal control considerations

- ▶ Completeness and accuracy of data
- ▶ Policies and definitions of measurement
- ▶ Homogeneity across process and definition
- ▶ Governance structure
- ▶ IT general controls
- ▶ IT access controls
- ▶ Data lineage
- ▶ Review and approval
- ▶ Support for assumptions and estimates



# Potential considerations to reporting production process

Introduction of nonfinancial reporting into the financial reporting processes can bring a number of challenges.



## ESG reporting integration considerations

Data	Aggregation	Report production	Control framework
<ul style="list-style-type: none"> <li>— New, nontraditional data sources (i.e., HR)</li> <li>— Data owners not familiar with reporting requirements</li> <li>— External data onboarding and quality challenges</li> </ul>	<ul style="list-style-type: none"> <li>— Aggregation</li> <li>— Financial and nonfinancial</li> <li>— Need to develop new, or expand existing, governance and ownership</li> <li>— Multiple submission sources with potential duplication</li> </ul>	<ul style="list-style-type: none"> <li>— Varying frequency across “E,” “S,” and “G”</li> <li>— Varying consumers with different literacy levels</li> <li>— Significantly different reporting templates</li> </ul>	<ul style="list-style-type: none"> <li>— Certification and “SOX caliber” attestation may be required eventually</li> <li>— Complicated case management process</li> <li>— Development and onboarding of new controls with testing</li> </ul>

## CPE QUESTION #4

Who is responsible for ESG in your company?

- A. Finance/accounting
- B. General counsel
- C. Investor relations
- D. Other

06

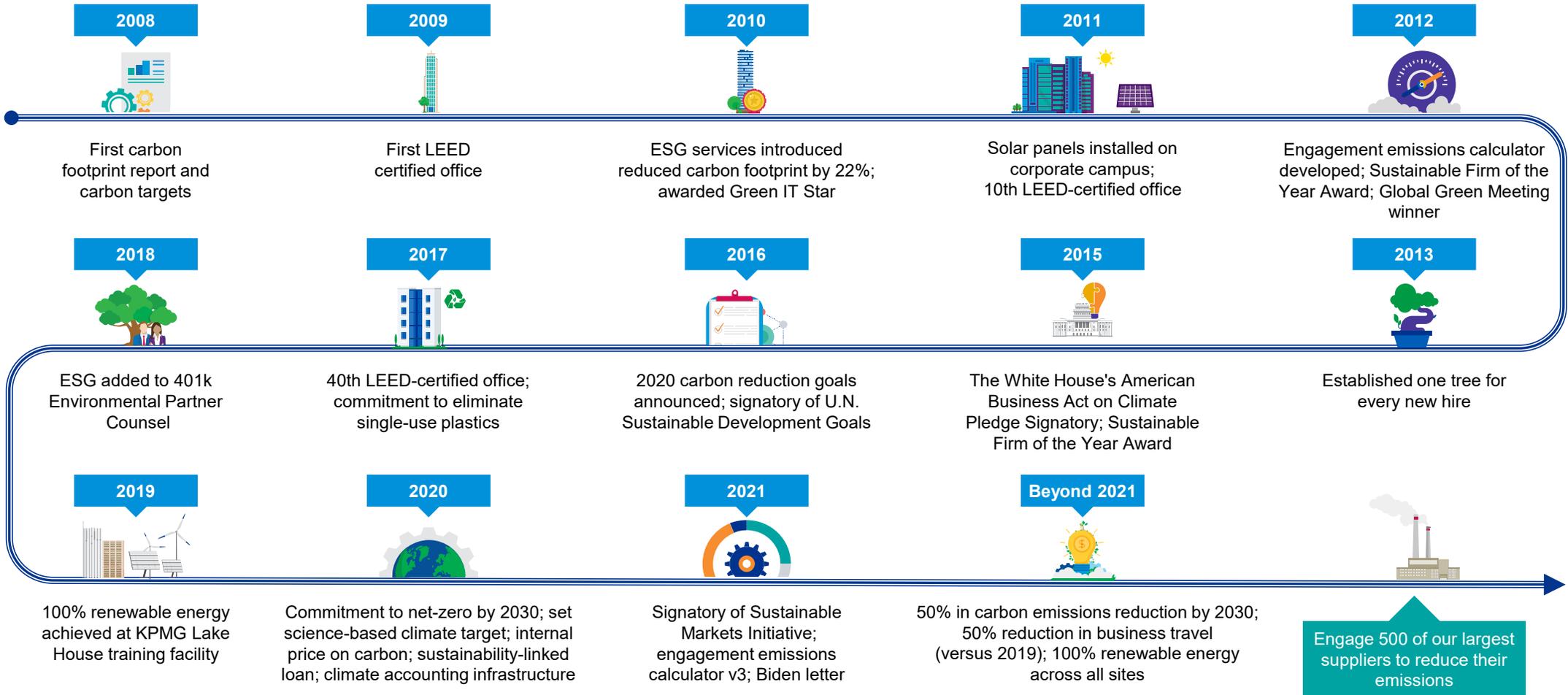
# Example ESG disclosures

# KPMG: Our impact plan

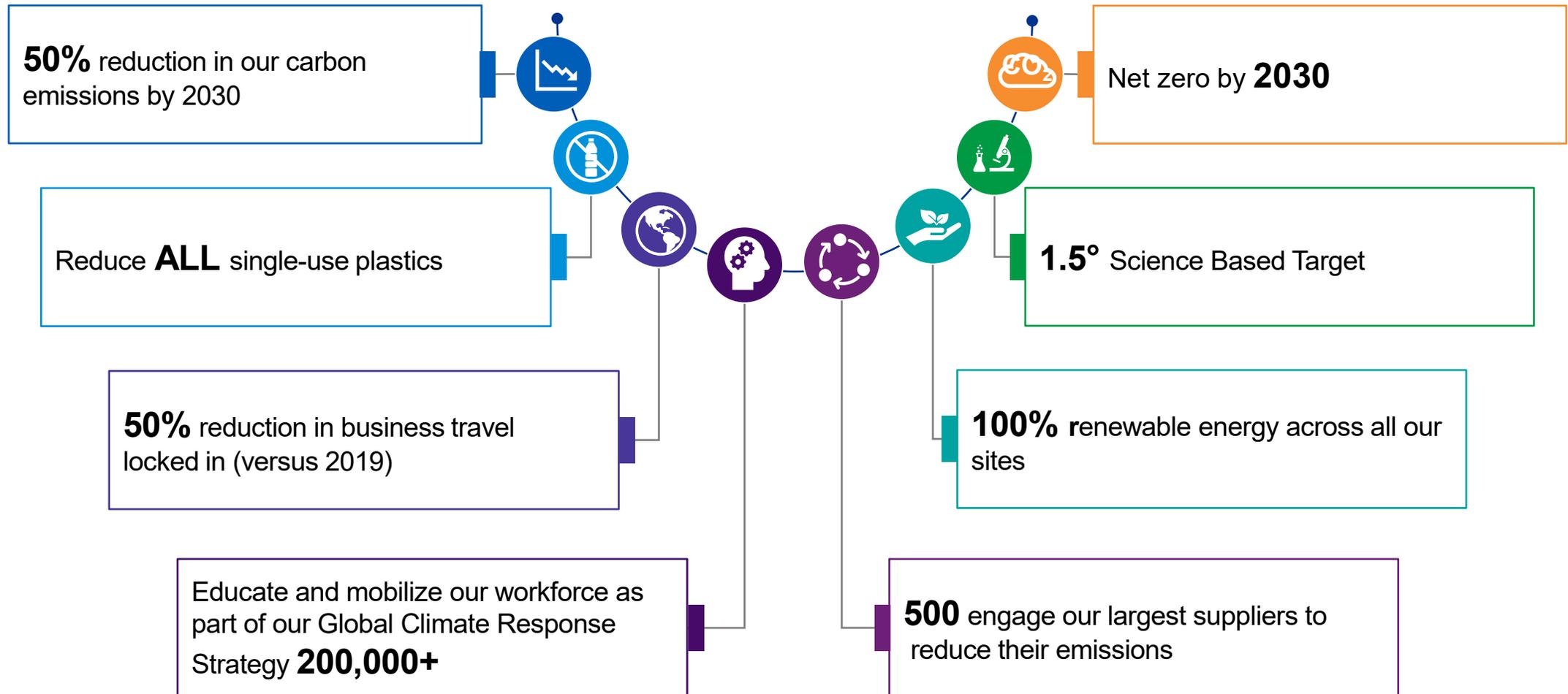
KPMG brings together our environmental, social and governance (ESG) commitments under one umbrella, Our Impact Plan, which incorporates our roadmap to become net-zero by 2030 and our commitment to increase inclusion and diversity and to drive sustainable growth for clients and stakeholders.



# The KPMG environmental journey



# KPMG global and U.S. commitments to ESG



# KPMG impact: Diversity, equity, and inclusion | Community



Time

People

Money

Employee  
volunteer hours

Hours spent  
serving on  
nonprofit boards

Nonprofit  
organizations  
supported

Employees who  
serve on non-  
profit boards

Total amount of cash  
contributions from  
KPMG LLP and KPMG  
Foundation

191k

24.5k

6,050

1,194

\$28m

## ACCELERATE 2025

- Initiative to create a firm that demonstrates the **rich and diverse cultures within the U.S.**
- Ensures more **underrepresented groups choose KPMG** as their employer of choice and advance to leadership positions
- Taskforce of business leaders established across the entire organization to **amplify efforts beyond the traditional departments like HR/People**
- Focuses on **bold leadership, values-driven perspectives, and being anchored by accountability** to achieve the goal

**178** Diversity Networks and Inclusion Councils

- African American
- Abilities in Motion
- Asian Pacific Islander
- Hispanic Latino
- KPMG Network of Women
- pride@kpmg?
- Veterans

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**60%** Employees and partners are diverse

More than **62%** New hires are diverse

**57%** Promotions into and within management are diverse

**KPMG**  
recognized for  
diversity and  
inclusion

## CPE QUESTION #5

How robust do you feel your internal controls are around your current ESG disclosures?

- A. I feel good
- B. I have some concerns
- C. I don't feel good
- D. N/A

07

# Thought leadership

# Select ESG-focused thought leadership

## Thought leadership



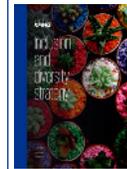
Dive into how utilities can turn ESG reporting into a strategic advantage, building alignment with stakeholders.



The call to action on climate change has advanced over recent years with companies facing more pressure than ever to develop and execute a meaningful net-zero strategy. In a world of concerned stakeholders, organizations that fail to mitigate their emissions face the likelihood of reputation damage.



Company performance on ESG issues is becoming an increasingly critical performance metric for investors, consumers, and management. Finance can drive success in ESG and enhance the strategic role of CFOs and CAOs.



In today's environment, organizations can no longer afford to treat inclusion and diversity (I&D) as a public relations or human resources issue. In this paper, we assess guiding principles and key success factors for inclusion and diversity as a competitive differentiator.



The disruptions that affected all industries in 2020 will forever reshape the financial services industry. Here, from the KPMG report *Ten key regulatory challenges of 2021*, we share insights related to climate as well as environmental, social, and corporate governance (ESG).



Climate action is underway in Washington. President Joe Biden's Administration's stated goals include a pollution-free power sector by 2035 and a net-zero-emission economy by 2050.



We explore how organizations are using consumer data and data-led decision-making to build the right data set to help drive growth and mitigate the wrong blend of data elements, exploring a fine balance between consumer privacy and regulatory scrutiny regarding the appropriate use of personal data.

## Publications and events

### 2020 and 2021 KPMG US CEO Outlook



### Speaking Events

- UN Forum on Business and Human Rights
- The Global Responsible Investing Forum
- COP25 (December 2019)
- World Economic Forum

### Events and Webcasts



### Journal publications



## CPE QUESTION #6

Would you like to have a conversation with a KPMG professional to learn more about this topic?

- A. Yes
- B. No

# Thank you & upcoming webcast

Join us for the

## **Future of SOX: State of SOX & Internal Controls webcast**

Date: Tuesday, January 18, 2022

Time: 04:00pm – 05:30pm CET





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