



# Impact of Environmental, Social, and Governance (ESG) Regulation on Environmental Data

Louisiana Air & Waste Management Association Annual Conference

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# Illustrative Key ESG Topics for Reporting

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. Data driven ESG metrics are receiving more scrutiny from stakeholders.

## 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



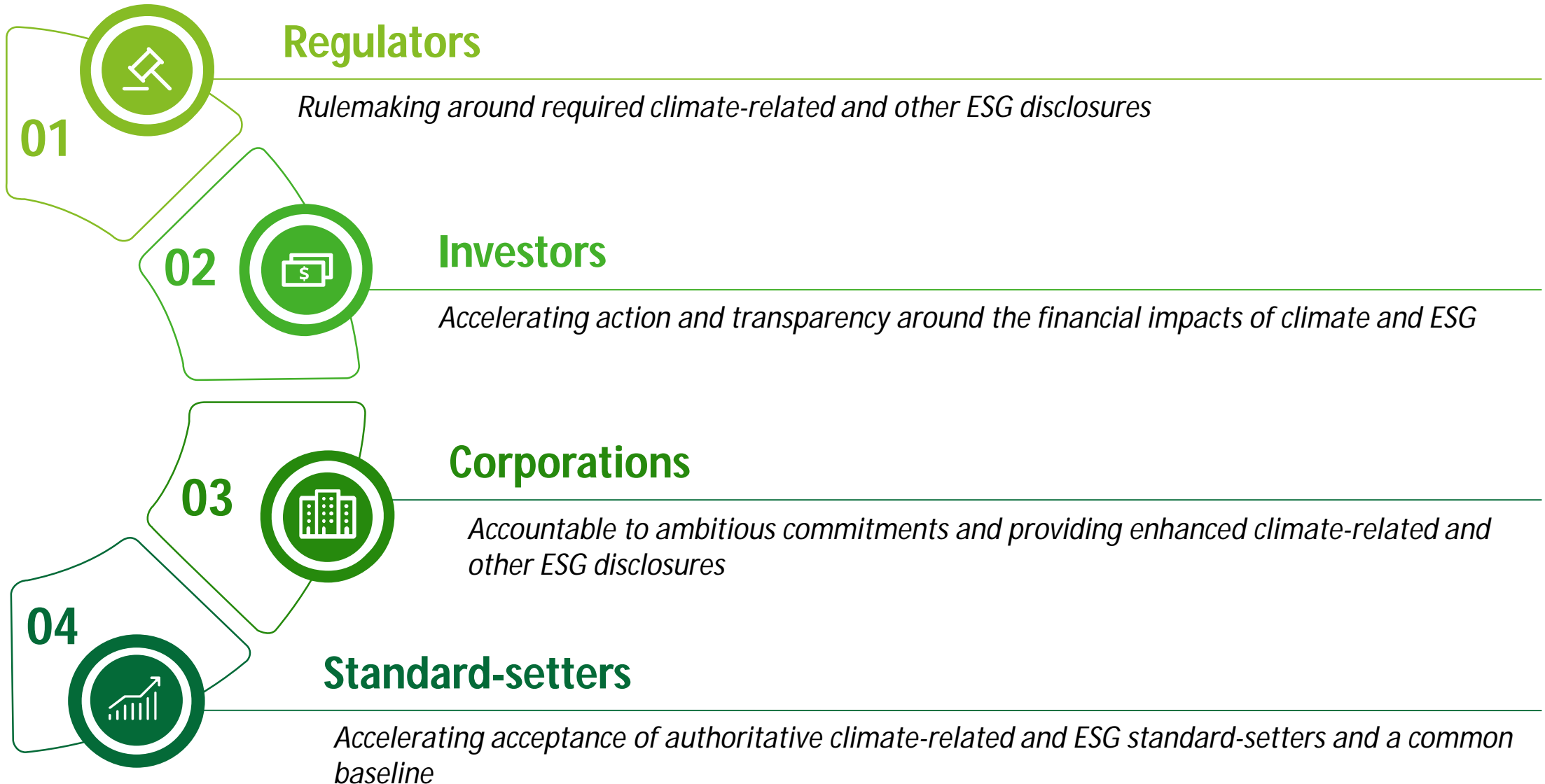
## Leadership & governance

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



# Drivers of ESG Acceleration

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



# Global ESG Disclosure and Regulatory Landscape is Evolving Rapidly

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

## United States:

- **SEC** proposed rule requiring disclosure of **governance of climate-related risks**, climate-related **financial statement metrics**, **GHG emissions data**, and information about **climate-related targets**.
- Passed legislation in **California** requiring disclosure of **GHG emissions data** and **climate-related financial risk** disclosure
- Proposed disclosure rule for **US federal contractors** to report **GHG emissions data**, **climate-related financial risk**, and **set science based GHG targets**

## European Union:

- The **European Commission** adopted 12 **European Sustainability Reporting Standards (ESRS)** which cover full range of ESG issues, including **climate change**, **air/water pollution**, biodiversity, and human rights
- **Carbon Border Adjustment Mechanism (CBAM)** requires reporting of **quantity** (net weight, tons) of each type of imported CBAM good, total **direct and indirect embedded GHG emissions**, **verification of emissions**, and **location of production** for:
  - Iron
  - Steel
  - Aluminum
  - Hydrogen
  - Fertilizers
  - Electricity

# Impact of ESG on Environmental Professionals

What's on the horizon: ESG-related regulation enhances Assurance, Governance, and Risk Management.



## Assurance

- Limited assurance of environmental metrics, followed by reasonable assurance
- ESG data being included in financial statements



## Governance

- Board oversight and expertise
- Established process for informing on climate and environmental risks
  - Remuneration policies
- Integration of sustainability into incentive schemes



## Risk Management

- Processes to identify, assess, and manage climate- and env.-related risks (both actual and potential)
- Significance/materiality of risks
  - Integration into overall risk management processes
- Adaptation/mitigation plans and policies



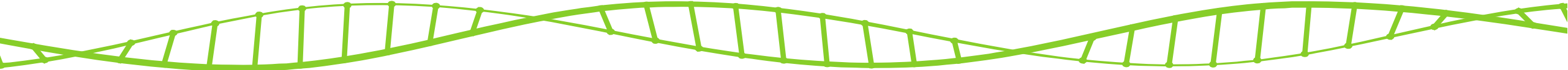
**Treating ESG Data with same care as Financial Data**



# Levels of Assurance Environmental Data may be Subject to

Below compares the two levels of assurance: limited assurance is most common in the ESG assurance space today.

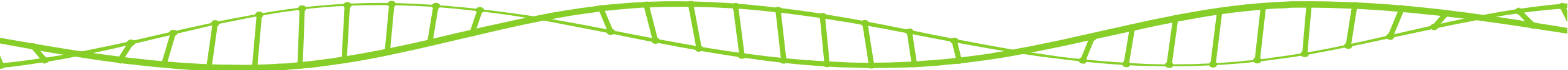
| Level          | Review (limited assurance)  | Examination (reasonable assurance)   |
|----------------|---|--|
| Report content | <b>Conclusion</b> about whether, based on the review, the practitioner is aware of any <b>material modifications</b> that should be made to the subject matter (e.g., GHG emissions) in order for it to be in accordance with the criteria (e.g., GHG Protocol), or to management's assertion, in order for it to be <b>fairly stated</b> | <b>Opinion</b> about whether the subject matter (e.g., GHG emissions) is in accordance with the criteria (e.g., GHG Protocol), in all material respects, or management's assertion is <b>fairly stated, in all material respects</b> |



# Levels of Assurance Environmental Data may be Subject to (Continued)

Below compares the two levels of assurance: limited assurance is most common in the ESG assurance space today.

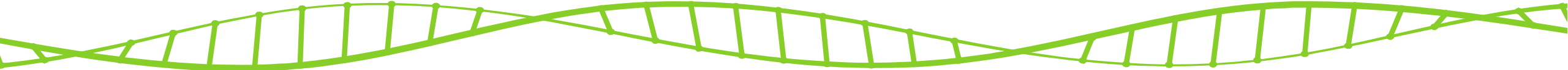
| Level                         | Review (limited assurance)  | Examination (reasonable assurance)   |
|-------------------------------|---|--|
| Evidence gathering procedures | <ul style="list-style-type: none"> <li>The nature and extent of procedures performed is substantially less than in an examination</li> <li>The nature, timing, and extent of procedures performed in a limited assurance engagement is limited compared with that necessary in a reasonable assurance engagement but is planned to obtain a level of assurance that is still meaningful</li> <li>Combination of assurance procedures, including any that would be performed for reasonable assurance</li> </ul> | <ul style="list-style-type: none"> <li>The nature and extent of procedures performed is substantially greater compared to a review</li> <li>The practitioner chooses a combination of assurance procedures which may include:               <ul style="list-style-type: none"> <li>Inspection, observation, confirmation, recalculation, reperformance, analytical procedures, and inquiry to obtain sufficient appropriate evidence by designing and implementing appropriate responses to assessed risks.</li> </ul> </li> </ul> |



# Levels of Assurance Environmental Data may be Subject to (Continued)

Below compares the two levels of assurance: limited assurance is most common in the ESG assurance space today.

| Level    | Review (limited assurance)  | Examination (reasonable assurance)  |
|----------|---|---|
| Controls | <ul style="list-style-type: none"><li>• Obtain an understanding of the control environment relevant to the subject matter</li><li>• Communicate control deficiencies identified</li></ul> | <ul style="list-style-type: none"><li>• Obtain an understanding of the control environment relevant to the subject matter including understanding the entity’s risk assessment process and the control activities relevant to the engagement and monitoring of controls</li><li>• Evaluate design and determine implementation of relevant controls</li><li>• Communicate control deficiencies identified</li></ul> |





# You are Likely Responsible for ESG Data Internal Controls

What is an internal control?

- **Internal control** is broadly defined as **a process**, effected by an entity's board of directors, management, and other personnel, **designed to provide reasonable assurance regarding the achievement of objectives in the following areas**<sup>1</sup>:
  - Effectiveness and efficiency of **operations**
  - Reliability of **reporting** – financial or ESG
  - **Compliance** with applicable laws and regulations

- 
- **Have you evaluated whether there are controls in place to adequately address ESG and environmental reporting risks?**
  - **Have you established with your team whether your controls, if operating effectively, can prevent or detect errors?**
  - **What is the frequency of the control and how that is appropriate in the context of the risk(s) it mitigates?**



# Utilizing Controls to Enhance Reporting

Controls may prevent or timely detect the spread of something undesirable.

## Types of controls:

**Preventive** — objective of preventing errors or fraud that could result in a misstatement from occurring

- Proactive and front-end “blocking” activities
- Emphasizes quality

### Examples:

- Segregation of duties in preparing annual emissions reporting
- System or document access controls (e.g., emissions monitoring systems, calculation workbooks)
- Comparison of emission factors in database with a third-party source



**Detective** — objective of detecting errors or fraud that has already occurred that could result in a misstatement

- Used to find loss, harm, errors, or irregularities after they have occurred
- Verify whether preventive controls are performed as intended

### Examples:

- Variance analysis on water discharge year over year
- Secondary review of third-party deliverables
- Review system access change logs



# Utilizing Controls to Enhance Reporting (Continued)

Controls may be manual or automated (or a hybrid).

## Nature of controls:

**Manual** — performed by an individual (e.g., approval signature)

### Examples:

- Variance analysis
- Calculate intensity metrics (e.g., production or hours vs total emissions)



**Automated** — mostly or wholly performed through information technology (e.g., automated control functions programmed into computer software)

### Examples:

- Restrictions on editing previously reported data and related support
- Restrictions on digits to prevent conversion errors, such as accidentally inputting natural gas usage in standard cubic foot (scf) vs million standard cubic foot (mmscf)



# Inquiry Alone is not Sufficient Evidence

As a control owner, it's critical to document and retain evidence of control performance and review.



## Documentation

In determining whether the evidence compiled is sufficient and appropriate to provide a reasonable basis for its evaluation, consider both:

- quantity of evidence (sufficiency)<sup>1</sup>
- quality of evidence - relevance and reliability (appropriateness)<sup>1</sup>

**Note:** Documentation is recommended to be continuously updated and maintained by management

1. AICPA AU-C Section 500 — Audit Evidence

# Ideal Control Documentation

Improving the sufficiency and appropriateness of evidence

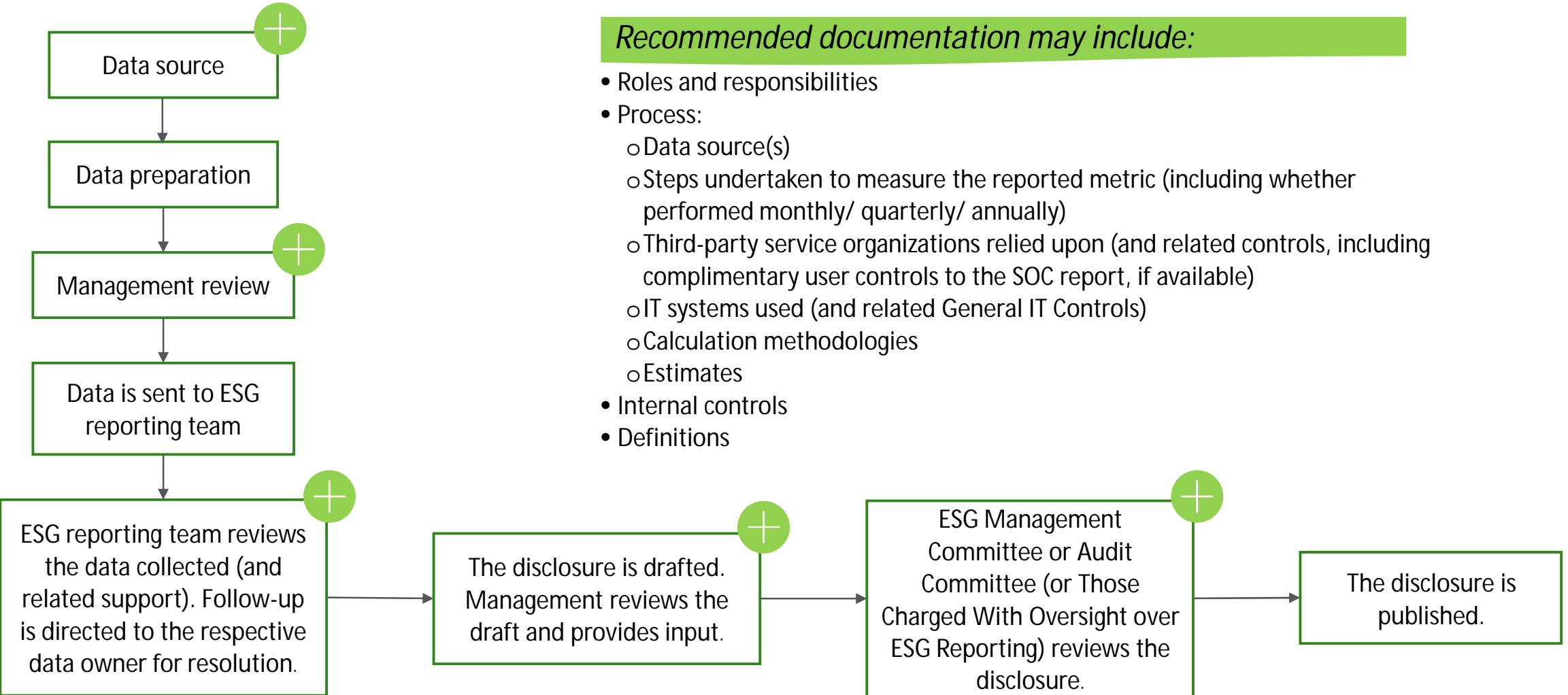


## For each instance of the control:

- Consistent and clear documentation
- Evidence of timely review (i.e., sign off and date)
- Evidence of review procedures documented within the support, which occurred at the time of review (e.g., highlighting the cells a different color, leaving a note next to the cell/item stating “checked formulas”)
- Cover sheet with review procedures clearly marked in a checklist with notes for how the control owner performed the procedures in the given instance
- Support readily available and organized in a control “packet”


# Example of Data Collection Processes and Internal Controls

Considerations to implement effective Data Process and Internal Controls



## Recommended documentation may include:

- Roles and responsibilities
- Process:
  - Data source(s)
  - Steps undertaken to measure the reported metric (including whether performed monthly/ quarterly/ annually)
  - Third-party service organizations relied upon (and related controls, including complimentary user controls to the SOC report, if available)
  - IT systems used (and related General IT Controls)
  - Calculation methodologies
  - Estimates
- Internal controls
- Definitions

 Represents internal controls to be identified and documented.

# Actions to Take Now

Accelerating preparedness for increased market and regulatory expectations for high quality and credible ESG disclosures



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



Hold personnel **accountable** for internal control responsibilities



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



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



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



Position oversight through **policies and procedures**



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