Preparing for a **sustainable future**

Issue 4 | Global
April 2023

Integrating Environmental, Social & Governance into Risk Management

Enhancing disclosures
Managing Risks
Improving outcomes

Why integrate ESG now?

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Leveraging existing capabilities

An integrated approach embeds ESG into strategy while leveraging existing governance mechanisms, with business operations at the core.

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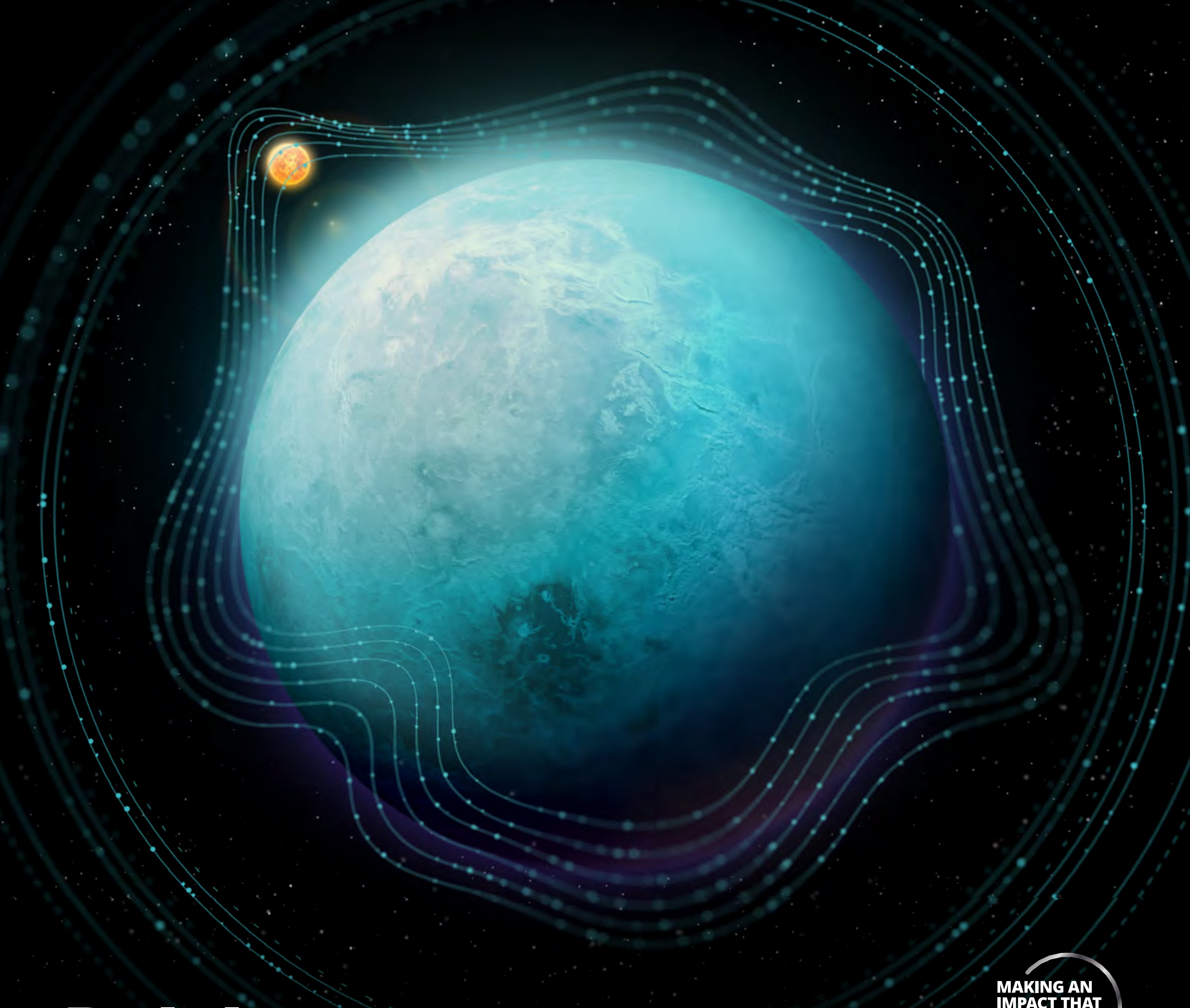
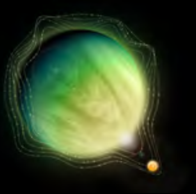


MAKING AN IMPACT THAT MATTERS since 1845

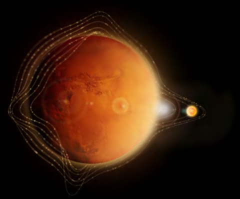
Our Integrated Risk Management series

Connecting the various parts of your business while keeping abreast of the impacts that social and political developments, weather or natural events and cyber attacks can bring isn't easy. This series of reports on integrated risk management, highlights how centralizing decisions and bringing disciplines together can make for improved decision-making and lead to a more effective approach.

Over the course of eight reports, we look at different themes and approaches to managing and governing your risk.

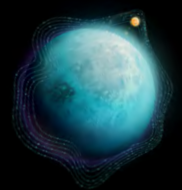


01: One small step
Improving your approach to risk governance often entrails reviewing, refreshing, and revising risk-related practices.

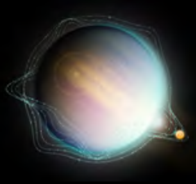


02: The connecting force
Building your integrated risk platform can help bridge silos, improve transparency and enable smarter decision-making.

03: Seeking new horizons
Navigating the constellation of markets, events and opportunities to preserve value and sustain growth.

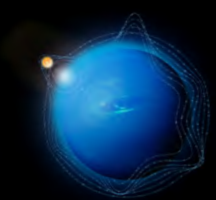


04: Preparing for a sustainable future
Harnessing the power of risk management to propel your ESG strategy and objectives.

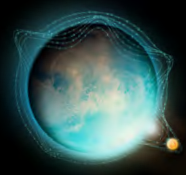


05: Mission unity
Building cohesive risk management to realize your purpose and achieve your planet, people and growth goals.

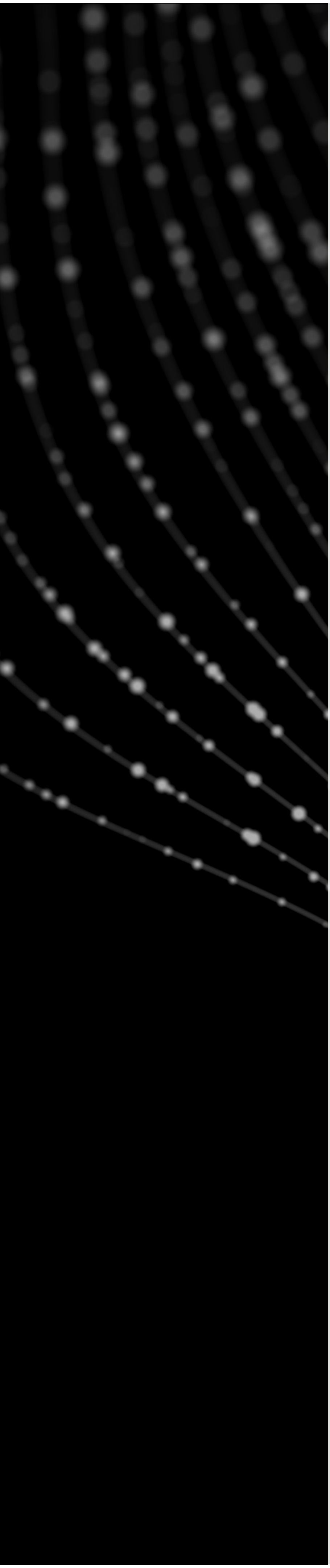
06: The biggest milestone
Transforming your capabilities and culture with confidence through unchartered space.



07: Greater intelligence
Developing an early warning radar to get ahead of emerging risks and opportunities.



08: Orbital forces
Integrating risk and assurance forces across the enterprise to build a cohesive system to manage risk well.



Integrating Environmental, Social & Governance into Risk Management

Managing the tension between the good of the organization and the good of society will test the mettle of senior leadership teams for years to come.

The environmental, social, and governance (ESG) issues driving this tension touch every area of the organization and all stakeholders. Adding to the challenges are evolving regulatory requirements and limited visibility into ESG risks and opportunities.

This means that approaches that integrate ESG risk management with enterprise risk management (ERM) and the business strategy have become essential.

The environmental, social, and governance (ESG) issues driving this tension touch every area of the organization and all stakeholders.

While many companies have ESG as a key element of risk management or the business strategy or both, relatively few have truly aligned ESG with ERM and the business strategy. Such an approach leverages existing ERM systems and embeds management of ESG risks and opportunities into activities at the operational level.

This document, the fourth in our series on integrated risk management (IRM)[1], is directed to senior executives, board members, risk managers, sustainability and ESG managers, and other leaders responsible for building and preserving enterprise value. Here, we present the case for integrating ESG into risk management, examine the roles of the board and senior executives, and discuss ways of framing and initiating the process.

1 Integrated Risk Management:
A comprehensive report series that explores risk frameworks, governance and intelligence platforms, 2020 – 2022
Deloitte Development LLC

Why integrate ESG now?

Ongoing climate, social, economic, demographic, and political change guarantees that the tension between organizational and societal needs will only intensify.

Given the multiple facets of ESG, no organization is immune to these forces and, while organizations in various sectors will face different challenges, most will need to address multiple ESG matters simultaneously (Exhibit 1).

Exhibit 1
ESG encompasses a broad range of risks and opportunities

Environmental

- Climate change responses
- Decarbonization
- Water usage and access
- Circular economy
- Product content and "green footprint"
- Sustainable supply chain
- Impacts of AI use
- Resilience to environmental events
- Environmental reporting & disclosures

Social

- Diversity, equity and inclusion
- Social impact / Community support and involvement
- Data privacy and cyber security
- Labor standards
- Human rights / due diligence
- Human capital management and workforce transformation
- Mental health & wellness
- Truth & reconciliation
- Social issues (e.g. war and racism) and resilience to social events

Governance

- Purpose and values
- Ethical conduct including ethical use of AI
- Reporting transparency and reliability
- Sustainable finance
- Corporate governance and board composition
- Fiduciary responsibility
- Leadership and board accountability
- Balancing stakeholder interests

The list of ESG issues in Exhibit 1 is hardly exhaustive; moreover, those issues vary across geographies and jurisdictions. For example, the EU's Corporate Sustainability Reporting Directive (CSRD) requires companies to report on the environmental and societal impact of their activities and requires limited assurance on nonfinancial reporting. Regulatory priorities in various geographies, together with the range and complexity of issues, strengthens the business case for taking an integrated approach to ESG. Such an approach will give senior executives and the board a clear, enterprise-wide view of ESG risks and opportunities and their potential impact on various stakeholders.

Consider these facts:

- ***Investors:*** Eighty-two (82) percent of investors believe that ESG integration will lead to outperformance in equities over the next three years[2]. Investment funds focused on organizations with sound ESG policies are seeking not only environmentally and socially responsible investments, but also those they see as more profitable and less exposed to ESG risks.

- ***Customers:*** Globally, some seventy (70) percent of individuals support organizing consumer boycotts against organizations they see as irresponsible[3]. On the other side, this represents an opportunity to win customers and their loyalty by addressing their ESG concerns through related policies, products, and services – and communication and disclosures.

- ***Employees:*** Eighty-six (86) percent of employees expect their CEOs to publicly speak out on important social issues[4]. ESG goals are seen as indicative of the organization's purpose and values, two elements that have become important in attracting and retaining talent, particularly among younger workforce.

- ***Suppliers:*** More than 1,000 organizations have set science-based targets to reach net-zero emissions[5]. Indeed, participants across the value chain are expecting their business partners to support their ESG goals, not only philosophically but with explicit targets, for example, regarding Scope 3 emissions.

- ***Regulators:*** The European Financial Reporting Advisory Group (EFRAG) and the UK's Financial Conduct Authority (FCA) aim to expand policies and disclosure requirements around ESG. While lagging the EU, the Asia-Pacific region has initiated a number of carbon reduction and reporting measures. In the United States, the Securities and Exchange Commission (SEC) and other regulatory bodies have similar aims regarding ESG reporting.

- ***Standard setters:*** The Global Reporting Initiative (GRI) and the Corporate Sustainability Reporting Directive (CSRD), along with rankings by The RepTrak Company, which ranks the reputation of the world's leading organizations, increasingly promulgate interest in and metrics related to ESG among investors, customers, and other stakeholders.

- ***Communities:*** Cities, provinces, states, governments, and countries in which organizations locate their operations or do business are deeply concerned about the ESG impact of those organizations on their citizens. These concerns find expression in news media reports, legislative initiatives, and lawsuits.

These and other stakeholder concerns translate to an urgent need for senior leaders to develop a more outside-in point of view. That perspective encompasses the full range of ESG issues as seen by external stakeholders, who determine the organization's reputation. An outside-in point of view considers issues not simply from the standpoint of the impact that ESG risks may have on enterprise value (the traditional inside-out view, which is still quite relevant) but also the potential impact of the enterprise on the environment, economy, and society.

2 ESG Asset Owner Survey: How Are Investors Changing? **2021 bfinance**

3 Radically Better Future: The Next Gen Reckoning for Brands, **2020 GlobeScan**

4 Edelman Trust Barometer, **2021 Edelman**

5 Companies Taking Action, **sciencebasedtargets.org**

The key challenges are twofold: first, how best to identify, assess, measure, monitor, and mitigate ESG risks and embed ESG into the business strategy and operations, and, second, how to measure the costs and benefits of addressing ESG issues through practical metrics and key performance indicators (KPIs). To address those challenges, organizations will need to bring ESG into IRM and operationalize management of ESG risks and opportunities at the day-to-day level.

Senior leaders understand this. Deloitte's 2022 ESG executive survey[6] indicates that organizations are moving from commitment to action as evidenced in the following findings:

- Nearly three (3) in five (5) executives (57 percent) report having implemented a cross-functional ESG working group to drive strategic attention to ESG while another 42 percent are taking steps to do the same.

- 61 percent report being prepared to disclose Scope 1 greenhouse gas (GHG) emissions, and 76 percent are prepared to disclose Scope 2 GHG emissions. However, most (86 percent) reported challenges measuring Scope 3 GHG emissions.

- While companies are enhancing sustainability disclosures, challenges remain. Major concerns cite data quality as the top data challenge – at 35 percent in 2022 versus 25 percent in 2021. Another twenty-five (25) percent cited access to data as the greatest challenge, down from 32 percent in 2021.

- However, nearly half (48 percent) are extremely or very concerned about not having adequate technology to facilitate ESG disclosure requirements.

These challenges reflect a larger issue. The data gathering, analysis, and reporting systems of most organizations are designed primarily to support operational and financial information needs. Leaders are now focusing on expanding those systems to include ESG data and KPIs to assist the organization in managing ESG risks and opportunities.

We believe that the board, in its role as advisor to management and overseer of organizational performance, has a responsibility to not only prioritize ESG as an agenda item in its meetings with management, but to prompt actions that move the organization to integrate ESG into IRM and more broadly into the organization's overall strategy.

Leaders are now focusing on expanding those systems to include ESG data and KPIs to assist the organization in managing ESG risks and opportunities.

6 ESG executive survey: Preparing for high-quality disclosures, 2022
Deloitte Development LLC

Boards can drive ESG

Deloitte's publication "*The 2023 Board Agenda*", examined issues of climate change, workplace and workforce matters, technology and cyber risk, the organization's role in society, and board composition and skills, among others, from the perspective of the last five years and as emerging topics[7].

In that same vein, "*On the audit committee's agenda | 2023: The year of the risk-centric agenda***"** noted that audit committee oversight will include a focus on the nature and extent of environmental and climate change disclosures, potential inclusion of ESG metrics in disclosures, and potential third-party assurance on ESG disclosures, depending on the jurisdictions where the organization does business[8].

A Deloitte and Center for Audit Quality (CAQ) 2023 survey of audit committee practices revealed a need for boards to take a fresh look at their audit committee structures, with an eye toward bolstering oversight and disclosures regarding ERM and ESG[9]. This report also noted that about one-third of respondents (32 percent) believe their audit committee members have appropriate ESG/sustainability experience and expertise. While somewhat encouraging, that percentage falls far short of where most audit committees need to be at this point.

This survey also found that responsibility for oversight of ESG disclosures and reporting most often rests with the audit committee (34 percent) followed by the full board (27 percent), and the nominating/governance committee (16 percent).

The above-cited publications supplement Deloitte Global's earlier research among 350 audit committee members across 40 countries[10], which found that a high percentage of boards have not fully addressed ESG risks as part of ERM.

Key findings include the following:

- 42 percent of respondents noted that their organization's climate response is not as swift and robust as they would like it to be.
- 70 percent have not completed a comprehensive climate change assessment, and only 18 percent confirmed that their climate impact assessment is reflected in their financial statements.
- 60 percent of audit committee members do not regularly discuss climate issues, and nearly half do not consider themselves "climate literate."
- Almost half do not believe they are well-equipped to fulfill their climate regulatory responsibilities.
- 65 percent noted that the main internal obstacle to progress on climate issues was lack of a clear strategy.

The latter point is good news because developing an ESG strategy is within the control of the senior executive team. In their governance and oversight roles, the board is well-positioned to call upon management to address ESG in the interests of the organization and its stakeholders.

7 On the Board's Agenda | The 2023 Board Agenda, 2023
Deloitte Development LLC

8 On the audit committee's agenda | 2023: The year of the risk-centric agenda, 2023
Deloitte Development LLC

9 Audit Committee Practices Report: Priorities and Committee Composition, 2023
Deloitte Development LLC

10 The Audit Committee Frontier – Addressing Climate Change, 2021
Deloitte Global

Questions for boards to pose to management might include:

- To what extent is ESG integrated into the overall organizational strategy and the business processes across the enterprise? Where could the organization benefit from improved integration?
- How is the organization's approach to ESG enabling the C-suite to understand strategic and emerging risks and opportunities?
- How is the organization integrating an understanding of strategic and emerging ESG risks into business operations? For example, how do business operations across the enterprise consider risks and opportunities related to ESG issues?
- How can the organization leverage existing capabilities within its ERM and governance framework to improve its understanding of emerging ESG risks and opportunities?
- How could strategic intelligence improve decision-making across the enterprise with respect to threats to strategy and opportunities to create value?
- What steps is management taking to identify, monitor, manage, and balance the ESG interests of the organization's stakeholders? How adequate are those steps, given those interests?

These and similar questions can prompt management to discuss and design initiatives that will bring ESG and ESG reporting into ERM and IRM. Fortunately, management can often readily leverage existing capabilities to support those initiatives.

Leveraging existing capabilities

An integrated approach embeds ESG into strategy while leveraging existing governance mechanisms, with business operations at the core.

Organizations can use existing infrastructure to set climate-related goals, identify opportunities as well as risks, conduct scenario analysis, undertake risk management actions, and support monitoring and reporting to fulfill rising stakeholder expectations to reduce GHG emissions and increase resilience.

A dynamic approach to ERM that leverages existing capabilities can help organizations to:

- Identify risks under various scenarios and chart a course for pursuing targets
- Capitalize on new business models, products and services, markets, and other value-generating opportunities
- Operationalize ESG initiatives and align them with risk topics, informed by cross-industry knowledge and an outside-in perspective
- Embed ESG management into existing models, tools, and technologies, making it more relevant to stakeholders and more collaborative with some stakeholder groups

Integrating ESG-related risk management processes into business operations can better position organizations to consider multiple risk domains within multiple functions and business units across the enterprise.

Generally, ERM can readily support ESG strategy and operations given its ability to:

- Facilitate identification, assessment, and management of emerging as well as existing risks
- Serve as a hub for addressing complex, interrelated, and cross-functional risks
- Include ESG in existing risk governance models and reporting structures
- Support change management for rollouts of risk-related processes
- Meet the needs and expectations of stakeholders inside and outside the organization

These capabilities should enable management to bring ESG considerations into strategic decisions and initiatives. ERM's risk anticipation, measurement, and monitoring capabilities, supported by risk analytics and data visualization technologies, can also bolster organizational vigilance, risk reporting, disclosures, and resiliency, providing support at every stage of the journey.

The ESG journey:

From reactive to proactive to integrated

Leading organizations are not waiting for regulators, investors, or other stakeholders to set the agenda. While bearing stakeholders' concerns in mind, they set their own agenda, one that will take those concerns into account while placing them in the context of the organization's purpose and strategy.

Embedding ESG into purpose and strategy fosters value creation, trust, brand equity, and resilience while identifying and addressing material risks as well as opportunities. Most organizations are in some phase of this journey, which often begins with a reactive commitment to corporate social responsibility and then moves to more proactive and comprehensive ESG models, culminating in integrated, purpose-led approaches (Exhibit 2).

Exhibit 2
The ESG journey

	Reactive: CSR	**Proactive: Comprehensive ESG**	**Integrated: Purpose-led organization**
Issue prioritization andstakeholder engagement	Sporadic assessments providing snapshots of concerns of specific stakeholder groups	Cross-stakeholder engagement to identify and integrate ESG topics into strategy, with the main focus on investors	Ongoing management of all stakeholder interests across the value chain, including upstream and downstream activities
Leadership and governance	Siloed CRS department generating positive PR, typically without strong board engagement or sustained ESG focus	Chief Sustainability Officer or equivalent drives ESG strategy, with board weighing in on key issues[11]	ESG driven by CEO working with the Chief Sustainability Officer and the executive team and the board to embed ESG into strategy and all activities; one or more board committees oversee various aspects of ESG with integrated ESG reporting to the board
Level of integration	ESG disconnected from strategy and purpose; CSR initiatives are ancillary to operations, products, and services	ESG efforts support operational effectiveness and are integrated into some aspects of operations, products, and services; there is some influence on strategy	ESG and purpose generate impact across operations, products, and stakeholder groups; ESG is integrated with strategy
Impact on stakeholders	Table stakes to build brand trust to support basic value proposition and license to operate	Stakeholders view ESG as important to the organization and see it as a differentiator	Stakeholders are loyal advocates and actively support the brand in broadly building trust

11 Deloitte CxO Sustainability Report 2023, 2023
Deloitte Global

Stakeholders are increasingly looking to organizations to provide more than products and services, and employment and monetary returns. They want organizations to fulfill a broader set of wants and needs. They want the organizations they work for, do business with, invest in, and host in their communities to reflect certain values. They want organizations to have a larger purpose.

That which the organization stands for is its purpose. Linking the purpose with actions is a key reason to embark on the journey to integrate ESG with strategy and embed it in operations.

For example, organizational uses of artificial intelligence (AI) are expected to drive cost savings and create new and disruptive business models, products, and services. Yet AI will also pose new risks, such as those related to unintentional model bias, operations, data privacy, intellectual property, deepfakes, fraud, cybersecurity, customer relationships, and ESG. The latter stem from energy usage, carbon footprint, impacts on stakeholders, and potential geopolitical risk. By articulating and activating specific AI risk governance and management policies, leaders can convey to regulators and other parties their commitment to extending their ESG commitments to uses of AI.[12]

While the changes driving ESG issues are occurring at different rates across different industries and jurisdictions, we see few (if any) scenarios in which ESG issues fail to impact enterprise value. Therefore, boards and senior executives – who are ultimately responsible for preserving and growing enterprise value – need to manage ESG risks in ways that address these changes.

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12 The biggest milestone: Transforming your capabilities and culture with confidence through uncharted space - addressing AI risks

Three key tasks:

Developing a risk taxonomy, assessing materiality, and incorporating ESG in risk appetite

To translate integrating ESG into IRM into actionable steps, we offer a glimpse into three key tasks – incorporating ESG into the risk taxonomy, assessing the materiality of ESG risks, and incorporating ESG into risk appetite.

Developing a risk taxonomy

The organization's risk taxonomy underpins everything from the risk register, to risk monitoring, to data analytics, to visualization tools such as heat maps. Historically, organizations have focused mainly on strategic, financial, operational, cyber, compliance, and legal risks. More recently, the focus has expanded to technological and reputational risks.

Deloitte's FORRESTT™ model provides a widely accepted framework for developing a risk taxonomy. As the acronym FORRESTT™ indicates, the model encompasses the most widely recognized risks: Financial, Operational, Reputational, Regulatory, Extended enterprise, Strategic, Technological, and Talent risks.

A FORRESTT™ + ESG model can accommodate these new risks and facilitate their recognition and classification, enabling the use of consistent risk language. Specifically:

- ***Environmental:*** Risks related to the organization's interactions with the physical environment, including sustainability, resource usage, and impacts on and from climate change
- ***Social:*** Risks related to how the organization interacts with the full range of its stakeholders including customers, employees, suppliers, investors, regulators, the media, and society
- ***Governance:*** Risks related to the methods and quality of the organization's governance and its adherence to ethical codes of conduct

Developing a risk taxonomy in this context calls for understanding the ways in which ESG risks can impact the organization and its stakeholders. This, in turn, calls for applying an ESG lens to the organization's finances, operations, extended enterprise, and other areas to determine which ESG risks could affect those areas and amplify other risks identified within the FORRESTT™ framework.

In developing the ESG risk taxonomy, organizations should consider regulatory viewpoints and guidance, when they exist. However, as regulators work to identify impacts, issue guidance, and promulgate metrics, leading organizations are developing their own ESG risk taxonomies.

Doing so provides four benefits: First, it enables them to integrate ESG more effectively into their IRM approaches and ERM systems. Second, it enables them to take proactive steps to address stakeholders' concerns and to provide relevant data regarding those concerns. Third, it positions them to have more informed conversations with standard setting organizations and regulatory agencies as they develop their metrics and guidance, including guidance for nonfinancial disclosures. Fourth, it enables them to better address ESG risks, now and in the intermediate to long term.

Assessing double materiality

The concept of "double materiality," first proposed by the European Commission in Guidelines on Non-financial Reporting[13],[14], is gaining traction. Furthermore, the new CSRD specifies the concept and tightens the scope of application. The double materiality concept can help in identifying and prioritizing material ESG risks, opportunities and impacts considering their effect on enterprise value (outside-in perspective) and the enterprise's impact on the environment and society (inside-out perspective).

Traditional, "financial materiality" (outside-in) assessments consider only the impact of risks and opportunities on enterprise value and how they are addressed. The "impact materiality" (inside-out) assessments consider the direct and indirect ESG impacts from the enterprise's business activities along the entire value chain on the environment and the society in a short-, medium- and long-term horizon.

These ESG risks, opportunities and impacts need to be identified, assessed, monitored, mitigated, and managed in an integrated manner. Here, especially the assessment of risks and opportunities by taking the short-, medium- and long-term perspective into account might require considering new assessment methods.

Therefore, given the greater shift from voluntary to mandated ESG reporting, and the introduction of the double materiality leads to the expansion of material issues. It has become a focus related to priorities and performance disclosure.

Determinations of materiality can highlight how ESG risks can impact traditional enterprise risks, such as GHG emissions as a driver of financial, legal, or reputational risks with potential short-term cost exemplary due to the EU ETS. Risks such as physical climate risks which will heavily impact most enterprises in 5, 15 or 20 years may require specific considerations, responses, and monitoring. Regarding strategy, this double materiality lens helps to underpin both risk mitigation and opportunities to be seized.

A double materiality assessment enables an executive team or board to ascertain alignment between risk management goals and the organization's strategy, mitigation activities, and reporting and disclosures.

Toward that end, this assessment facilitates:

- Understanding and prioritization of organization specific ESG topics based on ESG risks, opportunities, and impacts.
- Continuous improvement in ESG risk management, based on actionable information.
- Opportunities to strengthen relationships with key internal and external stakeholders.
- Data needed for robust KPIs regarding ESG efforts and related reporting, disclosures, and communications.

Regarding the latter point, CSRD require organizations to conduct a double materiality assessment to identify relevant risks, opportunities and impacts to identify relevant ESG topics; therefore, the sooner an organization ramps up efforts to assess double materiality, the better. Also, GRI requires to conduct a materiality analysis with a focus on the inside-out perspective.

13 The double-materiality concept: Application and issues, 2021
GRI

14 Guidelines on reporting climate-related information, 2021
European Union

Addressing ESG in risk appetite

The organization's risk appetite framework should address ESG risks. Used internally, risk appetite sets the nature and level of risk that the organization is willing to accept, both overall and in specific risk domains, while pursuing its strategic goals and objectives. Risk appetite may be communicated to external stakeholders, for example in a risk appetite statement in the annual report and should fulfill any disclosure requirements established by regulators. Indeed, regulators are increasingly setting ESG disclosure requirements, particularly in the EU, and we expect this trend to continue globally.

In general, organizations use one of two approaches to incorporating ESG into risk appetite:

- ***Prevailing approach:*** The first, and currently more common approach, is to include ESG risk implicitly in risk appetite statements for risk areas such as reputation, strategic, operational, financial, cyber, and sustainability among others, depending on the organization. This is a less direct way of addressing ESG risk as there is no explicit risk appetite statement to address ESG risks.
- ***Emerging approach:*** The second, more direct approach is to treat ESG risk as its own category with a risk appetite statement, so it is on par with other risk areas (rather than within them). This means taking a more detailed approach to specific ESG risks and, often, developing measures and supporting indicators of specific ESG risks to gauge their potential impact. As the evolution and management of ESG risks becomes more mature, more integrated into ERM, and more subject to regulatory scrutiny, organizations will increasingly migrate to this more explicit approach.

Given that risk appetite sets forth the nature and levels of risk the organization is willing to accept, senior leaders and Boards need to consider both the potential downside and upside impact of ESG risks on enterprise value. Every organization will have its own way of considering these impacts because each has its own way of creating value, that is, its unique strategic goals and objectives, business model, operations, culture, and regulatory requirements.

Each organization will also have its unique combinations of capital. For example, risk appetite could consider the impact of ESG risks on the five forms of resilience capital noted in the third issue of this series: people, reputational, operational, financial, and environmental capital[15]. Or it may take the International Integration Reporting Council's (IIRC) "six capitals" as a starting point: financial, manufactured, human, social, natural, and intellectual capital[16].

Senior leaders benefit from taking a structured approach to assessing all potential impacts of ESG risks on the organizations' forms of capital, drivers of value, and stakeholders from both upside and downside perspectives across the organization. Doing so will position leaders to embed ESG risk management into operations in all functions and at every level.

Note that these are only three examples of steps toward integrating ESG with ERM, which should be a high priority for senior leaders. Treating ESG only as a regulatory compliance obligation or seeing it only in terms of its financial impact can lead to a limited view of ESG. A limited view will in turn limit management's ability to fully address ESG risks and pursue opportunities.

15 Seeking new horizons: Navigating the constellation of markets, events, and opportunities to preserve value and sustain growth, 2023
Deloitte Global Risk Advisory

16 Enterprise Risk Management: Applying Enterprise Risk Management to Environmental, Social and Governance-related Risks, 2018
COSO | wbcsd

ESG risk response, monitoring and reporting

Integrating ESG with IRM positions the organization to more effectively address short-, intermediate-, and long-term ESG risks. Those risks have come to the fore, given weather events, societal change, immigration patterns, and political developments in many regions.

These forces also present opportunities to create value in new ways by understanding and responding positively to stakeholders' ESG expectations.

Ultimately, this calls for operationalizing ESG risk monitoring, response, and reporting. Historically, risk management and related ERM systems have tended to focus on the most immediate risks. ERM now faces the challenge of quantifying and tracking ESG risks on mid – and long-term bases. This is typically done through scenario analysis for example for climate risks, which are divided into physical risks, such as storms, floods, and heat waves, and transitory risks, such as climate-driven trends in customer behavior or new regulations.

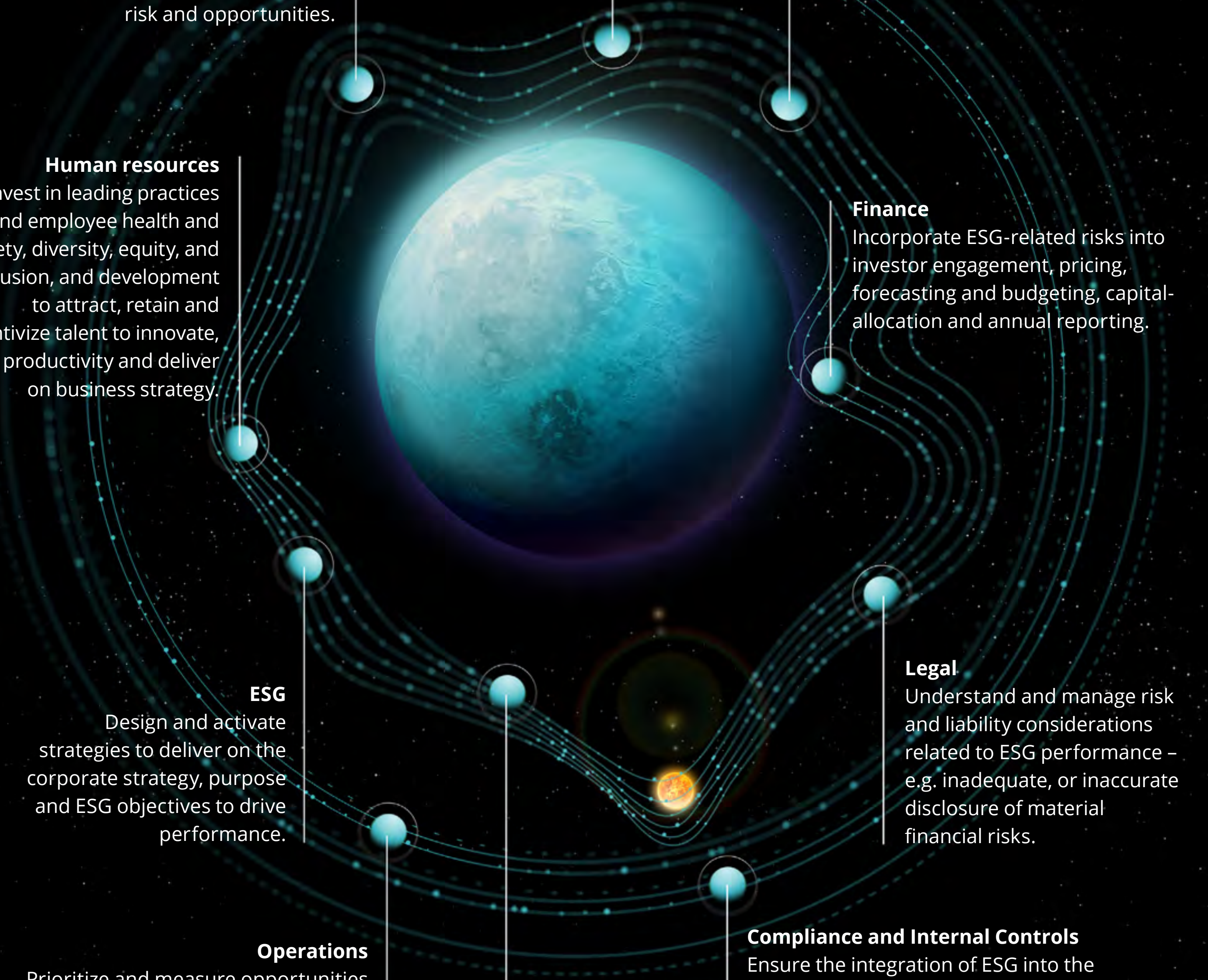
Updating and expanding strategic planning, reporting systems, scenario analysis, and the operating model to integrate ESG into IRM and the business now stands among the highest senior leadership priorities. Those steps will not only help to operationalize management of ESG risks and pursuit of opportunities; it will also enable more practical oversight of ESG.

Those steps will also bring ESG within the Three Lines Model[17]. This will enable the first line (the business) to understand and manage those risks, position the second-line (risk and compliance functions) to support the first line in those activities, and allow the third line (Internal Audit) to provide assurance that those risks have been adequately addressed by the appropriate functions (Exhibit 3 on the next page).

Updating and expanding strategic planning, reporting systems, scenario analysis, and the operating model to integrate ESG into IRM and the business now stands among the highest senior leadership priorities.

17 The IIA's Three Lines Model: An update of the Three Lines of Defense, 2020
The Institute of Internal Auditors, Inc.

Exhibit 3
Overseeing ESG within the organization



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

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

Communication
Optimize strategic communications to stakeholders to navigate changing expectations and credibly demonstrate prioritization and management of ESG risk 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 business strategy.

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

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

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

Compliance and Internal Controls
Ensure the integration of ESG into the existing management/ process control and compliance frameworks to support compliance around ESG risk

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

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

Broadening the lens and integrating ESG risks across the organization will enable management to address ESG risks and opportunities within the organization's Three Lines framework and ERM system and to operationalize day-to-day management of ESG issues.

In our view, incorporating ESG risks into IRM through the ERM system presents the surest path to that outcome.

As with societal goals such as carbon neutrality and greater equity, the organizational goal of truly integrating ESG with IRM, is a long journey, and cannot be achieved in the short run. Yet that is no reason to stand still. Rather, it is the reason to start now.

Lets Talk

As a consistently top-rated provider of risk-related services, Deloitte has a long and successful record of providing risk assessment and management, program design and operation, and technological services to organizations worldwide.

Specifically, we are prepared to assist with ESG strategy and governance, ESG risk assessment and measurement, integration of ESG and ERM, and development of metrics and monitoring to support internal efforts and external disclosures.

We look forward to assisting you and your organization in addressing your ESG risk management challenges.

Connect with us

Discuss the report and learn more about our approach.

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