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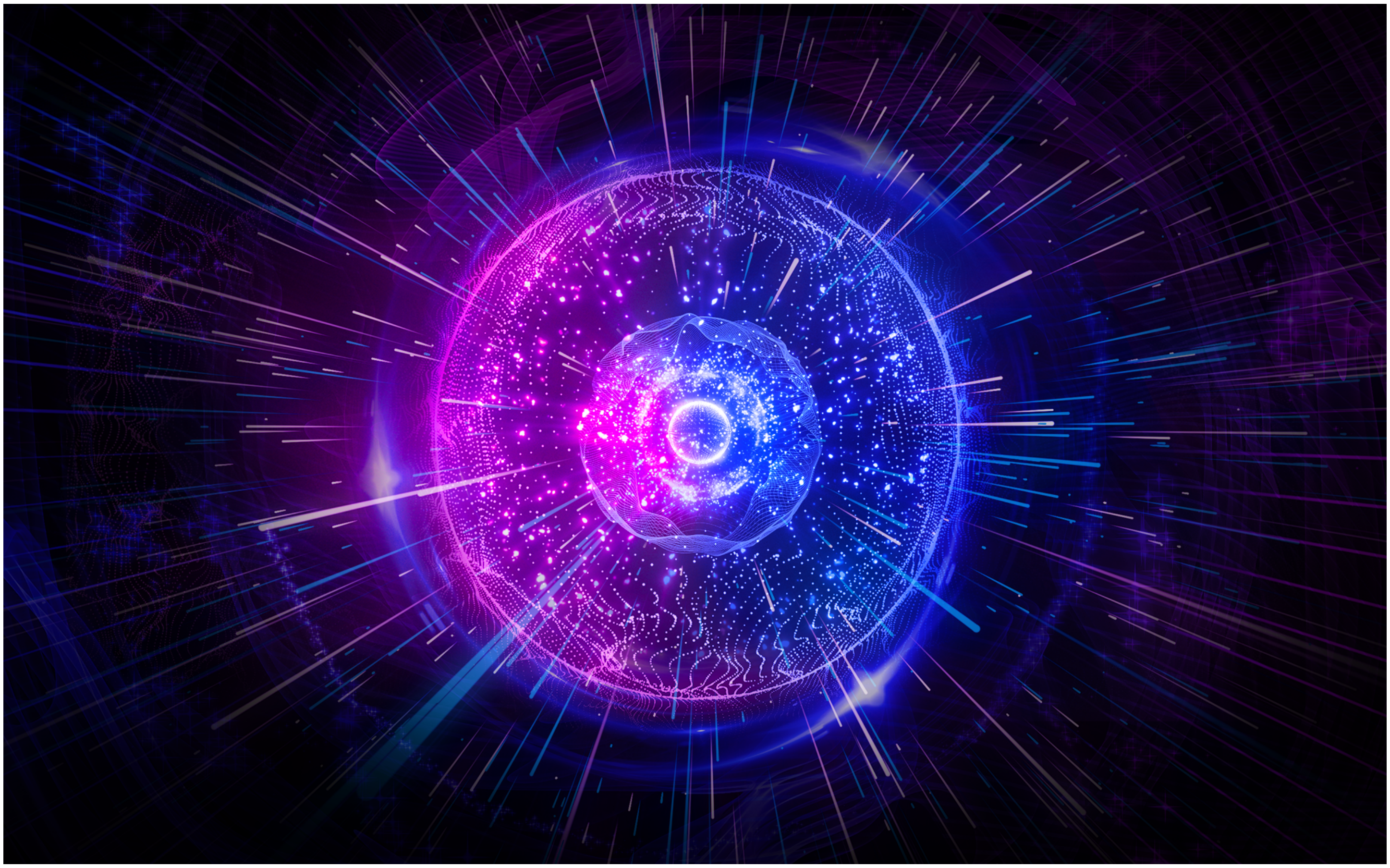


Controllership's role in building an integrated ESG reporting strategy

The environmental, social, and governance (ESG) disclosure and reporting risk landscape has changed. Regulators globally have issued proposed and final new rules mandating ESG disclosure. For example, companies in the United States with certain significant operations in the European Union may soon be required to provide vast amounts of ESG information as mandated by the Corporate Sustainability Reporting Directive (CSRD).

Controllership is uniquely positioned to design and implement efficient responses to the new risk calculus. And if your controllership responsibilities extend across multiple jurisdictions— domestically or internationally—you'll likely need a view into what those continuously changing requirements are as well as processes and internal controls that are thoughtfully developed, repeatable, and sustainable. Many organizations will likely seek to introduce new (or adapt existing) technology to further that objective.

Multi-jurisdictional companies may seek to add ESG reporting responsibilities to an existing controllership structure. They may also seek to set up an entirely new structure to facilitate ESG reporting. Controllership also can use ESG mandates to tip the scale toward "back-burnered" process and technology transformation. The proposed and final requirements may be a catalyst for broader transformational change, as the potential benefits may now outweigh the costs.

Whatever you choose, it's important to have a strategy and a tactical response plan. Due to increasing regulatory requirements as well as the initiation, convergence, and evolution of ESG standards and frameworks, the time is now.

Getting this all done is no small task. ESG reporting has implications for your organization's people, processes, and internal controls, not to mention technology to meet expectations timely and efficiently. But you can reduce complexity by approaching your preparations along four key dimensions: multi-jurisdictional reporting requirements, technical accounting, data collection, and business insights. Let's look at them one by one.

Multi-jurisdictional reporting requirements

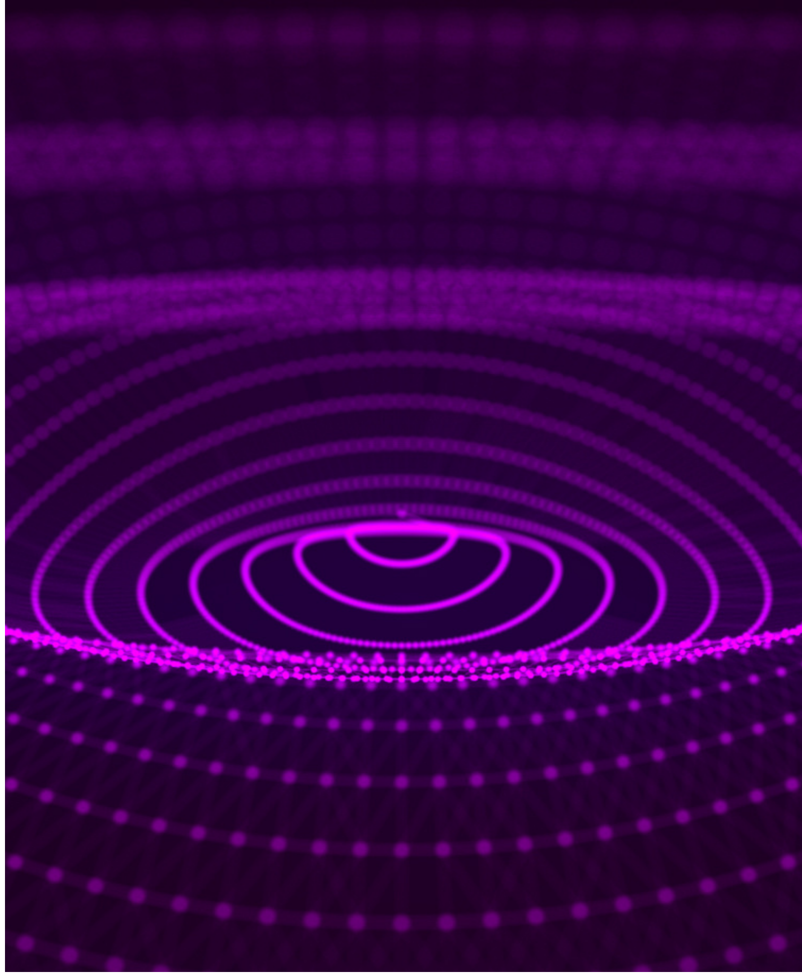
The reporting landscape is shifting rapidly. At home and abroad, governments and regulators are introducing proposed or final ESG disclosure mandates.

To stay on top of these responsibilities, you need to know what's required. As you inventory your requirements, we recommend identifying:

- Jurisdictions you operate in (e.g., cities, states, countries, regions).
- Regulations proposed or final in those jurisdictions.
- Timing of the proposed or final regulation, including the company's required implementation date.
- Due date for submission of proposed regulations, along with periods to present (i.e., retrospective reporting or current period only) and reporting frequency.
- Which standards and frameworks apply.
- How to efficiently address multi-jurisdictional mandates with overlapping requirements.
- Overlap and integration with existing financial reporting requirements.

Four key dimensions for reducing complexity in your preparations

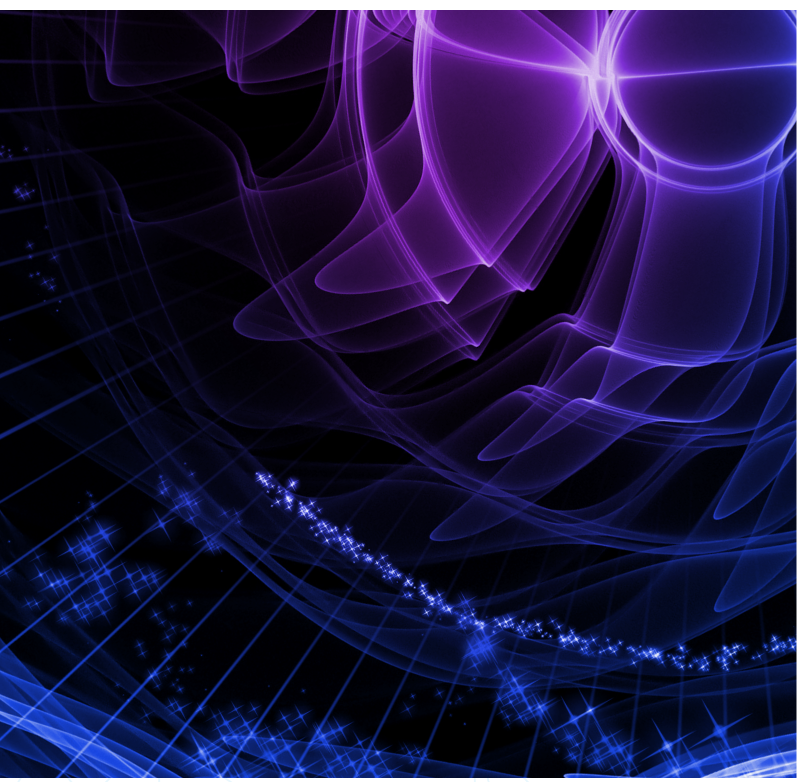
- Multi-jurisdictional reporting requirements
- Technical accounting
- Data collection
- Business insights



Who's in charge here? Navigating decentralized reporting responsibilities

In decentralized organizations, controllership leaders may be faced with a critical decision to determine whether those responsible for financial reporting requirements, including statutory reporting, should also be responsible for ESG reporting requirements. It's important that companies determine who's impacted and who needs to be engaged, cross-functionally and globally. Consider following a dynamic framework with a responsibility assignment matrix (a model that accelerates your implementation by helping you determine who's responsible, accountable, consulted, or informed). You may need to revisit your responsibility matrix periodically.

As companies embark on their responses to the ESG regulatory environment, it has created for many a natural tension between sustainability functions, to the extent they exist, and controllership as they begin to ask, "Who's in charge?" Getting to the right answer can be complex. To the extent a company has a sustainability function, those individuals may have been involved in the preparation and review of ESG information but likely not in a regulated context. Similarly, controllership and legal may not have been involved in the preparation of ESG information but they may have provided other types of information in a regulated context. You need both capabilities, as well as legal counsel, to gather your requirements effectively.



One thing is clear: The value of controllership has never been more critical. The role of controllership will need to move from "informed" and "consulted" to "responsible" and "accountable." This is especially important when determining reporting mandates, as certain of the mandates piggyback on financial reporting requirements (e.g., 10-K filing, statutory filings).

Companies with global operations and elements of a decentralized controllership function must at a minimum inform relevant parties in other jurisdictions and consider whether they should elevate those responsibilities to "responsible" and "accountable." Because the United States trails Europe and Asia on the nature and extent of regulated reporting requirements, US-headquartered organizations with global operations are often not aware of, or do not realize the importance of understanding, the global requirements.

It's not uncommon for in-jurisdiction personnel to prepare local financial statutory reports with limited oversight by controllership at headquarters. But this is often done effectively because there may have been years of trust built between headquarters and in-country personnel, with policies disseminated and adhered to and accounting standards (while often different among jurisdictions) well defined.

As it relates to ESG reporting, however, there's often a lack of understanding—not just at headquarters, but at the jurisdiction level as well—of who's responsible and where the data will come from to comply. Even with robust controllership functions in-jurisdiction, in-country personnel may not be accustomed to preparing or reporting ESG data or monitoring the regulatory landscape impacting their jurisdictional requirements.

If headquarters doesn't take responsibility to aggregate requirements, in-country personnel may not respond timely to requirements, and the broader organization may not reap the benefits of a well-governed, integrated process to respond to multiple mandates cohesively. Headquarters personnel know well that an effective partnership with their in-jurisdiction teams is critical to achieve timely reporting objectives, both consolidated and in-jurisdiction. In addition, regulators are likely to require consolidated reporting; aggregating information from different jurisdictions that have defined their own policies without influence or counsel from headquarters creates risk.

Companies will need to choose whether headquarters owns identifying the reporting requirements or the local jurisdictions do. Either way, the aggregation and long-term strategy of monitoring those requirements will be critical for efficiency and, likely, lower compliance costs.

Utilizing technology to manage reporting requirements
More companies are modernizing their finance organizations. As they do, they have an opportunity to transform their reporting workflow for financial and sustainability reporting. Technology can enable the monitoring of global reporting requirements and timelines, tackle overlapping ESG standards and frameworks efficiently, and seamlessly publish reports in different languages and jurisdictions. Technology can also bring standardization and automation to the process, allowing for streamlined, consistent, and reliable reporting. The ESG reporting mandates are a catalyst for taking a fresh look at technology to enhance your reporting processes.

Technical accounting

ESG disclosure may not be accounting for information in a currency, but it's accounting just the same. The technical considerations for ESG information present similar academic questions as found in financial reporting standards such as US GAAP or IFRS. To add complexity, the outcomes or considerations in ESG accounting don't always align with those reached in financial reporting standards.

Take greenhouse gas (GHG) emissions as an example. Identifying these emissions involves implementation questions with respect to the appropriate boundaries on control approaches (i.e., financial versus operational). Many of these considerations intersect and, at times, conflict with GAAP conclusions related to consolidation and presentation matters—some of the more complex areas of GAAP.

Keep in mind that while many of the accounting policies and applications associated with ESG technical accounting may overlap with those already determined by GAAP, ESG reporting has a much smaller body of interpretative material and established practice.

Sharpening your team's technical accounting skills for new ESG standards and frameworks
Those on your team who have a knack or joy for technical accounting will likely enjoy a new set of challenges in technical accounting for ESG information. Even so, effective organizations will also leverage the experiences and acumen of their sustainability function. If your sustainability function had been preparing ESG information using standards and frameworks, they do have experience with technical accounting; however, the level of rigor in the adherence to those standards and frameworks may be less than what will be required in regulated reporting. The existing ESG standards and frameworks include a smaller body of interpretative literature and established practice as compared to traditional accounting and reporting frameworks and have operated in a generally a less risky environment due to less influence and monitoring by regulators.

However, the landscape has changed. Interpretative literature is expanding, practices are being refined, and the risk of getting it wrong has increased with the expanded involvement of regulators. Controllership must see itself as a business partner, not an adversary, to its sustainability function. Mutual respect and understanding will be paramount to achieving the collective objective of preparing information in a way that's in accordance with maturing technical accounting for ESG information.

It's not uncommon for controllership that has dealt in financial accounting for years to find well-known ESG standards and frameworks lacking in conceptual consistency with financial accounting. For example, the GHG Protocol in some circumstances requires preparers to recast prior emissions for periods in which the preparer did not control the source of emissions for an acquisition. For financial accountants, retrospectively adjusting financial results to include activity not under the parent's control for an acquiree would be conceptually inconsistent with GAAP. These tension points are real. Similarly, the inverse is true—financial accounting principles might be conceptually foreign to ESG accountants.

As regulators seek to establish consistency between the concepts and boundaries that underlie financial and sustainability information—especially as they seek to present the information in the same report—"bilingual" capabilities (the ability to understand concepts applicable to financial and sustainability accounting) will be critical. Leaders in controllership and sustainability have a unique opportunity right now to establish the partnership's tone and tenor. Organizations that don't do that well may turn an already complex implementation into an incrementally stressful one fraught with interpersonal dynamics that are challenging to reverse.

Using technology to manage multiple standards and frameworks
Consider solutions that link to standards and frameworks so you can review ESG information against the appropriate reporting guidance. You can expect that different regulations will require similar information to be presented differently. Technology can let you see where there are similarities and differences, as well as document how you have considered and addressed those differences.

Enhancing your internal control environment
If individual in-jurisdiction personnel have the responsibility to respond to their relevant reporting requirements, then policies and processes that require consistency across the organization must be drafted, reviewed, and disseminated. This mandate exponentially increases in importance if disclosure is prepared in aggregate among different jurisdictions where each may arrive at different technical conclusions, absent policy dissemination.

On March 30, 2023, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) released a landmark interpretive report on how the COSO Internal Control – Integrated Framework (COSO Framework) can apply to sustainable business activities and information. The COSO Framework is intended to be leveraged at the entity, division, operating unit, and functional levels. Companies can begin customizing and adapting their governance structures and system of internal control to meet their unique sustainable business reporting objectives. Our summary of the report indicates that much like financial reporting, sustainability and ESG reporting is not intended to be an "annual and manual" activity but instead needs to be thoroughly integrated.

Data collection

Historically, the ESG information that companies issued hasn't always conformed to what controllership would consider leading practices of governance and internal controls. It also may have been sourced from disparate systems and spreadsheets via manual, error-prone processes. For these reasons, new reporting requirements may prompt you to cast a skeptical eye on those old data sets.

ESG data aggregation is a complex undertaking. The volume of information to gather can be significant. The European Union's Corporate Sustainability Reporting Directive includes 82 disclosure requirements (quantitative and qualitative) representing more than 1,000 different data points. That information may need to be pulled from a wide variety of systems by different people in different locations, not all of them in the same language. And it all needs to happen timely and in line with appropriate policies.

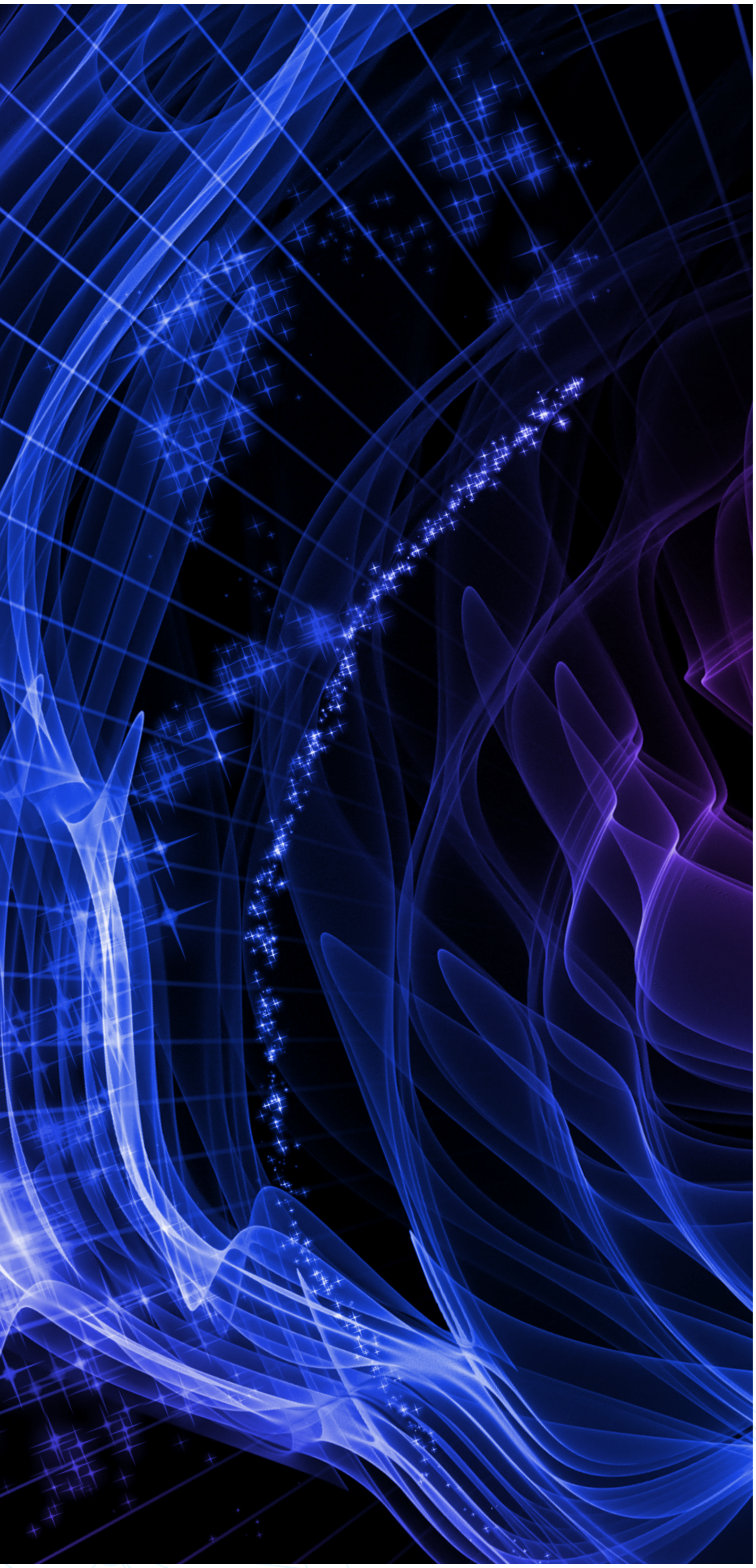
Identifying data sources and strategy for incorporation into reporting

After you've inventoried reporting requirements, working backward to identify what data is necessary and from where to obtain it (if even currently prepared!) is critical. You may need to source data from many people and technology platforms quickly. Technology can help facilitate data requests, automate data retrieval, reduce duplicative work, and optimize data collection tracking. Technology can also support data integrity and audit trails. A leading practice is to streamline data sourcing—including determining a single source of truth for data, automating the data collection, and using consistent, high-quality controlled data.

Companies may determine they have to gather data they don't currently possess to comply with the ESG requirements. This presents a unique challenge but also a narrow window of opportunity to design processes and internal controls that are appropriate for an organization's reporting structure versus aggregating data in disparate systems. Establishing a thoughtful data sourcing strategy at the outset can save time and expense, especially as the future of controllership matures from less-skilled resource tasks to more analytical business partnership tasks.

From data source validation to entity-level controls, internal controls should be used to provide transparent and accurate data collection. Collected, generated, and calculated ESG data should be validated and monitored—and only then reported. Alignment and integration with the existing control frameworks will create strong benefits, such as avoiding duplicate efforts. It's also critical that you design internal controls that recognize the need for expertise and competence to address the risk. Whether it's through upskilling your controllership function or partnering effectively with your sustainability function, there's little time to waste to understand the relevant skills of the team involved to make strides toward data being prepared accurately.

Although technology is no "easy button," it can transform data to build more efficient processes and enhance your internal control environment. Organizations that select technology before understanding the data governance model and internal controls will risk wasting time and money. Once you understand your future state processes—and know which people are responsible, accountable, consulted, or informed—you can bring in technology to enhance quality and potentially lower cost of compliance. That technology may also enhance controllership's ability to provide valuable insights to other parts of the organization.



Business insights

As companies mature and begin to build ESG information into their overall sustainable business strategy, senior management will likely look to the controllership team to share quality data they can use to (1) set goals and monitor progress and (2) monitor their response to sustainability risks and opportunities. Helping management tactically achieve the company's vision layers another responsibility for the controllership team on top of compliance with reporting requirements.

Controllership should confer with relevant constituents involved in strategy and risk management to understand the sustainability strategies they currently have or aspire to build. Determine how the strategies relate to any mandates (regulatory or voluntary) for reporting goals and progress.

As you weigh modeling and forecasting tools, consider how the data gathered for ESG can be integrated and leveraged in existing tools or whether any additional capabilities must be evaluated and implemented. As companies model sustainability information, they often seek to intersect that with financial forecasting and accounting implications. For example, many companies are modeling financial outcomes associated with GHG emissions as well as monitoring progress against publicly stated decarbonization goals. Consider capabilities that help you determine whether and how goals can be achieved, project likely outcomes of hitting or missing a goal, and include financial information with modeled scenarios. As individual jurisdictions also introduce laws and regulations that require certain behaviors (such as carbon reduction), the ability to see this information at the jurisdictional level may become essential.

A holistic view of ESG reporting

Each of these dimensions—managing reporting requirements, tackling the technical accounting, sourcing complex data sets from various sources, and enabling strategy—touches on multiple business functions. What's more, each one intersects with the other three. This means you'll need different disciplines and levels of experience to help carry out ESG reporting in a way that's efficient, cost effective, and supportive of your ability to be a good business partner to others in the organization.

There's no single template for what that ecosystem looks like. The extent to which you need to create new roles and responsibilities, build or enhance ESG information processes, and bring technology into the equation is unique to your organization. But if you approach it holistically, enlisting the help of colleagues across and outside the organization, you can bring order to potential chaos while further enhancing the controllership function's reputation for excellence in the organization.

Want to know more?

Have questions about the ESG landscape or ESG reporting in this changing landscape? Contact any of our Deloitte leaders listed below to get the conversation started.

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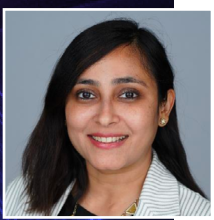

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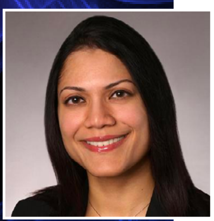

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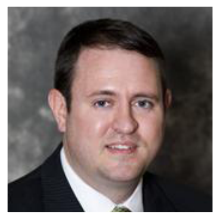

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