

2024 INTERNAL AUDIT WEBCAST SERIES

Course 4

ESG Reporting: How to Navigate the Evolving ESG Regulatory Landscape and the Role of Internal Audit

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BDO and Our Internal Audit Webcast Series



Aurora Bardoneschi

SUSTAINABILITY & ESG SERVICES DIRECTOR, RISK ADVISORY SERVICES

Aurora Bardoneschi leads sustainability and ESG client engagements, including definition of ESG strategy development, identification of ESG risks and integration into risk management system/ERM, design of processes and controls around ESG metrics as well as roadmaps to comply with ESG-related regulations at the national/international level.

Aurora has more than 10 years of experience and has supported multiple private and public companies in defining sustainability reporting according to international standards (e.g., GRI Standards) and European Directives (e.g., Corporate Sustainability Reporting Directive, EU Taxonomy, Non-financial Reporting Directive). She has worked across industries to help integrate sustainability plans and goals within business strategy. She has designed several stakeholder engagement activities and training sessions to C-suite executives.

Aurora joined BDO Italy in 2019 and she was seconded to BDO USA between June 2021 and May 2022. She is now part of BDO USA, located at the Miami office. Some of her recent projects include calculation of Greenhouse Gas (GHG) emissions (Scope 1,2, and 3); design of roadmap, governance and processes to comply with SEC proposed rules on climate-related disclosures and EU Directive CSRD (Corporate Sustainability Reporting Directive); materiality assessments and integration of ESG risks into the ERM framework and system.

EDUCATION

- ▶ M.Sc., International Development, University of Edinburgh
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MANAGING DIRECTOR, RISK ADVISORY SERVICES

Erin Sells is a Managing Director in Risk Advisory Services in our Chicago office. She has deep accounting and financial reporting knowledge developed through 19 years of practice in public accounting working with mid-sized and large public and private corporations and organizations. Erin has extensive experience with internal controls, complex transactions, accounting standard implementations, compliance standards, and financial reporting.

Erin is a strategic thinker with the ability to navigate complex situations and devise solutions to achieve operational excellence. She has experience in directing business process transformation through simplification and automation. Erin led the development of guidance for auditing internal controls related to compliance based on external regulations around management of state grants and funding policies. She has designed policies, procedures and an internal control framework for several financial statement and compliance areas.



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Brad Knight, CPA, CRMA

MANAGING DIRECTOR, RISK ADVISORY SERVICES

Brad Knight is a Managing Director in Risk Advisory Services from our Atlanta office. He has more than 20 years of experience leading and delivering internal audit, enterprise risk management, governance, and compliance engagements to Fortune 500 and middle market companies.

Brad has been deeply involved in identifying and delivering governance, risk and compliance solutions to clients, including all aspects of SOX implementation and compliance, business process documentation, enterprise risk assessments, internal audit co-sourcing, internal controls assessments, and SOC reporting. He has experience in a variety of industries including private equity, retail, manufacturing, healthcare, supply chain, and technology.

Brad is a licensed CPA in the state of Georgia and maintains a Certification in Risk Management Assurance from the Institute of Internal Auditors.



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EDUCATION

- ▶ M.Acc., University of Tennessee, Knoxville
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Learning Objectives



Define ESG, its importance, and how companies are currently tracking and reporting their efforts



Explain how regulatory reporting requirements are expected to change



Determine what the internal audit function can do to support the organization in getting ready for compliance requirements

Sustainability and ESG Regulations: Expanding requirements by type, geography and industry

When You Should Be Thinking About Sustainability & ESG Regulations

You Are a Public Company Or Plan to Go Public

- ▶ SEC's rules require U.S.-listed companies to disclose climate-related information.

You Are Doing Business in Europe

- ▶ Under the EU Corporate Sustainability Reporting Directive (CSRD), non-EU based companies will be impacted if they generate substantial revenue and have employees (e.g., a subsidiary) in the EU.
- ▶ The EU's Directive on Corporate Sustainability Due Diligence (CSDDD) would require organizations to identify, prevent and end adverse human rights and environmental impacts in their operations and value chains.

Your Customers Are Demanding It

- ▶ Large companies have made public ESG commitments (e.g., emissions reduction or net zero targets) and are requiring ESG-related information and data when setting up contractual agreements.
- ▶ Customers are asking for information about an organization's ESG approach and how they determined that their products or services can be claimed sustainable.

You Operate in Certain U.S. Cities and States

- ▶ Several states and major cities already have their own ESG and sustainability rules.
- ▶ Competitors are building strategies and reporting ESG progress. Companies not acting are at a disadvantage.

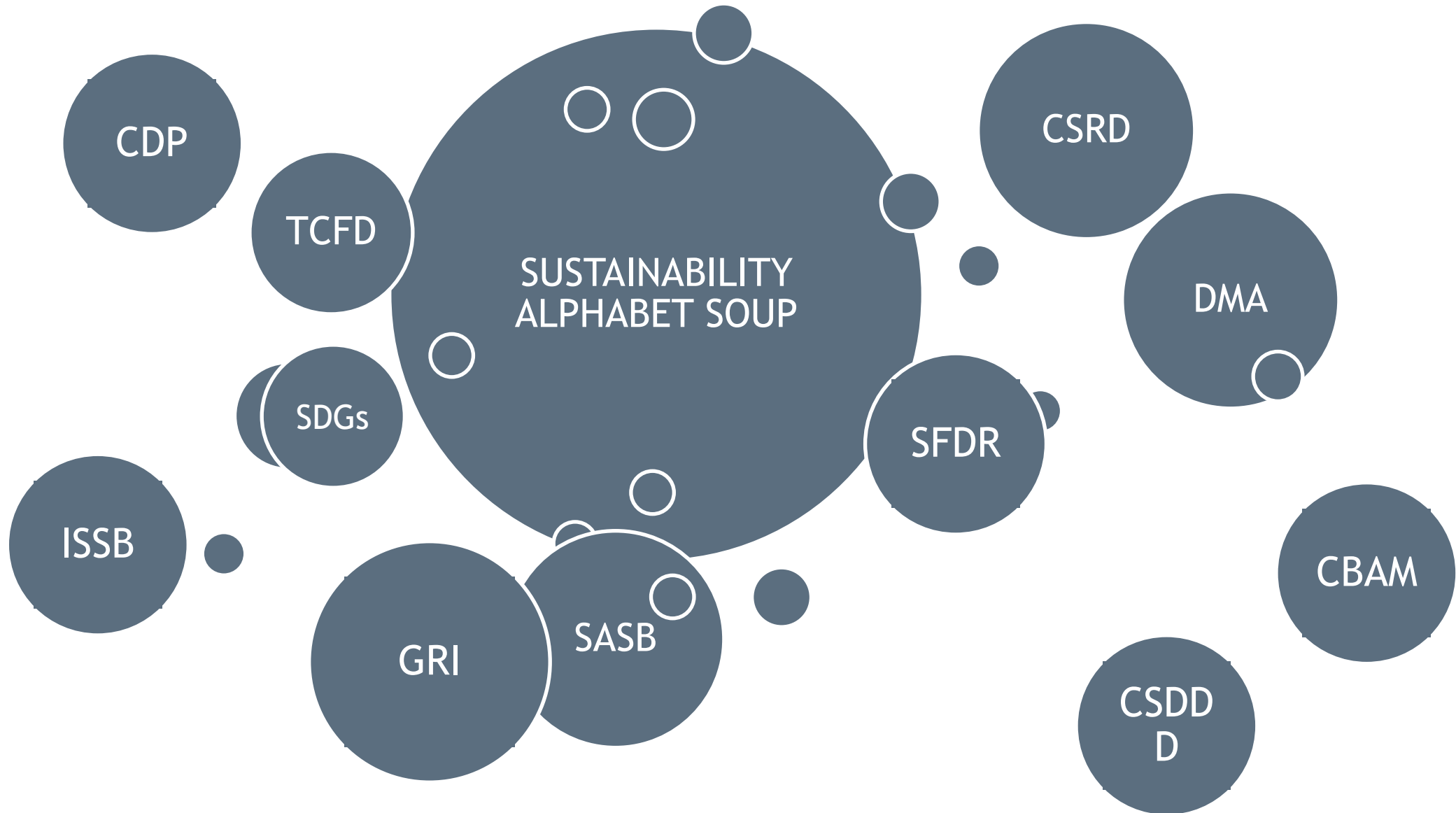
... or Only in California

- ▶ In California, the sale of new internal combustion passenger vehicles will be prohibited after 2035.
- ▶ California passed regulations that call for U.S. companies doing business in CA having more than \$1B in revenues to disclose their greenhouse gas emissions in their full supply chain (Scopes 1, 2 and 3) and use third-party assurance, and companies with more than \$500M to annually disclose climate risks and strategies.

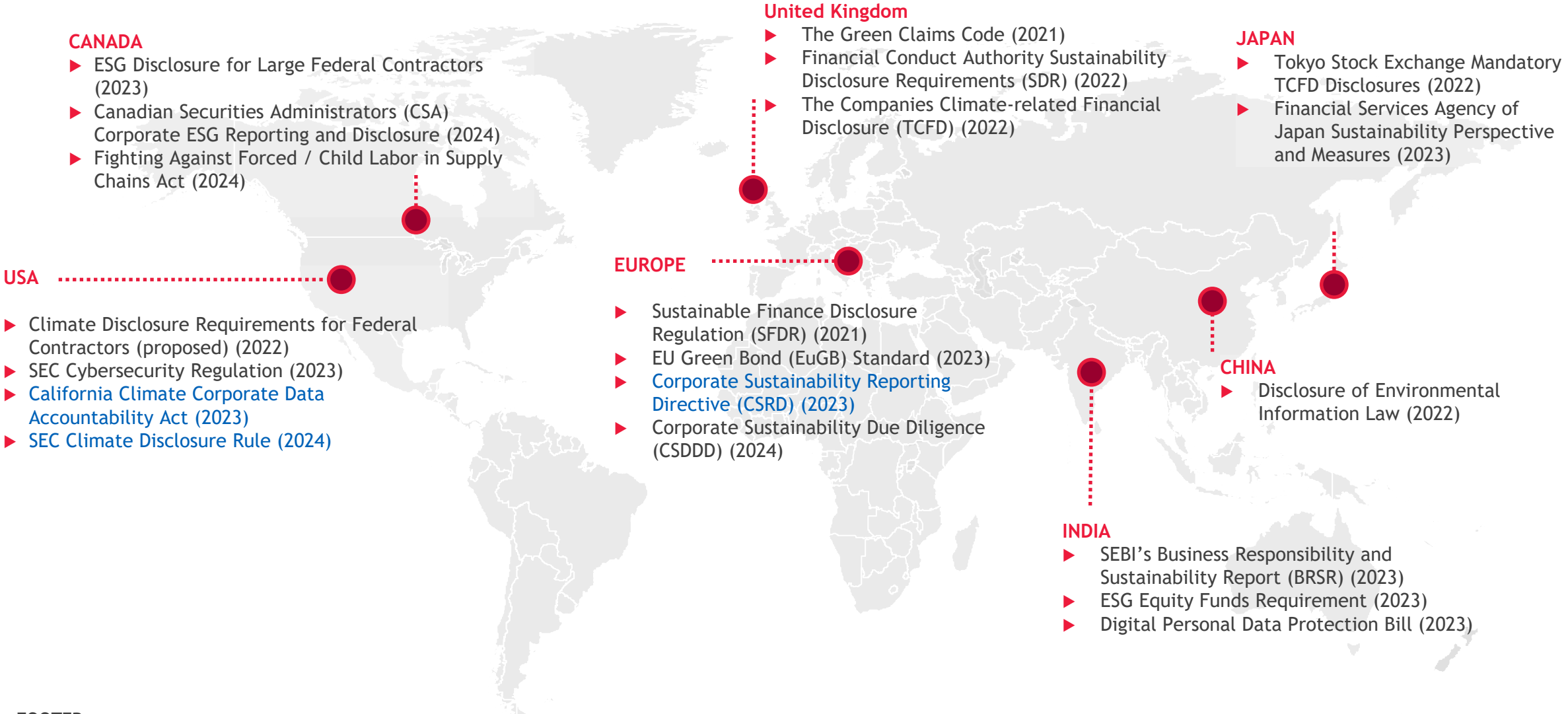
Your Investors are Requesting ESG Information

- ▶ Annual shareholder meetings continue to be an important venue for investors and other stakeholders to request ESG disclosures — and sometimes proxy votes speak louder than words.

A Guide to Sustainability Reporting



Primary ESG & Sustainability Regulations



Sustainability & ESG Regulations Disclosure Rules Comparison













COMPARING KEY ESG REGULATIONS

	CSRD	SEC Climate Disclosure Rules	CA SB 253	CA SB 261	CA AB 1305	Forced Labor in Canadian Supply Chains Act (S-211)
Scope	<p>Companies previously subject to the EU's Non-Financial Reporting Directive (NFRD) & EU Taxonomy.</p> <p>Companies that meet set criteria for size, revenue, employee count, and more.</p>	<p>Domestic and foreign registered companies in the U.S.</p> <p>The disclosure requirements apply to filers of Securities Act Forms S-1, F-1, S-3, F-3, S-4, F-4, and S-11, and Exchange Act Forms 10-K and 20-F.</p> <p>More information SEC Rule on Climate Disclosure Requirements Resource Center</p>	<p>Private and public U.S. companies with total annual revenues over \$1B and that do business in California.</p>	<p>Private and public U.S. companies with total annual revenues over \$500M and that do business in California*</p> <p>Excludes businesses subject to regulation by the Department of Insurance in CA or that is in the business of insurance in any other state.</p>	<p>Public and private companies that:</p> <p>Market or sell voluntary carbon offsets in California</p> <p>Operate in California, purchase or use voluntary carbon offsets sold within the state, and make claims about significant emissions reductions (e.g., “net zero,” “carbon neutral”)</p> <p>Operate in California and make claims in the state about significant emissions reductions (e.g., “net zero,” “carbon neutral”).</p>	<p>Listed on the Canadian Stock Exchange</p> <p>Meet the following criteria:</p> <ul style="list-style-type: none"> • \$20M CAD (\$14.7M USD) or more in global assets • \$40M CAD (\$29.5M USD) or more in consolidated revenue • An average of 250 or more employees <p>Produce, sell or distribute goods inside or outside Canada (do business in CA). Import goods produced outside of Canada. Control an entity engaged in with of the above activities.</p>
Timeline	<p>FY 2024 for all disclosures with limited assurance</p> <p>More information can be found in our CSRD Checklist</p>	<ul style="list-style-type: none"> • Large Accelerated Filers (LAFs) 2025 • Accelerated Filers (AF) 2026 • Non-accelerated Filers (NAF), Small Reporting Companies (SRC), Emerging Growth Companies (EGC) 2027 <p>Material impacts on financial estimates +1 year.</p>	<p>Scope 1 emissions and 2 emissions reporting required in 2026 (for FY 2025 disclosures), and Scope 3 emissions reporting in 2027 (for FY 2026).</p> <p>Requires assurance.</p>	<p>First annual climate risk disclosure report to be made available to the public on its website on or before January 1, 2026, and subsequently every other year.</p>	<p>First annual disclosure report to be made available on company websites on January 1, 2025.</p> <p>Must disclose whether an independent third party validated or verified project attributes.</p>	<p>The bill requires applicable entities and institutions to submit an annual report by May 31 detailing actions the company took in the prior fiscal year to prevent and reduce the risk of forced labor or child labor in their supply chains.</p>
Reporting	Annual	Annual	Annual	Biennial	Annual	Annual

Sustainability & ESG Regulations Disclosure Rules Comparison, cont'd.

COMPARING KEY ESG REGULATIONS						
	CSRD	SEC Climate Disclosure Rules	CA SB 253	CA SB 261	CA AB 1305	Forced Labor in Canadian Supply Chains Act (S-211)
Environmental Disclosures	<p>Metrics, targets, policies, and actions pertaining to material environmental matters.</p> <p>Proportion of turnover, capital expenditure and operating expenditure aligned with Article 8 of the EU Taxonomy Regulation.</p>	<p>Phased-in disclosures of Scope 1 and 2 GHG emissions, if material</p> <ul style="list-style-type: none"> • LAF: 2026 • AF: 2028 • NAF, SRC, EGC: Exempt 	<p>Scope 1, 2 and 3 emissions pursuant to the Greenhouse Gas Protocol standards and guidance (or an alternative standard, if one is adopted after 2033).</p>	<p>Climate-related financial risk report, in accordance with the TCFD recommendations, or any successor thereto, or equivalent reporting under another law, regulation, listing requirement or a framework that meets the requirements – such as the IFRS Sustainability Disclosure Standards S2.</p>	<p>Companies are required to disclose a broad range of information on their website with specific details that include, but are not limited to:</p> <p>Project specific details, i.e., name, location, timeframe</p> <p>Annual emissions reductions and protocol used to estimate reduction;</p> <p>Whether there is independent third-party verification of the company data and claims listed</p> <p>More information can be found in our insight Prepare Now: California Climate Laws Impact Thousands of Businesses</p>	
Social Disclosures	<p>Metrics, targets, policies, and actions pertaining to social matters.</p>	<p>Not required.</p>	<p>Not required.</p>	<p>Not required.</p>		<p>Companies must submit an annual report detailing actions in the prior fiscal year to prevent and reduce the risk of forced labor or child labor in their supply chains. Failure to report can result in a fine of up to \$250,000 CAD.</p>
Governance Disclosures	<p>Metrics, targets, policies, and actions pertaining to governance matters.</p>	<p>Board members or committees responsible for the oversight of climate-related risks.</p>	<p>Not required.</p>	<p>Governance around climate-related risks and opportunities, including board oversight, and management's role.</p>		
Third-Party Data Assurance	<p>Limited assurance for all material ESG disclosures, and reasonable assurance expected at a later date.</p>	<p>Phased-in assurance over Scope 1 and 2 emissions:</p> <p>Limited assurance:</p> <ul style="list-style-type: none"> • LAF: 2029. AF: 2031 • NAF, SRC, EGC: Exempt <p>Reasonable assurance:</p> <ul style="list-style-type: none"> • LAF: 2033, AF: Exempt • NAF, SRC, EGC: Exempt 	<p>Limited assurance over Scope 1 and 2 GHG emissions in 2026. Phased into reasonable assurance. Beginning in 2030 Scope 3 limited. Assurance requirements in 2030 (subject to review by the California Air Resources Board in 2027).</p>	<p>Not required.</p>	<p>Must disclose whether or not obtained.</p>	

Focus on CSRD Timeline

Organization Type	2024	2025	2026	2027	2028	2029
Entities already subject to the Non-Financial Reporting Directive (NFRD)						
Entities listed on an EU-regulated market, which are a large entity and have more than 500 employees						
All other large entities* (includes EU-domiciled entities and an EU-domiciled subsidiary of a parent company)						
Entities listed on an EU-regulated market, which are a large entity and have less than 500 employees						
Listed SMEs**, small credit institutions and insurance undertakings						
Non-EU Groups***						



Financial Reporting Year



Reports Due

* The CSRD defines large entities as those that meet two of the following three criteria: 250 employees, EUR 40m turnover, EUR 20m assets

** Listed companies that do not meet the large entity criteria

*** Companies that have an operating presence in the EU despite not being incorporated in an EU member state and not being listed on an EU exchange. To be in scope, these companies must have at least EUR 150m turnover in the EU in two consecutive fiscal years at the consolidated level and have a branch in the EU with at least EUR 40m turnover and/or a subsidiary in the EU that meets the large entity criteria.

Focus on CSRD Reporting Options

Global Reporting Option

it allows a U.S. (i.e., non-E.U.) parent company to report in accordance with the CSRD for itself and for all of its subsidiaries (i.e., one report covering the entire consolidated company from the perspective of the parent).

Subsidiaries' exemption

Issue a group-level report that applies either ESRS or equivalent

EU Reporting Options

it allows a U.S. (i.e., non-E.U.) parent company to report in accordance with the CSRD for itself and for all of its subsidiaries (i.e., one report covering the entire consolidated company from the perspective of the parent).

Non- EU parent exemption

Largest E.U. subsidiary(**) to produce a consolidated report containing information for all E.U. subsidiaries within the scope of the CSRD. This option is not for the enterprise-wide consolidated report; rather, this **“artificial consolidation”** is only allowed if the E.U. subsidiaries are not held by an E.U. holding company. **Option available until 2029.**

Non-exemption

It allows each E.U. subsidiary within the scope of the CSRD to issue a separate sustainability report

Non-EU parent company must comply with CSRD by FY2028 if they meet 150M revenues (*) generated in the EU at the consolidated level for the last two consecutive years.

(*) Article 2(5) of Directive 2013/34/EU, as amended by the CSRD, indicates that net turnover is defined as “the amounts derived from the sale of products and the provision of services after deducting sales rebates and value added tax and other taxes directly linked to turnover; however, for insurance undertakings referred to in point (a) of the first subparagraph of Article 1(3) of this Directive, ‘net turnover’ shall be defined in accordance with Article 35 and point 2 of Article 66 of Council Directive 91/674/EEC . . . ; for credit institutions referred to in point (b) of the first subparagraph of Article 1(3) of this Directive, ‘net turnover’ shall be defined in accordance with point (c) of Article 43(2) of Council Directive 86/635/EEC . . . ; and for undertakings falling under the scope of Article 40a(1) of this Directive, ‘net turnover’ means the revenue as defined by or within the meaning of the financial reporting framework on the basis of which the financial statements of the undertaking are prepared.” We believe that the definition of net turnover, when used for calculating thresholds under Article 3 of Directive 2013/34/EU, should generally be the same as that in the local reporting framework.

(**) The Union subsidiary undertaking referred to in paragraph 1 shall be one of the Union subsidiary undertakings of the group that generated the greatest turnover in the Union in at least one of the preceding five financial years, on a consolidated basis where applicable.

ESG and Internal Audit: The Role of IA Function, Key Challenges and Lessons Learnt

Key Emerging Topics and Reporting Challenges

CONVERGENCE OF STANDARDS

- ▶ The emergence of various regulations, and uncertainty on how regulators and countries will adopt new reporting standards(e.g., IFRS 1 and IFRS 2):
 - ▶ push companies to address ESG and Sustainability from a compliance standpoint,
 - ▶ May lead to miss the overall objective to integrate sustainability in a more tactical and strategic way

DETERMINING THE LEVEL OF COMPANIES' ACCOUNTABILITY

- ▶ The regulatory landscape is evolving rapidly and some of the most recent regulations are requiring targeted industries to disclose information at the product-level and/or commodities entering specific market:
 - ▶ Some regulations such as EU Deforestation Regulation and CBAM tie up the relationship between producer and consumer (B2B), creating dependencies between companies
 - ▶ Some regulations focusing on climate and Human Rights scrutiny along the value chain pushing companies to develop a broader strategy to manage risk beyond its typical value chain concept.

PHASED-IN APPROACH

- ▶ Most of the regulations require a third-party verification, initially a limited assurance and then reasonable
- ▶ Some of the regulations (especially in EU) have a phase-in approach: for example, CSRD requires US companies to comply initially at the EU level, following by compliance at the Group level later on:
 - ▶ The phase-in approach is forcing companies in adopting a two-fold compliance approach: compliance at the EU level while ensuring alignment with Group sustainability strategy (if already developed)
 - ▶ Initial consolidation at the EU entity level may require local expertise on topics and processes typically developed and managed at the corporate level

Key Considerations for Internal Auditors

CONTROL VS. INFLUENCE

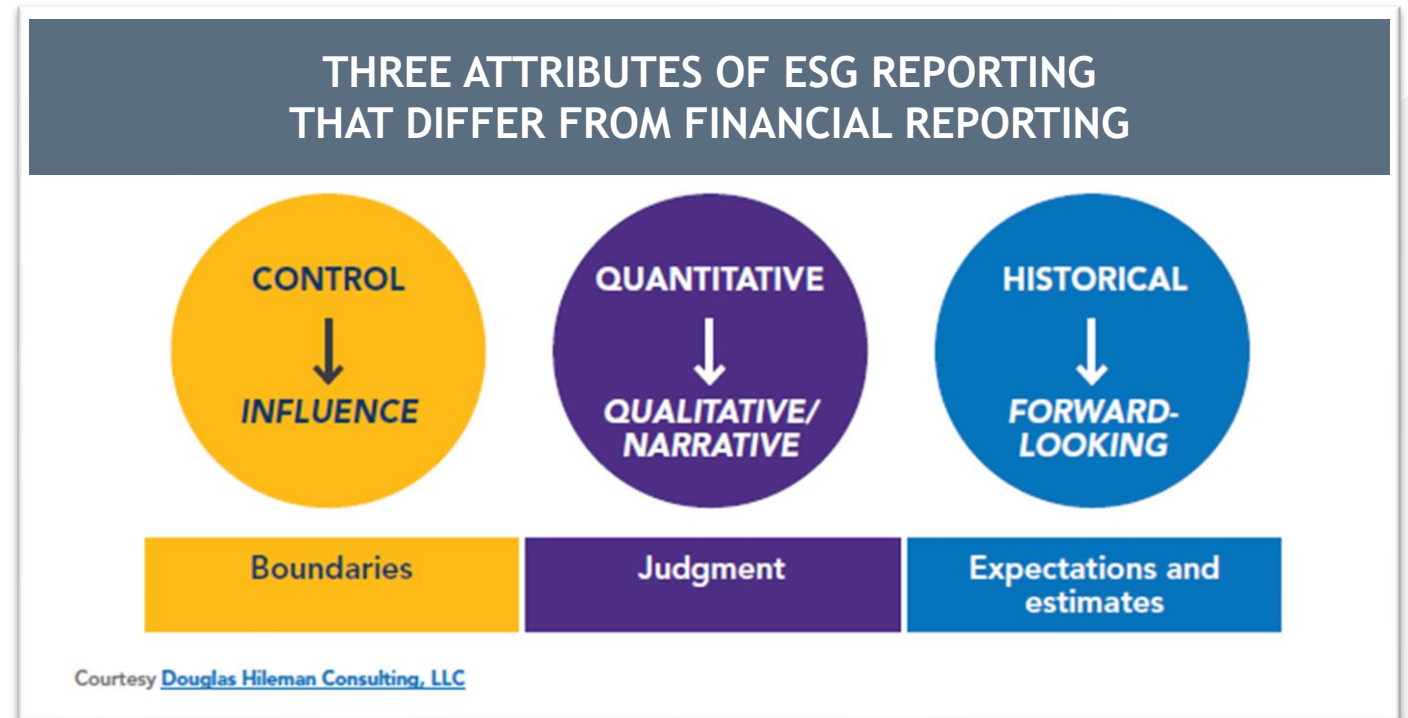
Depending on the framework or standards, sustainability reporting may be based on different concepts of “control” or “influence”.

QUANTITATIVE VS. QUALITATIVE

Sustainability information is inherently more qualitative than traditional financial reporting.

HISTORICAL VS. FORWARD-LOOKING

At its heart, sustainability is about wise use and preservation of resources over the long term. Long-term sustainability targets and goals inform business objectives. Further, communicating long-term goals and targets sets the stage for future reporting on the achievement of targets. The process of estimation is the same, but the time horizon is longer.



Lessons Learned in Applying ICFR over ESG Metrics

Prioritizing ESG Risks/Opportunities Based Upon

- ▶ Materiality assessment/risk tolerance
- ▶ Stakeholder impacts/expectations - engagement
- ▶ Market impact, valuation
- ▶ Decision-useful information
- ▶ Understand how the information has been reported in the past (e.g., greenwashing, level of scrutiny to publicly available documents)

Selecting Applicable Frameworks and Data interaction with Other System and Processes

- ▶ Assess availability of data
- ▶ Final environmental and social metrics can be derived from data with financial / regulatory considerations
- ▶ Process/internal controls for collecting/integrity of data

Identifying Business-Relevant ESG Issues

- ▶ Current process and assumptions
- ▶ Competitor analysis
- ▶ Integration into ERM

Clearly Define Board Oversight

- ▶ Identify full board/committee roles
- ▶ Update board charters
- ▶ Consider disclosure of oversight

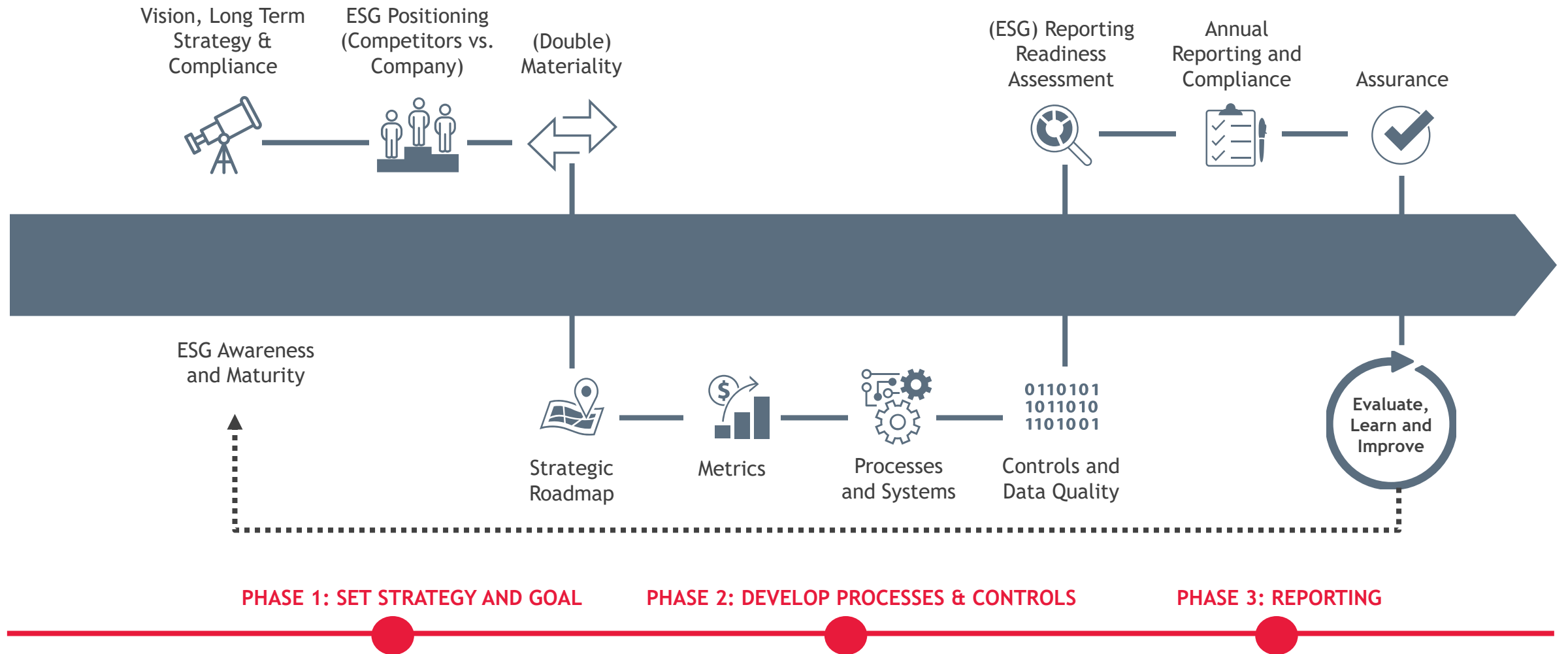
Maintaining ESG as a Regular Board Agenda Item

- ▶ Defining and formalizing responsibilities among board/committees/management
- ▶ Ensuring continued education on ESG matters

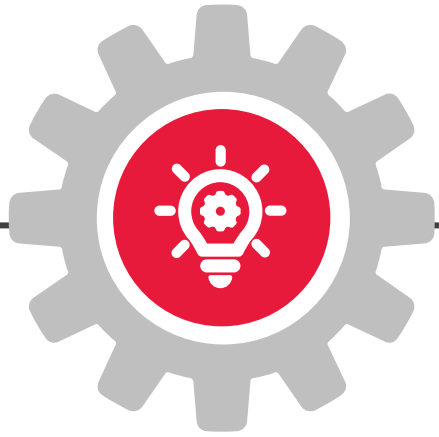
Assessing Need for Third-Party Assurance

- ▶ Compliance
- ▶ Data integrity

Sustainability Reporting Roadmap



Final Thoughts & Takeaways



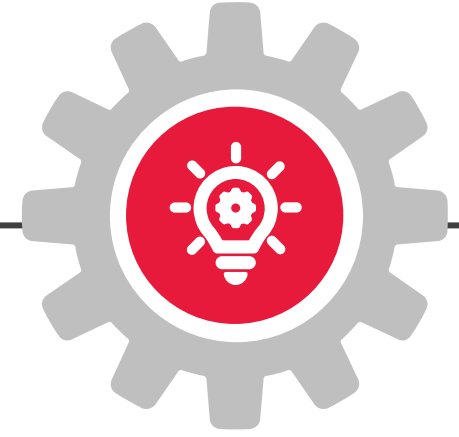
Internal Audit is Uniquely Positioned to Support

Internal Auditors have an understanding of the business, translatable skills, and similar experiences to ESG Reporting



Periodical Regulatory Assessment

Internal audit team can assess and report on ESG regulatory requirements (whether they are local, national, or global)



Governance is Key to Monitor ESG Risks and Trends

Internal auditors can promote board awareness and support the leadership in determining ESG-risks and upcoming regulations

Questions?



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TUESDAY, DECEMBER 3, 2024

3:00 – 4:00 PM ET / 2:00 – 3:00 PM CST

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