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► The views expressed by the presenters are not necessarily those of Ernst & Young LLP. Moreover, they should be seen in the context of the time they were made.
Learning objectives

After participating in this forum, you will be able to:

- Discuss how environmental, social and governance (ESG) fits into the long-term value that companies create
- List the drivers for recent investor interest in ESG topics
- Describe how Internal Audit (IA) can support ESG strategy and reporting
Discuss how ESG fits into the long-term value that companies create
Polling question

How do you think organizations demonstrate value outside of traditional financial metrics?

A. Positive press releases and public relations initiatives
B. Sustainability initiatives
C. Donations of resources (time or money) to good causes
D. Reporting on performance against ESG standards
E. All of the above
CEOs and boards are faced with new challenges

1. Declining public trust in institutions, including businesses and investors

2. Difficulties in communicating a true picture of value to investors due to the proliferation of data and organizational complexity

3. Traditional financial measures (i.e., tangible assets) becoming too narrow to measure value alone

4. A continued focus on short-term financial performance due to the lack of reliable measures of expanded value
The changing shape of business value

Components of S&P 500 market value have significantly shifted from tangibles to intangibles

Using long-term value to increase your control of your value narrative and drivers

1 https://www.oceantomo.com/intangible-asset-market-value-study/

Current perspective

Long-term-value perspective

COVID-19 underscored the value of having a robust remote-working infrastructure, including strong networks and cybersecurity practices, in place when the pandemic hit. For companies that had to develop those capabilities on the fly, this lack of ESG planning proved problematic.¹

Table Source: JUST Capital’s COVID-19 Corporate Response Tracker. Data as of June 9, 2020

ESG in 2020: social justice

**Investor attention on the intangibles of human capital and culture have increased in recent years and will likely continue to grow:**

- Within one month of George Floyd’s death, 217 S&P 500 companies had publicly responded to protect their reputations and businesses.¹
- In August 2020, the Securities and Exchange Commission finalized amendments requiring disclosure on human capital (such as measures or objectives for the attraction, development and retention of personnel).²
- During June 2020, a customer survey from DeVries Global found that 62% of Black Lives Matter respondents under age 35 will be “doing more research on brands and their inclusivity practices before purchasing.”³

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**Customer-facing companies responded quickly to social justice concerns.¹**

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Polling question

Which of the following topics may be covered by ESG reporting?

A. Greenhouse gas emissions
B. Human rights
C. Waste
D. Employee safety
E. All of the above
A closer look at societal and human value

ESG reporting has experienced rapid growth due to multiple drivers:

- **Investor interest**: 72% of investors say that they conduct a structured, methodical evaluation of ESG topics.\(^1\)
- **Customers**: 46% of consumers would be willing to forgo a brand name to buy environmentally friendly products.\(^2\)
- **Employee demands**: 73% of employees agree that it is important for their CEO to speak out on climate change.\(^2\)
- **Social license to operate**: Communities are seeking engagement and increased transparency.
- **Regulatory developments**: Jurisdictions around the world are developing guidance on ESG disclosures.

The scope of topics covered by ESG reporting can include:

<table>
<thead>
<tr>
<th>Environmental</th>
<th>Social</th>
<th>Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Energy efficiency and climate change</td>
<td>- Employee and customer safety</td>
<td>- Customer privacy and data security</td>
</tr>
<tr>
<td>- Circular economy</td>
<td>- Human rights</td>
<td>- Board diversity</td>
</tr>
<tr>
<td>- Waste management</td>
<td>- Community relations</td>
<td>- Corruption and bribery</td>
</tr>
<tr>
<td>- Water stewardship</td>
<td>- Diversity and inclusion</td>
<td>- Anti-money laundering</td>
</tr>
<tr>
<td>- Biodiversity</td>
<td>- Product quality and safety</td>
<td>- Business ethics</td>
</tr>
<tr>
<td></td>
<td>- Employee engagement and well-being</td>
<td>- Risk tolerance</td>
</tr>
<tr>
<td></td>
<td>- Selling practices and product labeling</td>
<td>- Compensation policies</td>
</tr>
</tbody>
</table>

Investor interest in ESG reporting
The evolving nature of ESG reporting

For us, every question about our engagement on environmental, social, or governance matters comes down to: ‘How does this affect the long-term value for our fund investors?’

- Vanguard’s voice on societal risks

Adapted from World Business Council for Sustainable Development (WBSCD)
Investors raise the ESG stakes

The vast majority of investors say that they usually conduct a structured and formal review of ESG disclosures

- 2018: 32% conduct a structured, methodical evaluation, 65% evaluate nonfinancial disclosures informally, 3% conduct little or no review.
- 2020: 72% conduct a structured, methodical evaluation, 25% evaluate nonfinancial disclosures informally, 2% conduct little or no review.

67% of investors say that they usually conduct a structured and formal review of ESG disclosures.

More than two-thirds of investors say that they make “significant use” of ESG disclosures that are shaped by the Task Force for Climate-related Financial Disclosures (TCFD).

83% of investors see a need for a new formal approach to measuring and communicating an entity’s intangible value in assessing long-term value.

70% of investors see independent assurance of ESG performance measures as “valuable” or “very valuable.”

Superior performance has contributed to increased investor focus on ESG

Relative performance of top quintile companies by ESG scores vs. equal-weighted universe

Cumulative relative performance (indexed to 100) when buying the top quintile stocks on Glass Door and selling the bottom quintile stocks, quarterly rebalancing

Top three investor engagement priorities for 2020

- Environmental issues/climate change: 59%
- Board diversity: 54%
- Talent management: 32%

Source: EY Center for Board Matters: 2020 Proxy Season Preview (EY 2020).
How IA can support ESG strategy and reporting
Polling question

How can IA support ESG?

A. Drive a hybrid
B. Assess resilience against top ESG risks
C. Understand whether investor and customer needs for ESG data are being met
D. Audit an annual ESG report
E. All of the above
ESG reporting standards and guidance

Organizations can fit into four distinct groups to provide greater consistency and encourage increased disclosures:

1. Publish guidance for voluntary disclosure, often with company feedback loops
   - Climate Disclosure Standards Board
   - GRI: Empowering Sustainable Decisions
   - IR
   - Sustainability Accounting Standards Board
   - TCFD

2. Request data from companies via questionnaires
   - CDP: Disclosure. Insight. Action
   - Dow Jones Sustainability Indices

3. Aggregate public data from companies
   - Refinitiv
   - Bloomberg

4. Create assessments of companies based on public and/or private information to sell to investors
   - FTSE4Good
   - MSCI
   - RepRisk: ESG data science and quantitative solutions
   - Truvalue Labs
   - Sustainalytics
Aligning materiality to disclosures

- High materiality: detailed disclosure
- Medium materiality: limited disclosure
- Low materiality: no disclosure
Developing an ESG strategy can help focus on where it makes sense to invest and guide reporting.
IA's role in ESG disclosures

IA provides the assurance on ~8% of reports and often performs procedures associated with external assurance.

Types of assurance (% of reports)*

<table>
<thead>
<tr>
<th>Year</th>
<th>External assurance</th>
<th>Internal audit only</th>
<th>No assurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>76%</td>
<td>14%</td>
<td>10%</td>
</tr>
<tr>
<td>2016</td>
<td>76%</td>
<td>12%</td>
<td>12%</td>
</tr>
<tr>
<td>2017</td>
<td>73%</td>
<td>17%</td>
<td>10%</td>
</tr>
<tr>
<td>2018</td>
<td>78%</td>
<td>8%</td>
<td>13%</td>
</tr>
<tr>
<td>2019</td>
<td>82%</td>
<td>8%</td>
<td>10%</td>
</tr>
</tbody>
</table>

IA can be part of the solution and add value to the company’s ESG journey

<table>
<thead>
<tr>
<th>Build ESG into the IA plan (including internal controls)</th>
<th>Assess company resiliency for top ESG risks</th>
<th>Conduct an internal audit of the annual ESG report</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assess whether investor and customer ESG information needs are being met</td>
<td>Support enterprise risk management (ERM) and sustainability to assess climate-related risks and opportunities</td>
<td>Support the integration of ESG risks into ERM</td>
</tr>
</tbody>
</table>
Activating the ESG strategy involves collaboration across the enterprise

Integrating ESG-related risks into your ERM frameworks
Five components of the guidance

Applying ERM to ESG-related risks

- Governance and culture for ESG-related risks
- Strategy- and objective-setting for ESG-related risks
- Performance for ESG-related risks
- Review and revision for ESG-related risks
- Information, communication and reporting for ESG-related risks

EY teams bring risk transformation and ESG experience, along with sector focus, to assist management in developing leading practices.

Closing remarks
Organizations can improve productivity by better managing environment, health and safety risks. We explore ways to climb the maturity curve. Learn more.

This fifth edition of our research sees a significant shift in how investors assess and use ESG information in their decision-making. Learn more.

Building and maintaining a resilient supply chain is a key success factor for businesses operating in a fast-changing world. Learn more.

The EY Global Climate Risk Disclosure Barometer provides a snapshot of disclosures of over 500 companies across sectors in 18 countries. The purpose of this report is to share the current state of global climate-risk reporting.

Measuring intangible assets such as human capital, organizational culture, and corporate governance are increasingly important to business value. Learn more in this report.

The 2018 EPIC report The report pilots the EY long-term value framework and identifies value drivers important for sustainable and inclusive growth, as well as potential metrics to assess them. It outlines several of these intangible assets and possible metrics for helping companies communicate their ability to generate long-term value to both investors and society as a whole.

Learn more: Report, press release, participant statement and long-term value website.

Applying enterprise risk management to ESG risks
This guidance is designed to apply to COSO’s ERM framework. It addresses an increasing need for companies to integrate ESG risks into their ERM processes.

Learn more: Report, press release

Sustainability Matters podcast
Sustainability is a business issue. Businesses are assessing the impact, risks and opportunities of megatrends, such as urbanization, digital and climate change. The Sustainability Matters podcast provides leading trends and practical advice around ESG issues and opportunities facing businesses today.

* Illustrative example of the various services available under our five service offerings.
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