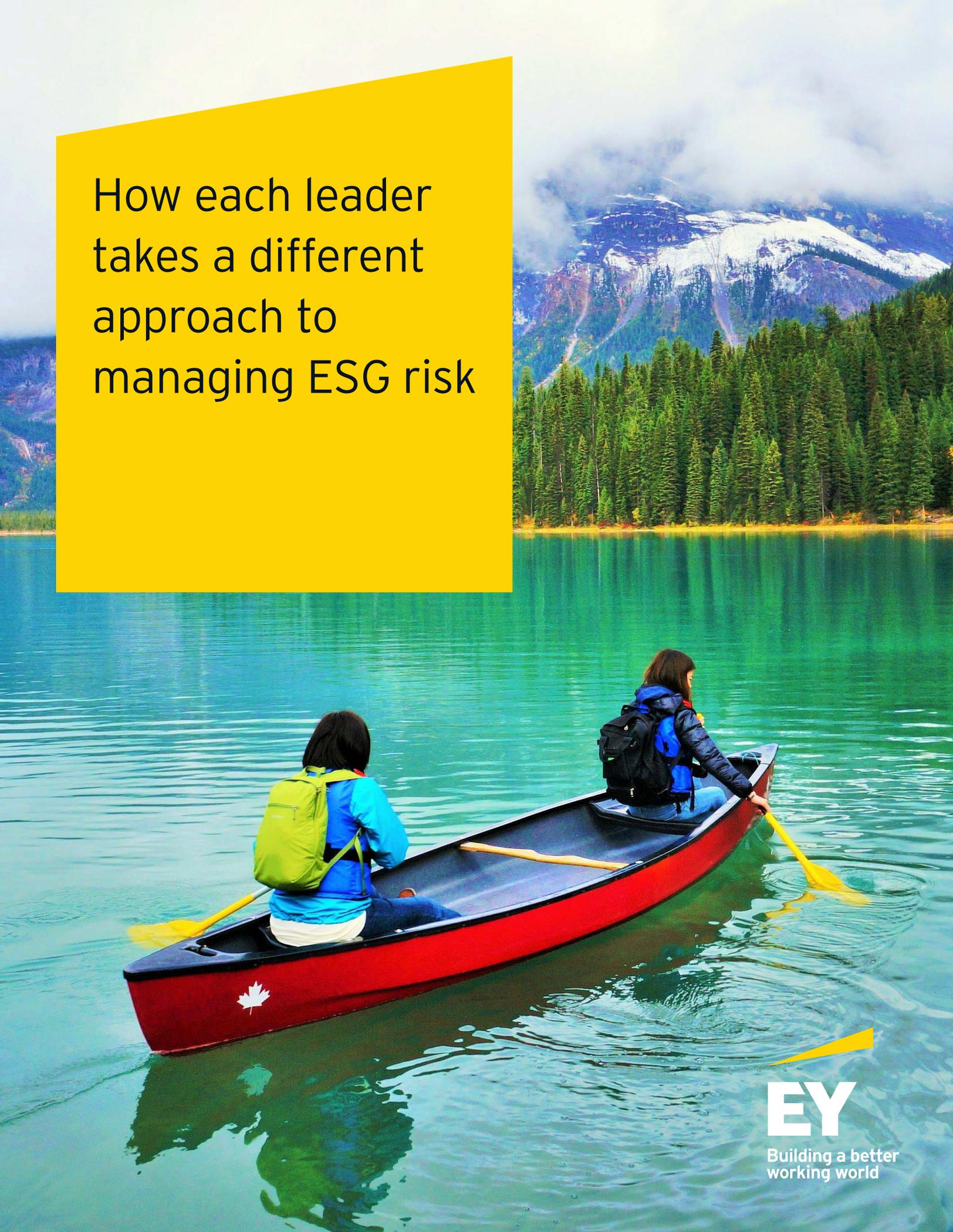


How each leader  
takes a different  
approach to  
managing ESG risk





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Though it's one of the most urgent issues facing the world today, ESG is a complex topic to navigate. We help our clients create disciplined approaches and strategies to their ESG risks — not only to meet the rapidly changing expectations from consumers, shareholders, employees and regulators, but also to catalyze positive societal and environmental impact.

Kapish Vanvaria

EY Americas Risk Market Leader

Environmental, social and governance (ESG) issues have become more than a priority for policymakers, investors and stakeholders across all industries. This transition to ESG represents a multigenerational journey that touches every aspect of our lives. The publicly announced net-zero commitments by 2050 or earlier by several organizations, and the Gender Diversity Rule approved by the SEC are just two of many signals that demonstrate value-led sustainability is here to stay across the private and public markets. It's not a fad, but an imperative. This creates both daunting threats and dynamic opportunities that every organization will need to address in their own way.

There is pressure on businesses to adopt more socially conscious practices, to reduce their carbon footprint, to be conscious of their brand reputation, to retain the best talent and to craft an approach to governance that continues to evolve with the market.

With the increasing role of stakeholder capitalism across all industries, many organizations feel pressure to report on

nonfinancial metrics and the value they create beyond financial profit. However, in this complex and often subjective discipline, the correlation between ESG performance and financial performance isn't always clear. This is a significant undertaking for businesses, not the least of which is because these initiatives are actually a confluence of business topics all pulling together under the umbrella of ESG.

ESG risks permeate a business in different ways. It's more than a line on the balance sheet, but rather a strategic, cultural and operational mindset that needs to be embedded across the entire organization. For this reason, there needs to be clearly defined ESG risk strategy and governance. Climate risk is the most material across the ESG spectrum in terms of impact and investor interest. One of the biggest challenges is the overall integration of ESG risks and strategies so individual business units are not working in silos, allowing ESG risk strategy to drift and lose focus. It's a bit like an orchestra where each business unit needs to own a part of the overall ESG risk strategy and function in harmony for it to work.

# What can you do as the head of your business unit to help craft an effective ESG risk management strategy?

Every leader in the C-suite has a role to play in evaluating their part of the company's function, the ESG risks that apply and what they can do to mitigate those risks. This first line of leaders – the chief marketing officer (CMO) and chief product officer (CPO), among others – is focused on the provision of products and services to clients, and on managing risk. These are the leaders of the company, the individuals who set the course for how the organization operates and how decisions are made. Their commitment to making ESG risk management a priority is key to getting buy-in from employees. As with any company-wide initiative, the path to success begins with the CEO.



# Chief executive officer

A majority of US CEOs (82%) see ESG as a value driver to their business over the next few years, and virtually all have developed a sustainability strategy. US companies are beginning to follow the example set by the European Union, where ESG reporting is further along and investors have come to see that improved government and community relations can accrue to the bottom line.<sup>1</sup>

## 1. What are the CEO's key considerations with respect to ESG risk?

- ▶ **Company culture: "Culture eats strategy for breakfast."**  
As the leader at the top of the organization, the CEO needs to go beyond talking about ESG. He or she needs to lead by example, making it clear that ESG is a company-wide philosophy that is integrated into the fabric of the organization. It's not about, "We're going to focus on ESG this month." Rather, it should be, "We need to be thinking about ESG in everything we do as a company." Make it part of the culture, the performance measurement, part of the decision-making of how the company functions on a day-to-day basis. Where most organizations struggle is in those early stages. To build that initial momentum, the CEO should develop a working committee with members of the board and management that is focused on the ESG risk strategy roadmap. Define roles, accountability, processes and procedures to get the ball rolling and bring the individual business units together.
- ▶ **Develop a compelling ESG risk strategy that is embedded into the corporate strategy:** One of the key roles of the CEO is to set the course for the company, to show the way to the next big goal. Here is where the company can move beyond traditional business unit silos and begin integrating ESG systematically at every level of the organization. This could be explicitly embedding circular economy into the strategy or ensuring key internal and external stakeholders are both fully invested in the circular economy plan and equipped with the necessary skills and knowledge to implement it.
- ▶ **Inspire each business unit:** The CEO needs to convey that every business unit needs to integrate ESG into team culture and everyday thinking. For example, does the capital allocation strategy contribute to the development and roll out of low-carbon technologies and wider decarbonization efforts? When M&A activity is discussed, is ESG part of the due diligence? Does the acquisition target, or the buyer, align with your values on net-zero emission goals and diversity, equity and inclusion (DEI) targets? Is there alignment when supplier and logistics agreements are being evaluated, when real estate decisions are being made, when travel plans are being coordinated? It needs to become part of the company's DNA and decision-making process

<sup>1</sup> *The CEO Imperative: US executives recalibrate risk radar*, [ey.com/en\\_us/ceo/ceo-survey-2022-us-findings](https://www.ey.com/en_us/ceo/ceo-survey-2022-us-findings).

## 2. What questions should the CEO be asking?

- ▶ What are our company's most material ESG risks? What are our biggest gaps in managing ESG risk?
- ▶ Does our company provide a net-zero transition plan that sets clear milestones over the short and medium term?
- ▶ How does our company measure up against our industry peers when it comes to ESG risk management?
- ▶ Have we embedded circular economy in our strategy?
- ▶ Do we have a sufficiently granular and feasible plan to meet our timeline for our net-zero and DEI commitment? Are these included in our comprehensive climate and human capital disclosures?



## 3. What are the top three things the CEO should activate immediately?

- 1. Walk the talk. Lead by example:** This could be committing to at least three of the U.N. Sustainable Development Goals (SDGs) and/or membership in climate and sustainability-related industry initiatives that highlight to employees, policymakers and other key stakeholders that the company is actively seeking to address climate challenges and works collaboratively with peers to identify solutions. Be purposeful about taking a leadership role in the company's industry, whether it's the ecosystem of regulators, investors, consumers or employees.
- 2. Establish an external advisory council:** This enables you to bring individuals to the table across various stakeholder groups, such as banks, NGOs and subject-matter professionals, who can build the board's expertise and comfort level with the ESG team while providing validation on the importance of ESG issues from a third party.
- 3. Create an ESG steering committee:** This will help companies commit regular time to ESG initiatives. This committee should provide formal guidance, and oversee and drive the implementation of ESG strategies and activities.

# First line of defense – own and manage risk

## Chief marketing officer

With social media's prevalence and 24/7 news cycles, companies are under constant scrutiny by customers, investors and stakeholders. The opportunity to expose ESG negligence is high on the list for those looking to make a splash. Organizations will need to go beyond simply telling consumers why their product is best and why their ESG practices are genuine. They'll need to prove it and show why the product and the organization are worth the consumers' investment. The prevalence of advertising fraud, brand safety and data breaches presents significant ESG risks, as does consumers' increasing vigilance for brands that attempt to "purpose-wash."

### 1. What are the CMO's key considerations with respect to ESG risk?

- ▶ **Marketing strategy:** CMOs are responsible for determining the brand's direction and marketing strategies with an objective of increasing brand awareness and the top line (revenues). The CMO has a significant role to play in setting the course of a company's ESG risk strategy and sharing the added value to the society story with employees, consumers and stakeholders. From social media to the company's vision and mission statement and the message to investors, the CMO should consider how an ESG-informed marketing strategy will be integrated throughout the company brand. Centering marketing efforts around the company's sustainability, DEI and employee well-being strategies, and then telling that story effectively will increase brand loyalty and value - and will ensure every touch point between the organization and the consumers of tomorrow is taken into consideration. Moreover, there is increasing evidence that doing so substantially improves top-line performance.
- ▶ **Understand what your data is telling you:** CMOs have a heavy reliance on the use of data analytics to understand their organization's environmental footprint, conduct market research and data analysis on their target market, understand the current customer experience (think of the largest customer population being Gen Z and millennials) and be informed about market trends to figure out how to best reach their demographic and make sales. One of the biggest challenges the CMO will face in executing their role with the ESG risk strategy is the ability to get consistent and reliable data sources. Sustainability-conscious customers will be on the lookout for attempts to "greenwash" products and services. The CMO can protect against this, and secure the company's reputation, by ensuring that the company's messaging regarding its ESG work reflects what is happening in the organization.

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Companies with an above-average customer experience and employee experience outperform the laggards in the market by 15%.

- ▶ **Sharing your story:** The most effective marketing strategies in any business involve sharing an engaging story. The CMO needs to work across product lifecycles and business units to develop a narrative that effectively conveys what the company is doing, including setting and communicating ESG goals. This will also add an element of accountability from investors, employees and customers. The company's story should consider how ESG risks will be integrated throughout the company brand. Talk to your people, learn about the challenges they face, the ambition they used and the results they earned through their efforts.

## 2. What questions should the CMO be asking?

- ▶ Do we have cleansed, standardized and reliable data platforms and scientific processes from which we can share updates on how our company is managing ESG risk? Do we have analytics tools to help detect the anomalies in data sets?
- ▶ What external market intelligence data sources can we use to benchmark and better tell our ESG story?
- ▶ Do we have the right talent to manage our brand's reputation and respond to inquiries about our ESG risk management strategy?
- ▶ Do we have a compelling narrative to share that has been vetted for accuracy?

## 3. What are the top three things that the CMO should activate immediately?

1. **Public relations:** Develop a public relations strategy that shares the organization's ESG efforts through appropriate media channels to give greater visibility to its commitment to ESG. This can include communicating how their ESG efforts translate into superior returns and better risk mitigation. Highlighting direct connections between sustainability and business performance can support your ESG marketing efforts and resonate with both investors and customers.
2. **Transparency:** It's more powerful in building trust with employees, investors and consumers on sharing where ESG commitments may have fallen short and how the organization will course correct. This can be an opportunity to clearly identify your organization's key differentiators and be what makes your company unique with its ESG value proposition.
3. **Develop a channel strategy:** Identify which channels work best for your ESG message. Know the audience you're speaking to and take time to create alignment, but also messaging that resonates with the target audience of that channel.

# Chief product officer

Circular economy, the idea of recycling, refurbishing and reusing materials for as long as possible, is gaining traction in today's economy. It also fits in with the philosophy of ESG risk management. All materials used in an organization's product design should be used in such a way that they can be recycled indefinitely. This needs to happen on a time scale that's relevant to people and not 1,000 years into the future.

## 1. What are the CPO's key considerations with respect to ESG risk?

- ▶ **Produce a more circular result:** The CPO needs to center the design and development of products around the organization's ESG risk strategy. What gets measured gets done. Determine the environmental benefits and impact at each stage of a product's life – from raw material extraction through its use phase(s) to final disposal or recycling. A product lifecycle analysis policy and process should be established to guide the design and development of the products.
- ▶ **Implement transparent design practices:** Having an understanding of the materials that are used to design the products and how vendors who provide those material are selected across the entire value chain of the product development is a key imperative for the CPO. For example, the ESG risk strategy for the product design phase should give consideration to minimal usage and shorter cycle time for scarce resources so they can be recovered sooner for reuse. Materials that can be transported a shorter distance should be prioritized over materials with longer transportation times to reduce CO2 emissions at the product design and development phase.

- ▶ **Study your packaging:** Product packaging provides a significant opportunity to minimize your carbon footprint and demonstrate your commitment to the ESG principles of the consumer. Research teams should be constantly monitoring what's happening in the packaging space and what options might best serve their needs, with a bias toward dematerialization of packaging. In addition, the CPO and their teams should pay particular attention to tech startups, whose enthusiasm and energy to develop new solutions to old methods could be a great fit from both a cultural and operational standpoint.

## 2. What questions should the CPO be thinking about?

- ▶ What process does your company follow when it comes to researching and developing new products?
- ▶ How efficient is your product manufacturing or service delivery operation?
- ▶ How often does your team monitor and review their packaging suppliers through the lens of ESG risk?

## 3. What are the top three things the CPO should activate immediately?

1. **Develop a product lifecycle analysis policy:** Use this to measure the benefits and environmental and social impact of materials used in the product design and development phase.
2. **Leverage your third-party risk management program:** Use these results to vet material vendors to ensure they align with your ESG standards.
3. **Join global sustainability focused industry organizations:** Get involved and bring along your company's suppliers and distributors to advance key environmental goals, such as stop global warming, restore biodiversity and protect the oceans.



# Second line of defense – oversee the management of risk

This is the next level of governance, focused on expertise, support, monitoring and challenges; it is closer to the day-to-day operations of the business. They have a better sense of what's working, what's not and what issues still need to be addressed and strategized against.



# Chief financial officer

There are several areas for CFOs and other finance leaders that will likely be important as the finance function continues to evolve and provide the trusted and enhanced reporting insights their business requires.<sup>2</sup> The CFO needs to ensure that there is a strong connection between financial and nonfinancial reporting, and that ESG risks and opportunities are reflected across the balance sheet, income statement and cash flow statement. CFOs and other finance leaders should be proactive and work across business units to understand ESG risks under different scenarios of the future.

## 1. What are the CFO's key considerations with respect to ESG risk?

- ▶ Resolve the ESG reporting gap with investors: CFOs and other finance leaders can play an instrumental role in helping to meet ESG requirements from investors. Evaluate transition risks of policies, technology impact and legal framework. Quantify financial impact and report to shareholders.
- ▶ Be diligent about monitoring accounting standards: Stay abreast of developments from key regulators such as the International Financial Reporting Standards (IFRS) Foundation, the International Accounting Standards Board (IASB) and the International Sustainability Standards Board (ISSB).
- ▶ Take the lead in advancing the integration of ESG risks into the overall enterprise risk management program: ESG is a strategic risk for organizations that requires immediate attention from your enterprise risk management function. They need to review the company's risk universe for completeness of ESG-specific risks and assess monitoring and reporting processes, as they can help enhance the company's operational risk response.

## 2. What questions should the CFO be thinking about?

- ▶ Are you confident that your risk management team's scenario planning and tabletop exercises are sufficiently building enterprise resiliency related to material ESG risks?
- ▶ How are you upskilling and/or bringing in talent with ESG-specific skills?
- ▶ How are you bringing the outside in to effectively enhance your visibility concerning ESG risks and challenge internal bias and inertia?<sup>3</sup>
- ▶ As you explore new strategies, transactions and innovations, what steps are you taking to better understand the ESG risk dimensions that they introduce?
- ▶ In this era of radical transparency, are there opportunities to enhance your communications and disclosures about ESG risk with key stakeholders?

## 3. What are the top three things the CFO should activate immediately?

1. Develop a strategy that involves building more agile and fluid operating models: Use these models to inform your decision-making as ESG risk management protocols change and evolve.
2. Create a bold technology road map: This can be a valuable tool for transforming financial analytics and providing enhanced and trusted reporting, including advanced tools such as artificial intelligence (AI).
3. Develop a future talent strategy for finance: Set standards for key skills and personnel needs in your finance operation. Create an environment based on continuous and dynamic learning that attracts and motivates the next generation of CFOs and other finance leaders.

<sup>2</sup> *The CFO Imperative: How do you transform data into insight?* [ey.com/en\\_us/assurance/how-do-you-transform-data-into-insight](https://ey.com/en_us/assurance/how-do-you-transform-data-into-insight).

<sup>3</sup> *How to enhance risk oversight in an age of transformation*, [ey.com/en\\_us/risk/how-to-enhance-risk-oversight-in-an-age-of-transformation](https://ey.com/en_us/risk/how-to-enhance-risk-oversight-in-an-age-of-transformation).

# Chief information officer (CIO)/chief information security officer (CISO)

One of the biggest challenges organizations face on their ESG journey is getting standardized, reliable data sources to fuel data-driven decisions. CIOs have a central role to play with ESG data, from developing a modern tech infrastructure to navigating the ESG risk data landscape. They identify, mine, enrich and maximize the utility of ESG data across the enterprise, leading to responsible growth, stakeholder trust and customer confidence. The CIO works closely with the CISO, who can act as the company's chief trust officer, ensuring that the company's privacy and intellectual property (IP) are secured.

## 1. What are the CIO and CISO's key considerations with respect to ESG risk?

- ▶ **Data protection:** It's critical to think about data and information from a disclosure and privacy perspective. In today's ESG-driven environment, organizations exist to comb through data to expose companies that do not adhere to ESG standards. This is a new threat organizations must contend with. Further, malicious actors have a new threat vector: The data can potentially be tampered with, stolen or leaked.
- ▶ **Vet and verify:** Some companies are sharing reports and metrics to demonstrate their commitment to ESG and how they are faring at a moment in time. It's important that the data being shared has been properly verified and vetted for public consumption, even if it's not being shared openly. Releasing inaccurate information could cause reputational harm and might be difficult to walk back. There are actors who might want to tamper with data or steal data and release it on their timetable. Every angle for potential intrusion must be considered and addressed.
- ▶ **Eliminate the bias:** If AI-based systems are being used to collect, assess and analyze data, it's critical that biases are removed from the data sets and algorithms.

## 2. What questions should the CIO and CISO be thinking about?

- ▶ Who are the threat actors that may be interested in your data?
- ▶ What drives their malfeasance? Is it geopolitical? Corporate sabotage? Braggings rights?
- ▶ How can artificial intelligence help with information-gathering and understanding your level of ESG risk?

## 3. What are the top three things the CISO should activate immediately?

1. **Run tabletop exercises as a top priority:** Identify stakeholders from across the organization to participate in a simulated breach in real time. All of the policies in the world can't replace the act of the doing. Build the muscle memory so that you're not scrambling during an event.
2. **Ensure that access to data is well thought out:** All assets under management should be identified. With the completed inventory, protections can be assigned based on their value and recovering these assets after an event.
3. **Get external expert support ahead of time:** Use independent third parties to conduct assessment of the effectiveness and maturity of the organization's cyber controls and overall program, including data privacy. The assessment should include assessing controls for legal risks to understand how the organization is protecting data that is governed by regulations or belongs to outside parties. Too often, the assessment is done on breach day. In addition, ensure essential experts (e.g., legal, public relations, business continuity) are part of the crisis management team ahead of time and sign them up now.

#### 4. What are the top three things the CIO should activate immediately?

1. Prioritize ESG within the IT: CIOs can lead enterprise ESG efforts in their backyard. Start by analyzing IT's consumption of energy, including Scope 1 and 2 emissions. Work collaboratively with the CISO to determine which pieces of data need to be collected, stored and reported on for the organization's ESG initiative as a whole. Both IT and security will have to implement the handling and protection of the data.
2. Implement a circular economy program: Another starting point for ESG practices while reducing information risk is creating hardware recycling programs inhouse. Repurposing materials from company laptops or other devices is an effective way to reduce your carbon footprint. Handling this program internally allows for the proper controls to be taken with enterprise data that may still exist on those devices.
3. Supplier governance: Evaluate the carbon footprint of your external vendors, starting again within the IT department. Do you use an off-site cloud or data storage center? If so, how are they sharing ESG-related data with you? Blockchain ledgers can play a key role in ensuring third-party data is traceable and immutable, creating a risk-averse supplier data governance model.<sup>4</sup>

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<sup>4</sup> EY Blockchain Consulting Services, [ey.com/en\\_us/consulting/blockchain-consulting-services](https://ey.com/en_us/consulting/blockchain-consulting-services)



# Chief operating officer (COO)



The COO can see the company through a different lens, balancing the work on managing ESG risk against the day-to-day operations of the business. They manage business operations that impact ESG and can identify gaps that may exist to ensure that both facets of the business function effectively and are aligned to the ESG priorities of the organization. They can assess whether employees need to commute daily (emissions) to come into the office (real estate building carbon emissions). But they also play a role in contributing, understanding and managing ESG risk strategies related to the physical buildings, carbon emissions, greenhouse gas emissions and other factors. The COO can also explore decarbonization opportunities, such as usage of hydrogen and other low-carbon power sources, investment in research and development across the physical infrastructure lifecycle, and advocating net-zero targets to building owners and developers. They can also look at CO2 emissions from suppliers, evaluate fair-trade practices for all upstream suppliers and study water stewardship within the value chain.

## 1. What are the COO's key considerations related to ESG risk?

- ▶ **Value chain:** Through an established procurement function, a third-party risk management program and due diligence process should be leveraged so the organization can ensure collaboration across its value chain to reduce emissions, and deforestation efforts (as an example) and ensure factors under the social domain are aligned to the organization. For example, for an organization in the apparel sector, having a traceable sourcing policy publicly listed on the company website will define which areas the company is sourcing materials and labor from based on social and environmental factors. COOs should also keep in mind, however, that a traceable sourcing policy is only one part of the equation. A sustainable sourcing target/policy, a monitoring and auditing policy, and transparency into the audit result are also crucial.
- ▶ **Utilize technology:** To take the supply chain sourcing model a step further in terms of the social and environmental impacts, the company can use innovative technologies such as ForestMapper, a map that visually represents endangered forests on a global scale and helps companies transition to more sustainable fiber supply chains, to identify areas of potential risk in sourcing.
- ▶ **Compliance:** If the organization does not have separate CCO to monitor and manage compliance activities, the COO needs to be vigilant about keeping up with new ESG

regulatory reporting requirements and guidelines as they change to make sure the company remains in compliance. With new ESG commitments, the COO needs to ensure the existing compliance systems, processes and infrastructure are appropriate and effective. The company can leverage both internal and third-party auditing programs to ensure compliance outside its organization. Working through the value chain, COOs should work internally, as well as with external partners, to drive toward the same goal. With multiple measurements and reporting frameworks for ESG risks, the COO can play a key role in supporting the organization with harmonizing a common ESG risk taxonomy.

## 2. What questions should the COO be thinking about?

- ▶ Is the ESG risk strategy reflected across all policies related to the operations of the organization? Key metrics measure the progress of achieving ESG goals and targets?
- ▶ Have the short- and medium-term operational emissions target been set?
- ▶ How resilient are the current business models to climate change/catastrophic events? Are the business models aligned to climate scenarios?
- ▶ Is the ESG risk strategy embedded across the operations of the organization and understood by all levels of employees?
- ▶ Is the ESG strategy/vision shared among external partnerships? What are the monitoring/reporting requirements to ensure compliance through the entire supply chain?

## 3. What are the top three things the COO should activate immediately?

1. **Develop a community of interest:** Work with internal and external stakeholders to innovate existing business models to lower carbon processes and practices.
2. **Explore innovative tools:** Take steps to support and enable a sustainable value chain.
3. **Evaluate current processes for identifying ESG compliance and regulatory updates:** Ensure that the company is aware of changes and can quickly develop a response strategy. Develop an ecosystem of external advisory, government agencies, and nongovernmental organizations (NGOs) to understand emerging compliance requirements.

# Chief human resource officer (CHRO)

Often the CHRO's key role as it relates to ESG risks is understood monitoring the company's human capital and DEI policies. However, CHROs can play a much broader role in ESG risk strategy.

## 1. What are the CHRO's responsibilities related to ESG risk?

- ▶ **Human capital:** CHROs can join C-suite colleagues at the tip of the spear by addressing risks related to the decarbonization of the organization by developing processes and policies to enable effective long-term remote working models. They can play a role in reducing carbon emissions from vehicles and updating performance measurement to evaluate an individual's contribution to the ESG goals of the organization. They can also update learning and development career journey maps to incorporate ESG topics that are aligned to the organization's mission and targets.
- ▶ **Talent acquisition:** The CHRO can support the company's objective with the DEI agenda by ensuring job postings are written in a way that attracts applicants from different backgrounds.
- ▶ **Lead by example:** The CHRO can lead the DEI mandate by ensuring their team reflects the DEI goals of the organization. This could include having more underrepresented populations in the HR organization than the organization's DEI goals specify. This will also bring diversity of thought and action when developing/updating HR policies and procedures, job postings and new working models.

## 2. What questions should the CHRO be thinking about?

- ▶ How can you be more inclusive and people-centric to make technologies friendlier and more accessible and useful to employees?
- ▶ What gaps exist in your hiring strategy that if addressed would strengthen your ability to mitigate the organization's ESG risks?
- ▶ How do you monitor changes to HR policy to ensure your company remains in compliance with the latest policies and procedures?

## 3. What are the top three things the CHRO should activate immediately?

1. Convene a team to evaluate hiring practices: Identify weaknesses that can be improved to attract and retain needed talent.
2. Initiate regular messaging: Keep your team updated on the latest HR policies, as well as invite feedback and collaboration on how to build a better workplace.
3. Get involved: Identify and participate in industry forums and organizations that advocate for strong HR departments and bring good ideas back to your team.



A photograph of two people in a raft on a river. They are wearing blue helmets and orange life jackets. The raft is orange and blue. The background shows a forest of tall trees and a river with white water rapids.

# Third line of defense – independent assurance on risk management and control effectiveness

These leaders are focused specifically on auditing and keeping their company updated on the latest changes to ESG policy. ESG issues span various functions within a company, and ownership of data risks and controls may be unclear or unassigned. The auditing team can help bring structure to this process and ensure that the company is moving forward collaboratively to address ESG.

# Chief audit executive (CAE)

The CAE must develop their team's ability to be innovative, dynamic, and to think outside the box, challenging the status quo and relentlessly driving improvement. They should monitor internal audit (IA) plans for alignment with the new key priorities of the wider organization and adjust accordingly. CAEs should be driving the focus of IA to be integral to recovery plans by understanding, assessing and monitoring the effectiveness of response to all risks.<sup>5</sup>

## 1. What are the CAE's responsibilities related to ESG risk?

- ▶ Proactive advisory: Internal audit can play a proactive role in the organization's ESG efforts by attending key steering committee meetings, staying abreast of regulatory expectations on ESG matters and providing guidance to management on appropriate controls.
- ▶ Targeted oversight: This position is key to conducting targeted reviews of ESG controls across the organization through various internal audit reviews.

## 2. What questions should the CAE be thinking about?

- ▶ How are your internal audit functions identifying ESG risks in the risk universe?
- ▶ What is the methodology to audit a systemic enterprise-wide risk such as ESG?
- ▶ Do we have the appropriate skill sets to assess the process and controls related to decarbonization, scenario analysis of catastrophic events, biodiversity, technical accounting reporting and disclosures, greenhouse gas emissions and the more technical areas of ESG.

## 3. What are the top three things the CAE should activate immediately?

1. Monitor ESG controls: Internal audit teams have a duty to regularly monitor control processes and activities throughout the organization and improve or comment upon their accuracy, efficiency and effectiveness.
2. Enhance transparency and reliability of ESG performance data and disclosures: Internal audit can support the transparency and reliability of ESG data and information, enhancing the credibility of disclosures and identifying gaps for improvement.
3. Link ESG to enterprise risk management: Internal audit can ensure that ESG risks are not limiting the company's achievement of strategic objectives by linking the management and reporting of ESG to enterprise risk management systems and processes.

<sup>5</sup> COVID-19: How CAEs can shape the future of internal audit, [ey.com/en\\_us/consulting/covid-19-how-caes-can-shape-the-future-of-internal-audit](https://www.pwc.com/en_us/consulting/covid-19-how-caes-can-shape-the-future-of-internal-audit)

# Board of directors

A recent EY survey of board members shows that 84% of boards don't believe management teams manage risk well.<sup>6</sup> The biggest problem they see is that companies manage risk in silos and are not diligent about communicating with each other about the challenges their business faces. While risks are being managed, few companies look at the interdependencies.

## 1. What is the board of directors' responsibilities related to ESG risk?

- ▶ Do this on day one: Develop a working committee with members of the board and management focused on the ESG risk strategy and governance framework. Ensure accountability and oversight at the board level of the organization's ESG efforts. Ensure the board understands how the company is revisiting and adapting its risk management strategy and management's approach to the three lines model in response to ESG risks, including internal and external changes, changes in strategy and risk landscape, and the company's operating model.
- ▶ Lead by example with board composition: Ensure that there is gender and ethnicity representation on your board. If you're a publicly traded company in the US, representation is required by NASDAQ's Board Diversity Rule, approved by the SEC on August 6, 2021.<sup>7</sup>
- ▶ Find people with ESG skill sets and experience: Boards are increasingly focused on which ESG risk factors are material to the company and how management is reflecting them in strategic planning and risk management. Ensure there's an appropriate climate-related skill set on the board.

## 2. What questions should the board of directors be thinking about?

- ▶ Does the organization have a detailed plan on achieving net zero by the stated target date?
- ▶ How would you describe your understanding of how management views the most material ESG topics and how that can be mapped to the full board or committees within?
- ▶ How are ESG risks integrated into the overall risk management framework?

## 3. What are the top three things the board of directors should activate immediately?

1. Trust but verify: Boards should take an approach that includes review of direct and indirect metrics for climate-related risks, culture, and human capital risks.
2. Consider using your proxy statement to discuss ESG governance: Include which of the various board committees are involved so investors can understand how the board is approaching oversight of these items.
3. Develop key performance indicators: The board's performance assessments of the CEO should include KPIs aligned to the organization's ESG goals.

<sup>6</sup> *The Board Imperative: Is now the time to reframe risk as opportunity?* [ey.com/en\\_us/global-board-risk-survey](https://www.ey.com/en_us/global-board-risk-survey)

<sup>7</sup> *What NASDAQ-listed companies should know about NASDAQ's board diversity rule*, [listingcenter.nasdaq.com/assets/Board%20Diversity%20Disclosure%20Five%20Things.pdf](https://listingcenter.nasdaq.com/assets/Board%20Diversity%20Disclosure%20Five%20Things.pdf)



# Chief legal officer (CLO)

New laws, regulations and changes in the way investors, regulators, customers, employees and the public view ESG issues have broad implications for organizations. “We are seeing a major pivot from a world in which sustainability was about messaging and voluntary commitments to a world in which implementation is key and reputational risks are becoming more acute,” says Cornelius Grossmann, EY Global Law Leader. “The public no longer expects companies to simply do no harm; they are also expected to appropriately respond to environmental and social issues. This puts a huge amount of responsibility on organizations.” While this shift will affect most business functions, law departments are likely to play a key role, given their focus on compliance and risk management and their involvement in a broad range of issues that connect into sustainability.<sup>8</sup>

## 1. What are the CLO's key considerations with respect to ESG risk?

- ▶ Assess stakeholder pressure and risks to the organization – In the EY 2022 General Counsel Sustainability Study, law department leaders reported that the pressure they feel from customers and employees on sustainability concerns is only slightly behind that of investors and regulators. In the past several years, these customer and employee stakeholders have grown significantly more active in voicing their concerns on organizations' environmental and social practices. Interestingly, law departments report that the top risks for their organizations around sustainability are loss of customers due to reputational harm and damage to the brand. As a result, while managing risks around compliance, litigation and transactions remains a critical focus, CLOs should consider whether to expand their focus on other reputational or nonlegal risks.

- ▶ Develop a decision-making framework. Working across the business to develop a framework for decision-making around complex sustainability questions will be critical, as many of the most pressing issues are not clearly addressed by regulations. Law departments are well placed to undertake or even lead this work. Their role, at the center of a mass of interconnected sustainability issues, gives them unique insight into these topics. A clear framework will bring structure to how these issues are addressed, as well as help the team confront its increased workload.
- ▶ Define the law department's role. While some organizations may structure themselves so that the law department plays a leading role across sustainability issues, others will choose a different path. In these organizations, the law department may end up partnering with other functions, either as an equal or as an ad hoc advisor. The optimal level of involvement will depend on the industry the organization operates in, the risks it faces in each area and the mitigation strategies that are required to manage those risks. Although the level of involvement may vary by organization, nearly all law departments in the study – 99% – reported that they expect significant increases in workload due to the rising importance of sustainability, and many require additional expertise and budget to keep pace. As a result, it will be important for CLOs to make sure the law department's operating model provides the capacity, talent and other resources required to meet evolving expectations.

<sup>8</sup> *The General Counsel Imperative: How the law department is key in unlocking your sustainability strategy*, [ey.com/en\\_us/law/how-the-law-department-is-key-in-unlocking-your-sustainability-strategy](https://www.ey.com/en_us/law/how-the-law-department-is-key-in-unlocking-your-sustainability-strategy)

## 2. What questions should the CLO be asking?

- ▶ Is my law department focused appropriately on the organization's most critical sustainability risks?
- ▶ Have we developed a detailed view of how the regulatory landscape is likely to evolve over the medium term to future-proof the organization's policies and law department operational strategy?
- ▶ Are there areas where the law department should become more actively involved or other business functions we should collaborate with more on sustainability?
- ▶ What resources, expertise or support does my legal team need to manage an increasing workload of complex ESG and sustainability-related issues?

## 3. What are the top three things the CLO should activate immediately?

1. Educate leaders on the risks the organization faces. Currently, only 15% of respondents in the EY General Counsel Sustainability Study believe their organization's leaders fully appreciate the environmental risks. Similarly, only 39% believe leadership fully appreciates the social risks to the organization.
2. Work with the C-suite to clearly define the organization's goals. Understanding goals and values is critical to effective decision-making. While 69% of general counsels say their organization's social goals are clearly defined, only 22% say the same for environmental goals.
3. Drive internal conversations to develop an agreement on how to reconcile trade-offs and competing goals. Competing goals are inevitable, and a robust framework to manage them is important. It is not straightforward, however, with 95% of law departments saying that reconciling trade-offs between financial and sustainability goals is a challenge.



## Summary

Every organization will be impacted by the environmental, market and societal forces amplifying sustainability. At the same time, organizations are contributing to these forces and their impact on our planet and society. Stakeholders are demanding more action and disclosure from companies. Companies that fail to adapt face losing access to capital investment and commercial opportunities with sustainability-conscious firms, alongside reputational damage and investor backlash. Companies that proactively manage ESG risks and opportunities can create sustainable long-term impact and financial value for all stakeholders. There is an opportunity for companies to reimagine the way they do business and their role in their community, their industry and the world. Now is the time to begin that journey.



## Use cases:

### Large consumer goods company:

- ▶ **Excerpt:** The EY organization built a decarbonization program for a Fortune 500 retail company that had an extensive third-party logistics network by assessing its global footprint, providing a quantified roadmap and strategizing costing scenarios to enable the company to meet its goals.

### Large personal care company:

- ▶ **Excerpt:** A leading beauty and personal care company needed help measuring the impact of its product and had limited visibility across its supply chain. The EY organization designed and implemented a unique tool that assessed and improved the environmental and social impact of an existing or future product. The EY organization also helped create a supplier network risk map.

### Global meat and poultry company:

- ▶ **Excerpt:** A global meat and poultry company with over 40 distribution centers and outside cold storage facilities needed a way to effectively track and manage contract tracing of its employees and provide off-site quarantine accommodations for individuals who were infected. The solution would need to include medical surveillance, identification of infected individuals and ongoing administration and tracking of those individuals to make sure they were properly cared for and could eventually return safely to work. The EY organization established a strategic alliance with a software company to create a digital platform that accomplished:
  - ▶ Confidential mobile-enabled tracking of employee health, including temperature monitoring, testing, and self-assessments
  - ▶ Mobile-enabled inspections of COVID-19 exposure risks, including pre-populated criteria from reputable health organizations
  - ▶ Management and tracking of COVID-19 corrective actions and compliance tasks
  - ▶ Detailed reporting and immediate notification of COVID-19 issues

### Large media and entertainment company:

- ▶ **Excerpt:** An \$18 billion media and entertainment company needed to deliver on commitments to sustainability and on aspirational goals to be carbon and water neutral, as well as send zero waste to a landfill. It also wanted to create partnerships within its supply chain to support the company's overall sustainability goals. The EY organization assessed its supply chain impacts as well as services it had purchased, and codesigned supplier collaboration projects aligned with the company's goals.

### Large health insurance provider:

- ▶ **Excerpt:** A \$75 billion health insurance provider needed to determine how changes in the economy resulting from the transition to a zero-carbon future would impact sectors, markets and the client's current and future customer base. The EY organization performed a climate change scenario analysis, modeled economic impacts through 2050 and developed an assessment of potential physical risks posed to different economic sectors under a range of climate scenarios.

### Large industrial manufacturer:

- ▶ **Excerpt:** A \$7.3 billion diversified industrial manufacturer of solar energy panels and components needed to set new ESG 2030 goals in line with its industry peers especially now that the CEO is evaluated on ESG performance and a three-year ESG plan to increase disclosure, improve performance and establish strong governance. The EY organization helped identify topics, goals and an action plan that could be implemented on its three-year ESG plan with a phased approach.

### Large specialty retailer:

- ▶ **Excerpt:** The largest specialty retailer in the United States is focused on water-saving methods across its supply chain, implementing a program to encourage its mills and laundries to reduce water used in garment finishing by 20%. Each supplier is encouraged to conduct an environmental footprint assessment using the Sustainable Apparel Coalition's Higg Index. For the last 15 years, all supplier denim laundries have had to adhere to a water quality program that requires them to meet or exceed legal effluent discharge requirements.

### Fortune 500 consumer products and goods company:

- ▶ **Excerpt:** The EY organization teamed with a multinational Fortune 500 CPG company to create a roadmap to decarbonize logistics operations by 2025, starting with North America, followed by Europe and then other regions. The plan would include the use of emerging technologies, such as alternative fuels, and help the company realize its bold sustainability ambitions.

The EY organization built a new solution (EY Alternative Fuels Model) to run real-time scenarios of lane-level detail with emerging technologies, producing compelling outputs outlining cost and emissions impacts of alternative fuel conversion, along with feasibility of associated infrastructure and vehicle maturity.

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