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#DeloitteESGnow
The ESG Regulatory Whirlwind: Accountability on the Horizon

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Introduction

Expectations for consistent, comparable, and transparent climate-related and other environmental, social, and governance (ESG) disclosures continue to increase — driven by investor demand, stakeholder pressures, and more recently, regulatory attention. Climate change has been a central topic in U.S. policy discussions in many government departments and agencies — from President Biden's day-one action to rejoin the Paris Climate Agreement, to SEC Commissioner (then Acting Chair) Allison Herren Lee directing the SEC's Division of Corporation Finance to enhance its focus on climate-related disclosures in public company filings, to SEC Chair Gary Gensler's recent statement that the SEC has the necessary authority to move forward with rulemaking on climate, human capital, and other ESG disclosures.[1] In the forthcoming regulatory environment, it will be essential for companies to improve the completeness, accuracy, and reliability of their ESG-related disclosures by employing sound governance, oversight, and data-management processes and controls. Companies may need to rapidly enhance their existing disclosures if the oversight mechanisms the SEC applies to climate-related and other ESG disclosures are similar to those for financial reporting.

[1] Remarks from SEC Chair Gary Gensler during the GameStop hearing in the House Financial Services Committee on May 6, 2021.

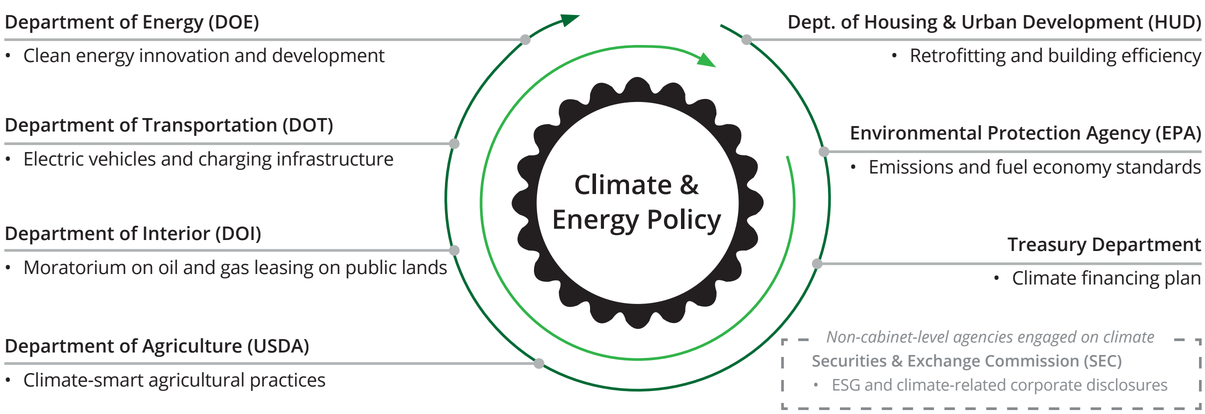
U.S. Climate and ESG Policy — Policy and Market Developments

U.S. Climate Commitments Announced at Biden Administration's Climate Summit

On April 22, 2021, dozens of world leaders, climate activists, and business stakeholders gathered virtually for a summit hosted by President Biden. The summit brought together key parties and businesses from countries around the world to discuss global climate challenges and to pledge their support for taking steps to address climate change.

At the summit, President Biden unveiled an enhanced nationally determined contribution (NDC[2]) for the United States, pledging to reduce greenhouse gas emissions by 50 to 52 percent from 2005 levels by 2030. The U.S. NDC was developed by the National Climate Task Force by using a whole-of-government approach that took into account technology availability, current and future cost reductions, and the role of enabling infrastructure. As communicated at the summit, the U.S. NDC would be achieved through enhanced regulation of key industries and aggressive action in key states. As a result, companies would be required to comply with additional regulations and legislation that have yet to be specifically identified.

Whole-of-Government Approach



In addition to the U.S. NDC, a commitment to double financing for climate aid ($5.7 billion) by 2024 was announced via the proposed U.S. International Climate Finance Plan. The funds will be used to support climate adaptation efforts for countries most exposed to the impacts of climate change. The United States was the only country to pledge additional funds for climate aid at the summit.

Other U.S. Climate Policy Proposals Made by the Biden Administration

The new U.S. NDC was announced amid months of climate-related discussions and recent policy proposals made by the Biden administration. President Biden recently signed an executive order that directs all government agencies to develop a strategy for identifying and disclosing climate-related financial risks to government programs and assets within 120 days.

[2] An NDC is a formal submission to the United Nations Framework Convention on Climate Change (UNFCCC) in connection with the Paris Climate Agreement.

Other noteworthy U.S. policy proposals and executive orders from the Biden administration to date include, but are not limited to, the following:

Jan 20
- Rejoined the Paris Climate Agreement
- Established an Interagency Working Group on the social cost of greenhouse gases

Jan 27
- Reaffirmed the climate crisis as a national security priority and appointed a new Special Presidential Envoy for Climate
- Established National Climate Task Force to address greenhouse gas emissions
- Proposed Civilian Climate Corps to support job creation and environmental restoration
- Paused new oil, coal, and gas leases and permits on U.S. land and waters

Feb 26
Revised the social cost of carbon dioxide to that of its 2017 cost ($51 per metric ton), adjusted for inflation

Mar 31
Introduced American Jobs Plan, proposing $2T in investment and infrastructure for the U.S., including climate-focused investments in Power and Decarbonization ($70B), Electric Vehicles ($174B), Resilient Infrastructure ($50B), Houses and Buildings ($223B), Research and Development ($35B), and Tax Incentives

May 7
Established a Climate Change Support Office within the State Department

May 20
Ordered all government agencies to develop a strategy to identify and disclose climate-related financial risk to government programs, assets, and liabilities within 120 days

ESG and Climate-Related Developments From U.S. Regulatory Bodies and Organizations

- The Commodity Futures Trading Commission (CTFC) established a new climate risk unit.
- The Federal Reserve created two committees to identify, address, and respond to climate-related risks to financial stability.
- The FASB released a staff educational paper on intersection of ESG matters with financial accounting standards.
- The SEC announced the formation of the Climate and ESG Task Force, requested input on whether current climate change disclosures adequately informed investors, issued a risk alert on ESG investing, and established a Web site to highlight actions and provide ESG investing information.
- The House Financial Services Committee advanced the Climate Risk Disclosure Act, which would amend the Securities Exchange Act of 1934 to require disclosures related to climate change.
- SEC Commissioner Allison Herren Lee gave a speech addressing her views on common misconceptions regarding materiality in the context of ESG disclosure.

For more information about these developments, see Deloitte's March 22, 2021, *Heads Up* and the May 2021 issue of Deloitte's digest *Creating a Climate of Change*.

Convergence of ESG Disclosure Standards

In addition to U.S. activity, substantial recent progress has been made to establish climate-related and other ESG disclosure standards globally. In April 2021, the IFRS Foundation trustees indicated that they were moving forward with their proposal to create an International Sustainability Standards Board (ISSB), as addressed in the foundation's September 2020 consultation paper. The ISSB will take into account the work of other standard setters, such as the Task Force on Climate-Related Financial Disclosures, as well as the prototype proposed last December by an alliance of five standard setters for an approach to climate-related disclosures.

The proposed ISSB has received increasing support from other global and U.S. organizations. The International Organization of Securities Commissions announced the formation of a Technical Expert Group, co-led by the SEC and the Monetary Authority of Singapore, to work with the IFRS Foundation as it establishes the ISSB. From a U.S. perspective, SEC

[Commissioner Lee](#) expressed support for the ISSB, as did U.S. Secretary of the Treasury Janet Yellen.

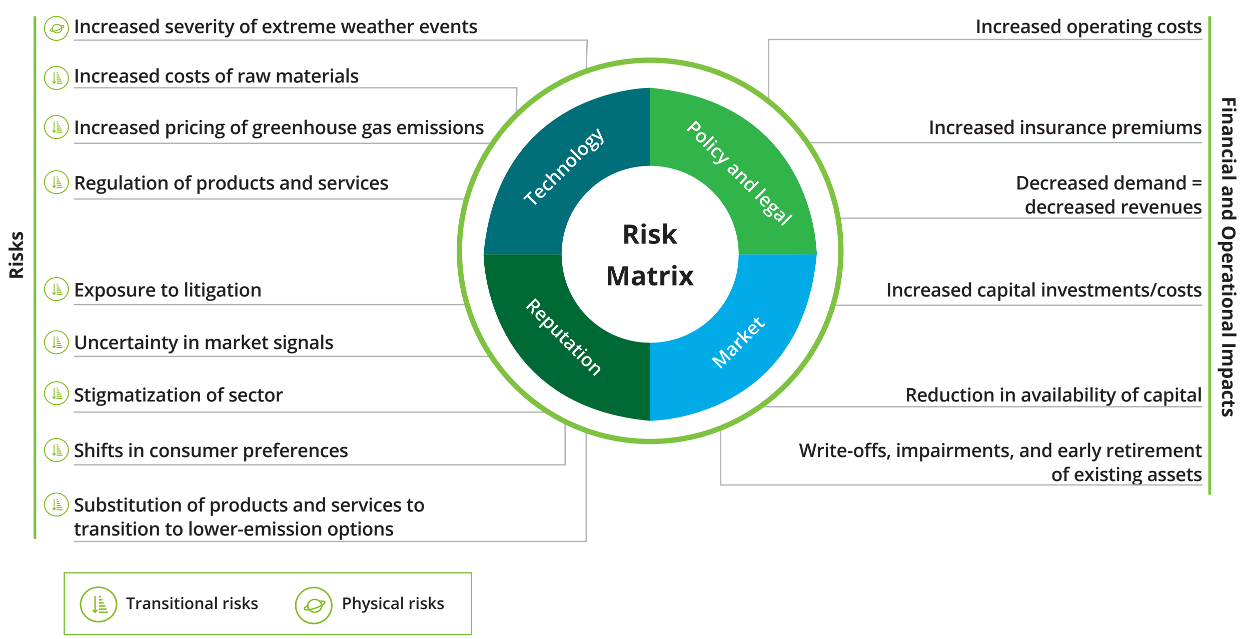
As next steps, the IFRS trustees aim to issue a proposal by the end of September 2021 and may announce the establishment of an ISSB at the 26th United Nations Conference of the Parties (UN COP26) in November 2021. For more information, see Deloitte's May 4, 2021, *IFRS in Focus*.

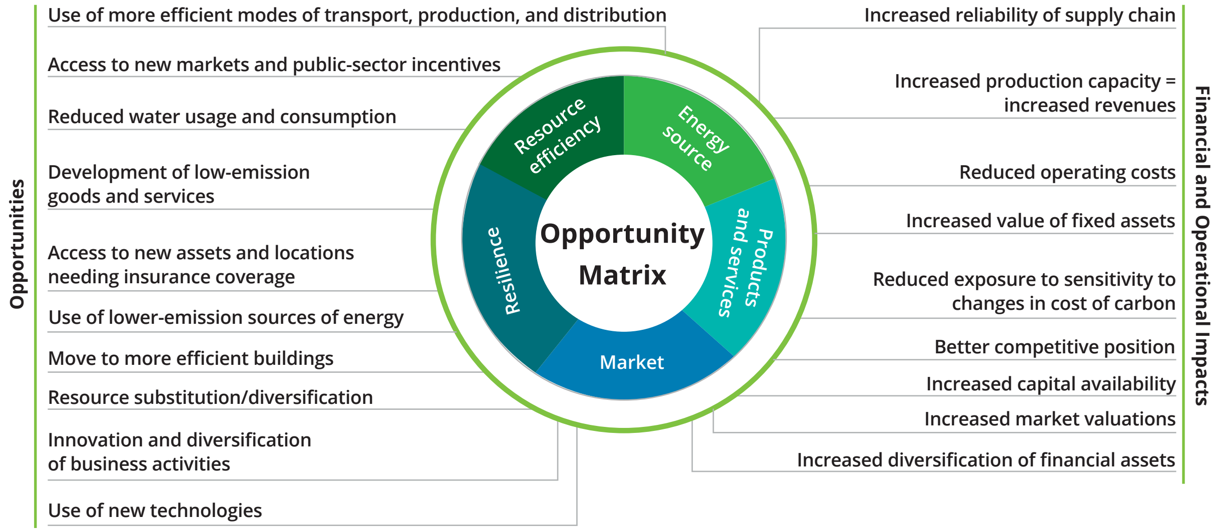
While it remains to be seen how this activity will affect U.S. companies, the flurry of recent U.S. climate policy and regulatory headlines indicates that the focus on ESG performance and disclosures will almost certainly increase.

Implications for Issuers

Financial and Operational Impacts Associated With Climate-Related and Other ESG Events

Climate change creates risks and opportunities in the capital markets and can have both financial and operational impacts on businesses. Increasingly severe weather events and rising sea levels may lead to asset damage and higher insurance premiums. Carbon taxes and reputational risks may increase operating costs and create barriers to accessing capital or high-quality talent. Investors and stakeholders are seeking reliable and comparable information on these potential impacts so that they can better assess the resiliency of corporate strategies to climate-related and other ESG events. These events could affect a company's financial accounting and reporting in the context of the existing accounting guidance, the current regulatory environment, and financial statement audits. For more information about ESG-related accounting and financial reporting considerations, see Deloitte's May 26, 2021, *Heads Up*.





Increasing Demand for High-Quality Climate-Related and Other ESG Information

The passage of the Sarbanes-Oxley Act in 2002 transformed the capital markets, bringing to light the importance of strong systems of governance and internal controls over financial reporting. In the first year after the act's passage, companies were tasked with adapting to the new requirements and managing the costs and level of effort associated with enhancing systems of internal controls. These enhancements ultimately led to more mature systems of governance as well as improved data integrity and financial accountability, providing additional confidence in the capital markets.

The Biden administration's actions to address climate change, along with the recent SEC discussions to mandate climate-related and other ESG disclosures and the pending formation of an ISSB, indicate a trend toward standardization and regulation of this information. Companies should begin to prepare themselves for mandatory climate-related and other ESG disclosures, since this regulated landscape for ESG disclosures will differ significantly from the current landscape of voluntary reporting. To adapt to disclosure standardization, companies will need to focus on improving data integrity and reliability by enhancing management processes and controls. Regulatory oversight will help drive ESG integration and transparency, which are currently being demanded by investors and other stakeholders. As a result, ESG reporting processes and controls may soon be expected to mature to the level of financial reporting.

Internal controls have value beyond compliance and external financial reporting. Effective internal controls can help organizations grow on a sustained basis and can lead to confidence in all types of information. In establishing effective internal controls to improve the integrity of climate-related and other ESG disclosures, companies can leverage existing resources such as the *Internal Control — Integrated Framework* of the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The Role of Assurance

As climate-related and other ESG disclosure guidance transitions from voluntary to mandatory, the role of assurance will become critical to achieving disclosure effectiveness. Currently, only 11 percent of S&P 100 companies have received assurance from a professional services assurance provider regarding some of their ESG information. Assurance providers can support companies as they navigate the regulatory developments and assess the current state of their internal controls over climate-related and other ESG metrics and disclosures. As with the processes associated with financial statement audits and internal controls over financial reporting, assurance over climate-related and other ESG information is intended to enhance the reliability of information reported by companies.

As companies begin the to integrate climate-related and other ESG considerations into their systems of internal control, as well as their broader business decisions, they may consider asking the following:

- Is the company currently following a framework or a standard for disclosing this information?
- How is climate-related and other ESG information captured in company systems? How is this information currently used?
- What is the company's governance and oversight over this information?
- What additional controls and procedures will the company need to implement to subject climate-related and other ESG disclosures to the same level of internal controls as financial reporting?
- What is the company's current preparedness to receive assurance services over climate-related and other ESG information? How can the company enhance its preparedness?

With climate-related and other ESG regulations on the horizon, companies can seek assurance readiness and third-party assurance services to enhance the maturity of their systems, processes, controls, and governance related to this information. Independent auditors are well-positioned to deliver assurance services, since the profession is steeped in bringing independent standards-aligned analysis, objectivity, and accountability to the review of company-reported information. As a starting point for improving the quality of climate-related and other ESG disclosures, companies can look to their financial reporting processes and control environment and begin to prepare for mandatory reporting requirements and future assurance. For more information, see the Center for Audit Quality's *ESG Reporting and Attestation: A Roadmap for Audit Practitioners* and *The Role of Auditors in Company Prepared ESG Information: Present and Future*.

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