



ERM's role in ESG

How Enterprise Risk Management
can help companies craft and
execute ESG strategies



The ESG imperative

There is growing pressure on organizations from investors, consumers, lawmakers, and even business partners to demonstrate progress on environmental, social, and governance (ESG) practices. ESG initiatives—such as lowering a company’s carbon footprint or hiring a diverse workforce—are generally praised for their positive contributions to society. In recent years, investors have started taking a keen interest in ESG, likely because of the correlation between ESG performance and high returns.¹ We might assume the other side of the coin is true as well; businesses with low ESG performance tend to have limited long-term business sustainability.

Still, as companies make progress toward incorporating more of ESG into their business models, this creates its own set of risks, including financial and reputational, which the Enterprise Risk Management (ERM) function should consider assessing and addressing. While **risk is the name of their game**, ERM teams are also experts at cost/benefit analysis and can help properly gauge the trade-offs as the company plots its ESG strategy. With an eye on activities across the enterprise, ERM departments can also see any overlaps and conflicts between ESG and other strategic initiatives. By working together, ESG and ERM teams can achieve their strategic goals faster and more efficiently.

The current landscape

Today, companies are operating in an environment where mandatory reporting standards for ESG are well underway and continue to evolve. In fact, all major regulations set by the U.S. Securities and Exchange Commission (SEC), Corporate Sustainability Reporting Directive (CSRD), and the International Financial Reporting Standards (IFRS) S1 and S2 require businesses to disclose:

- The processes and related policies used to identify, assess, prioritize, and monitor sustainability-related risks and opportunities,
- The extent to which, and how, the processes for identifying, assessing, prioritizing, and monitoring sustainability-related risks and opportunities are integrated into and inform the entity’s overall risk management process.

ERM and ESG integration is no longer a feature that organizations would consider “nice to have.” Instead, it’s a “must have.” Collaboration of the two functions means Chief Risk Officers, General Counsels, Chief Compliance Officers and Chief Audit Executives will partner to establish an ESG approach and strategy as well as identify possible risks. This provides organizations with better processes to manage the steps taken, keeping in mind that now those steps will be subject to public scrutiny.

How can ERM significantly contribute to ESG efforts? Better yet, how can ERM play a supporting role in ESG’s strategy, planning, and oversight?

¹ KPMG 2022 CEO Outlook, 2023



ERM's role in the evolution of ESG programs

The impact of ESG will continue to grow within the operations and strategies of corporations.

01

First, there are increasing mandates: Companies are moving from voluntary ESG reporting to required disclosure. In particular, European companies will now be **required to report sustainability areas, processes, targets, and steps to achieve under CSRD**. These rules will affect nearly 600 of Fortune 1000 U.S. companies. Notably, public interest group, IFRS, is working with various countries to adopt their list of global standards for sustainability and climate. Additionally, The SEC is expected to pass climate standards in fall 2023, and California will pass similar standards in October.

02

Second, ESG is not a project. It's a long-term strategic initiative that will affect multiple divisions and geographies within an organization—and it will do so for the next 10-20 years. As the business ecosystem changes to reduce reliance on fossil fuels, investments and infrastructure will change, having a profound impact on how companies allocate capital.

Are there benefits to these new requirements?

Yes: There are the prospects of enhancing an organization's reputation among investors and consumers, more engaged employees, lower energy costs, and lower cost of capital. In addition, now we have the crucial ability to identify the exact tipping point where a company needs to switch capital investment strategies to address changes in the business ecosystem.

With these new disclosure requirements, now more than ever, **it's essential that ERM professionals are included in the planning and execution of ESG activities and reporting**. In the long run, this will inevitably help organizations achieve the full value of their ESG programs and ensure they follow strategic practices, not just those that are driven by compliance. Involving ERM from the start can help identify and address risks, such as reputational, workforce, costs, etc.

To implement these suggestions, leaders must plan for changes to organizational processes and headcount. They should immediately consider allocating funds, people, and time to tackle these challenges. Equally as important, **companies must integrate their ESG and ERM teams**—particularly ERM professionals tasked with data and risk reporting—to develop a cohesive plan that aligns with the overall company-wide strategy.



ESG risks that ERM can address

Climate change is the top priority for ESG programs and poses the greatest risk to the business—especially from a financial point of view. With the trajectory of global warming and increasing cases of extreme weather and natural disasters, the possibility of physical risks, such as supply chain disruption and damage to facilities, is growing. It's helpful to think of sustainability as the central piece to a large ESG puzzle. Corporate sustainability—typically viewed as environmental, social, and economic responsibility—has been of growing importance, particularly with younger generations. Needless to say, as the purchasing power of Gen Z and Y continues to rise, so too does pressure on businesses to operate as environmentally and socially responsible players in the economy.

It's extremely beneficial to try viewing this through an ERM lens to understand additional risks, including the potential impact of ESG costs:

1

Businesses that make public statements and pledges about their ESG initiatives are being tracked. If they fail to meet expectations, there will likely be reputational consequences.

2

Each marketing disclosure, such as product descriptions and financial returns, could be accidentally incriminating. Avoid misleading information that violates consumer protection laws.

3

With more and more organizations using third parties to do business, the reputations and actions of these vendors reflect directly on the companies that hire them. To avoid their scrutiny or legal issues becoming a problem for the enterprise, thorough research about their business practices should be conducted.

The breadth and scale of ESG is daunting. It includes a myriad of interconnected risks that are fluid and ever-changing. These risks cannot be solved within the ESG function alone. The fact of the matter is ESG professionals are not trained to think through and mitigate such risk areas. A risk strategy should be fully developed for every ESG initiative, from start to finish. That's where ERM comes in. As specialists in risk assessment and solutions, organizations need their ERM departments to be fully integrated with ESG teams. Together, as essential partners, they can help avoid negative headlines that stem from flashy ESG commitments. With ERM's help, ESG should become embedded into the organization's mission, objectives, and core values to drive desired behaviors and create a trend toward positive ESG impacts.

To get started, here are some questions organizations may use as conversation starters during ERM updates and discussions:

Have ESG objectives been aligned to support the business strategy?

Has ESG been integrated into risk appetite statements, metrics, and tolerances?

Have material ESG risks been identified?

Are we accurately disclosing the linkage between ESG and ERM?

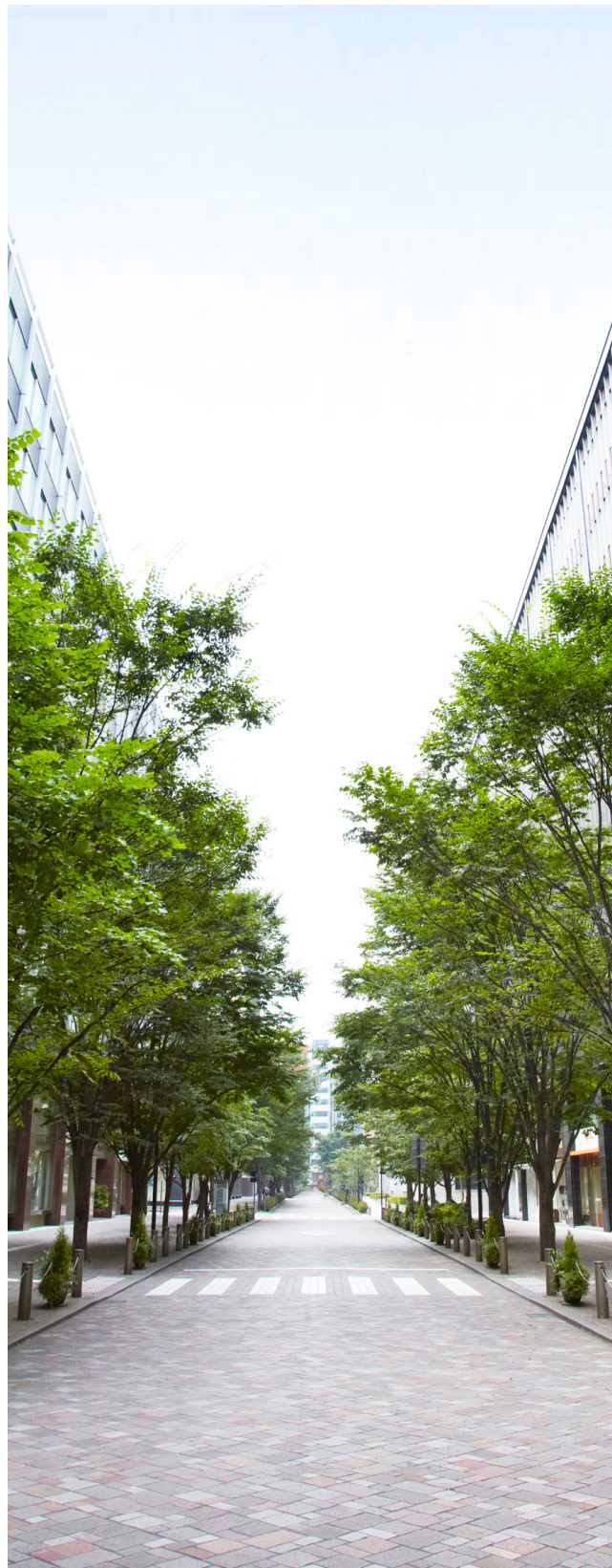
Have quantitative KPIs for ESG objectives been established and monitored?

Have roles and responsibilities been assigned on ESG matters for each function across the organization?

Do we understand what can go wrong now, and in the future, and are we addressing mitigation to these areas?

Has the strategy for risk reporting and disclosure communication been formulated?

Does data collection and exposure data management support ESG risk management?





The intersection of ESG with ERM

The goal of connecting ESG to ERM practices is to help ensure ESG is incorporated into the mainstream practices of the company and overall strategy. The primary objective remains: **An optimized ESG strategy should drive growth and innovation.** The following considerations may provide a starting point for businesses when thinking about finding natural synergies between their ERM program and their developing ESG approach and strategy:

- The board and C-Suite executives are aware of their responsibilities for ESG governance and disclosure, including how ESG is aligned with risk management.
- ERM should play a role in capturing or considering ESG and sustainability opportunities as part of their risk management program, as these opportunities may help address other risks.
- ERM should help facilitate linking ESG risks to the company's overall strategy and better align ESG risk objectives with strategic objectives and opportunities.
- The ERM function should consider some of the key risks that are already present, including strategic, reporting, capabilities and competence, transition/transformation, technology, and data risks. Operational areas will be covered under the company's ESG materiality assessment. Some considerations include:
 - Stakeholders are not aligned on their opinions of ESG. While most see these initiatives as positive contributions to society, this opinion isn't universal. ESG-related risks exist no matter what a company does and stakeholders will never be fully aligned. This is especially true if goals have already been published.

- The SEC guidance and Europe's CSRD requirements are not aligned. CSRD is much more extensive and there is no relief for U.S.-held subsidiaries in Europe. To comply, companies with large European operations will have to move faster and spend more to align with regional requirements.
- While companies have talked ad nauseum through their CSR reports about all that they do, this is not being supported through their actions regarding investments in leadership and talent with specific ESG knowledge, as well as tools to help them on their journeys. Without this investment, progress will be slower and costs will expand as compliance becomes mandatory.
- For any major transformation to be successful, the organization must get its change management right. In the case of a multi-year, multi-generational change like ESG, failure to account for this will impact the company's ability to hit its ESG goals. Additionally, given economic uncertainty, investments in long-term business transformation for ESG will clash with short-term needs because of desires to meet and exceed financial goals.

- The technology and data infrastructure needed to support annual ESG reporting, and audit requirements does not yet exist. The ability to move beyond the first year of reporting into continuous processes and controls requires investments in technology that are not budgeted for and may conflict with other mission critical investments.
- The operational ecosystem for businesses is changing. For example, the phase out of gas vehicles in California by 2035 will force changes in business models that companies are not focused on due to more immediate needs.
- Leverage ERM practices to establish the ESG approach and strategy by evaluating ESG risks as part of your enterprise risk assessments and consider their interconnectivity. Not only are these risks interconnected, but they also exhibit dependencies between the strategic risk areas.
- ESG creates fundamental change in how organizations operate, so ESG is a significant strategic initiative, requiring your ERM function to take a strategic perspective.

How KPMG can help

- Governance Control Gap Framework Assessment
 - In today’s complex business environment, a robust ESG control framework is vital for long-term success. KPMG’s Governance Control Gap Framework Assessment offers a comprehensive review of your current ESG controls using the COSO Internal Control Integrated Framework. Our experienced team identifies gaps and provides actionable recommendations for enhancement, ensuring your organization remains compliant, mitigates risk, and optimizes performance. Invest in your organization’s sustainable future with KPMG’s tailored and efficient assessment solution.
- Dynamic Risk Assessment focused on ESG risk
 - Elevate your organization’s ESG risk management capabilities with KPMG’s Dynamic Risk Assessment, designed to create an inventory of publicly reported ESG metrics and to perform a comprehensive metric risk assessment. This cutting-edge solution allows your organization to effectively risk-rank metrics, guiding further process and control buildout.
- Risk Toolkit Accelerator
 - Revolutionize your ESG risk management approach with KPMG’s Risk and Controls Toolkit. Containing example risk and control matrices for common metric processes and leading practice ESG controls, this comprehensive toolkit streamlines your organization’s path to effective metric reporting. Additionally, our toolkit offers illustrative organization-wide and data governance control sets, ensuring your organization remains at the forefront of risk mitigation and ESG disclosure excellence.
- Internal Assurance Model Framework
 - The Internal Assurance Model solution fosters excellence in ESG and sustainable business management through guidance, recommendations, and training to establish a robust internal assurance framework. Comprising an expert-driven Internal Assurance Model, guiding principles for tailored framework design, and targeted training for ESG functions, our offering ensures your organization is well-prepared for evolving expectations and regulatory requirements. Elevate your ESG practices with confidence and empower your organization to thrive in a complex business landscape.

Please reach out to us to learn more about how our solutions and methodologies can help enhance your ESG framework.

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