



Sustainability Risk Intelligence – Assessing Environmental, Social and Governance Risks

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Agenda

1. Defining Sustainability
2. Common Standards and Frameworks
3. Identifying Sustainability Risks
4. Internal Audit Value Proposition

Defining Sustainability

What is Sustainability?

The World Commission on Environment and Development (WCED) issued a report at a 1987 UN conference that defined sustainable development:

“Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.”

Alternative perspective:

Sustainable organizations utilize business practices that enhance stakeholder value, minimize negative impacts on the environment, and have a positive effect on society.

Short version - “Producing more with less”

What's Driving Sustainability?



Increased awareness and significance of environmental and social issues

Shareholder and public activism on environmental & social issues



Institutional Investors (SRI) influencing capital markets



Increased demand for transparency and communications

Increased regulation and oversight



Evolving frameworks & standards



Sustainability reporting and verification may be mandated

Shifting market demands and growth opportunities



Consumers favoring sustainable options (Clean Tech, Fair Trade)



Sustainability becomes a key driver of value and brand equity

Sustainability has become a business imperative for most industries

Why is Sustainability Important?

Increased recognition that financial statements capture only a portion of corporate risks and value-creation potential. Intangible factors are increasingly seen as having a greater impact on enterprise value, such as:

- 1) Governance practices (e.g., codes of conduct, anti-corruption/FCPA practices)
- 2) Brand and reputation management (e.g., 3rd party relationships, social media)
- 3) Energy and resource utilization (e.g., sourcing, efficiencies and waste stream)
- 4) Health & Safety (e.g., wellness, occupational incidents, environmental remediation)
- 5) Human rights and labor practices (e.g., supplier risks in emerging markets).

Companies are developing Key Performance Indicators (KPIs), measurement methods, and reporting systems to more effectively address the potential business and financial risks of these impacts, and to better respond to stakeholders.

* The Global Reporting Initiative (GRI) publishes the most widely used sustainability reporting framework – issued guidance for 14 industries.

Common Standards and Frameworks

Frameworks

Financial Assessment Frameworks

ESG performance measures are viewed as leading indicators of long-term financial performance and potential sources of risk and/or value creation. No judgments made on a company's intrinsic ethical worth.

Institutional investors use analytical models that integrate environmental, social and governance (ESG) criteria into the investment analysis and seek to balance the level of ESG-driven risk (e.g., reputational, supply chain, geo-political, legal, and regulatory risk) and management's ability to manage such risks.

Non-Financial Industry Assessment Frameworks

Voluntary sustainability assessment frameworks are developed by the private, public, and NGO sectors to promote certain corporate behaviors relevant to ESG issues. They typically apply to all organizations in all industries and measure adherence to standards and performance frameworks, but are not risk based assessments.

Sustainability assessment criteria may be based upon principles, standards, and metrics established by the GRI, the U.N. Global Compact (UNGC), the International Organization for Standardization (ISO), and other standard-setting organizations.

Financial Frameworks – Indexes

The quality of a company's strategy and its ability to manage opportunities and risks related to ESG activities are increasingly being quantified by rating agencies. The following is an example of commonly known indexes:

- Dow Jones Sustainability Indexes (DJSI)
- Carbon Disclosure Leadership Index (CDLI)
- Carbon Performance Leadership Index (CPLI)
- FTSE4Good Index Series
- NASDAQ OMX CRD Global Sustainability 50 Index
- S&P U.S. Carbon Efficient Index

* There are currently over 100 sustainability ratings in existence, compared to approximately 20 in 2000.

Non-Financial Frameworks

Non-financial frameworks provide guidance to organizations on measuring and reporting on their sustainability performance. They foster consistency and provide insights into key performance indicators such as energy and water use, GHG emissions, waste and social performance indicators related to human rights issues in order to help improve a company's ability to manage sustainability risks.

The following are common frameworks and standards:

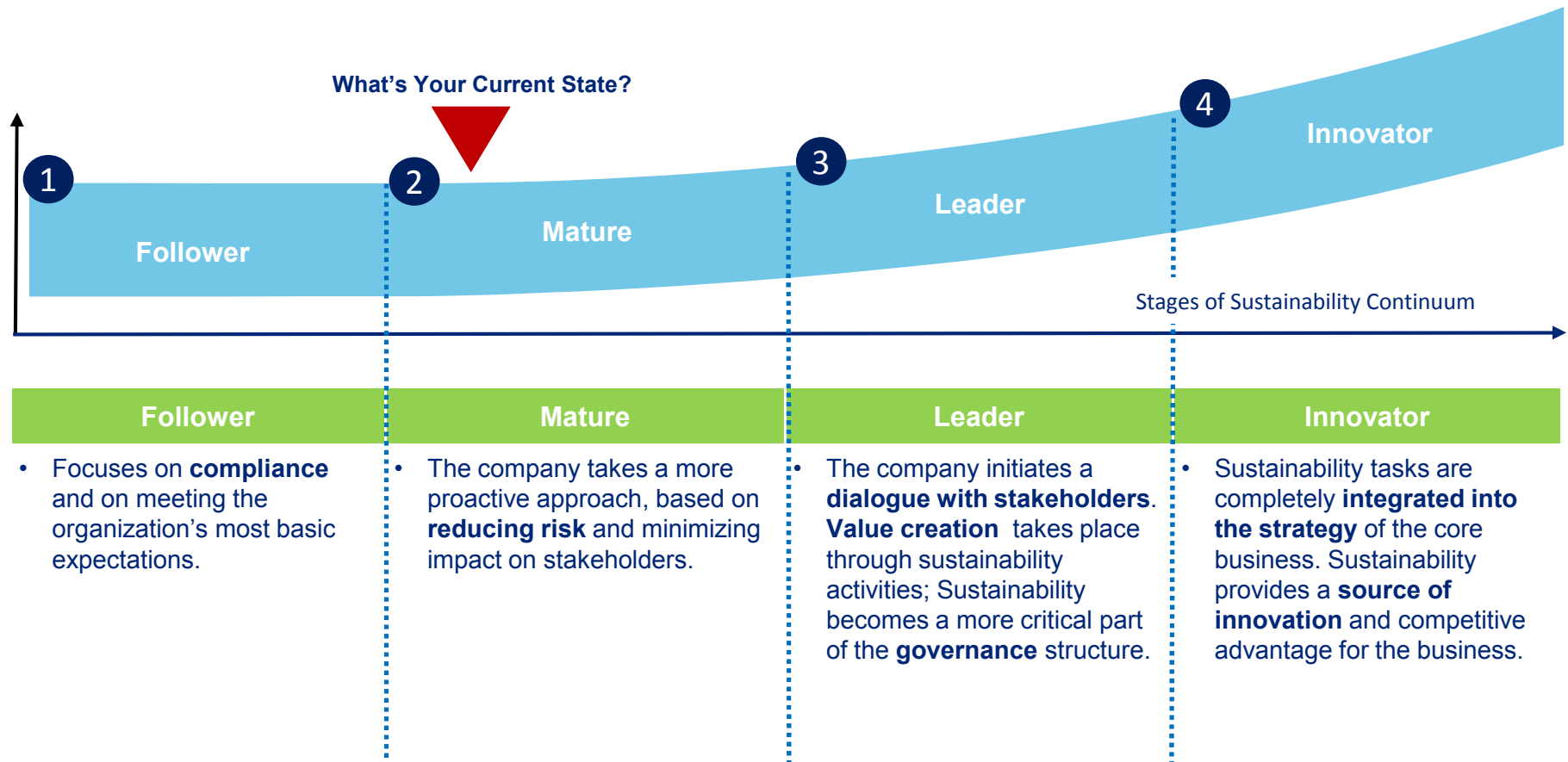
- GRI G3 Guidelines
- GHG Protocol
- ISO14001:2004 / 14004:2004 – Environmental Management Systems
- ISO 26000:2010 – Social Responsibility
- UN Global Compact Management Model (10 Principles)
- Social Accountability Standard (SA8000)

Identifying Sustainability Risks

The Risk Intelligent Organization - Sustainability Maturity Model (Illustrative only)

Assessing your culture and governance structure will help determine the maturity of your sustainability efforts and the types of risks (value protection vs. creation) that are top of mind with management. This will also highlight areas of improvement (gaps).

Four-phase development of sustainability maturity within a company and the changes that an organization should undertake to gradually shift from being an isolated activity to an integrated process



Sustainability Governance – Risk Ownership

Board & CEO							
Sustainability & climate change strategy							
Chief Financial Officer	R&D	Chief Marketing Officer	Chief Operating Officer	Chief Information Officer	Facilities	Head of Supply Chain	Chief People Officer
Sustainability Risk Disclosures	Clean Tech Investments	Sustainability marketing	Carbon data collection & management	Cloud Computing / Energy efficient networks	Onsite low carbon energy generation	Sustainable upstream supply chain	Employee engagement
Carbon regulatory impacts	Sustainable product / service development	Sustainable product / service marketing	Low carbon manufacturing processes		Sustainable building	Sustainable waste stream management	Social Compliance
Carbon accounting & reporting	Smart grid development & implementation	Regulatory affairs & lobbying	Low carbon corporate fleets		Facility energy efficiency	Low carbon distribution & logistics	
Sustainability assurance & verification	Carbon capture & storage		Green energy strategy				
ESG compliance	External research funding						
Tax credits & incentives							

Source: Verdantix Critical Moments® Climate Change & Sustainability Spending Market Forecast

Risk Intelligence – A Holistic Approach

Enhancing your Enterprise Risk Assessment process:

- Identify current and contemplated initiatives / programs
 - Assess sustainability governance structure
 - Verify the business case (ROI, Strategic alignment)
- Assess sustainability related communications
 - Informal communications (social media)
 - Formal reporting (10-K risk factors, sustainability report)
- Evaluate the regulatory climate (regional, national, global)
 - Evaluate impacts on suppliers and customers (EPA, AB 32, Food & Product Safety)
 - Consider SEC Climate Change interpretive guidance / proxy disclosure enhancements
- Benchmark the field
 - Competitor assessment and marketplace analysis
 - Determine if your company is listed on an index and performance criteria used
 - Survey stakeholders (customers, suppliers, NGOs, investors)

Regulatory Drivers in the United States

Two significant regulatory developments in the US are driving the need for more robust reporting and disclosure capabilities.

- The EPA Mandatory Greenhouse Gas Reporting Rule became effective in 2010, with the first reports due by March 2011:
 - Monitor and reporting required for ~10,000 facilities across 17 industries (emitters over 25,000 mt CO₂e)
 - Data collection at the facility level: CO₂, CH₄, N₂O, SF₆, HFCs, PFCs
- On February 2, 2010, the SEC issued an interpretive release that outlines the Commission's views on applying existing disclosure rules to climate change matters:
 - Potential positive impacts on the registrant, not just negative effects
 - Affects from international accords and treaties related to climate change and greenhouse gas
 - Actual and potential indirect consequences of climate change-related regulations or business trends
 - Actual and potential impacts of the physical effects of climate change on the business

Identifying and Assessing Sustainability Risks

Identify key risks across organizational silos and heat map focus areas*:

- Governance
- Strategy
- Operations/infrastructure
- Compliance

The IIA's IPPF - Evaluating Corporate Social Responsibility / Sustainable Development (February 2010):

- Defines CSR and Sustainable Development
- Discusses potential CSR / Sustainability risks and impacts
- Describes various CSR / Sustainability activities
- Discusses potential reporting implications
- Suggests approaches to evaluating CSR / Sustainability within your organization
- Provides suggested approaches to evaluating and auditing CSR / Sustainability activities

* Refer to the Deloitte Sustainability & Climate Change Risk Intelligence Map for additional details.

Potential Sustainability Risks

Organizations may be exposed to a variety of risks associated with Sustainability activities, including the following*:

- **Reputational:** Damage due to unethical actions (e.g., including external business partners), negative publicity (e.g., social media), lack of transparency in disclosed sustainability information, governance lapses, or the appearance of indifference to social issues (e.g., human rights).
- **Compliance:** Failure to comply with regulations relating to the environment, health, safety (food, product, human), employment/labor, and fraud (FCPA).
- **Operational:** Risks associated with an organization's impact on the environment and community resulting from its production processes (including supply chain partners) or service delivery activities.
- **Financial:** Suboptimal ROI from sustainability initiatives, inefficient use of R&D funds (Clean Tech, sustainable products), unrealized savings (tax credits & incentives), investments in SRI funds.

* This is a partial listing of potential risks and is not meant to be a complete list of all sustainability related risks.

Internal Audit Value Proposition

Improved Board Risk Oversight

Using a Risk Intelligent approach to conducting risk assessments will help you define the scope of your organizational sustainability efforts, measure the impact on enterprise value, and determine potential exposures / vulnerabilities.

Audit Committees and Management are coming under increasing pressure from major stakeholders to explain how sustainability drivers impact their business.

- Top line growth remains a challenge, one that can be answered by developing sustainable products/services.
- Shareholders are pressuring companies to disclose their sustainability exposures.
- Business partners are requesting more information on these exposures from their suppliers.
- Regulators are taking a hard look at what sustainability aspects should be regulated.
- Heightened media attention reinforces stakeholder interest and concern.

Internal audit is well positioned to educate Audit Committee members and management on emerging ESG risks and to improve the Board's ability to exercise its risk oversight responsibilities.

Enhanced Enterprise Risk Management Program

The business impact of sustainability is complex, and risks vary by industry and geographic scale. Many companies do not know how to address these risks, and may summarily dismiss sustainability without fully understanding their vulnerability. Therefore, companies need to understand the sustainability uncertainties that impact shareholder value.

Internal audit can help enhance existing ERM programs and assist management with identifying potential risk factors that should be disclosed, for example:

- Commodity, raw material and energy price risks
- ESG legislative and regulatory requirements
- Impact of resource scarcity and emissions
- Strategic risks (competitors' marketplace positioning for "green" products)
- Disruption to suppliers, distributors and partners from ESG infractions
- Divergent stakeholder perceptions
- Brand / reputational risk (health & safety, human rights violations)

Internal Audit Plan – Assuring ESG Metrics

Internal audit can add value and improve an organization's ESG initiatives by bringing an independent and objective approach to evaluating KPIs.

An internal audit of sustainability activities can improve the quality and reliability of reported data as well as management's ability to make good decisions. The scope of an internal audit may include:

- An assessment of the reporting process
- Testing the accuracy and consistency of sustainability data included in all reports and external communications
- Verifying if data is presented according to an accepted reporting framework.

Assessing ESG Risks - Synopsis

Provide an integrated perspective on sustainability risks:

Value Protection – Focus on risk management, compliance, preventing reputational damage, and controls to minimize potential fines, penalties, and litigation.

Value Creation – Strategic focus on developing sustainable products / services, strengthening stakeholder relationships, and operating more efficiently.

Common Organizational Challenges:

- Sustainability initiatives may not be integrated into the overall business strategy
- Governance structure may not be well defined
- Limited assurance over data (KPI) accuracy, reliability and completeness
- Ineffective measuring, monitoring and reporting processes or systems.

Question and Answer Session



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