Integrating ESG into Internal Audit

Bank & Financial Institution Internal Audit Club

KPMG Phoomchai Business Advisory Ltd.

5 August 2024

Speaker

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Supachate has more than 20 years of experience providing both internal and external audit, IPO projects, Enterprise Risk Management, Business Process Improvements and Sarbanes-Oxley Section 404 Advisory Services for KPMG’s local and international clients. His professional advisory experience covers financial services, logistics, aviation, real estate, manufacturing, industrial market and automotive, consumer market, telecommunication and hospitality.

Contents

01 Introduction to ESG and ESG Impacts

ESG and Sustainability

What is sustainability？

A definition of Sustainable Development ***"meeting the needs of the present without compromising the ability of future generations to meet their own needs"*** *defined by the United Nations Brundtland Commission, 1987.*

What is ESG？

ESG stands for Environmental, Social, and Governance

IFC defines ESG as ***a set of environmental, social, and governance factors considered*** *by* ***companies*** *when* ***managing their operations****, and* ***investors*** *when* ***making investments****, in respect of the* ***risks, impacts, and opportunities.***

Source: ESG and Sustainability: Your 101 Guide for Understanding Corporate Sustainability - Green BusinessBureau
Source: IFC ESG Guidebook

Sustainability vs ESG vs CSR: What's the Difference ?

Sustainability is an **overall concept**, whereas ESG and CSR are terms used to describe specific business models.

Corporate Social Responsibility (CSR) is a **management concept** whereby companies integrate social and environmental concerns in business operations and interactions with their stakeholders.

Whereas **ESG** is the **assessable outcome** concerning a company's overall sustainability performance.

"Sustainability" the overall concept

CSR (corporate social responsibility)	ESG (environmental, social, and governance)
a business model for companies that impacts their internal processes & culture	a measurable sustainably assessment, popular with investors
encompasses the activities a company undertakes to have a greater global impact	has become a set of criteria for sustainability assessment
nowadays needs to be a priority, as consumers are demanding it	financial performance is a key purpose of ESG valuation
about building accountability	about quantifying existing accountability
can be used for good but also to mislead	can be used for good but also to mislead

Source: What is CSR? | UNIDO

Source: ESG Vs CSR Vs Sustainability | What's the difference? 2022 Examples (thesustainableagency.com)

Driving factors for ESG transformation

Amongst many countries, Thailand has set carbon reduction targets to reach carbon neutrality by 2050 and Net zero emission by 2065 for Thailand. Compliance pressure is increasing.

Capital markets are expecting ESG focus and performance from companies.

Customers, employees and investors now expect companies to have purpose beyond making money for shareholders.

Regulators, investors and other stakeholders are driving companies for ESG Transformation and transparency in ESG disclosure

…but this is just the tip of the iceberg.

Many companies are discovering a need to demonstrate improvement in ESG performance with an established ESG strategy and pathway to achieve their goals

This is driving a need for ESG transformation.

ESG transformation creates value

ESG is not a cost. A strong ESG strategy has tangible benefits, including:

Decreased Cost of Operations

Lowered costs through building operational energy and operational expenditures

Enhanced Capital Access

Better access to capital sources at more favorable terms for sustainable financing

Improved Asset Value and premium

Improved rent or sale premium, valuation of assets, attracting high quality tenants

Reputational Improvement

Heightened reputation from existing and prospective employees and investors based on the support for ESG

Competitive Differentiator

Ensures that you can position yourself proactively regarding ESG and not be 'left behind' by peers

What are the Global Megatrends?

The megatrends can broadly be grouped into trends reflecting changes in the status and expectations of individuals, changes in the global economy and changes in the physical environment.

Digital Disruption

Climate Crisis

Demographic shifts

Economic power shifts

Labor shortages

Civil, Civic and Equality Movements

Rapid urbanization

Source: https://home.kpmg/xx/en/home/insights/2013/10/what-are-the-global-megatrends.html
Source: https://www.pmi.org/learning/thought-leadership/megatrends
Source: Megatrends - Issues - PwC UK

Digital Disruption

Technological advancements (such as robotic process automation and machine learning) — are **changing the business world rapidly**

Investments in **technological advancements** and **advanced analytics** are going a new form of business transformation.

As business and models change rapidly, creating **new risks and opportunities**

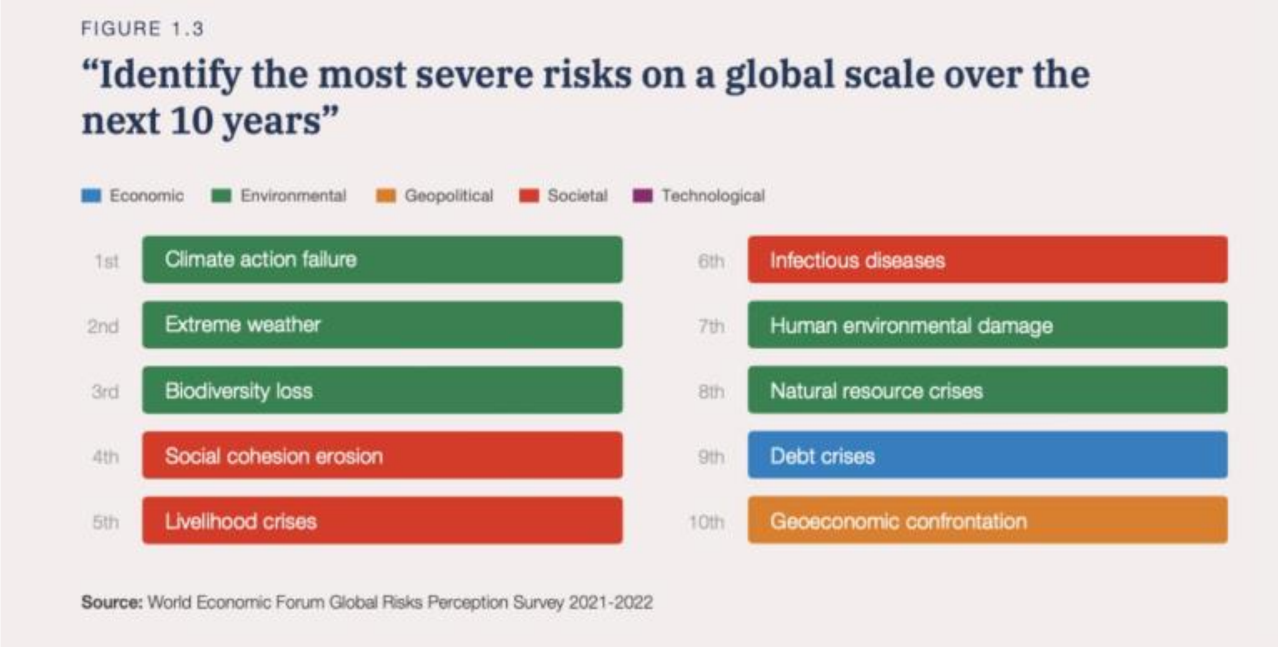
Megatrend Management Considerations

- Design, implement, and assess governance and control frameworks over digital processes
- Utilize the availability information for audit procedures and assurance
- Provide broader insights on all the risks and assurance over the risks management

Source: internal-audit-key-risks-and-areas-of-focus-for-2022.pdf (assets.kpmg

Climate Crisis

Most severe Global risks for the next 10 years



- **Climate change is a long-term trend**, moving up the global agenda.
- Climate crisis is the one that organizations cannot ignore, for those that do not take action face the **genuine risk of an existential crisis**.

Megatrend Management Considerations

Ensure **integration of climate risk** in an organization with **adequate measures**

Provide assurance, data and report on climate change

Source: THE ESGT MEGATRENDS MANUAL (2022-2023 Edition) by MG Publishing – Issuu
Source: Harnessing internal audit against climate change risk | Research reports | Policy and research | IIA
Source: Climate Change: A Top Imperative for Companies and Internal Audit - Internal Audit 360

Climate action will dominate the next decade

According to the Global Risk 2023 Report by World Economic Forum, climate action failure will be most severe global risk in the next decade.

	2 years from 2023	10 years from 2023
1	Cost of living crisis	Failure to mitigate climate change
2	Natural disasters and extreme weather events	Failure of climate change adaptation
3	Geoeconomics confrontation	Natural disasters and extreme weather events
4	Failure to mitigate climate change	Biodiversity loss and ecosystem collapse
5	Erosion of social cohesion and societal polarization	Large-scale involuntary migration
6	Large-scale environmental damage incidents	Natural resource crises
7	Failure of climate change adaptation	Erosion of social cohesion and societal polarization
8	Widespread cybercrime and cyber insecurity	Widespread cybercrime and cyber insecurity
9	Natural resource crises	Geoeconomics confrontation
10	Large-scale involuntary migration	Large-scale environmental damage incidents

Source: The Global Risk Report, 2023, World Economic Forum

All **6 environmental risks** feature in the top 10 risks over the next 10 years while **"Biodiversity loss and ecosystem collapse"** is viewed as one of the fastest deteriorating global risks over the next decade,

9 risks are featured in the top 10 rankings over both the short and the long term, alongside **two new entrants** to the top rankings: **"Widespread cybercrime and cyber insecurity"** and **"Large-scale involuntary migration".**

Climate action will dominate the next decade

According to the Global Risk 2023 Report by World Economic Forum, climate action failure will be most severe global risk in the next decade.

2 years from 2023 | **10 years from 2023**

Risk categories
- Economic
- Environmental
- Geopolitical
- Societal
- Technological

	2 years	10 years
1st	Misinformation and disinformation	Extreme weather events
2nd	Extreme weather events	Critical change to Earth systems
3rd	Societal polarization	Biodiversity loss and ecosystem collapse
4th	Cyber insecurity	Natural resource shortages
5th	Interstate armed conflict	Misinformation and disinformation
6th	Lack of economic opportunity	Adverse outcomes of AI technologies
7th	Inflation	Involuntary migration
8th	Involuntary migration	Cyber insecurity
9th	Economic downturn	Societal polarization
10th	Pollution	Pollution

All 5 **environmental risks** feature in the top 10 risks over the next 10 years.

Source: The Global Risk Report, 2023, World Economic Forum

Demographic Shifts

By **2050** the world's population is expected to increase by **2 billion** people

By **the end of the century** as fertility rates continue to decline.

By 2050 there will **be just two working age people** per one elderly person in Europe

Megatrend Management Considerations

- **Provide broader insights on all the risks** and assurance over the risks management
- **Design apprenticeships for younger recruits** and **skills training for older workers**
- **Ensure fair remuneration** and transparency
- **Assess the methods used to monitor, measure, and report on the programs**

Source: Shifting Demographics | United Nations

Source: Demographic and social change - Megatrends - PwC UK

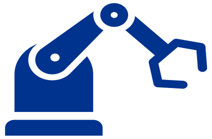
Source: How Internal Audit is helping organizations build trust | EY - Global

Economic Power Shifts

The global economic system has changed over the past few decades: **emerging and developing countries have established themselves as important sales markets and make a significant contribution to global economic growth**. This is both an opportunity and a challenge in terms of the **production systems of the future**.

- An economic power shift from **west to east** is taking place
- **In emerging countries,** the level of purchasing power is approaching the level experienced in industrial countries
- Consequently, the **demand for consumer goods is growing**
- The shift in economic power will have a large impact on **growth potential for companies and the countries** in which future investments will be made.

Megatrend Management Considerations



Explore risk management

Provide broader insights on all the risks and assurance over the management of risks

The world in 2050 the economies of the group of the Emerging Seven (E7) consisting of:

(China, India, Brazil, Russia, Mexico, Turkey, & Indonesia)

Source: Megatrend: shift in economic power | KUKA AG

Source: Shift in economic power - Megatrends - PwC

Labor Shortages

Labor shortages from the past years will continue and likely accelerate

- The labor shortage will continue to be a significant challenge for businesses
- Many manufacturing plants adopt automated technology to address that gap.
- Businesses need to find ways to be competitive to **attract, hire, and retain quality employee**
- **Employee engagement, wellbeing, and retention** continue to be top agenda items

Megatrend Management Considerations

Design and assess learning and development program

Assess the organizations' succession plan

Audit the "hire to retire" processes and evaluate the efficiency of HR processes

Source: internal-audit-key-risks-and-areas-of-focus-for-2022.pdf (assets.kpmg)

Source: 2022 Trends for Skilled Labor (skillwork.com)

Civil, Civic and Equality Movements

- **Diversity, equity and inclusion (DE&I) efforts**, it's been a challenge to make them effective because of the all-encompassing changes required.
- Although numerous businesses show DE&I business success, **women and ethnic minorities** continue to remain **underpaid and underrepresented at corporate levels.**
- **Integrate DE&I through creating conditions** that give everyone the same chance to **contribute, grow and thrive**.
- It can be **risks** for organizations in terms of **business disruption and loss of trust**

Megatrend Management Considerations

Design DE&I programs embracing to companies

Assess the methods used to monitor, measure, and report on the programs

D&I statistics test for accuracy

Source: Who We Are is How We'll Grow | Accenture

Source: Global Megatrends 2022: Civil, Civic, and Equity Movements (pmi.org)

Source: Internal Audit's Role in Driving Diversity, Inclusion - WSJ

Rapid Urbanization

“ 2/3

Of the world’s population will live in cities by 2050

Urbanization is creating significant **opportunities for social and economic development and more sustainable living.**

Opportunities

Cities **over the world** create economic value at least

$30 Trillion

Asian's cities create more economic value

$930 Billion

Democratic city

Inclusive city

Smart city

Increase productivity

Equality

Resilience

- **Uncontrolled rapid urbanization** presents challenges such as **constrained capacity and finance for infrastructure** delivery
- **Unplanned and poorly managed urbanization** can give rise to **inequity, pollution and costly development patterns**.

Megatrend Management Considerations

Capture the potential of the new markets that will be created through rapid urbanization.

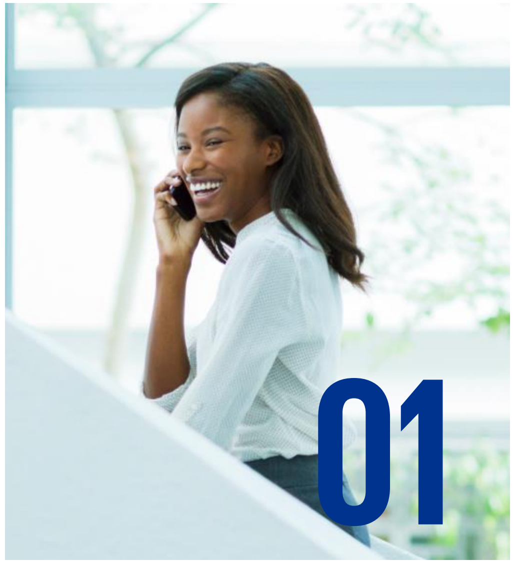
Assess the risks and opportunities

Source: Urbanization การขยายตัวของความเป็นเมือง (okmd.or.th)

Source: Global megatrends - Future State 2030 - KPMG Global (home.kpmg)

Source: Rapid urbanisation - Megatrends - PwC UK

Local Regulatory Trends & Future Commitment



Thailand's Personal Data Protection Act (PDPA)

National Action Plan on Business and Human Rights

Nationally Determined Contribution – Paris Agreement

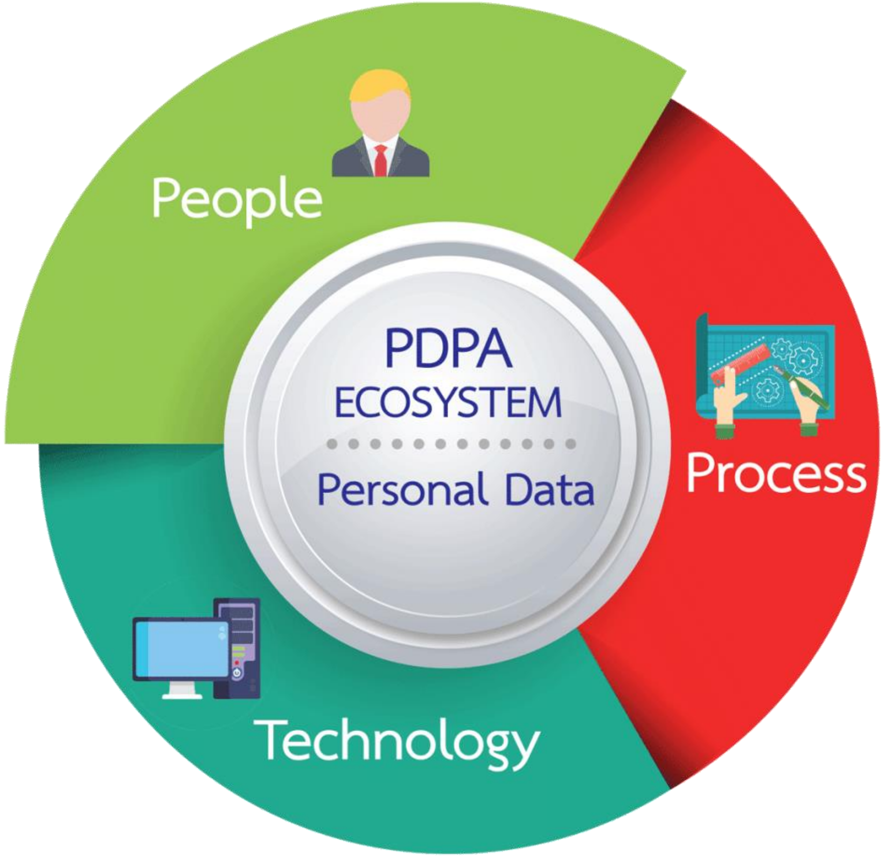
56-1 One Report

Thailand's Personal Data Protection Act (PDPA) - Governance

- **Personal data is any information relating to a natural, whether directly or indirectly.**
- Regulate to **protect a data owner from the unauthorized or unlawful collection, use, or disclosure and processing** of their personal data.
- Full effect on **1 June 2022.**
- Non-compliance with the PDPA could result in civil penalties, criminal penalties, and administrative penalties.

The rights of data owners under the PDPA include the following:

- Right to be informed
- Right to access
- Right to data portability
- Right to object
- Right to erasure / right to be forgotten
- Right to restrict of processing
- Right to rectify



Source: https://home.kpmg/th/en/home/insights/2022/06/legal-news-flash-issue-14.html

Source: PDPAคืออะไร ? - สรุป พ.ร.บ.คุ้มครองข้อมูลส่วนบุคคล ที่ต้องรู้ (t-reg.co)

National Action Plan on Business and Human Rights (NAP)

"Human rights are rights inherent to all human beings, regardless of race, sex, nationality, ethnicity, language, religion, or any other status" defined by United Nations.

- **The First National Action Plan on Business and Human Rights** (2019–2022) was initiated by the Royal Thai Government (RTG)
- Aim to **respond to human rights violations**
- Provide **concrete measures** through the integration of policies, laws, regulations, measures, and interventions, both at the national level and international level
- Focus on **improving, and addressing urgent and important human rights** issues caused by **business activities**

Four priority areas:

Labour

- **Comply with labour laws** and standards
- **Establish policies and measures** eliminating discrimination in workplace
- Provide a **complaint or grievance mechanism**
- Promote access to **the Employee Welfare Fund**

Community, Land, Natural Resources and Environment

- **Inform the public** about relevant projects
- Conduct the **EIAs and EHIAs** according to the laws
- **Set up channels for complaints**, negotiation and remediation
- **Develop remedial and rehabilitation measures** for people affected.

Human Rights Defender

- **Create knowledge and understanding** on the work of human rights defenders
- **Work with civil society** to prevent, mitigate and remedy impacts on human rights
- **Improve the remedy system** and measures for victims of human rights abuses

Cross Border Investment and Multinational Enterprise

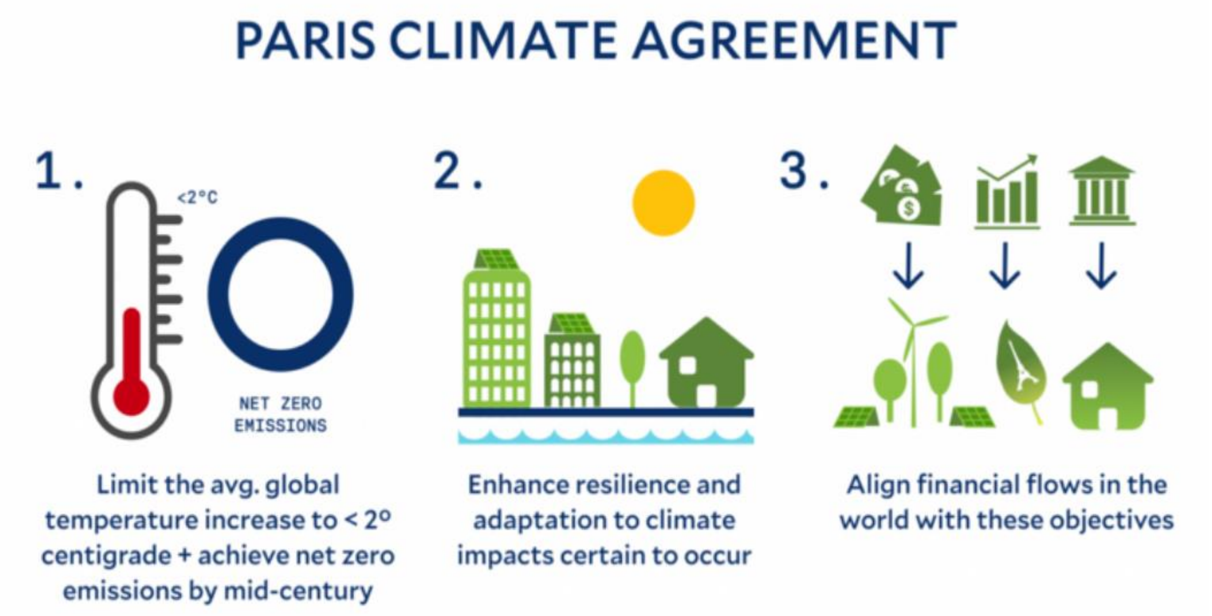
- **Promote awareness of international principles** and standards
- **Perform human rights due diligence (HRDD)**
- Ensure **subsidiary companies and the supply chain abide by laws**

Source: https://www.undp.org/asia-pacific/bizhumanrights/publications/first-national-action-plan-business-and-human-rights-thailand

Nationally Determined Contribution – Climate change

In line with the Paris Agreement, Thailand aims to peak its **greenhouse gas emissions in 2030**, with the ambition to move towards **net-zero emissions by 2065.**

- The NDC was formulated in accordance with the Philosophy of Sufficiency Economy and the principle of Sustainable Development, and relevant national plans.
- Thailand's NDC indicates an emission reduction of **20% from the projected business-as-usual (BAU) level by 2030, carbon neutrality target by 2050, net-zero target by 2065.**
- The contribution could be achieved through **adequate** and enhanced access to **technology development and transfer, financial resources and capacity building.**



Source: A refresher on the Paris Climate Agreement | The MacMillan Center (yale.edu

Source: https://unfccc.int/sites/default/files/resource/Thailand_LTS1.pdf

56-1 One Report - Reporting

- Name of new report regulations, require by SEC for **all listed companies** to submit including **Sustainability Development section**
- Elevate **the disclosure of ESG of listed companies to reflect the sustainable operations** under good governance by considering to the impacts on environment and social
- Required **sustainability performance assurance** especially for **GHG emission**
- One Report will be required for reporting **year 2021, to be published in 2022.**

56-1

Part 1: Business Operation
1. Policy and business overview
2. Nature of business
3. Rick factors
4. Assets
5. Legal disputes
6. General information and other material facts

Part 2: Management & Corporate Governance
7. Securities and shareholders
8. Organizational structure
9. Corporate governance
10. Corporate social responsibility
11. Internal control and risk management
12. Related transactions

Part 3: Financial Position & Operation Results
13. Significant financial information
14. Management discussion and analysis

One Report

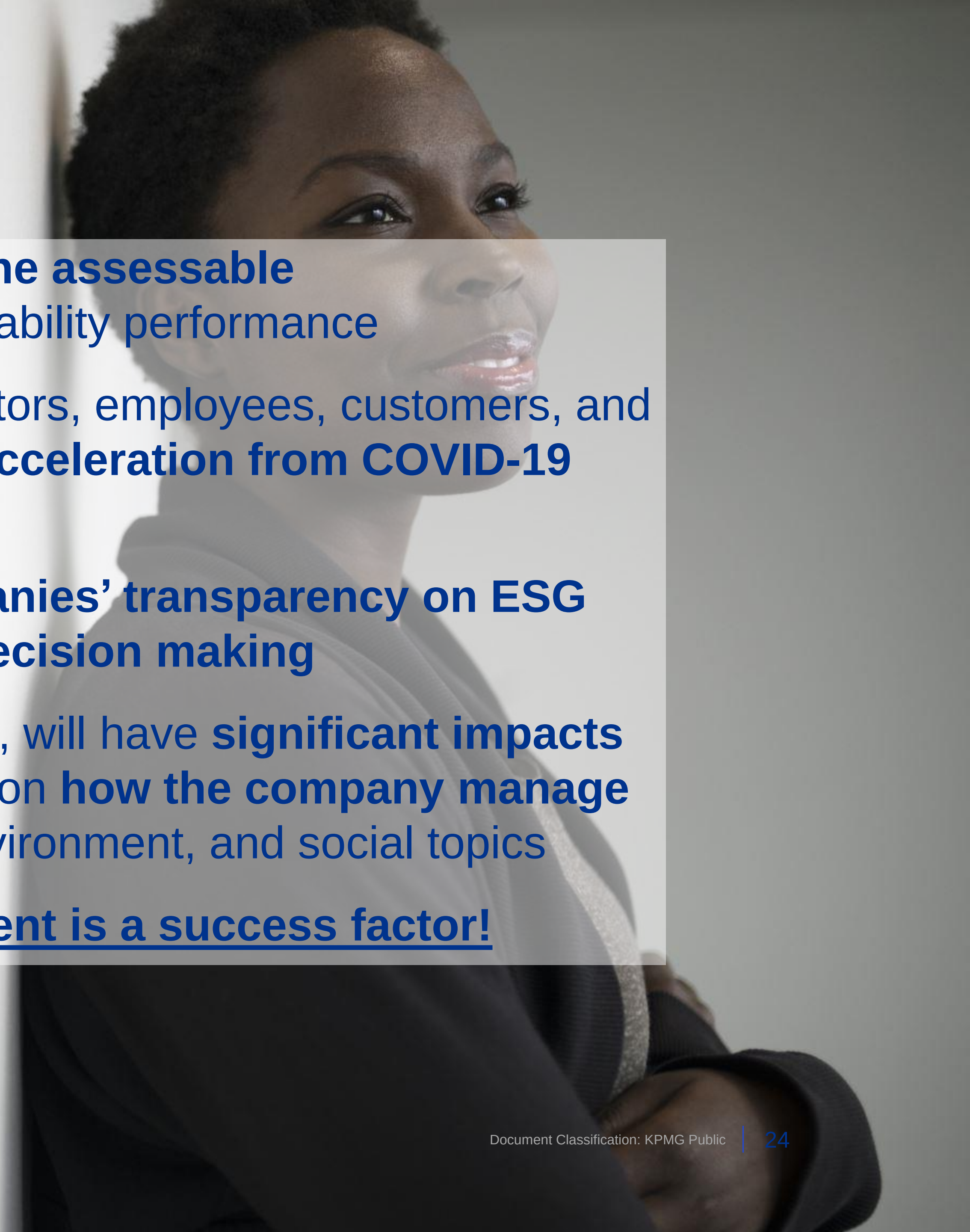
Part 1: Business Operation
1. Organizational structure
2. Risk management
3. Corporate sustainability
4. Management discussion & analysis
5. General information & other significant information (dispute, auditor's renumeration)

Part 2: Corporate Governance
6. Corporate governance policy
7. Governance structure and significant information of committees, subcommittees, executive management, employee and others
8. Significant results of corporate governance
9. Related transaction

Part 3: Financial Statement

Source: KPMG ESG research

Key Takeaway



- **Sustainability is an overall concept** & **ESG is the assessable outcome** concerning a company's overall sustainability performance
- **Rising interest of ESG management** from investors, employees, customers, and community will be an **ongoing context**, with an **acceleration from COVID-19** situation
- **Investors increased their awareness on companies' transparency on ESG management** which affecting their **investment decision making**
- **Global megatrends, as well as local regulatory**, will have **significant impacts** on company **positively and negatively** depends on **how the company manage opportunities & risks** regarding governance, environment, and social topics
- **<u>Systematic corporate sustainability management is a success factor!</u>**

02
Overview of ESG Risks

ESG Overview in Financial Sector

FS are increasingly recognizing the breadth and depth of ESG within their own businesses and the impact they can have on society. FS will be measured across all ESG metrics, but will have to prioritize different elements of ESG depending on their appetite and focus. Responsibility will be not just for their direct impact, but also for every part of their lending portfolio.

- Air and water pollution
- Sea level rise and drought
- Resource depletion
- Deforestation
- Land degradation
- Energy efficiency
- Reactions of legislator/regulator to promote sustainability or bans on unsustainable activities (e.g. CO_2 tax)
- Structural changes in demand and supply for products, services and commodities

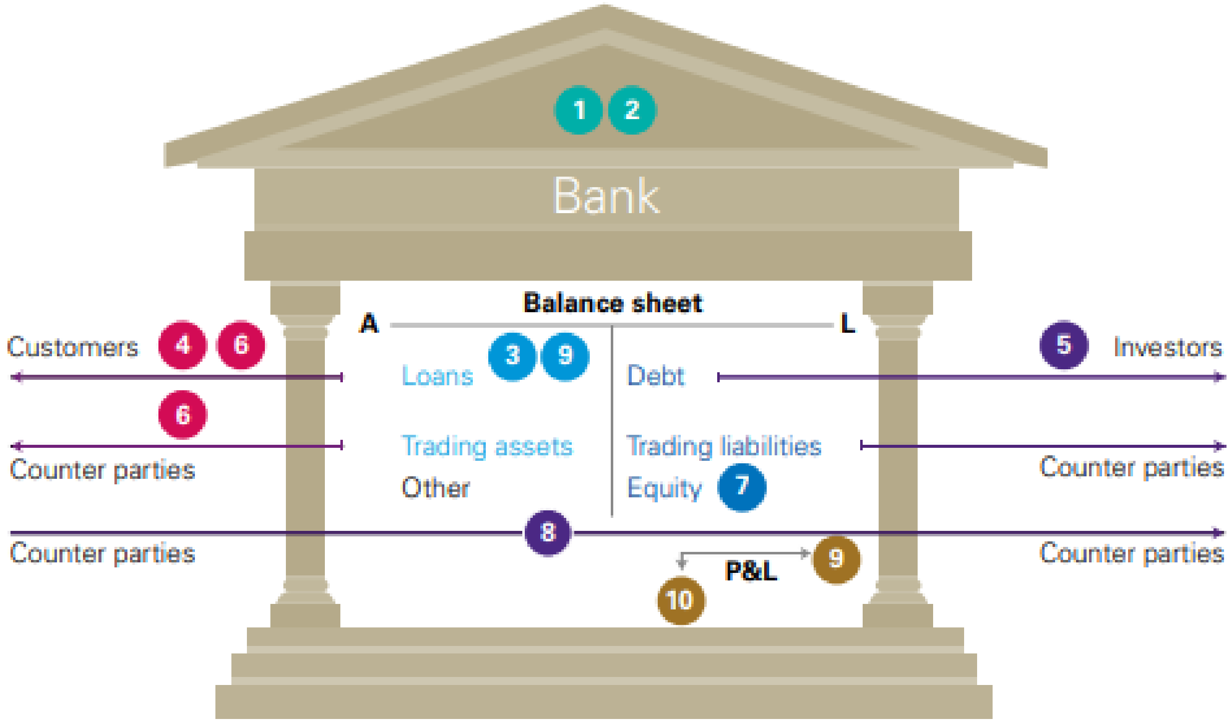
- Noncompliance with labour standards
- Inadequate payment of labour
- Human capital management (employee attraction, retention, training, education)
- Lack of assurance of industry safety standards and health protection for employees
- Product safety and liability
- Data protection and privacy
- Human rights

- Board composition
- Compliance with regulatory standards
- Corruption or attempted bribery
- Executive remuneration
- Business ethics
- Risk management
- Lack of proper assurance of data protection
- **Greenwashing risks**

Source: ESG risk in Banks, KPMG International, May 2021.

Key Areas of the Bank Prone to ESG risks

ESG risks can affect the banks' P&L and liquidity issue where ESG risks can affect the bank directly (e.g. storm damage to bank buildings), but also affect customers (change in sales opportunities, production disruptions, etc.) leading to, for example, higher loan defaults.

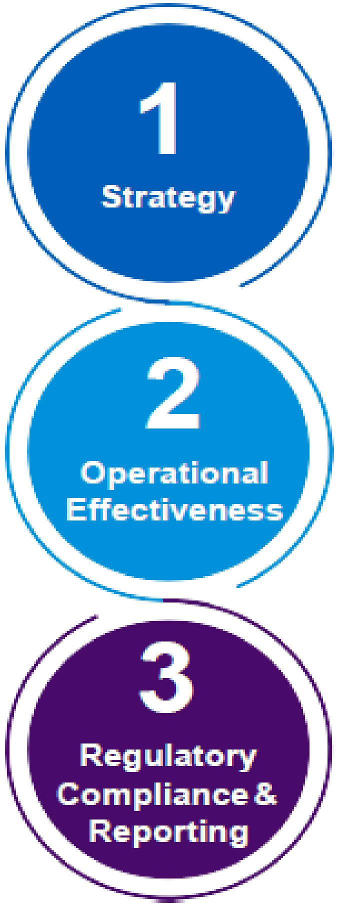


1. Consideration of sustainability in **the business strategy** and the organizational setup/governance
2. Adjustment of **product and customer portfolio**
3. Identification/classification of sustainable **assets**
4. Offering of sustainable **financing to customers**
5. **Refinancing** with sustainable instruments
6. Consideration of ESG (risk) in **pricing & risk management**
7. Consideration of ESG risks within the **capital charge**
8. Inclusion of ESG criteria in the **distribution process**
9. **Reporting** of own ESG risks and their impact to supervising authorities and stakeholders
10. ESG **Data Management**

Source: ESG risk in Banks, KPMG International

ESG is a Board level priority-what are Boards concerned about?

ESG is a priority on the Boardroom agenda. This provide an open door to initiate ESG discussion and provide Board level training and information sessions.



- How does the Bank compare to peers?
- How is the Bank going to meet its public net zero commitments?
- Are the products offered ready from an ESG perspective?
- Is the ESG incorporated in the target operating model?
- How is a Bank engaging with its clients and their transition strategies?

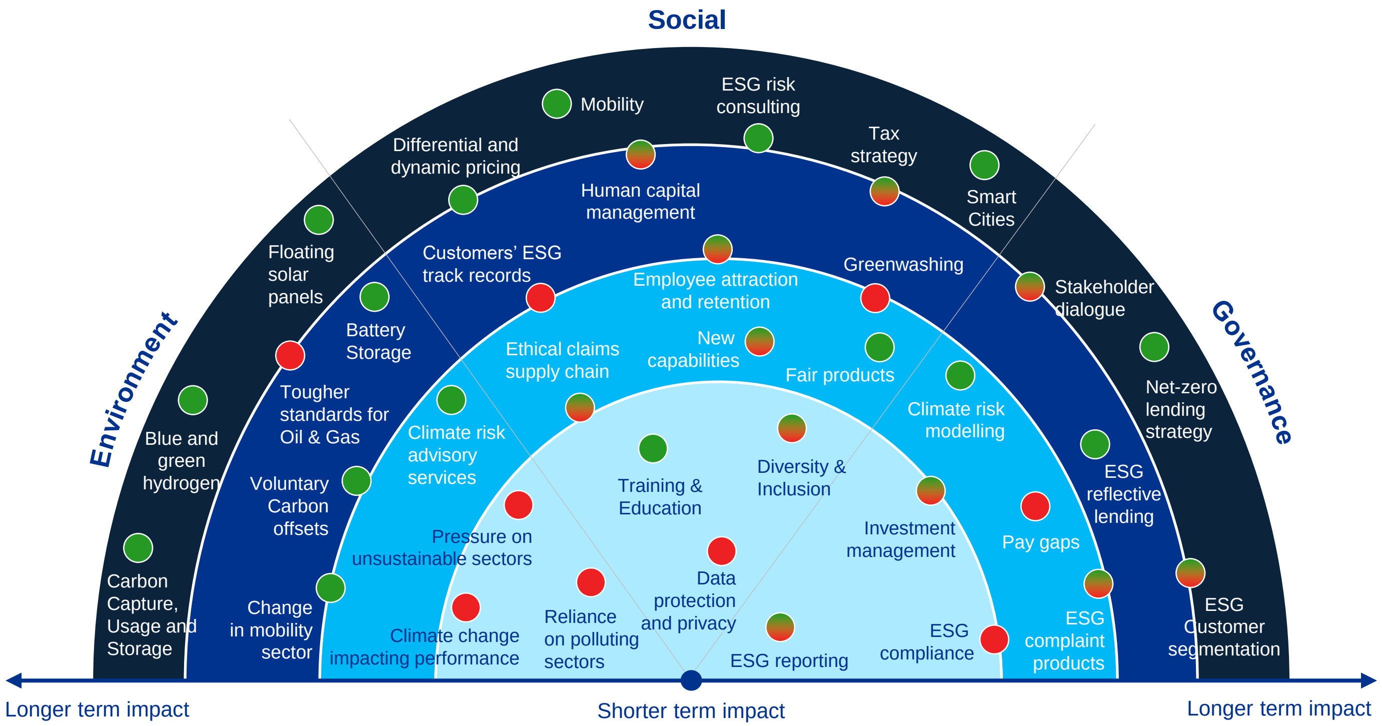
- Is the Bank aware of ESG matters across its organization, including processes, system and controls?
- Does the functional decision making take ESG matters into account?
- Is ESG considered while developing products and services?
- Are ESG risks and opportunities integrated in procedures and policies?
- Is the Bank taking advantage of the opportunities that IDE policies can bring?

- Is the company ready to cope with existing and upcoming regulatory requirements?
- What are the gaps that can already be identified?
- Is the company measuring, reporting and disclosing non-financial ESG information that is critical to understanding both strategic intent, risks and opportunities?
- Who in the Bank is responsible for ESG at functional and Board levels?

Source: Transitioning to a Green Economy , KPMG playbook April 2022

There are a wide range of risks and opportunities to consider for the banks

Potential ESG risks and opportunities for Banks



Source: KPMG Global Analysis, 2022

Key: Opportunity Threat Both opportunity and threat

Implications for Banks

New risks, new opportunities – customers face a new set of risks and opportunities associated with ESG (e.g. reputation, supply chain management, transition to net zero), creating new opportunities for risk transfer products and financing products

Decarbonisation opportunities – businesses and households are transitioning to new ways of operating (e.g. renewable energy and sustainable practices), creating new financing markets in the process

Business model change – opportunities created by new industries and ecosystems, e.g. mobility and smart cities, that create new types of customers and financing needs

Rising expectations – regulators, investors, customers and stakeholders expect progress on ESG. Banks need to demonstrate compliance and action

Data and modelling – reporting on ESG and integrating ESG into lending requires enhanced data collection and analysis, and new modelling approaches to take account of climate change and ESG factors

Environment

Financial impacts from climate change

Environmental groups sue one of the largest energy companies for misleading the public over Net Zero

The case is part of a growing trend of environmentalists **taking the company to the court** over **alleged breaches to ESG practices.** The company's investments and reducing greenhouse gas emissions are claimed **'greenwashing'.**

California environmental group sues the world's biggest food, beverage and consumer goods companies for plastics fouling California waters

The companies are being sued by a California environmental group for creating a **plastic pollution "nuisance" which** has caused to the **climate change and oceans.**

The U.S. could lose **$520bn** across 22 industrial sectors due to global warming

1.2% decline in the annual gross domestic product (GDP) for **every 1 degree Celsius increase** in temperature.

Climate change and extreme weather directly impact **70% of all economic sectors** worldwide routinely.

Source: Reuters press

Source: The Guadian press

Social

Heathrow fined for USB stick data breach

It comes after a staff member lost a USB stick last October containing **"sensitive personal data"**, which was later found by a member of the public.

£120,000

Heathrow Airport Limited fined for serious failings in its data protection practices

A social media company to be fined to settle U.S. employment discrimination claims

The company agreed to pay to settle civil claims by the U.S. government that of giving **hiring preferences** to temporary workers including those who hold H-1B visas that let companies temporarily employ foreign workers in certain specialty occupations.

$14.25m

to settle U.S. employment discrimination claims

Source: Heathrow fined for USB stick data breach - BBC News

Source: U.S., Meta settle lawsuit over discrimination in housing advertising tool | Reuters

Governance

22 Thai Sailors Arrested Over Attempt To Smuggle 32.9 kg Cocaine Into Nigeria

Economic impact:
- Loss the business opportunities during the retention period

THB 16.5m

the carriage cost during the investigation (14 days)

$ 3.9m

The company was claimed for damage and delayed deliverable.

The alleged 11 former committees and executive in a corruption lawsuit

The Securities and Exchange Commission, Thailand (SEC) alleged the former committees and executives of one company in the lawsuit of **economic crime and raw material inventory corruption.**

THB 2,157m

Total amount of the company damage

Source: Thairath Press

KPMG

03
Thailand Regulatory Landscape for ESG

Regulations and guidelines development around ESG risks

During Paris Agreement (COP21)

Thailand intends to reduce its GHG emissions by 20% from the projected business-as-usual (BAU) level by 2030.

2015


Sustainable Banking Guidelines
Responsible Lending
by
The Thai Bankers' Association
13 August 2019

2019

Sustainable Banking Guidelines on Responsible Lending

TBA issued **the Sustainable Banking Guidelines on Responsible Lending** provides the guidance for banks based in Thailand to establish a responsible lending strategy to manage their environmental and social (E&S) impacts and risks.

One Report 56-1

SEC in Thailand mandates the listed companies to disclose sustainability reporting in the 56-1 One Report annual public filing effective from the financial period ending 31 December 2021.

2020

Sustainable Finance Initiatives for Thailand, Aug-2021

- (1) Develop a practical taxonomy
- (2) Improve the data environment
- (3) Implement effective incentives
- (4) Create D-led products & services
- (5) Build human capital

TCFD

SEC has declared **support for the Task Force on Climate-Related Financial Disclosures** (TCFD supporter) by becoming an official TCFD supporter.

2021

BOT Directional Paper on "Transitioning towards Environmental Sustainability under the New Thai Financial Landscape"

2022

State Enterprise Development Plan (2023 – 2027)

State-owned enterprises must focus on issues related to **global warming, CO2 reduction, BCG model implementation in the investment projects,** The organization shall establish the **operation guideline on sustainability (ESG)**

BOT's Policy Statement

BOT issue policy statement for financial institutions to **disclose climate-related information in line with international standards such as TCFD, ISSB.**

2023

Thailand Taxonomy Phase 1 is focused on two sectors: **energy and transportation - June 2023**

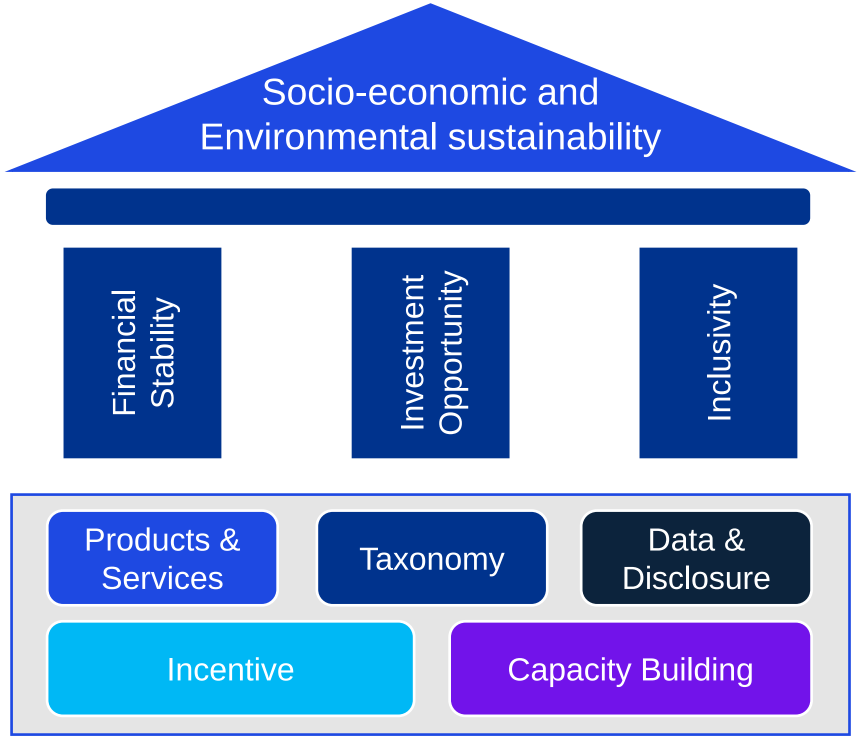
What is next…?

IOSCO* endorses **the ISSB's Sustainability-related Financial Disclosures Standards** and encourage its members to adopt. Thailand SEC will follow the suit.

Taxonomy Phase 2 will be focused on Manufacturing sector, Agriculture sector, Real estate and Construction sector.

BOT expects FIs to align their report with TCFD/ISSB. **Large FIs expected to disclose in 2024 and other FIs in 2025.**

BOT's Determination to Addressing Climate Risks



BOT Directional Paper on "Transitioning towards Environmental Sustainability under the New Thai Financial Landscape"
Aug 2022

The BOT has laid out **5 building blocks** to prepare FIs for the imminent impacts from climate change.

Under the 1st block (product & services), the BOT expects FIs to be able to assess the impacts from climate risks via **scenario analysis and stress testing** and incorporate climate risks into every day-to-day business process.

Product & Services

- Conduct climate stress testing and incorporate climate risks into end-to-end business
- BOT will launch **guidelines** in accordance with BCBS/ISSB **within 2022** and **industry practice in 2023**.

Taxonomy

- Establish principle-based taxonomy around climate change in line with ASEAN Taxonomy.
- Co-op with TGO and SEC staff to respond to identify transparent indicators under Thailand Taxonomy.

Data & Disclosure

- BOT expects FIs to align their report with TCFD/BCBS/ISSB and **mandate large FIs in 2024** and **other FIs in 2025**.
- Co-op with MNRE/ME/MOT and private org. to build Big Data (Green Data Ecosystem).

Incentive

- During the transition, BOT support SMEs to transit to sustainable economy.
- In long term, BOT will impose stricter regulation to enforce companies to address climate risks.

Capacity Building

- BOT will develop workshops to train FIs about climate disclosure and scenario analysis.
- BOT expects FIs to have sufficient personnel to effectively assess climate risks.

BOT's Policy on Climate-Related Risks

Governance

Roles of board and senior executives in strategy planning, environmental compliance, and resource allocation are key to successful incorporation of environmental aspects to business operation.

Risk Management

FIs should incorporate climate-related risks into their existing risk management framework and have processes to assess the risks on both transactional and portfolio levels.

This includes portfolio heatmaps, key risk indicators (refer to IFC standards), and **scenario analysis and stress testing** (under Pillar 2).

Strategy

FIs should consider environmental impacts on their business including assessing their risk appetite and materiality and support customers with sustainable finance products and services.

Disclosure

FIs should effectively disclose climate-related information on governance, strategy, risk management, and metrics and targets in line with such international standards as the TCFD and the ISSB at least annually.

BOT's Policy on "Environmental and Climate Change Aspects on Financial Institutions,"
Feb 2023

The BOT will begin evaluating progress in implementing the policy guidelines **starting in 2024**.

BOT will collaborate with the banking sector to **develop an industry handbook** to align with the policy **in 2023.**

Thailand Taxonomy

Thailand Taxonomy
1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of marine and water resources
4. Resource resilience and transition to a circular economy.
5. Pollution prevention and control
6. Protection and restoration of biodiversity and ecosystems

Sector Coverage

- Energy
- Transportation

Assessment process

- Break down company/project operations into different economic and check the coverage of activities under section 4 of Thailand Taxonomy.
- Assess activity against Technical Screening Criteria of Green, Amber and Red
- Ensure compliance with ‘Do No Significant Harm’ (DNSH) & meet ‘Minimum Social Safeguards’ (MSS) and prepare final report

Source: Thailand Taxonomy, Phase 1

Thailand Actions on Climate Change

Carbon Tax and GHG Disclosure

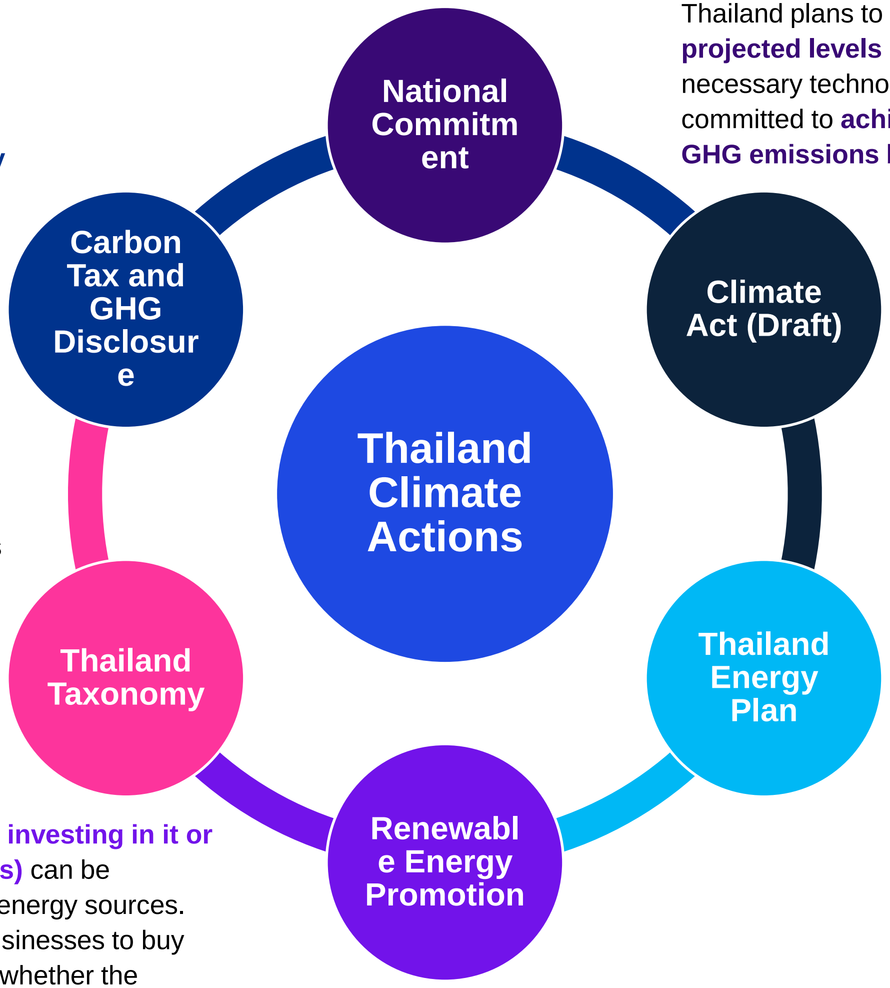
The Excise Department plans to impose **a carbon tax on the energy, transport and industrial sectors** to encourage more companies to use cleaner or renewable energy. **Starting from May 31, 2026,** the Company will need to annually report their CO_2 emissions, even for imported goods. Non-compliance will lead to increased taxes.

Thailand Taxonomy

Thailand Taxonomy is a **classification system for sustainable economic activities** with a focus on environmental sustainability. **Companies should prepare for upcoming challenges**, such as regulatory support, data collection systems, interoperability, and meeting future criteria to secure financial support.

Renewable Energy Promotion

There are two **alternatives for utilizing renewable energy: investing in it or purchasing it**. First, **Renewable Energy Certificates (RECs)** can be considered as market-based incentives for using renewable energy sources. Another option is the **Utility Green Tariff (UGT),** allowing businesses to buy electricity from renewable sources. The rates vary based on whether the sources are specified or unspecified and their respective emission factors.



National Commitment

Thailand plans to **reduce its greenhouse gas (GHG) emissions by 30% from projected levels by 2030**, with a potential increase to 40% if they receive necessary technology, financial, and capacity support. Additionally, Thailand is committed to **achieving carbon neutrality by 2050 and reaching net-zero GHG emissions by 2065 as long-term goals.**

Climate Act (Draft)

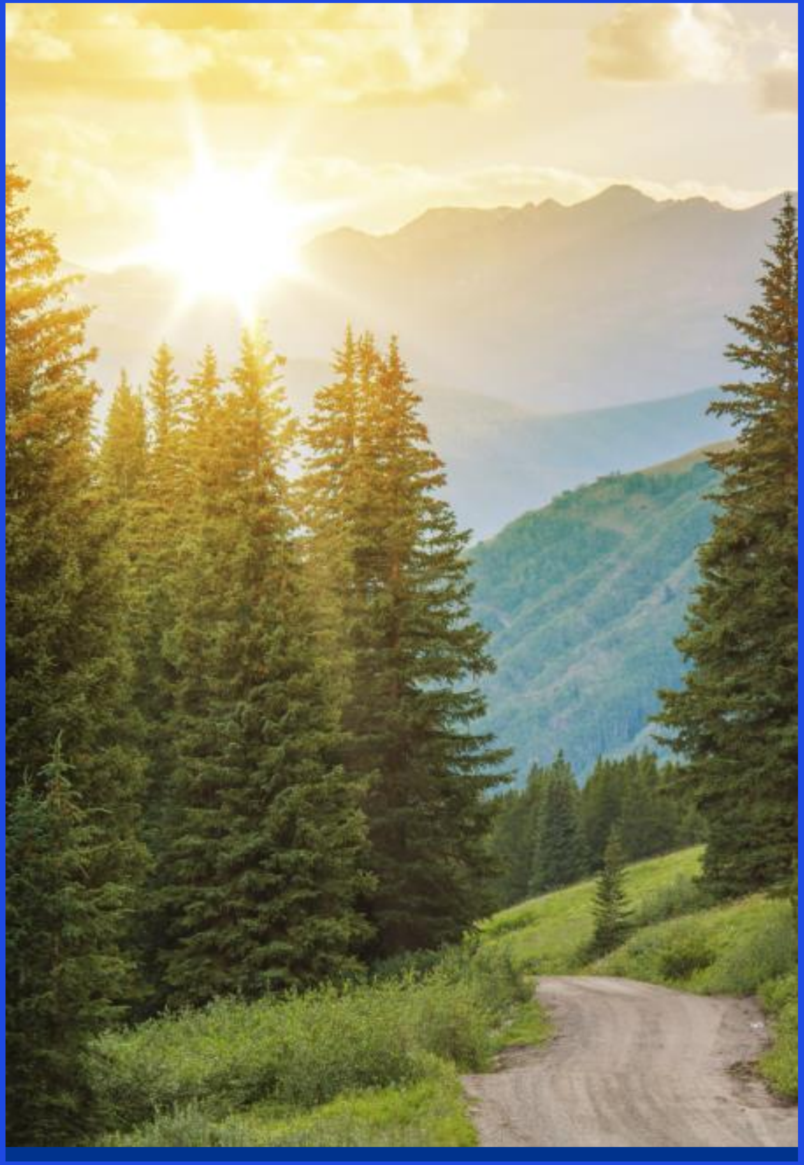
The draft Climate Change Act lays out **Thailand's action plan for climate change mitigation and adaptation, including emissions reductions**. Some of the key sections in the draft law involve citizen rights, the National Climate Change Policy Committee, and a national GHG database.

Thailand Energy Plan

An opportunity to use or invest in the **renewable energy for electricity & to lower Grid Factor.**

- ***Power Development Plan 2018-2037***, increasing shares of electricity from renewable sources by 2050.
- ***Alternative Energy and Development Plan (AEDP) 2018-2037***, increasing alternative energy to drive the economy, strengthen energy security and support environmental sustainability.

04
ESG in reporting (One Report, TCFD, IFRS ISSB)



Overview of Sustainability Reporting Frameworks

Framework	Description	Audience	Report Focus	ESG Focus
IFRS	International sustainability Reporting Framework	All stakeholders	How business impacts on society	Environment, Social, Governance
GRI	Set out the standards used to company to report the topics that are material to business.	All stakeholders	How business impacts on society	Environment, Social, Governance
SASB	Industry specific standard to help companies select topics that may impact their financial performance.	Investors	How business impacts on business	Environment, Social, Governance
TCFD	Guidance to disclosing impact of climate related risks.	Investors and financial stakeholders	How business impacts on business	Environment, Governance
CDSB Climate Disclosure Standards Board	Framework for reporting environmental and natural capital information (aligned with TCFD).	All stakeholders	How business impacts on society	Environment, Governance
CDP DISCLOSURE INSIGHT ACTION	Disclosure of environmental information through questionnaire – ability to benchmark against peers.	All stakeholders	How business impacts on society	Environment, Governance
S&P Global	ESG Scores measure companies' performance on key ESG risks and opportunities, the quality of their disclosures.	All stakeholders and investors	How business impacts on society	Environment, Social, Governance

Key Global Trends in Sustainability Reporting

Sustainability reporting grows incrementally with an impressive 96% of the world's leading 250 companies report on sustainability, a rate likely to increase as new regulations on non-financial reporting is introduced.

96%
Of G250* companies report on sustainability or ESG matters

64%
Of G250 acknowledge climate change as a risk to their business

Less than half of the companies report on
Biodiversity loss

GRI, TCFD and SDGs
Form the most commonly used anchors for sustainability reporting

TCFD adoption nearly doubled in 2 years, going from **37% to 61%** among the G250

49%
of the G250 acknowledge social elements as a risk to their business, with Western Europe as the leading region

71%
Of N100* companies identify material ESG topics

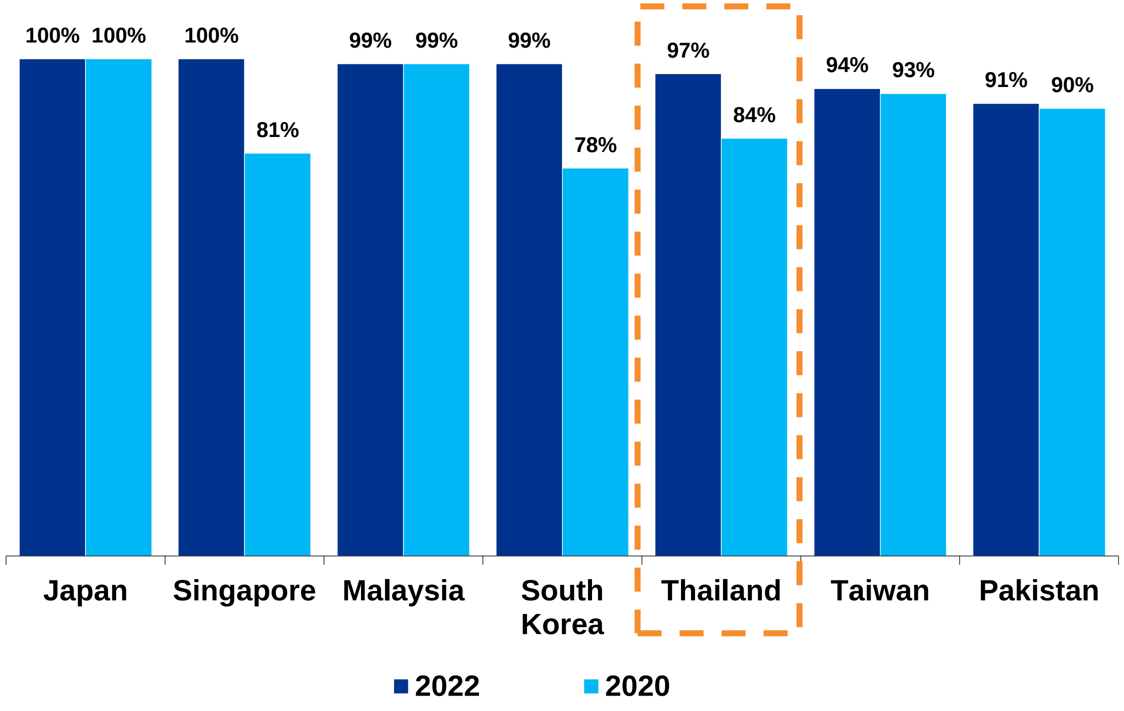
Fewer than half of G250 companies have leadership level presentation for
Sustainability

Note: G250:World's 250 largest companies by revenue based on the 2021 Fortune 500 ranking
Note: N100: Worldwide sample of the top 100 companies by revenue in 58 countries, territories and jurisdictions
Source: Big shifts, small steps (kpmg.com), KPMG Survey of Sustainability Reporting 2022

Trend of Sustainability Reporting in Thailand

Thailand is among the top seven Asia Pacific countries that have sustainability reporting rates higher than 90 percent: Japan (100 percent), Singapore (100 percent), Malaysia (99 percent), South Korea (99 percent), Thailand (97 percent), Taiwan (94 percent) and Pakistan (91 percent).

Top Seven Asia Pacific Countries' sustainability reporting rates



Securities and Exchange Commission in Thailand **mandates the listed companies to disclose sustainability reporting in the 56-1 One Report** annual public filing effective from the financial period **ending 31 December 2021**.

Source: Big shifts, small steps (kpmg.com), KPMG Survey of Sustainability Reporting 2022

Implication of 56-1 One Report

SEC

56-1 One Report

Part 1: Business Operation

1. Organizational structure
2. Risk management
3. Corporate sustainability
4. Management discussion & analysis
5. General information & other significant information (dispute, auditor's renumeration)

Part 2: Corporate Governance

6. Corporate governance policy
7. Governance structure and significant information of committees, subcommittees, executive management, employee and others
8. Significant results of corporate governance
9. Related transaction

Part 3: Financial Statement

Sustainability Policy

Environment

- Environmental policy, target & management approach
- Environmental performance, i.e. GHG, energy, water, waste, pollutions

Social

- Social policy, target & management approach
- Social performance related to employee, customers, community, e.g. human rights, labor practices

Governance

- Risk management – cover ESG risks, incl human rights, CG
- MD&A – ESG impact associated with business results

Mitigate Impacts to Stakeholders in Business' Value Chain

Sustainability/ESG performance

Alignment with national and global benchmarks

Alignment with national and global reporting frameworks

GRI

GRI Standard

IOD Thai Institute of Directors

Corporate Governance Report of Thai Listed Companies (CGR 2023) - Category 2Role of Stakeholders and Business Sustainability

SET

Thailand Sustainability Investment List (THSI)

Corporate Sustainability Content in 56-1 One Report

Mandatory for Listed Company

Corporate Sustainability

- Sustainability policy
- Management approach
- Target/Goal (corporate level)
- Key change CY/PY (if any)
- Alignment with SDGs

Management of Impacts to Stakeholders in Value Chain

- Relationship with stakeholders through business' activities (upstream & downstream)
- Value creation along the value chain
- Stakeholder identification
- Stakeholders' concern/interest and corporate response

Management in Environmental Aspects

GHG | Energy | Water | Waste | Pollutions

- Environmental policy & management approach*
- Target/Goal (short- & long-term)
- Emerging risk/issue & key change CY/PY (if any)
- Plan and implementation, incl improvement
- Performance with CY/PY comparison*
- **GHG data verification ****
- Non-compliance/Breach (if any)

Management in Social Aspects

Employee | Customer | Community

- Social policy & management approach *
- Target/Goal (short- & long-term)
- Emerging risk/issue & key change CY/PY (if any)
- Human rights management - risk and due diligence process
- Plan and implementation
- Performance
- Key change CY/PY (if any)
- Non-compliance/Complaint
- Dispute within 3 years

* Material issue(s)
** By TGO-certified or internationally-recognized verifier. If under processing or data unavailable, specify current status with rationale.

Reporting Standard & Framework- Guideline in Thailand

Voluntary for Listed Company

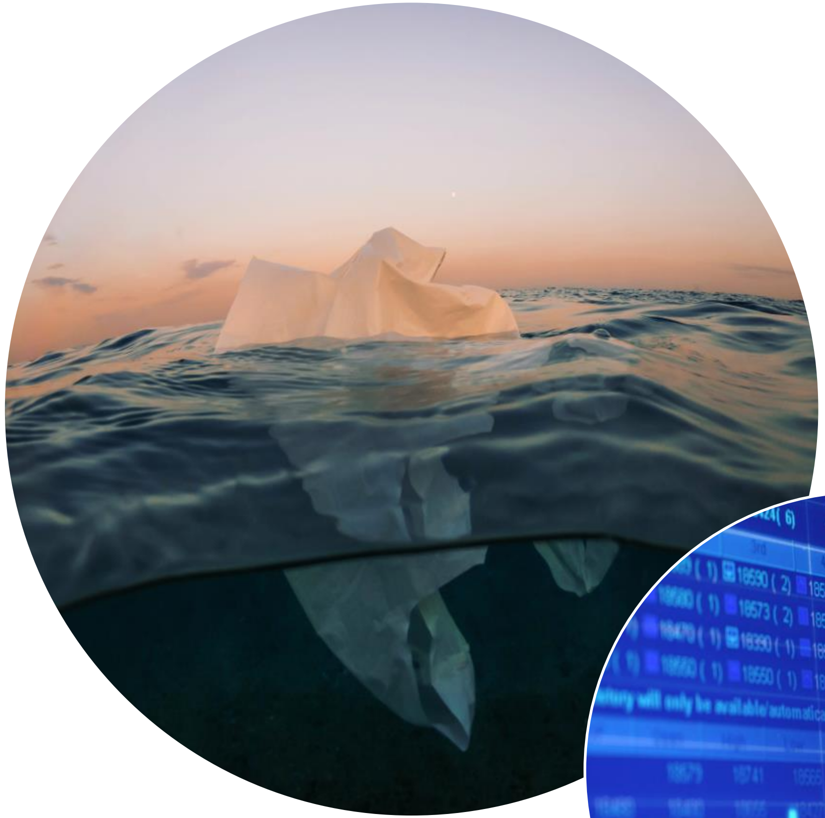
SET

- The Stock Exchange of Thailand (SET) has continued to provide its **annual sustainability report** in alignment with global sustainability reporting frameworks, including GRI Standards, SDGs and IIRC's Integrated Reporting.
- SET unveils Sustainability Reporting Guide for listed companies together with **ESG metrics for each industry group**, covering environmental, social and governance (ESG) material topics.
- The ESG metrics guidance are **8 main industry sector**; including Agro & Food Industry, Consumer Product, Financials, Industrials, Property & Construction, Resources, Services, Technology

https://www.setsustainability.com/download/zxvt2pkafreiq75

https://www.setsustainability.com/libraries/1119/item/SD_REPORTING

What is TCFD and Why it is Important ?



What is TCFD?

The Task Force on Climate-related Financial Disclosures, or TCFD, is a global organization formed by Financial Stability Board (FSB) to develop **a set of recommended climate-related disclosures** that companies and financial institutions can use **to better inform investors, shareholders and the public of their climate-related financial risks.**

Why TCFD is important ?

Climate change presents financial risk to the global economy. Financial markets need clear, comprehensive, high-quality information on the impacts of climate change. This includes the risks and opportunities presented by rising temperatures, climate-related policy, and emerging technologies in our changing world.

2022 TCFD Status

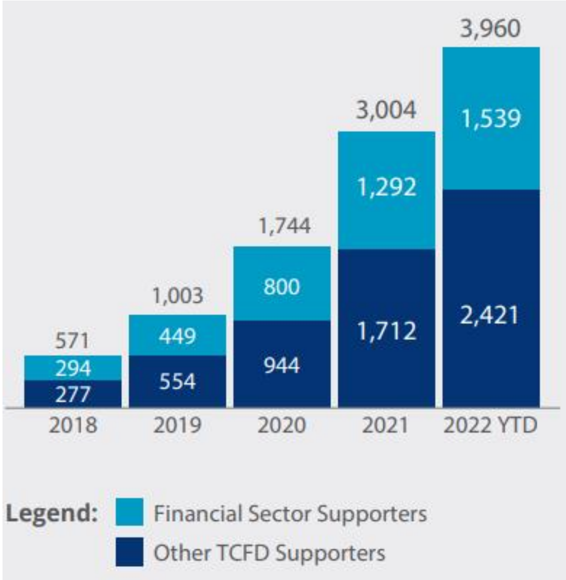
Approx. 4,000

supporters in

101

jurisdictions

Number of TCFD Supporters



KPMG

Core Elements of TCFD Disclosure

To help identify the information needed by investors, lenders, and insurance underwriters to appropriately assess and price climate-related risks and opportunities.

Governance

Disclose governance around climate-related risks and opportunities

Recommended Disclosures:

a. Board's oversight of climate-related risks and opportunities
b. Management's role in assessing and managing risks and opportunities

Strategy

Disclose the actual and potential impacts of climate risks and opportunities on your business

Recommended Disclosures:

a. Risks and opportunities identified in the short, medium, and long term
b. Actual and potential impacts on the business, strategy, and financial planning
c. Scenario analysis of impacts including a 2°C scenario

Risk management

Disclose how you identify, assess, and manage climate-related risks

Recommended Disclosures:

a. Processes for identifying, assessing and managing climate-related risks
b. Integration of climate-related risk into overall risk management

Metrics and targets

Disclose the metrics and targets used to assess and manage climate risks and opportunities

Recommended Disclosures:

a. Metrics used to assess climate-related risks and opportunities
b. All GHG emissions (Scopes 1,2 and 3) and related risks
c. Targets and performance against those targets

What are climate-related risks?

Climate Related Risk

Physical Risks

Acute risks that relate to more frequent or more severe one-off disruptions to companies from extreme weather.

Chronic risks that stem from sustained greenhouse gas emissions leading to gradual changes in climate and precipitation patterns, and extreme variability in weather patterns.

Transition Risks

Legal and regulatory may lead to rising costs from possible fines, regulations or litigations.

Reputational (e.g. brand damage, shifts in consumer preferences).

Technological (e.g. costs to transition to lower emissions technology).

Market (e.g. changing customer behavior).

Climate-related opportunities

Climate-related opportunities may also arise from both physical changes (e.g. warmer average temperatures allow new crops to grow) or transition changes (e.g. developing new technologies to facilitate climate adaptation or participation in carbon market).

Climate-related risks are important to consider and to be addressed due to their potential impacts on various aspects of our lives and planet.

- **Physical risks must be considered over time horizons.** The bold strategies and actions should be taken to prevent potential hazards from climate drivers.
- **Transition risks will be incurred and pressure business to launch proper policies for climate change.** Too intensive or weak policies can accelerate the failure of climate adaptation and green washing.
- **Climate opportunities will be created when physical and transition risks are managed.** Potentially, climate opportunities can be **reflected in climate solution** for example:
    - **Electricity:** Renewable energy & clean energy, such as solar PV, solar thermal, wind, geothermal, and hydroelectric.
    - **Building:** Retrofit building and sustainable materials for construction.
    - **Transportation:** EV, low carbon fuel for aviation and shipping.
    - **New technology**: green hydrogen, carbon capture storage.

Example of Climate Risk & Opportunity

Physical Risk

Acute

- Inland flooding
- Heat wave
- Strom surges and inundation
- Intense rainfall

Chronic

- Heat and water stress
- Sea level rise
- Coastal erosion
- Higher temperature

Transition Risk

- Regulation and policy pressure
- Change in investor sentiment
- Shifting market preferences
- Cost of indirect emissions
- Financial Loss
- Reputational risk

Opportunity

- Adoption of low-emission energy sources
- Resource efficiencies and cost savings
- Access to new markets
- Building resilience along the supply chain
- Technologies for Net-zero Emissions

Source: 2022-TCFD-Status-Report.pdf (bbhub.io)

The “big three” Climate Disclosure Standards are Emerging

IFRS Sustainability Disclosure Standards

European Sustainability Reporting Standards

US SEC Climate Related Disclosure Rules

- Released the first two **IFRS set S1 and S2 in June 2023.**
- **IFRS S1** require an entity to disclose information about its **“sustainability-related risks and opportunities”** while the IFRS S2 focus on disclosure of material information about **“climate related risks and opportunities”.**
- The standards are **effective** beginning **on or after 1st January 2024,** but adoption on standard will depend on local jurisdictions.

As part of the CSRD, the first set of draft European Sustainability Reporting Standards (ESRSs) were released and **disclosures will be required as early as the 2024 reporting period.**

The twelve ESRSs require companies to provide information on:

- **Governance and strategy** to address material sustainability topics;
- **Impacts, risks and opportunities** arising from those topics; and
- **Quantitative metrics and targets**.

On March 21, 2022, the **SEC issued a proposed rule** that would enhance and standardize the climate-related disclosures provided by public companies and proposed climate rule **is currently pending.**

The proposal incorporates the concepts and many disclosures of the **TCFD framework.**

An effective date will **remain open until the SEC adopts the final rules.**

Source: ESG Reporting - KPMG Global

The global ESG Reporting Landscape is Transforming

April 2021
European Commission **adopts the CSRD proposal** requiring large companies to report on social and environmental impacts starting in 2024.

December 2021
The European Commission published the first delegated act on **sustainable activities for the first two environmental objectives of the EU Taxonomy.**

EU SUSTAINABLE FINANCE

April 2022
- European Union issued the **Corporate Sustainability Reporting Directive (CSRD) to support the European Green Deal.**
- European Financial Reporting Advisory Board issues exposure draft of the European Sustainability Reporting Standard (ESRS) for public commentary.

July 2023
Adoption of the Delegated Act on the first set of European Sustainability Reporting Standards (ESRS) by the European Commission.

European Commission

March 2021
Sustainable Finance Disclosure Regulations (SFDR) go into effect for asset managers and financial advisers operating in the EU.

October 2021
- **GRI standards updated**

November 2021
- IFRS Foundation announces the formation of its global reporting standardization initiative through the ISSB.
- UK Financial Conduct Authority releases Sustainability Disclosure Requirements discussion paper.

March 2022
US SEC announces climate disclosure proposal

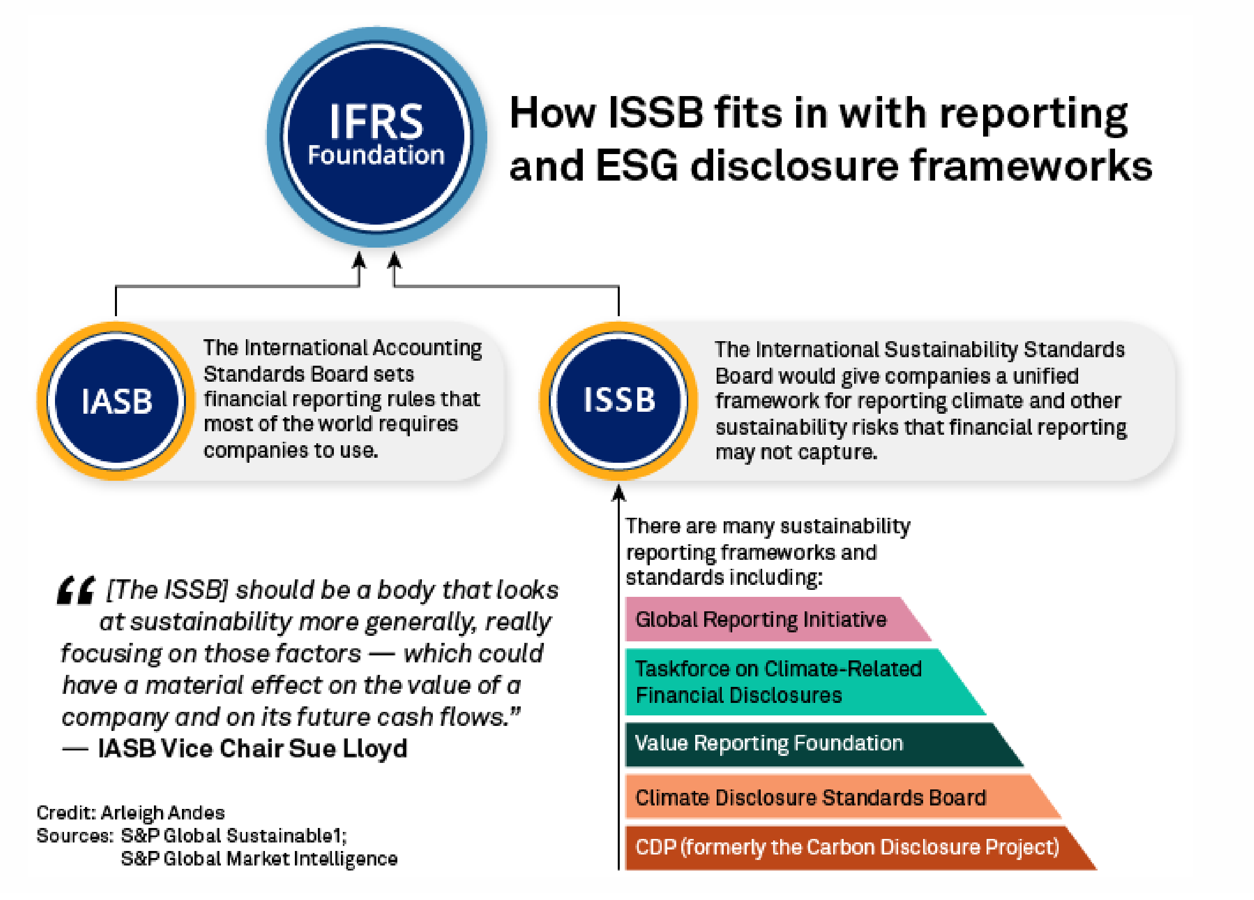
U.S. SECURITIES AND EXCHANGE COMMISSION

June 2023
International Sustainability Standards Board (ISSB) issued its **first two IFRS standards.**

IFRS ISSB

IFRS Foundation Introduction

> ***The IFRS Foundation** serves the public interest by developing globally **accepted reporting standards** that meet investors and other capital market participants' need for transparent and comparable information to make economic decisions.*



https://www.spglobal.com/esg/insights/new-global-sustainability-board-aims-to-cut-through-disclosure-confusion

IASB vs. ISSB?

- **The International Accounting Standards Board (IASB)** is responsible for IFRS **Accounting Standards.**
- IFRS newly announced **International Sustainability Standards Board (ISSB)** for **Sustainability Disclosure Standards.**

Why announced ISSB?

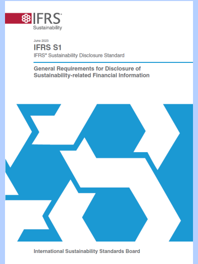
- Corporate and investor demand for **a unified ESG disclosure framework** is prompting the creation of an international sustainability board.
- The sheer number of sustainability reporting frameworks and standards has led to **confusion and inconsistent disclosure** in the market.
- Corporate interest in voluntary **sustainability reporting is growing** as individual countries explore mandatory disclosures.

ISSB - Reporting Contents

ISSB

ISSB develops **a comprehensive global baseline of sustainability disclosures**

General Requirements for Disclosure



- **General feature of reporting, including materiality**
- Four core content areas of reporting, including governance, strategy, risk management, metrics and target
- Practical guidance, including fair presentation of information

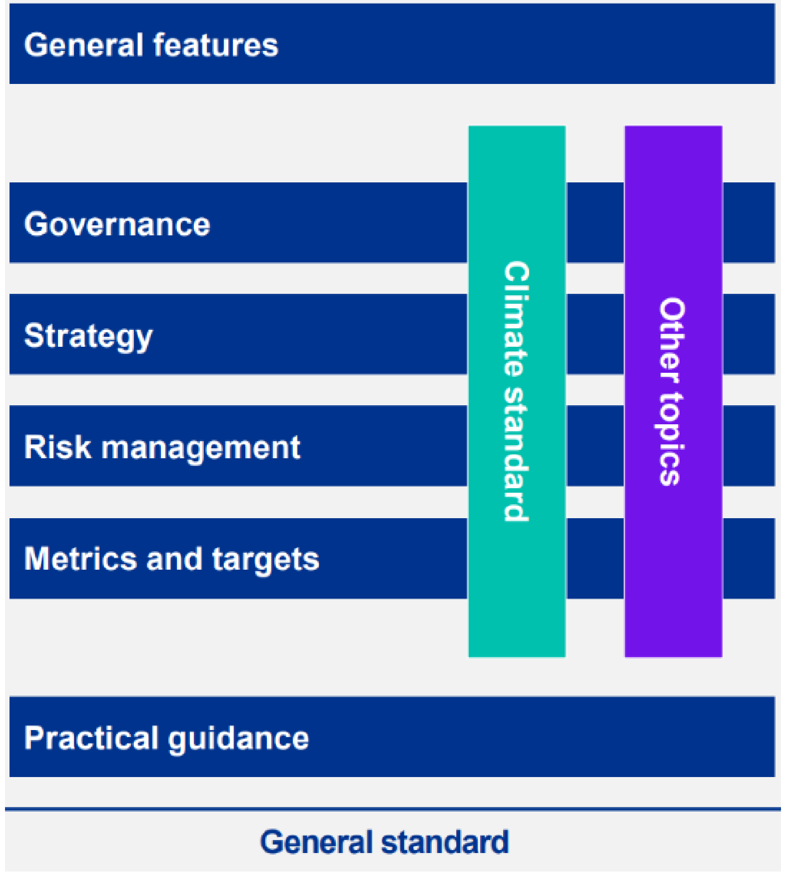
Climate-related disclosure

It builds on four contents area with additional guidance as below

- Disclosure of **risks, climate transition plan, and scenario analysis**
- **General and industry-specific metrics**

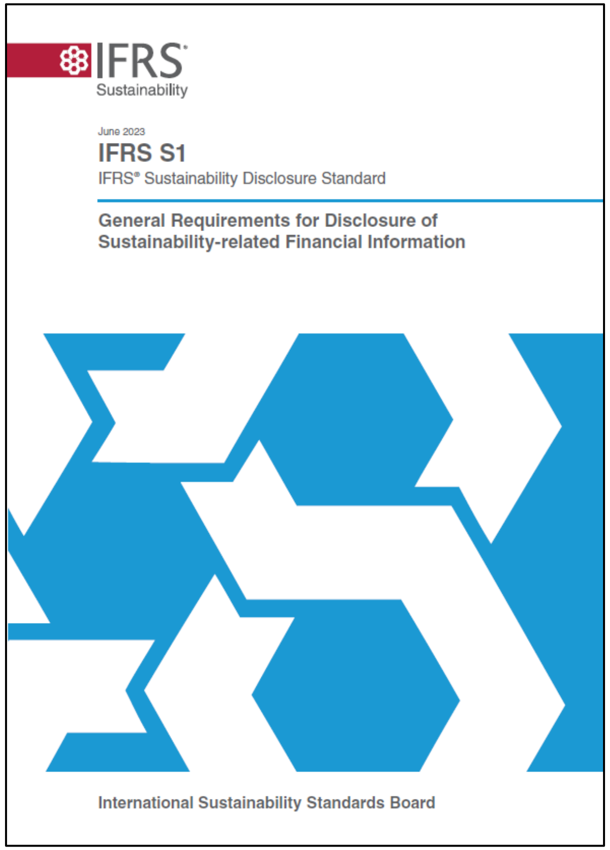
Future proposal (Other topics)

Additional standards for specific topics are expected to develop in the future, e.g. biodiversity, human rights etc.



Source: https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2023/05/issb-talkbook.pdf

IFRS S1 - General Requirements for Disclosure



The objective of IFRS S1 is to require an entity to disclose information about its "**sustainability-related risks and opportunities**" that is useful to users of general purpose financial reports in making decisions relating to providing resources to the entity.

IFRS S1 applies to:

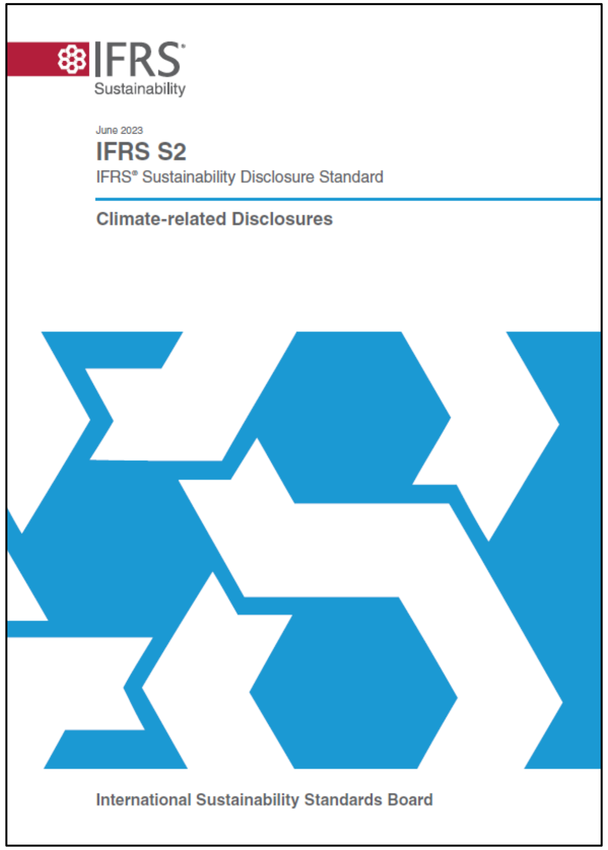
- IFRS S1 requires an entity to disclose information about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium or long term.
- IFRS S1 prescribes how an entity prepares and reports its sustainability-related financial disclosures including:
  - *Fair presentation*
  - *Practicalities of reporting (reporting period, consistency of data and information etc.*
  - *Source of guidance and effective date and transition*

IFRS S1 Core Content: Sustainability-related risks and opportunities

- **Governance** processes, controls and procedures the entity uses to monitor, manage and oversee *sustainability-related* risks and opportunities.
- **Strategy** for managing sustainability-related risks and opportunities.
- **Risk management** to identify, assess, prioritize and monitor *sustainability-related* risks and opportunities.
- **Metrics and Targets:** performance in relation to its *sustainability-related* risks and opportunities, including progress towards any climate-related targets.

Source:https://www.ifrs.org/content/dam/ifrs/publications/amendments/english/2023/issb-2023-c-basis-for-conclusions-on-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information-part-c.pdf?bypass=on

IFRS S2 – Climate-related Disclosures



The objective of IFRS S2 is to require the disclosure of material information **about "climate related risks and opportunities".**

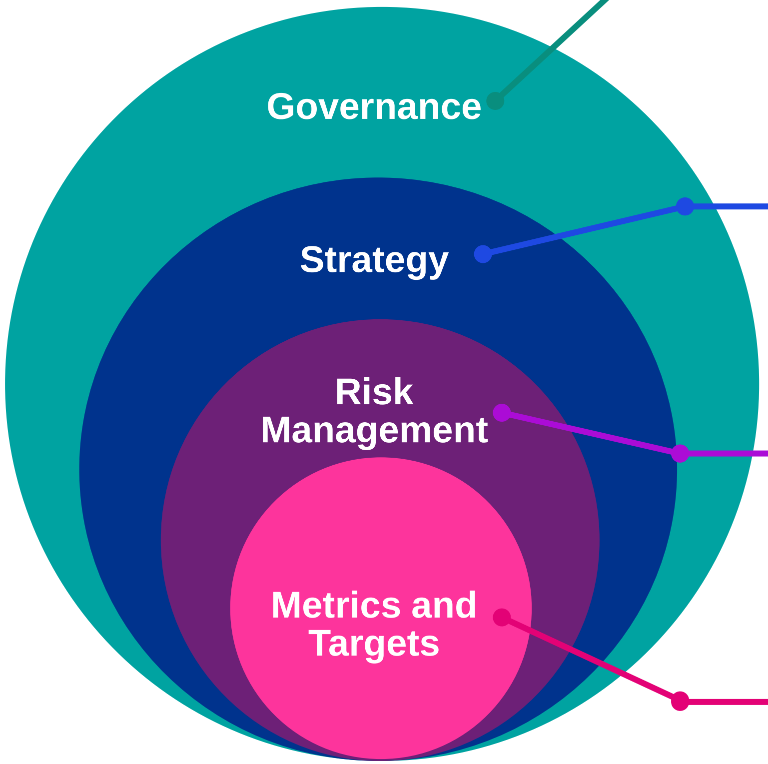
What information is required?

IFRS S2 applies to:	IFRS S2 Core Content: Climate-related risks and opportunities
IFRS S2 applies to: a.climate-related risks to which the entity is exposed, which are: a. climate-related physical risks; and b. climate-related transition risks; and b.climate-related opportunities available to the entity.	• **Governance** processes, controls and procedures the entity uses to monitor, manage and oversee *climate-related* risks and opportunities, • **Strategy** for managing *climate-related* risks and opportunities, • **Risk management** to identify, assess, priorities and monitor *climate-related* risks and opportunities, • **Metrics and Targets:** performance in relation to its *climate-related* risks and opportunities, including progress towards any climate-related targets.

Source: https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s2-climate-related-disclosures/

Contents requirement of IFRS S1 and S2 are structured around TCFD pillars

(Alignment with TCFD Pillars)



Organization's governance of climate-related risks and opportunities

Actual and potential impacts of risks/opportunities on business, strategy, and financial planning

Climate Related Disclosure

- Climate-related risks and opportunities (Physical risks and Transition risks)
- Transition plans
- Scenario analysis

Processes used for risk identification, assessment and management

Metrics and targets used to assess and manage risks and opportunities

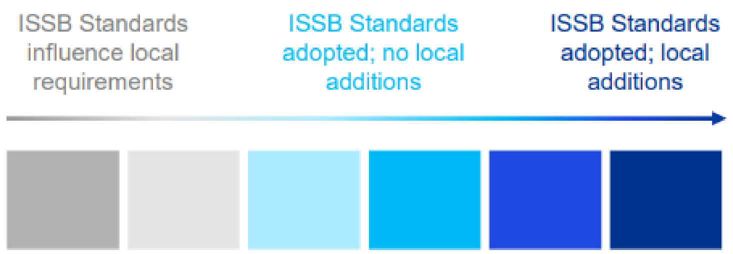
Climate Related Disclosure

- Cross-industry metric categories
- Industry-based requirements

How and When Could the Standards Affect You?

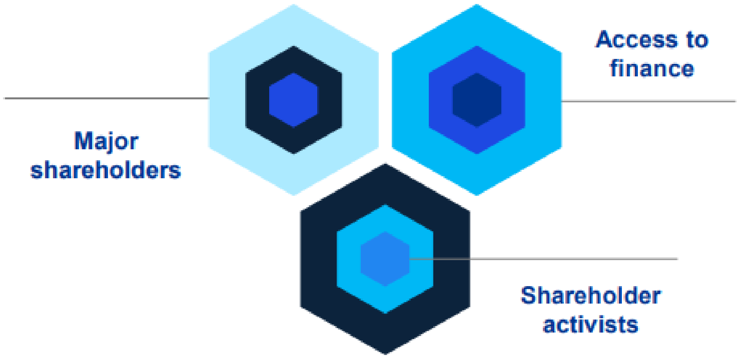
Mandatory Adoption

- The standards are effective for annual reporting periods beginning on or after **1 January 2024**. Early application is permitted.
- However, **adopting the standards is dependent on local jurisdictions**, so the first application date might be different for companies around the world.
- With strong support from **IOSCO**, a rapid route to adoption is expected in a number of jurisdictions.
- In some jurisdictions, the **standards will provide a baseline** either to influence or to be incorporated into local requirements. Other are likely to adopt the standards in their entirety.



Voluntary Adoption

- Companies may **choose to adopt the standards voluntarily.**
- Investors are increasingly willing to use their voting power to **drive transparency over sustainability-related matters**, including transition plans and their impact.
- Investors have generally supported. the adoption of **TCFD** and **SASB** standards in the past Therefore, they may be expecting to **adopt the standards quickly.**
- **The ISSB brings the same focus, comparability and rigor** to sustainability reporting as the IASB has done for financial reporting.



Source: Get ready for ISSB sustainability disclosures - June 2023 (kpmg.com)

What to Do Now ?

1. Understand the impact

- Research and understand current and emerging requirement.
- Understand when, where and how this will impact your company.

2. Determine what is material

- Determine which topics are relevant to report on.
- Decide what information is material about those topics.

3. Assess maturity

- Assess the maturity of processes, the control environment, data model and policies.
- Understand the current distribution of role and available knowledge and capacity.

4. Transform reporting

- Design the future stage of your reporting.
- Deploy your target operating model, including training as well as support for change management.

5. Get ready for assurance

- Assess the control environment, data quality and availability of sufficient documentation to support assurance.
- Rectify issues ahead of the formal assurance process.

Source: https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2023/05/issb-talkbook.pdf

IFRS ISSB Adoption across the Globe

Several major countries, including Australia, Canada, Hong Kong, Japan, Malaysia, New Zealand, Nigeria, Singapore and the UK, have shown interest in adopting the ISSB standards. Notably absent from this list are EU member states. As part of the EU's green new deal, the bloc has developed and is adopting European Sustainability Reporting Standards, or ESRS.

Brazil

The Brazilian Ministry of Finance and the Comissão de Valores Mobiliários (CVM) have announced that the ISSB's IFRS Sustainability Disclosure Standards will be incorporated into the Brazilian regulatory framework, setting out a roadmap to move from **voluntary use starting in 2024 to mandatory use on 1 January 2026.**

Communication

SASB

SASB STANDARDS
Now part of IFRS Foundation

SASB standards enable organizations to **sustainability disclosures** about **risks and opportunities** that affect enterprise value.

Focus/ Objective:

- Industry-based standards, **77 different industry-specific** SASB Standards for disclosure topics and performance metrics
- **Five dimensions** of sustainability: Environment, Social Capital, Human Capital, Business Model and Innovation, and Leadership and Governance.

CDP

CDP is a not-for-profit charity that runs the global **disclosure system for investors, companies, cities, states and regions** to manage their environmental impacts by measuring and acting on their environmental impact.

Focus/ Objective

- CDP aims to incentivize and guide these key users on a journey through **disclosure towards becoming a leader on environmental transparency and action** across three categories:

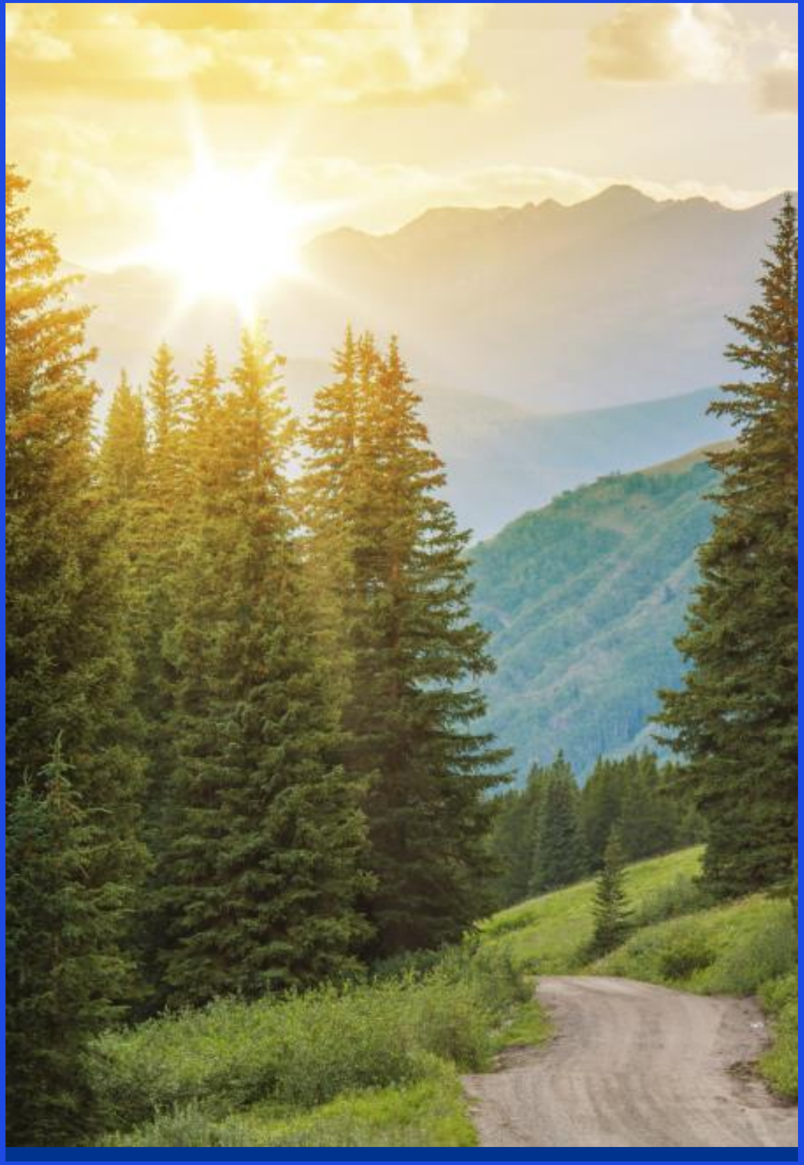
Climate change

Forests

Water security

Source: https://www.cdp.net/en/states-and-regions#5dbfad9259fe9f905dd91b1b9b5486db
Source: https://www.sasb.org/standards/

05
Integrating Sustainability into Internal Audit



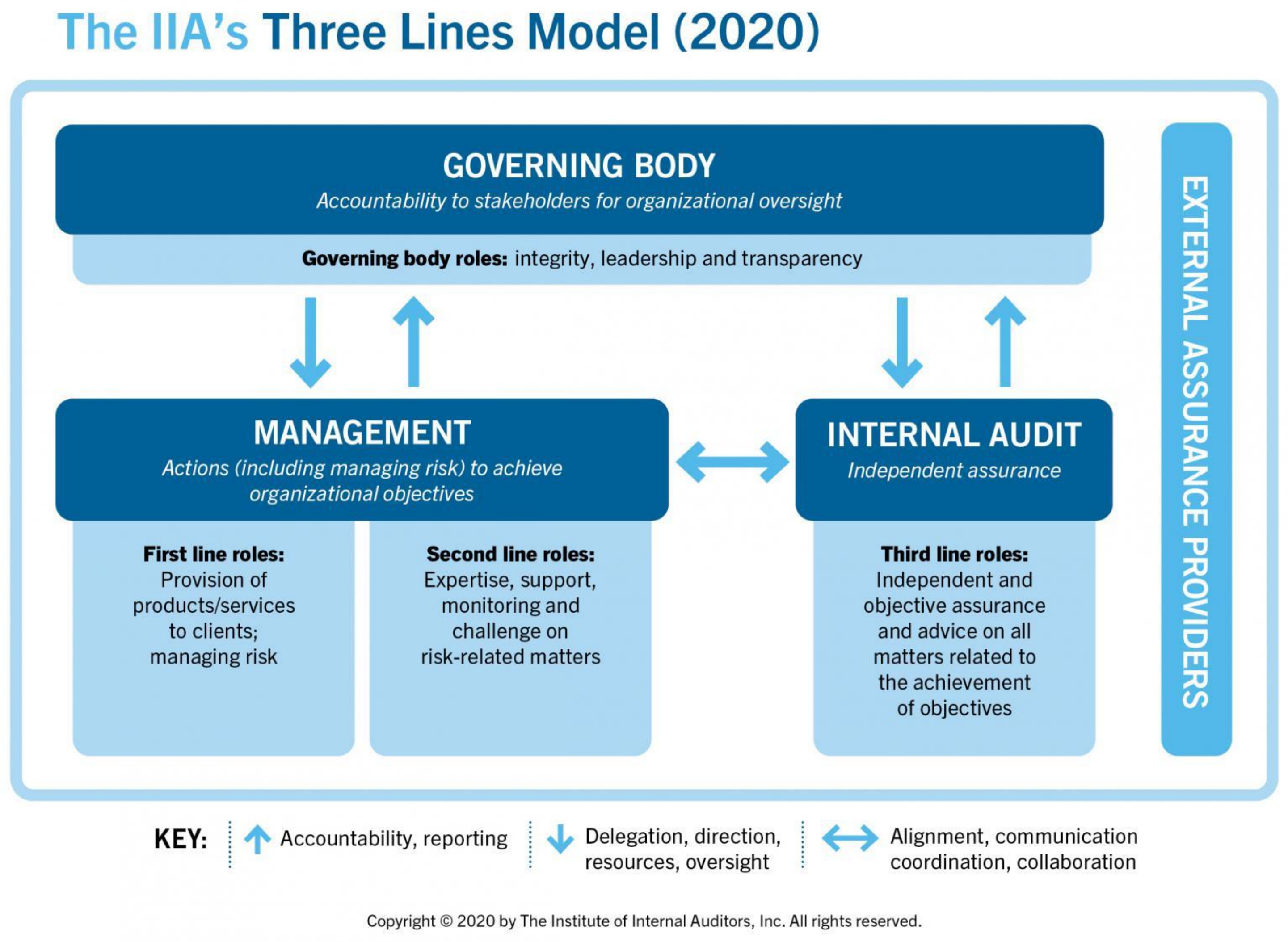
Why Embed Sustainability Considerations in the Three Lines Model?

In a volatile and uncertain environment, efficient governance structures and procedures are needed to fulfill goals, including important sustainability issues.

It is critical that material sustainability issues are embedded into business decision-making processes and that governance mechanisms are in place to ensure effective oversight of risk management and controls

– WBCSD COO Rodney Irwin
– President and CEO, The IIA Anthony Pugliese

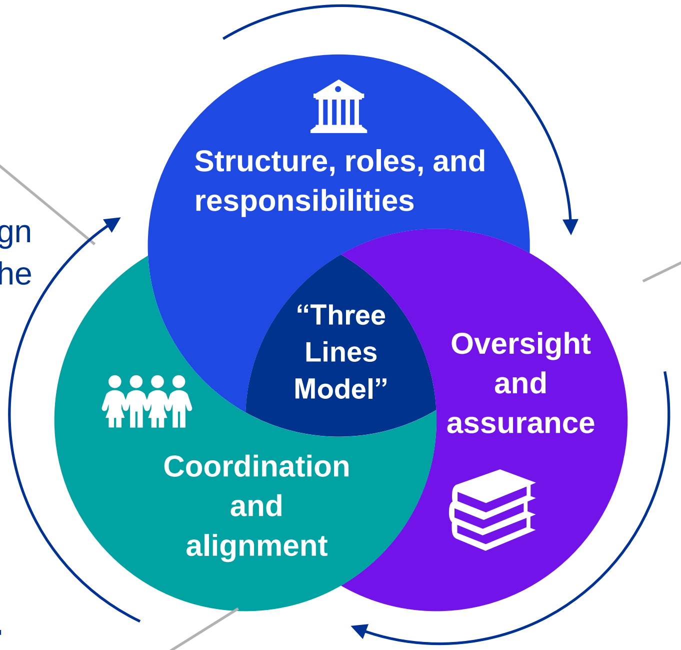
Source: https://www.theiia.org/en/content/tools/advocacy/2022/embedding-esg-and-sustainability-considerations-into-the-three-lines-model/



> The IIA's Three Lines Model is a global resource for successful governance. It helps organizations identify structures and methods to best manage risks and achieve objectives, including ESG-related risks.

Source: https://www.wbcsd.org/Projects/Embedding-ESG-into-decision-making/Resources/Embedding-ESG-and-sustainability-considerations-into-the-Three-Lines-Model

Applying the model



Governing body

Structure, roles, and responsibilities

- The most effective when it is adapted to align with the objectives and circumstances of the organization.
- How an organization is structured and how roles are assigned are matters for management and the governing body to determine.

Internal audit

Oversight and assurance

- The governing body depends on reports from management, internal audit, and others to monitor and achieve its objectives.
- Management provides valuable assurance on planned, actual, and forecast outcomes, on risk.
- Assurance may also be drawn from external providers.

Management

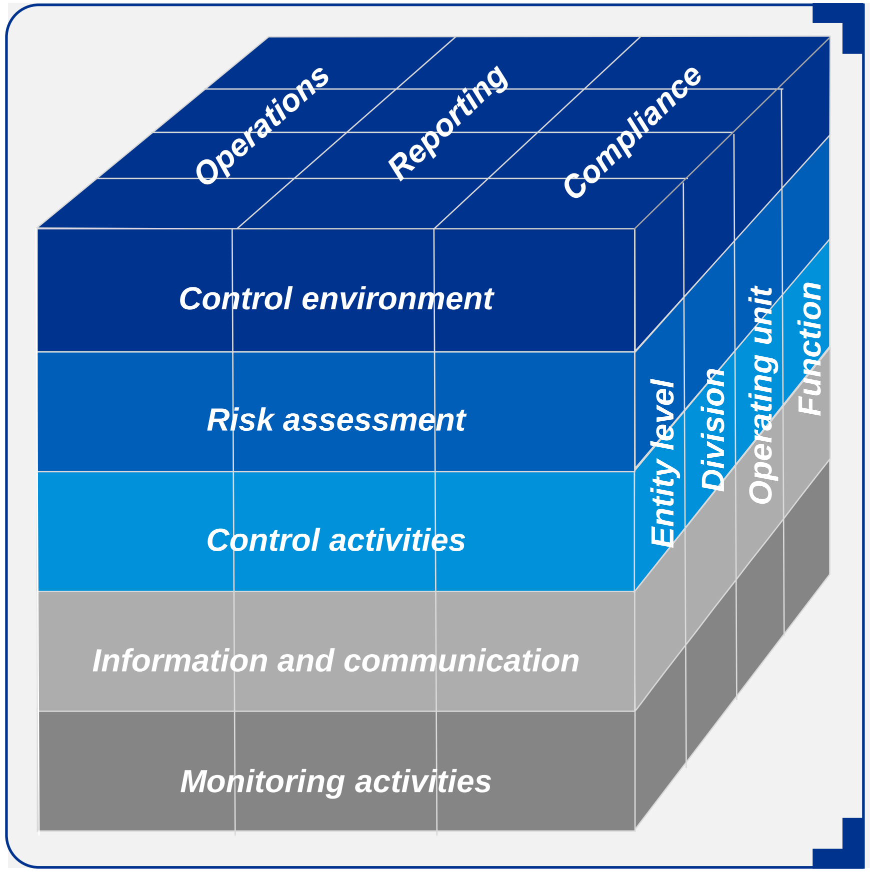
Coordination and alignment

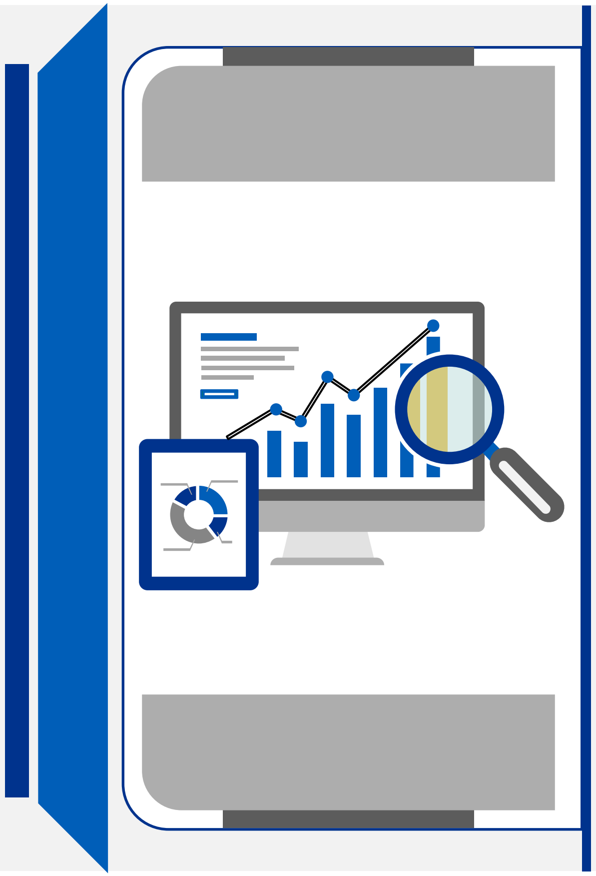
- Strong alignment of activities via cooperation, collaboration, and communication is essential for effective governance.
- Through **internal auditing**, the governing body ensures that governance structures and procedures are suitably structured.

Source: https://www.theiia.org/globalassets/site/about-us/advocacy/three-lines-model-updated.pdf

Internal Control Considerations

COSO model





Internal audit functions that operate in conformance with the IIA's globally recognized standards are well-positioned to help their organizations apply established, credible internal control frameworks to their ESG efforts.

Source: The Institute of Internal Auditors ("IIA") in its White Paper published in 2021 'Internal Audit's Role in ESG Reporting

Source: https://deliverybackbone.kpmg.com/collaboration/display/MTLDir/ICOFR+Trends+and+Hot+Topics?preview=%2F775338393%2F775338396%2FIAER+ESG+Talkbook.pptx

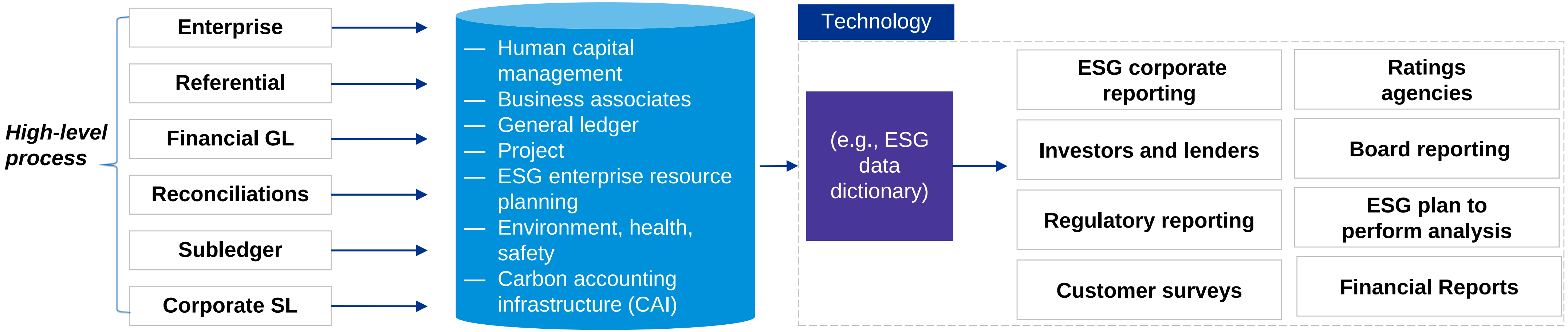
Internal Control Considerations

- Completeness and accuracy of data
- Policies and definitions of measurement
- Homogeneity across process and definition
- Governance structure
- IT general controls
- IT access controls
- Data lineage
- Review and approval
- Support for assumptions and estimates

Source: https://deliverybackbone.kpmg.com/collaboration/display/MTLDir/ICOFR+Trends+and+Hot+Topics?preview=%2F775338393%2F775338396%2FIAER+ESG+Talkbook.pptx

Potential considerations to reporting production process

Introduction of nonfinancial reporting into the financial reporting processes can bring a number of challenges.



ESG reporting integration considerations

Data
- New, nontraditional data sources (i.e., HR)
- Data owners not familiar with reporting requirements
- External data onboarding and quality challenges

Aggregation
- Aggregation
- Financial and nonfinancial
- Need to develop new, or expand existing, governance and ownership
- Multiple submission sources with potential duplication

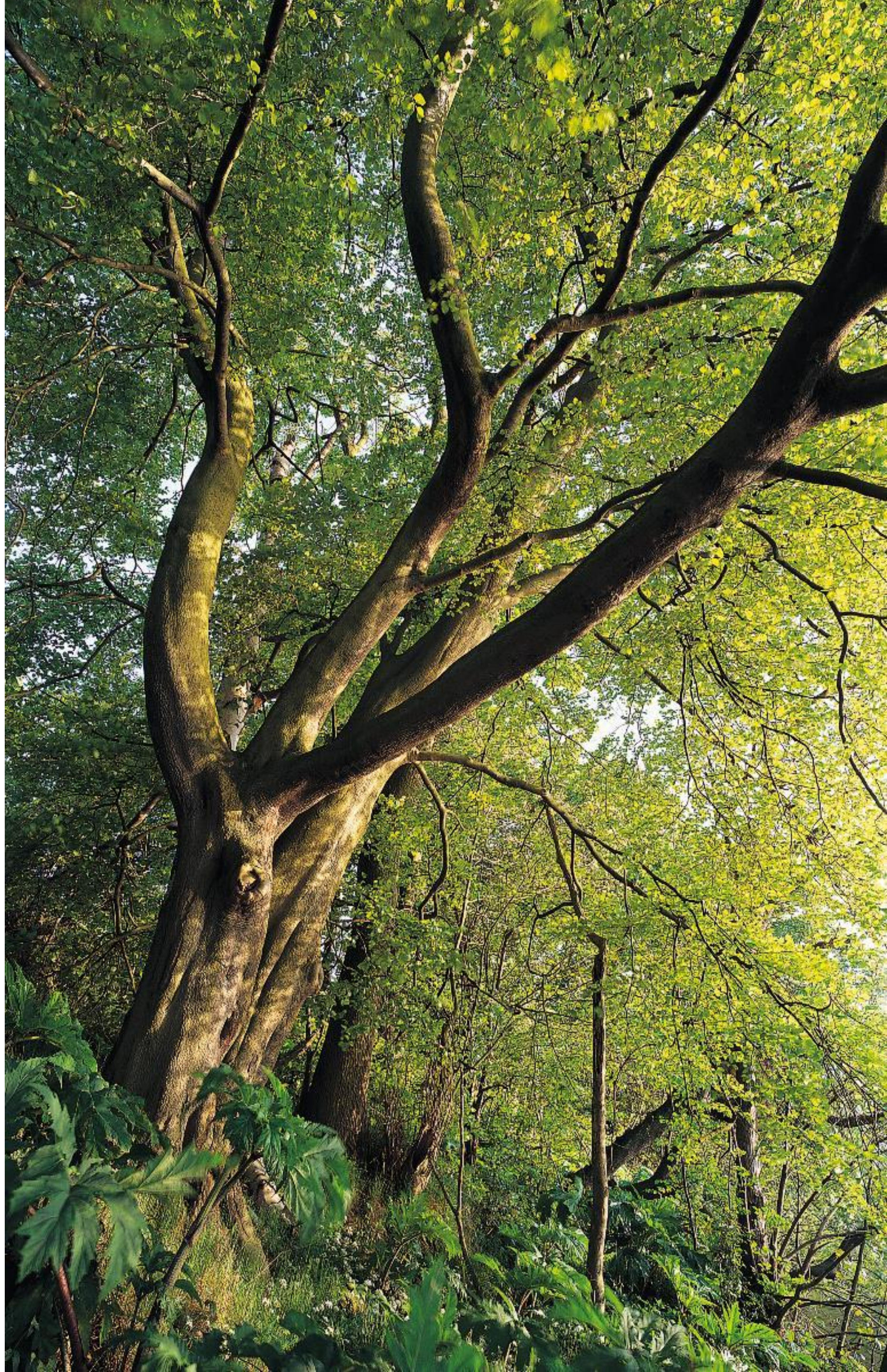
Report production
- Varying frequency across “E,” “S,” and “G”
- Varying consumers with different literacy levels
- Significantly different reporting templates

Control framework
- Certification and attestation may be required eventually
- Complicated case management process
- Development and onboarding of new controls with testing

Source: https://deliverybackbone.kpmg.com/collaboration/display/MTLDir/ICOFR+Trends+and+Hot+Topics?preview=%2F775338393%2F775338396%2FIAER+ESG+Talkbook.pptx

KPMG's Sustainability Audit Methodology

A company's internal audit activity should also go beyond simply identifying risks to include identifying root causes, potential risk management strategies and preventive controls, as well as ensuring that governance, risk management and internal controls are operating effectively throughout the organization. In order to so, they can rely on **KPMG's Sustainability Audit Methodology.**



KPMG

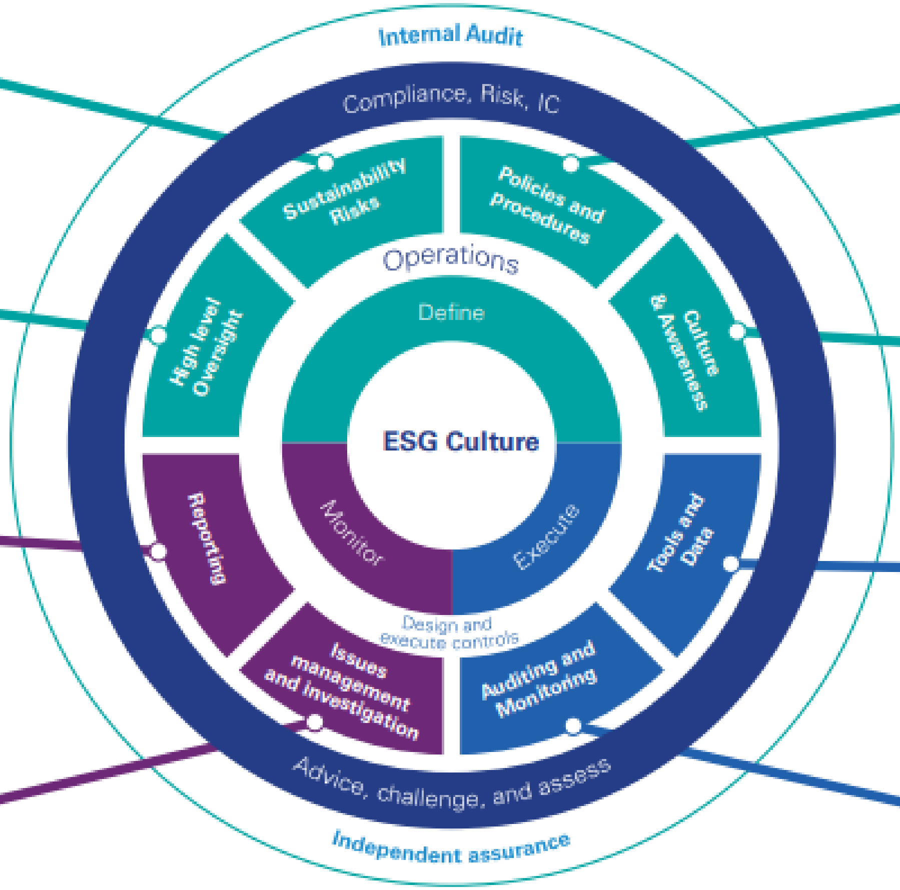
KPMG's Sustainability Audit Methodology

- Risk (& opportunity) assessment
- Regulatory requirements
- New product review
- Third party due diligence

- Definition of ESG
- Mission, vision, values & strategy
- Periodic review by top management
- Context & stakeholder analysis
- Time, resources & budget

- Periodic reporting to management & the board
- Mandatory regulatory reporting
- External reporting to stakeholders
- Recordkeeping

- Issues/complaints management & remediation
- Responding to government investigations/exams/inspections
- Response plan & process for investigating alleged non-compliance
- Continuous improvement



- Entity-wide policies & procedures on human rights, health & safety, etc.
- Existence of relevant processes (e.g. investment process, credits,etc.)
- Consistency between policy framework
- Policy management

- Engage & create dialogue with all stakeholders
- Culture/tone of sustainability & behavioral change
- Regular and frequent training & communication

- Technology to support sustainability program (testing, training records, etc.)
- Predictive measures: key risk indicators and key performance indicators
- Root cause analysis & trending

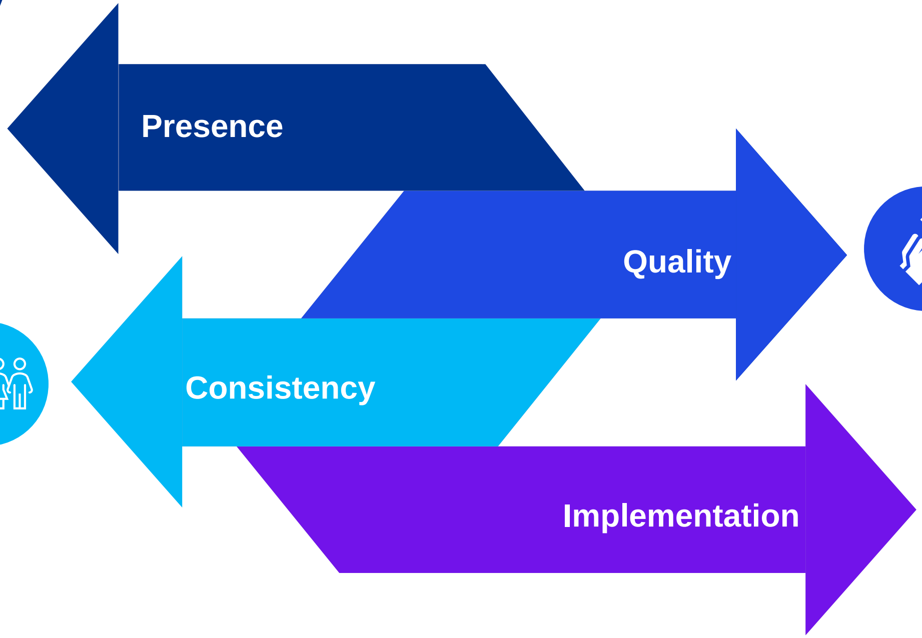
- Tracking of regulatory change
- Transactional, process & control testing
- Third party and employee compliance due diligence & management (licensing)
- Periodic SR program evaluation
- Involvement of 2nd & 3rd line

Governance	Human rights	Labor practices	Environment	Operating practices	Customer issues	Community

KPMG's Sustainability Audit Methodology

In order to facilitate an assessment of the organization's maturity, the elements of the sustainability audit methodology are evaluated based on the criteria as following:

The presence are appropriately aggregated, clearly described and understandable in the context of the requirements of the applicable framework.



The level of quality is meet expectation.

Consistency in comparison with other measures

The degree of implementation throughout the organization.

Position of Internal Auditor

Management teams across organizations are recognizing the opportunities and risks ESG presents. This includes the due-diligence required to integrate ESG measures across any organisation. To make informed decisions, directors must have reliable assurance on the effectiveness of ESG management, including ESG governance, risk assessment, KPI monitoring and reporting. That assurance should come from internal audit.

Assurance

REVIEW REPORTING METRICS FOR RELEVANCY, ACCURACY, TIMELINESS, AND CONSISTENCY

REVIEW REPORTING FOR CONSISTENCY WITH FORMAL FINANCIAL DISCLOSURE FILINGS.

CONDUCT MATERIALITY OR RISK ASSESSMENTS ON ESG REPORTING

Understanding on how ongoing ESG efforts or public commitments to reaching ESG goals can rise to the level of materiality.

INCORPORATE ESG INTO AUDIT PLANS.

Advisory

BUILD AN ESG CONTROL ENVIRONMENT

Advise on developing specific internal controls for ESG reporting

RECOMMEND REPORTING METRICS

Provide insights into the kind of data that accurately reflects relevant ESG efforts within the organisation.

ADVISE ON ESG GOVERNANCE

Provide guidance on ESG governance because of its holistic understanding of risk across the organisation.

Source: https://global.theiia.org/about/about-internal- auditing/Public%20Documents/White-Paper-Internal-Audits-Role-in-ESG-Reporting.pdf

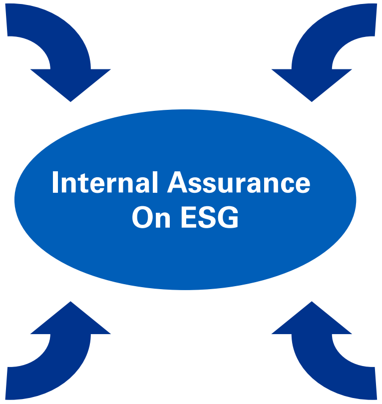
Why Internal assurance in ESG is so Important

Accelerating ESG compliance

- To ensure with the ESG compliance with regulator such as BOT, SEC
- Validation is required on climate disclosures and in a number of other country disclosures
- Assurance will become best practice as ESG progress and reporting evolves
- There are other areas of ESG not yet covered by the SEC; this could easily change

Board and Executive leadership confidence

- Boards and Executive leadership are going to be asked about their strategy and goals involving ESG and progress towards those goals
- Assurance will be needed in order to give boards and management the confidence to speak to company progress with some degree of evidence supporting what is said



Reliance by Stakeholders

- Stakeholders and analysts will continue to rely on SD report to compare companies on ESG areas outside of mandatory disclosures
- If stakeholders rely on that information, companies will need to put some diligence into validating what they put out publicly or face consequences
- Stakeholders will include investors, regulators, customers, vendors, lenders, etc

Gaps in other compliance areas

- ESG disclosures cover much more than just climate change and GHG
- These additional areas may already be subject to compliance and disclosure rules in the region or locality of the entity

Source: KPMG ESG In Internal Audit 2022

High Level Questions to IA

- Is the Board equipped and presented with the right information to adequately evaluate and oversee the ESG aspects of the company's strategy?
- Has the company identified and assessed all ESG-related risks and issues that are material to the business?
- Are there clear ownership and accountability assigned within the company to oversee material ESG issues?
- Are ESG drivers incorporated into the company's performance evaluation and management?
- Is the company's reporting transparent to clearly articulate the influence of ESG issues on strategy?

Our Approach to Audit Planning

Step 1: Strategic Analysis	Step 2: Enterprise Risk Assessment	Step 3: Internal Audit Plan Development	Step 4: Internal Audit Execution	Step 5: Reporting
• Understand and gather information relevant to the Company's sustainability process and strategies • Gain an understanding of the entity and its control environment of sustainability process by conducting interviews with key management and other relevant personnel;	• Identify and assess the strategic or significant risks to the Company sustainability's process/objectives and reliability of data collection	• The risk rating from the Enterprise Risk Assessment will be used in the creation of a risk-based internal audit plan for the organization. The timing of the processes to be audited will be sequenced according to the risk rating i.e. high risk processes will be audited before lower risk processes.	• Perform the business process review, creation of the audit program, and execution of internal audit work using ESG framework for IA. Execution also includes validation and testing of controls and documentation of issues.	• The deficiencies, weaknesses and/or non-compliance of controls from the completion of the strategic, process, and internal audit execution phase of the audit work will be reported to management.

Auditing ESG Risks

It is essential that Internal Auditing identifies the specific risks of each ESG pillar and establishes a specific approach towards work. When assessing ESG-risks, organizations should think beyond the 'traditional' reputational risks. Issues and malpractices related to ESG can pose environmental, compliance, financial and reputation risks that can severely damage the company.

01

AUDITING ENVIRONMENTAL RISKS

Many organizations must include the risks associated with the transition to a sustainable economy and the measures taken to deal with these risks.

Examples include :

- Climate risks.
- Environmental risks.
- Environmental management.

02

AUDITING SOCIAL RISKS

Social risks are driven by numerous factors, including care for and contribution to society and the promotions of positive impacts in stakeholder communities.

Examples include :

- Diversity and equality.
- Providing value to society.
- Innovation.
- Human resources management.
- Health, safety and wellbeing of employees.
- Training

03

AUDITING GOVERNANCE RISKS

Governance in this sense includes those aspects related to the organization's internal structures, policies, decision making processes and how these factors reverberate with stakeholders.

Examples include :

- Governance structure and responsibilities
- Stakeholder expectations.
- Strategy, Risk Management and Investment.
- Internal regulatory framework and Information systems.

Source: https://home.kpmg/be/en/home/insights/2021/04/rc-have-you-considered-auditing-your-organization-sustainability.html

Example 1: Embedding ESG in the Internal Audit

Internal Audit of Procurement :

Standard scope control objectives:

1. All suppliers are pre-approved
2. Key contracts are tendered by min of 3 suppliers
3. A Procurement Committee approves all long term contracts
4. All goods are receipted prior to payment
5. Supplier performance is monitored with KPIs

Extend scope to assess the ESG control objectives:

1. Supplier terms and conditions are agreed to ensure compliance with the relevant regulations (i.e. child labour, anti-human trafficking, forced labour)
2. The procurement policy is aligned with our net carbon zero objectives.
3. Supplier terms incorporate KPIs to enable the business to measure, minimise and report freight miles on supplies.
4. All supplies are delivered in recycled packaging

Example 2: ESG Focused IA Review

Internal Audit of ESG Reporting Framework :

01

- ESG reporting framework has been developed to meet the requirements of all internal and external stakeholders
- ESG Reporting Framework was approved by the Board.

02

The framework and objectives were communicated to all staff

03

The framework includes metrics which are aligned with corporate strategic objectives to manage ESG ; net zero, waste (kg) and freight (miles), modern slavery, living wage standards and health and safety standards.

04

- The metrics are reporting on a regular basis to senior management.
- Remedial action has been taken when adverse metrics are identified.

05

Data collected to measure the metrics is complete and accurate.

Examples of Audit Approach of Environmental Risks

Environmental management

Subject Matter	Risks	Audit Approach
• Distinguishing between greenhouse gases and pollution emissions	• Absence of a long-term strategy aligned with the company business	• Verify the existence of an approved strategy communicated to senior management
	• Absence of a specific deployment plan that is integrated in the activity.	• Verify that the strategy is included in the road map, action plans and objectives set are specific and measurable. • Confirm that there are intermediate targets that enable any deviations to be detected.

Source: https://auditoresinternos.es/uploads/media_items/220221-internal-audit-and-esg-criteria-la-f%C3%A1brica-de-pensamiento.original.pdf

Examples of Audit Approach of Social Risks

Subject Matter	Risks	Audit Approach
• **Diversity and equality**	• Discrimination leads to reputational damage and talent drain.	• Assure that an approved code of ethics that covers diversity issues is published • Evidence the approval and publication of policies promoting work life balance. • Assure the existence of due diligence process for Human Rights.
	• Weak vendor due diligence program or processes can lead to indirect criminal liability for organizations.	• Review onboarding process for new vendors or suppliers that include acceptance of ethics code covering social and environmental risks. • Review evidence for ethics training given to vendors.
	• Weak vendor due diligence program or processes can lead to indirect criminal liability for organizations.	• Verified the compliance of the strategic plan and goals in the longer term related to ESG matters and associated indicators.

Source: https://auditoresinternos.es/uploads/media_items/220221-internal-audit-and-esg-criteria-la-f%C3%A1brica-de-pensamiento.original.pdf

Examples of Audit Approach of Governance Risks

Subject Matter	Risks	Audit Approach
• **Strategy, Risk Management and Investment**	• ESG strategy and goals are not defined.	• Verify that specific and strategic ESG goals have been set and published, including Key Performance Indicators (KPIs). • Review design and effectiveness of KPIs.
	• ESG strategy is not aligned to global or other strategy	• Verify that ESG strategy is consistent with other strategies.
	• ESG risks are not considered when establishing the company's strategy.	• Verify assessment of new trends in sustainability to identify risks.
	• ESG strategy is not fluidly communicated.	• Verify disclosure of ESG strategy to stakeholders.

Source: https://auditoresinternos.es/uploads/media_items/220221-internal-audit-and-esg-criteria-la-f%C3%A1brica-de-pensamiento.original.pdf

Key Performance Indicators for ESG Internal Audit

Focusing on the added value generated by internal audit activity for both internal and external stakeholders. Each of stakeholder groups have different requirements and interests in terms of the performance and perceived value of internal audit and may therefore require different KPIs. The examples performance indicators of interest to each stakeholder group are following ;

External stakeholder's view.

- Indicators of the independence of ESG internal audit.
- Percentage of ESG high-risk audit covered each year.
- Results of internal quality assessments.
- Number of repeat findings.

Internal Stakeholder's views :

- Materiality of audit findings to helps management understand the ESG issues.
- Changes to processes resulting from implementing ESG internal audit recommendations.
- Cost savings generated by implementing internal audit recommendations.
- Percentage of ESG audits completed versus those planned and budget.

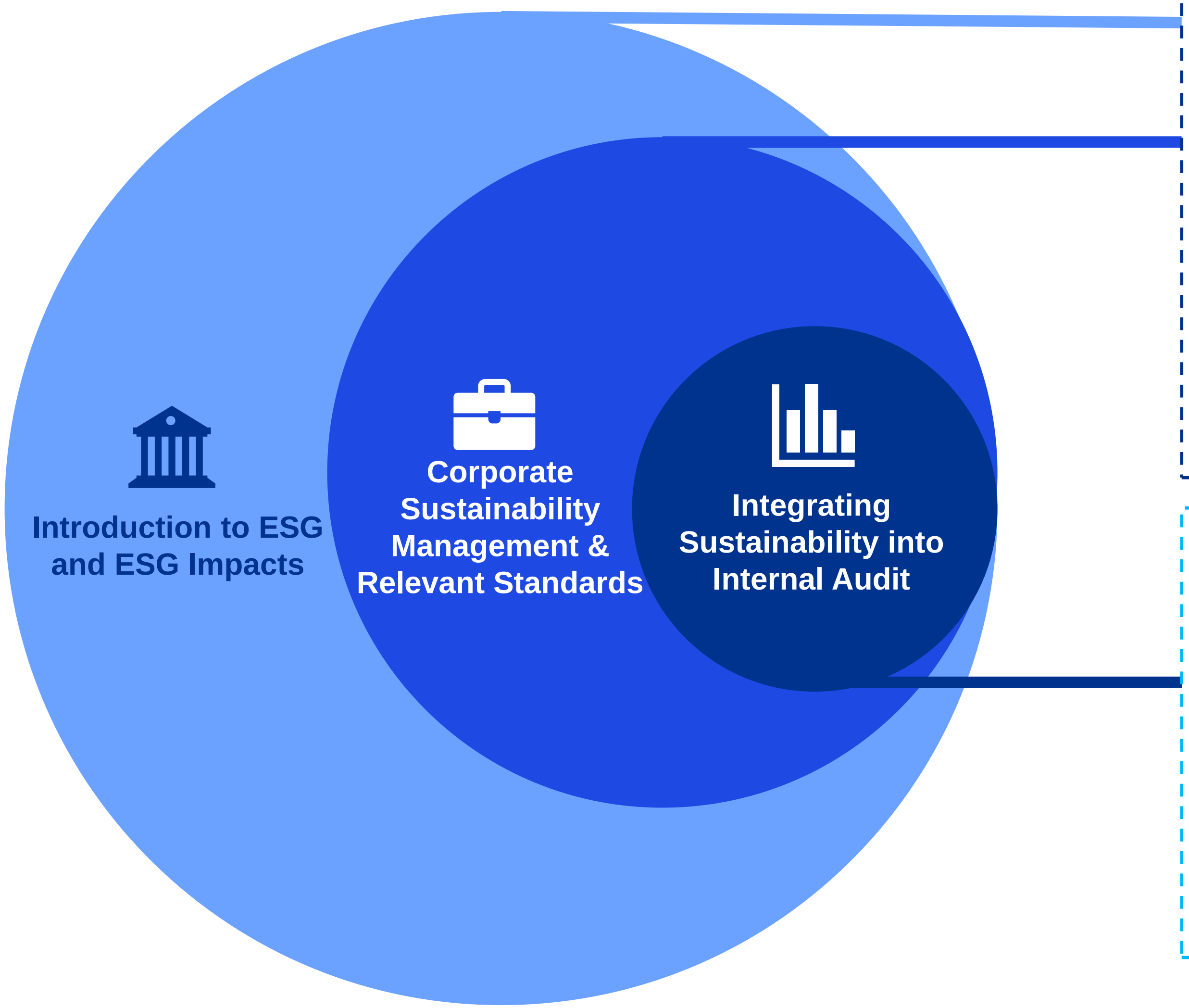
Source: https://auditoresinternos.es/uploads/media_items/220221-internal-audit-and-esg-criteria-la-f%C3%A1brica-de-pensamiento.original.pdf

Summary

As the third line within organisations, the Internal Auditor is well-positioned to support companies in their ESG efforts in providing objective insights, assurance and advice and can **play an integral part to their ESG response**

The Internal Auditor should view ESG holistically, assessing the feasibility and credibility of the company's strategy and objectives, screening its due diligence procedures, evaluating the quality of the ESG policies and procedures, and in particular, verifying whether the ESG culture of the organization is sufficient. Internal audit should examine these aspects at both an operational and strategic level, across different departments.

Key Takeaway



- **Understand sustainability and ESG** in big picture and way to implement in organizations
- **Comprehend the sustainability management** throughout the process
- **Facilitate ESG risks and megatrends** in the fast-changing landscape
- **Enable to embrace sustainability management standards** into particular process in the future

- **Three Lines Model through ESG lens**
  - Governing body
  - Management (1st and 2nd line)
  - Internal audit (3rd line)
- **Positions and roles of internal audit** (Assurance and Advisory)
- **ESG internal audit methodology and approach**

Q&A

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