Preparing ESG programs for investigation and litigation risk

EY Forensic & Integrity Services

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Environmental, social and governance (ESG) issues are driving companies to refocus their legal and compliance resources. Amid advancing global regulations, activist litigation and product scrutiny, it is imperative that ESG programs evolve to withstand regulatory examination and legal threats.

Increasing pressure on ESG disclosures

Given the complexity of frameworks and regulatory uncertainty, many companies are in the developmental stages of fortifying their ESG structures and legal functions. Regulators are driving clarity to this topic. The SEC's proposal to enhance and standardize required climate-related disclosures[1] is in line with EU regulations and the global standards of the Task Force on Climate-related Financial Disclosures,[2] providing further guidance on disclosure requirements.

The U.S. Department of Justice launched the Office of Environmental Justice to help implement a comprehensive environmental justice enforcement strategy.[3] As a result, companies may face scrutiny on disclosures, heightened analysis between peer companies and more cross-border enforcement. As companies adapt, they should weigh public-facing statements against reputational risks that may be tantamount to "greenwashing" or other negative interpretation, regardless of a statement's intent. It is therefore imperative that companies answer the question: Can I back up my statements on ESG disclosure?

In addition to regulator concerns, companies face whistle-blower and shareholder lawsuits relating to misstatements, omissions, inaccurate financial statements and external litigation arising from an array of ESG claims.

Rising risk areas for ESG disclosures

As companies align business models with ESG goals, risks arise at each stage of the reporting process. Setting unrealistic performance targets or overstating ESG commitments and investments are common pitfalls. Additionally, if ESG initiatives are siloed throughout the organization with insufficient communication across departments, it invites unreliable data and inaccurate reporting of financial and nonfinancial data. Particular risk areas arise depending on the individual needs of businesses (e.g., understanding forced labor issues by region throughout a global supply chain). Governance over ESG programs is key to reduce risk.

Are you ready?

1. Have you set realistic goals and aligned your compliance program to those goals?
2. Have you incorporated ESG into your risk assessments, including considering risk areas such as the ability to support public statements on ESG commitments?
3. Do you have a strong understanding of the procedures and controls in place to collect, cleanse, analyze, validate and substantiate data for ESG reporting purposes?

Key takeaway

ESG goals should align with the organizational structure; verifying board oversight and leadership is pivotal to a resilient ESG framework. Incorporating this ESG framework into the existing enterprise risk assessment is critical for identifying the organization's risk landscape, including regulatory and litigation exposure. Organizational leadership should be aware that they may face increased regulatory scrutiny, so setting the right data targets, standardizing data collection and substantiating data are challenges that they will face as peers and competitors make advancements toward setting industry thresholds.

1. "SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors," *SEC website*, sec.gov, March 21, 2022.
2. https://www.fsb-tcfd.org/.
3. "Justice Department Launches Comprehensive Environmental Justice Strategy," *U.S. Department of Justice website*, justice.gov, May 5, 2022.

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