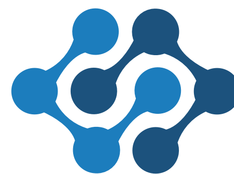
BUILDING A SUSTAINABLE ENTERPRISE – AN EXECUTIVE VIEW TO LEADING FOR THE FUTURE



DECISION INC.

When it comes to ESG (Environmental, Social, and Governance) reporting, understanding the basics is crucial. However, the interpretations of 'sustainability' and ESG can vary among different individuals. Despite their prevalence among investors, companies, regulatory bodies, and scholars, there is no universally agreed-upon definition for these concepts.

Many corporations and regulatory bodies tend to use 'sustainability' and 'ESG' interchangeably.

For instance, the London Stock Exchange's Guide to ESG Reporting acknowledges that companies often use terms like 'sustainability' or 'corporate responsibility' to refer to ESG-related strategies or initiatives.

However, sustainability goes beyond ESG and encompasses a holistic approach to addressing long-term environmental, social, and economic challenges for the betterment of society and the planet.

I. What is ESG?

ESG is a framework within the business and investment context that evaluates and measures a company's sustainability and ethical impact based on environmental, social, and governance criteria.

ESG assesses a company's performance and impact in areas beyond just financial metrics.

This encompasses a wide range of factors that investors, stakeholders, and the public consider when evaluating a company's sustainability and ethical practices. These factors are categorised into three main pillars:

1. **Environmental:**

This includes a company's impact on the environment, such as its carbon footprint, water usage, waste management, and efforts to mitigate climate change.

2. **Social:**

Social factors encompass a company's relationships with its employees, customers, suppliers, and the communities in which it operates. It involves issues like diversity and inclusion, labour practices, community engagement, and human rights.

3. **Governance:**

Governance focuses on a company's internal processes and structures. It includes issues like board diversity, executive compensation, ethics, transparency, and compliance with legal and regulatory requirements.

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II. The ESG Opportunity

Embracing the growing significance of ESG factors offers businesses a remarkable opportunity. In this evolving landscape, organisations can harness ESG considerations not just for societal and environmental improvement but also as a strategic tool to boost performance and foster growth. ESG opens a plethora of opportunities for organisations across various dimensions:

Enhanced Performance

Companies that prioritise ESG tend to experience improved operational efficiency, reduced costs, and increased competitiveness in a rapidly changing business landscape.

Innovation and Growth

Developing sustainable products, services, and technologies not only addresses global issues but can also lead to new revenue streams and market opportunities.

Stakeholder Engagement

ESG practices enhance relationships with stakeholders, fostering trust and loyalty among customers, employees, communities, and investors. Consumers want to know that the brands they engage with match their values. Employees are focused more than ever before on working in purpose-driven workplaces. Community support and partnerships can be key drivers of business success, with positive ESG actions by organisations contributing to local communities and social well-being. Furthermore, investors seek out companies that deliver on sustainable business with a strong ESG focus.

Access to Capital

Businesses that demonstrate strong ESG performance may find it easier to attract investment and secure financing, as ESG integration is seen as a sign of long-term viability and responsible management.

Regulatory Compliance

As governments and regulators worldwide focus more on sustainability and social responsibility, businesses that proactively integrate ESG practices into their operations can be better prepared to navigate future regulatory changes and avoid potential penalties, reducing policy and legal risks.

Resilience and Risk Management

Companies with strong ESG practices are better equipped to navigate unexpected disruptions, such as pandemics, natural disasters, or supply chain disruptions. Identifying and addressing ESG risks, such as supply chain disruptions due to environmental factors or negative social impacts, can help businesses build resilience and reduce vulnerabilities.

Long-Term Value Creation

ESG integration is aligned with the concept of sustainable business practices. By considering the long-term impacts of decisions, businesses can create value that extends beyond short-term financial gains, ensuring their viability and success over time.

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III. Challenges Executives Face to Progress

Executives embarking on the journey of ESG implementation encounter a range of formidable challenges, each of which demands careful consideration and strategic solutions for progress:

1. Siloed Data and Multiple Data Sets:

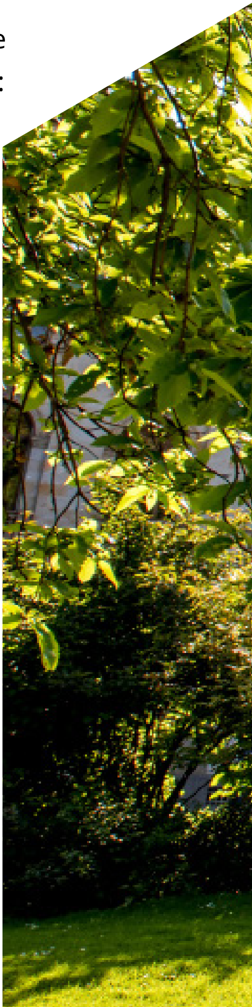
Implementing ESG initiatives often involves contending with data scattered across disparate sources. Data related to environmental impact, social responsibility, and governance practices often resides in various systems within the organisation and may need to be sourced from external partners.

The complexity of accessing, consolidating, and analysing this data can be both resource-intensive and time-consuming. To address this challenge, organisations need to invest in data integration solutions and establish clear data management protocols that streamline the process of collecting and processing ESG-related information.

2. Internal Lack of Clarity on Reporting and Compliance:

Achieving consistency in ESG reporting can be hindered by a lack of clarity within the organisation regarding reporting requirements and compliance standards. Different stakeholders may interpret these requirements differently, leading to confusion and inconsistencies in reporting practices. Moreover, the absence of universal ESG standards complicates the process further.

Executives must prioritise education and communication to ensure that all internal parties understand the significance of ESG reporting and are aligned on the metrics and criteria to be measured. This may involve developing internal guidelines or seeking external expertise to establish best practices.



3. Overall Governance Buy-In:

Successfully advancing ESG initiatives often hinges on securing buy-in from all levels of the organisation, particularly from senior leadership. **Executives may face resistance if ESG is not perceived as a strategic priority or if the benefits are not clearly communicated.**

Overcoming this challenge requires making a compelling business case for ESG, emphasising the long-term value it can create, such as improved reputation, risk mitigation, and access to sustainable financing. Demonstrating the alignment of ESG goals with the organisation's overall strategy is crucial in gaining support from senior leadership.

Addressing these challenges in ESG implementation necessitates a multifaceted approach that combines data management strategies, internal education and alignment efforts, and a persuasive governance strategy.

Executives must recognise that ESG is not merely a compliance exercise but a strategic imperative that can drive sustainable growth and resilience in an increasingly ESG-conscious world.

IV. ESG Reporting Frameworks, Standards and Guidelines

Today, stakeholders encounter multiple sustainability guidelines and standards.

The lack of a universal policy ensuring reporting consistency has resulted in a mismatch between what different brands disclose through documentation.

So, auditors, regulatory authorities, and global corporations juggle with region-specific legal, ethical, and financial challenges.

The ever-evolving ESG reporting landscape demands a comprehensive approach toward determining a framework, optimising its integration, and monitoring compliance.

The following leading global frameworks help enterprises, investors, and regulators communicate ESG performance and sustainability accounting compliance insights with stakeholders.

1. Global Reporting Initiative (GRI)

The GRI is a globally recognised framework for sustainability reporting. GRI provides guidelines and standards that help organisations report on their economic, environmental, social, and governance performance. GRI's comprehensive approach allows companies to disclose their sustainability impacts, risks, and opportunities, promoting transparency and accountability. **GRI is developing Sector Specific Standards for 40 industries, starting with those that generate the biggest impacts.** They support reporting organisations in writing sustainability reports by defining material topics for the industry and key information to disclose.

Currently, the Sector Disclosures are available for the following sectors:

The Global Sustainability Standards Board (GSSB) is currently reviewing the GRI's Sector Standard Project for Mining, expected to be approved in Q4 2023. A Sector Standard Project for Financial Services is aimed for Q4 2024. The textiles and apparel sector has previously been approved by the GSSB as one of the next sectors for which a standard will be developed. Sectors are prioritised based on the seriousness and the likelihood of their impacts – considering the overall size of the sector, distribution around the world, and the number of organisations that can use the GRI Standards.

2. International Financial Reporting Standards (IFRS)

While primarily known for financial reporting, IFRS has expanded its scope to include sustainability reporting. IFRS aims to integrate ESG factors into financial reporting, enhancing the disclosure of climate-related risks and other non-financial information, thus enabling investors and stakeholders to make more informed decisions. This includes the release of IFRS S1 (General Requirements for Disclosure of Sustainability – related Financial Information) and IFRS S2 (Climate-related Disclosures).

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. An entity is required to provide disclosures on governance processes, sustainability strategies, risk management practices and performance on sustainability metrics.

"IFRS S1 (General Requirements for Disclosure of Sustainability – related Financial Information) and IFRS S2 (Climate-related Disclosures)."

The objective of IFRS S2 is to require an entity to disclose information about its climate-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 S2 applies to climate-related physical and transition risks. This includes reporting on Scope 1 and Scope 2 greenhouse gas emissions, before having to report on Scope 3 emissions, one year later. IFRS S1 and S2 are effective for annual reporting periods beginning on or after 1 January 2024.

3. European Sustainability Reporting Standards (ESRS)

The ESRS has been developed by the European Financial Reporting Advisory Group (EFRAG) and the Corporate Sustainability Reporting Directive (CSRD) as part of the European Union's sustainability reporting initiatives. The two overall standards ESRS 1 (General Requirements) and ESRS 2 (General Disclosures) contain the general principles and disclosures that must be considered when preparing sustainability reports. ESRS 1 lists minimum requirements that must be disclosed in the course of reporting in order to understand the impact, the risks and the available opportunities with respect to environmental, social and governance frameworks. ESRS 2 explains the disclosure requirements for the preparation of a sustainability statement and applies to all companies, regardless of their activities and sustainability relevance.

ESRS requires firms to assess whether each disclosure requirement is material based on a "double materiality" assessment that covers both an organisation's environmental and financial impacts. The first time companies within the scope of CSRD will have to apply ESRS will be FY 2024 – that is, for periods beginning on or after 1st January 2024.

4. Task Force on Climate-Related Financial Disclosure (TCFD)

The TCFD is not a reporting standard *per se* but a set of recommendations for disclosing climate-related financial information. Focusing on the "E" of ESG reporting data, TCFD has become the recognised environmental sustainability compliance framework.

TCFD helps organisations assess and disclose climate risks and opportunities, promoting better-informed decision-making in the face of climate change. **The Task Force divided climate - related risks into two major categories: (1) risks related to the transition to a lower-carbon economy and (2) risks related to the physical impacts of climate change.**

The Financial Conduct Authority (FCA) introduced rules in November 2020 that required premium-listed companies (those on the London Stock Exchange's Main Market) to disclose how they comply with the TCFD recommendations in their annual reports.

These rules apply to companies with a financial year starting on or after January 1st, 2021.

5. United Nations Sustainable Development Goals (SDGs)

While not a reporting framework, the United Nations SDGs provide a global sustainability roadmap. **Many organisations align their sustainability efforts with the 17 SDGs to address pressing global challenges, and reporting progress on these goals is an integral part of their sustainability reporting.**

6. Sustainability Accounting Standards Board (SASB)

SASB focuses on industry-specific sustainability disclosure standards. It offers guidelines for reporting on financially material ESG factors that are relevant to a particularindustry. This approach ensures that companies within the same sector report on comparable ESG metrics.

7. International Sustainability Standards Board (ISSB)

The ISSB is an emerging body tasked with developing globally recognised sustainability reporting standards. It seeks to establish consistent reporting frameworks for ESG issues, creating a common language for organisations worldwide to communicate their sustainability performance.

8. The Climate Disclosure Standards Board (CDSB)

CDSB focuses specifically on climate-related financial disclosures. It provides a framework for organisations to report on the environmental impacts and climate risks they face. CDSB's framework aligns with other ESG reporting standards and helps companies disclose climate information consistently.

Corporate leaders and investment advisors may find themselves confronted by numerous ESG reporting frameworks, which can be daunting. Nevertheless, it is imperative to confront challenges related to climate risks, socio-economic instability, and financial improprieties, as they are essential components of sustainable development. Choosing the right ESG framework to align with globally can be a complex decision. The choice largely depends on your organisation's goals, industry, and the expectations of your stakeholders, in addition to local regulatory reporting requirements.

V. How ESG Impacts Different Roles

ESG considerations permeate various organisational roles, from information technology and sustainability managers responsible for data collection and goal setting to finance professionals who integrate ESG into financial planning and risk assessment.

The CFO, as the top financial executive, plays a pivotal role in ensuring ESG disclosures and strategies align with the organisation's broader financial objectives. Effective collaboration and communication between these roles is essential for successfully embedding ESG principles into an organisation's culture and operations.

Chief Information Officer (CIO):

CIOs hold a critical responsibility in the ESG landscape. They are tasked with collecting, managing, and securely storing ESG data. This data encompasses a wide range of environmental, social, and governance metrics. Information Officers need to implement technology infrastructure capable of efficiently handling this data. Furthermore, they **play a pivotal role in setting up systems for reporting ESG information, often involving complex data analytics and reporting tools.**

Finance Professionals:

Finance professionals, including financial analysts and controllers, are instrumental in the ESG integration process. They must consider ESG factors when conducting financial planning, risk assessment, and investment decision-making. **ESG data can inform financial models, helping organisations understand how environmental, social, and governance issues may impact their financial performance, risk profile, and valuation.** This requires a deep understanding of how ESG metrics correlate with financial outcomes.

Sustainability Manager:

Sustainability managers are at the forefront of an organisation's ESG efforts. They are responsible for setting ESG goals and targets in alignment with the organisation's broader sustainability strategy. **Their role extends to managing and overseeing sustainability programs, which may include initiatives related to reducing carbon emissions, promoting diversity and inclusion, or enhancing governance practices.** Sustainability managers serve as a bridge between ESG aspirations and corporate objectives, ensuring that sustainability practises are integrated into the organisation's overall mission.

Chief Financial Officer (CFO):

The CFO holds a critical role in ESG reporting and financial strategy alignment. **They are accountable for ensuring that ESG-related financial disclosures meet regulatory requirements and stakeholder expectations.** This may include reporting on climate-related risks, social impact, and governance practices in annual reports or dedicated ESG reports. Moreover, the CFO plays a strategic role in ensuring that ESG considerations align with the overall financial strategy of the organisation. This alignment ensures that ESG initiatives are adequately funded, integrated into budgeting processes, and contribute to long-term financial sustainability.

VI. Framework to Implement ESG Reporting

1. Governance

An organisation should describe the board's oversight of sustainability-related impacts, risks and opportunities, and its process for integrating sustainability issues into the overall governance approach. **Investors and other stakeholders have an interest in understanding the role played by the organisation's board in overseeing sustainability issues** – such information informs an assessment as to whether these issues are receiving appropriate board and management attention.

Example

Setting sustainability goals and targets, capital allocation plans, frameworks and guidelines selected and allocation of appropriate skills and competencies to be determined.

2. Strategy

An organisation should describe how an assessment of sustainability-related impacts, risks and opportunities has influenced the organisation's strategy, and what impact this has had on the organisation's overall performance, both positive and negative. **Investors and other stakeholders need to understand how sustainability issues may affect an organisation's business model, strategy, and financial planning** over the short, medium, and long term; such information is used to inform expectations about the future performance and impact the organisation will have.

Example

The organisation's most significant sustainability-related risks and opportunities across its value chain that the organisation reasonably expects could positively or negatively impact its business model, strategy, cash flows, access to finance, and its cost of capital.

3. Management Approach

An organisation should describe how sustainability-related impacts, risks and opportunities are identified, assessed, and integrated into the organisation's management processes. **Investors and other stakeholders need to understand how an organisation has integrated sustainability issues into its management processes; such information informs assessments of the organisation's overall risk profile and performance prospects.**

Example

How it assesses the likelihood and effects associated with its identified sustainability impacts, risks, and opportunities (such as the qualitative factors, quantitative thresholds and other criteria used).

4. Metrics, targets, and performance

An organisation should describe the performance metrics and targets used by the organisation to measure, monitor, and manage its sustainability impacts, risks and opportunities, and its performance against these metrics and targets. Access to the metrics and targets used by an organisation allows investors and other stakeholders to better assess the organisation's exposure to sustainability issues, and its progress in managing those issues (and their impact). It also provides a basis to compare organisations within a sector or industry.

Example

For environmental issues, whether the metric or target is absolute, normalised, intensity, or activity-based; and for social issues, whether the target is linked to specific outcomes for affected stakeholders, the timeframe over which the metric or target applies, and whether the metric or target applies to the consolidated group, a single entity, its upstream or downstream value chain, or specific geographic regions.

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VII. Conclusion

ESG represents a pivotal transformation in the way businesses operate, presenting opportunities for growth and resilience. To optimise the benefits of ESG, organisations must address key areas such as data management, reporting clarity, metric definition, and securing governance buy-in. A clear understanding of ESG's role, coupled with the adoption of structured frameworks, facilitates this transformative journey, generating value for stakeholders.

Recognising the varied impact of ESG on different roles within a company underscores the importance of collaboration and communication for successful integration. **Embracing ESG reporting standards like GRI, IFRS, ESRS, and TCFD aligns global sustainability efforts, ensuring transparency and accountability.**

By embracing ESG, organisations can enhance performance, engage stakeholders, foster innovation, access capital, and build lasting value. Addressing ESG challenges strategically is essential for thriving in a market increasingly attuned to ESG considerations.