People, Planet and Profit. Digital Transformation challenges

What is ESG?

Environment, Social, and Governance ("ESG"), represents a collection of methods to assess a company's operational effectiveness in terms of its social and environmental impact. This assessment can be done either internally or externally by investors or other stakeholders.

The environmental factor considers if a company engages in pollution or adopts eco-friendly practices. It includes an analysis of the company's practices in relation to the proper use of natural resources and care for the environment, covering issues such as climate change, waste treatment, pollution, or the impact of CO2 emissions.
The social factor considers how the company interacts with and influences its workforce, client, suppliers, and the broader community. Governance is about how a company is run, including its leadership, policies, internal controls, audits, board supervision, and executive pay.

ESG helps investors and others stakeholders measure a company's impact and potential growth, beyond just its financial status. No more focus on EBITDA or EPS indicators. Therefore, the article called "People, Planet and Profit" (3P method) which is how the stakeholders of new world would be analysing market participants. It can also be used to assess the external risks faced by a company as well as its future growth prospects.

Following is the list of focus areas in your ESG journey.

ESG Categorization

Environmental	**Social**	**Governance**
Renewable Energy Climate change Energy use Deforestation Recycling Transportation Water management Extreme Weather GHG emissions Oceans Soil health Effluents and waste	Diversity, equity, and inclusion Community relations Human rights Education and training Data privacy Employee compensation and benefits Health and safety, product use Union rights Modern slavery Marketing and communication	Anti-bribery and anti-corruption Data privacy Transparency, Disclosure Whistleblower policy Anti-fraud Shareholder rights and engagement Corporate board, structure Commitment and direction (purpose)

In today's world, where climate change, social responsibility, and corporate governance take center stage, companies face increasing pressure to align with ESG principles. To adhere to these principles, companies need an ESG strategy.

What is an ESG Strategy?

An ESG strategy represents a business model that that places a strong emphasis on social responsibility alongside profit generation as mentioned 3P method. This approach provides companies with a framework to track progress towards sustainability goals, offering valuable quantitative and qualitative information for investors and stakeholders who value environmentally and socially conscious organizations. Putting in place a strong ESG plan can boost a company's finances, streamline operations, and fuel growth, leading to greater success.

All businesses seek profits, but today's investors and shareholders, as well customers and consumers, want to see businesses making efforts to make the world a better place as they generate those profits.

Without adding value to society and the environment, profit in the medium to long term is no longer achievable because the company loses trust in the market with its stakeholders. It's not enough to make a profit, it's essential to create value.

ESG in the Digital Age: Maximizing Efficiency and Value through Integration

ESG digitization refers to the process of using digital technologies and data analytics to enhance a company's ability to measure, manage, and report on its ESG performance and initiatives. It also makes it possible to monitor internal action plans with a view to mitigating or compensating for the impacts caused.

Digital technology has undeniably transformed and improved business processes, and ESG is no exception. Hence, to make the most of digital solutions, integrating ESG into the overall digital strategy is essential. This ensures efficiency and adds value to the company's operations.

There are mainly two ways by which digitization impacts ESG performance.
First, digitization enables companies to reduce agency costs and increase governance (G) scores.
Second, digitization facilitates companies to improve goodwill and further increase social (S) scores.
The digitization of ESG isn't merely embracing new technologies; it involves a fundamental shift in how businesses function and provide value.

ESG digitization is an ongoing process that requires commitment, resources, and a strong organizational culture focused on sustainability. By using digital technologies effectively, companies can enhance their ESG performance, improve transparency, and meet the evolving expectations of investors, customers, and regulators.

Building Blocks of ESG Implementation

The process of implementing robust ESG strategy involves several key components:

- **Data Collection**: Companies install IoT sensors in their factories, offices, and supply chains to gather real-time data on energy consumption, emissions, and resource usage.

- **Data Analysis:** Advanced analytics platforms process this data to identify patterns, anomalies, and areas for improvement.

- **Decision-Making:** AI algorithms assist in making decisions, such as optimizing production schedules to reduce energy-intensive processes during peak demand hours.

- **Reporting and Accountability:** Transparent reports are generated, showcasing progress and areas that need attention, fostering a culture of continuous improvement without greenwashing.

  The real magic of ESG lies in achieving improvements and capturing those achievements to share with public.

ESG reporting and Creating a Sustainability Report

A Sustainability report, also known as an ESG report, is a publication by a company or organization that details its environmental, social, and governance impacts. This report serves as a transparency mechanism, helping the company disclose the challenges and potential benefits it encounters.

Sustainability reports are becoming more critical as investors and stakeholders push for increased transparency in companies' sustainability and ESG strategies. Additionally, many legislative documents now require companies to properly disclose non-financial information.

How should companies report non-financial information?

> GRI (Global Reporting Initiative) is an international organization setting independent standards for non-financial information reporting, helping companies assess their impacts on climate, the environment, human rights, and corporate governance. These standards are widely adopted by global corporations.
>
> While GRI standards are not mandatory, the proposed Corporate Sustainability Reporting Directive (CSRD) and the upcoming European Sustainability Reporting Standards (ESRS) are aligned with the GRI structure. ESRS will be akin to IFRS for sustainability reporting, making compliance compulsory for companies.

By adhering to GRI standards and producing high-quality reports, organizations can gain a better understanding of their contributions to the United Nations Sustainable Development Goals (UN SDG) and effectively communicate and manage their sustainability efforts.

Sustainability report is an ideal and effective means of enabling companies to answer in a single document a wide variety of questions that stakeholders may raise.
However, creating a Sustainability report can be challenging, as it must meet the requirements of the reporting methodology and have the right balance of information from the individual agendas. The report must reflect the details of material topics and, prior to its availability to stakeholders, must be verified by an independent external entity. Moreover, the companies need to determine how to communicate relevant information and what ESG information and indicators to report.

Aligning External Reporting and Internal Benefits

Delivering Internal Benefits

Metrics related to sustainability can offer valuable insights to organizations for making better decisions and managing their performance and impact. When evaluating how they handle sustainability data for internal reporting, organizations should consider the following factors:

- **Data Governance**: Does the organization follow its data governance policy to responsibly manage the creation, collection, validation, storage, use, archive, and deletion of sustainable business-related data?
- **Integration of Information**: Is relevant and reliable sustainability data integrated into existing management reporting systems, processes, and reports? And is this data actively used for operational decision-making?
- **Data Lineage**: Is there a clear connection to the original sources of sustainability data throughout information systems and the supply chain?
- **Technology Utilization**: Does the organization use technology to establish and maintain data lineage, access information, and connect to source data? If not, can it do so easily?
- **Connections and Dependencies**: Are connections and dependencies between sustainability data and other types of information maintained?
- **Data Collection Frequency**: How often is key sustainability data collected, and can it be collected and reported internally in a timely and cost-effective manner?
- **Decision Support**: Is decision-useful sustainability information integrated into key analyses that support management decisions, such as resource allocation, product development, mergers, acquisitions, compliance, and risk management?
- **Alignment with Stakeholders**: Are employee and supply chain partner incentives aligned with the organization's sustainable business objectives, including product design that meets sustainability demands from customers?
- **Meaningful Reporting**: Does the reporting go beyond mere compliance with financial reporting standards and help in making meaningful decisions about resource deployment and achieving the organization's purpose? No more Greenwashing.

Evaluating these factors can help organizations ensure they are effectively managing sustainability data for better decision-making and performance management.

Delivering External Benefits

Meanwhile, the same information can provide decision-useful disclosures for external users, such as investors, employees and customers.
The organization should consider the listed factors when examining its data management practices for KPIs specific to external sustainability reporting objectives.

- Integrate sustainability data into their existing systems or establish controls if needed.
- Create consistent policies for collecting and reporting sustainability data.
- Clearly assign responsibility for data collection and have a plan for correcting issues.
- Document their reporting processes and make sure they're consistent with external communication.
- Obtain assurance from external audit firms on adequacy of the data quality and internal controls (“ESG Audit opinion”).
- Be confident in the quality of the data, so the CEO or CFO can certify it without hesitation.

Top Takeaways for organizations to establish effective internal control for Sustainability:

- Aligning the company's purpose with a sustainability purpose, ensuring adequate risk management, defining SMART (simple, measurable, achievable, relevant, timely) objectives and respective actions.

- Commit to establishing effective internal controls for sustainability, covering operations, compliance, and various types of reporting. Customize control measures to suit your organization's specific needs.
- Achieve effective internal control over sustainability by implementing the 17 principles, adapting them to your organization's maturity, industry, and resources.
- Collaborate with others to determine the best organizational structures, roles, and responsibilities for efficient internal and external operations, and ensure effective internal control. Utilize the Three Lines Model to delineate these responsibilities.
- Stay updated and educated on sustainability topics. Participate in seminars, read new publications, and consider certificate programs. Learn from both internal and external sustainability professionals and understand the best market practices in order to make decisions.
- Prioritize internal assurance and confidence in sustainability reporting before seeking external assurance. Utilize the internal audit function for objective assurance and guidance.
- Transform ESG reporting into an automated, efficient, and continuous process, rather than an annual manual task.
- Recognize the dynamic nature of the field and the likelihood of changes. Regularly monitor and evaluate progress to make necessary corrections and improvements.
- Form a cross-functional team comprising sustainability experts and internal control and reporting specialists. Recognize that good internal controls benefit business beyond compliance and mandatory external disclosures.

The Importance of ESG Digitization

The influence of digital technology is readily apparent across the entire business environment. It leads to decreased operational expenses and a reduction in human by automating tasks that used to be manual. Additionally, the risk of data silos is significantly reduced since information is stored in the cloud rather than physical devices. Beyond its impact on everyday business functions, technology also enhances the ESG process.

How PKF Antares can assist

Our ESG offerings provide impactful strategies tailored to the ever-competitive business landscape. We are proficient in assisting you with the deployment of essential technology solutions that enable precise definition, tracking, measurement, and reporting of your ESG performance, all aimed at enhancing your stakeholder value.

Feel free to get in touch to discover how we can empower you to utilize technology for achieving your ESG objectives.

Ab Akbar, Digital Transformation
Erkin Atakhanov, Managing Partner