ESG Essentials:

Accounting and Audit Requirements

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What is ESG?

Setting the Scene

<u>ESG is everything you do</u>

What is ESG?

E

Environmental

Our impact on the world we live in

- Climate change
- Greenhouse Gas (GHG) emissions
- Resource depletion, including water
- Waste and pollution
- Deforestation
- Hazardous materials
- Biodiversity

S

Social

Our contribution to the communities we operate in

- Working conditions, including slavery and child labour
- Impact on local communities
- Conflict regions
- Health and safety
- Employee relations and diversity
- Data protection

G

Governance

Our license to operate

- Executive pay
- Bribery and corruption
- Political lobbying and donations
- Board diversity and structure
- Tax strategy
- Data breaches

❑ ESG simply means Environmental, Social, and Governance and it **proposes non-financial performance indicators** (of risks and opportunities) that evaluates a company's responsibility, long-term viability, environmental influence.

❑ **Typically, ESG compliant entities are more resilient in the face of crisis**.

❑ ***ESG isn't something you do. It is everything you do!***

02

ESG & Credit Guarantee Institutions

Impact on Credit Guarantee Institutions

Environmental, Social, and Governance (ESG) factors have increasingly become intertwined with financial systems, and credit guarantee institutions are no exception

Reputation Management

Positioning as an institution that underscores ESG principles in its guarantee process attracts ethically-driven businesses and builds stakeholder trust.

Enhanced Risk Assessment

Incorporating ESG metrics allows credit guarantee institutions to better evaluate long-term risks, ensuring they back traders less likely to default due to ESG-related incidents.

Strategic Alignment

Aligning with ESG-forward traders, credit guarantee institutions ensure they're supporting sectors poised for success in a sustainability-driven future, safeguarding their investments and maintaining market relevance.

Impact on Credit Guarantee Seekers

Access to Guarantees

Traders with strong ESG records may find quicker approvals and more favourable conditions when seeking credit guarantees. Conversely, poor ESG compliance may result in delays or denials.

Pricing and Terms

Credit guarantee institutions might offer beneficial terms, including reduced premiums or fees, for traders demonstrating robust ESG practices

Competitive Edge in Trade

Demonstrated ESG compliance can enhance negotiations, especially with partners or customers who emphasise sustainability, leading to advantageous trade terms

Future Preparedness

As international regulations and standards evolve towards sustainability, traders emphasising ESG are better positioned to navigate the changing landscape and ensure continued access to credit facilities.

Source: [Barclays]

03

ESG Information Reliability through Accounting & Audit

ESG Information Reliability through Accounting & Audit

Similar to audits of financial statements and internal control over financial reporting, **third-party assurance** enhances the reliability of ESG information and builds confidence among stakeholders.

Auditors conduct attestation engagements to provide assurance that ESG information is presented in accordance with certain criteria.

“We help management and the board feel confident in the reported ESG information, which is important given the increased focus and attention from external stakeholders.” *Marjorie Whittaker.*

> “Accountants and auditors have an expanding role to play in determining the integrity of their company’s or their clients’ disclosure of ESG topics”

Source: *Accounting and Audit*

> “There has been an uptick in ESG reporting worldwide, with a recent KPMG study demonstrating that 80% of companies now report on ESG topics”

Source: KPMG

> “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.”

Source: KPMG

04

ESG Reporting and Requirements

ESG Reporting

IFRS Sustainability Disclosure Standards - The Standard to Adopt

The International Sustainability Standards Board (ISSB) formed to develop standards for a global baseline of sustainability disclosures on 26 June 2023, issued its inaugural standards—IFRS S1 and S2. The new sustainability disclosure standards are slated to be **effective from January 2024.**

ISSB

Has issued IFRS S1 & S2 in

IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information

IFRS S2 Climate-related Disclosures

The ISSB builds on the work of

GRI Global Reporting Initiative

SASB Sustainability Accounting Standards Board

SDGs Sustainable Development Goals

TCFD Task Force on Climate-related Financial Disclosures

COP26 Conference of Parties (26th edition)

The Corporate Sustainability Reporting Directive (CSRD)

This new directive modernises and strengthens the rules concerning the social and environmental information that companies have to report.

The new rules will ensure that investors and other stakeholders have access to the information they need to assess the impact of companies on people and the environment and for investors to assess financial risks and opportunities arising from climate change and other sustainability issues. Finally, reporting costs will be reduced for companies over the medium to long term by harmonising the information to be provided.

Role of Internal Audit in ESG Reporting

- Independent, objective assurance and advice are fundamental to the role and mission of internal auditing, which makes its involvement in ESG reporting critical.

- As risks associated with ESG become more evident and prevalent in decision-making by the governing body and executive management, directors must have reliable assurance on the effectiveness of ESG risk management, including ESG reporting. That assurance should come from an internal audit.

01

- **Build an ESG control environment**
- **Recommend reporting metrics**
- **Advise on ESG governance**

Advisory

02

- **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**
- **Incorporate ESG into audit plans**

Assurance

Reporting Best Practices to Consider

Link sustainability reporting to the overall business strategy

Set clear and measurable targets, such as carbon reduction goals

Involve key stakeholders to ensure their perspectives are considered

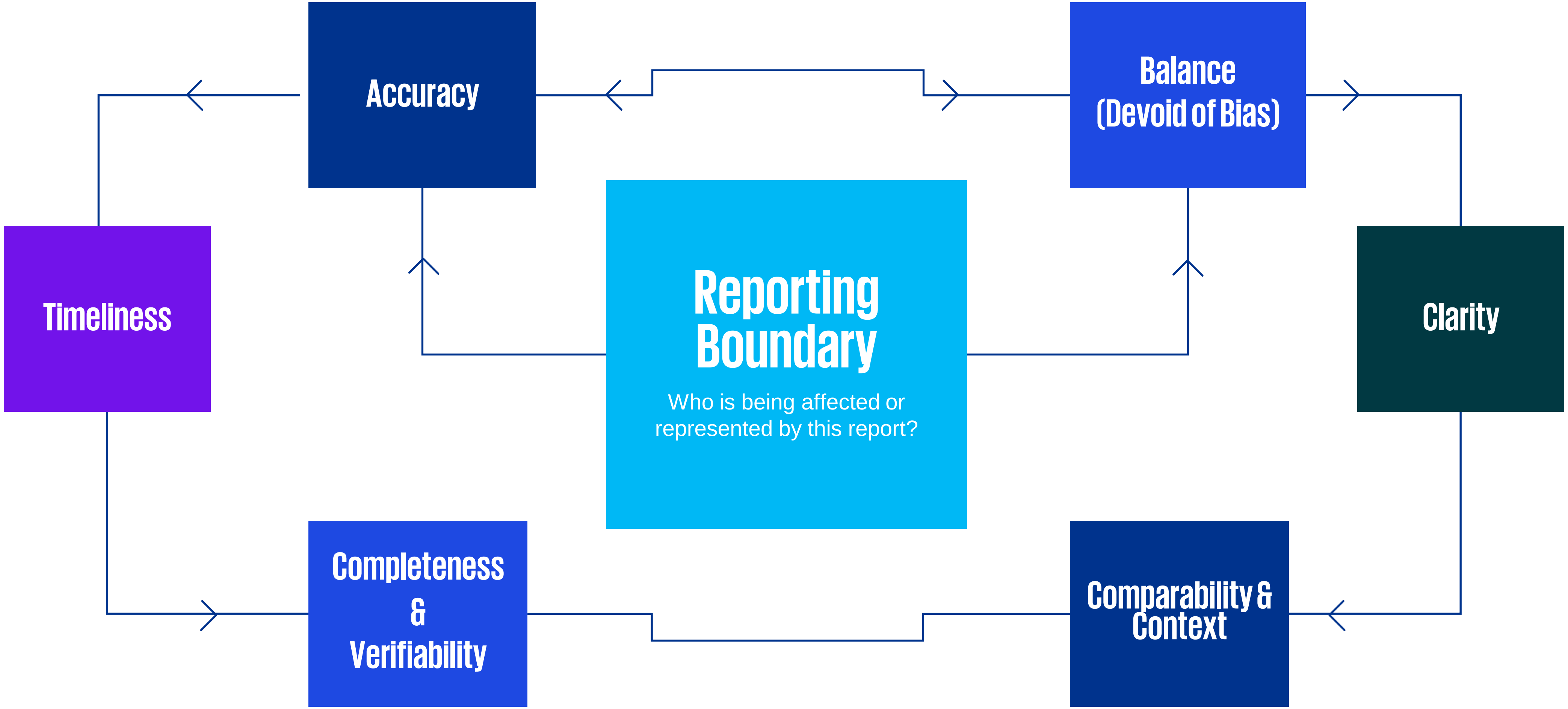
Provide context and benchmarks to compare performance against industry standards.

Use clear and accessible language and data visualisation for better understanding

Consider obtaining third-party assurance to enhance credibility.

Report periodically to provide consistent updates on sustainability performance

The Reporting Principles



05

ESG Data Collection and Management

ESG Data Collection and Management

- Data forms the foundation for all situational analysis. It is what enables an organisation to see its current position clearly, reveal opportunities, and uncover threats.

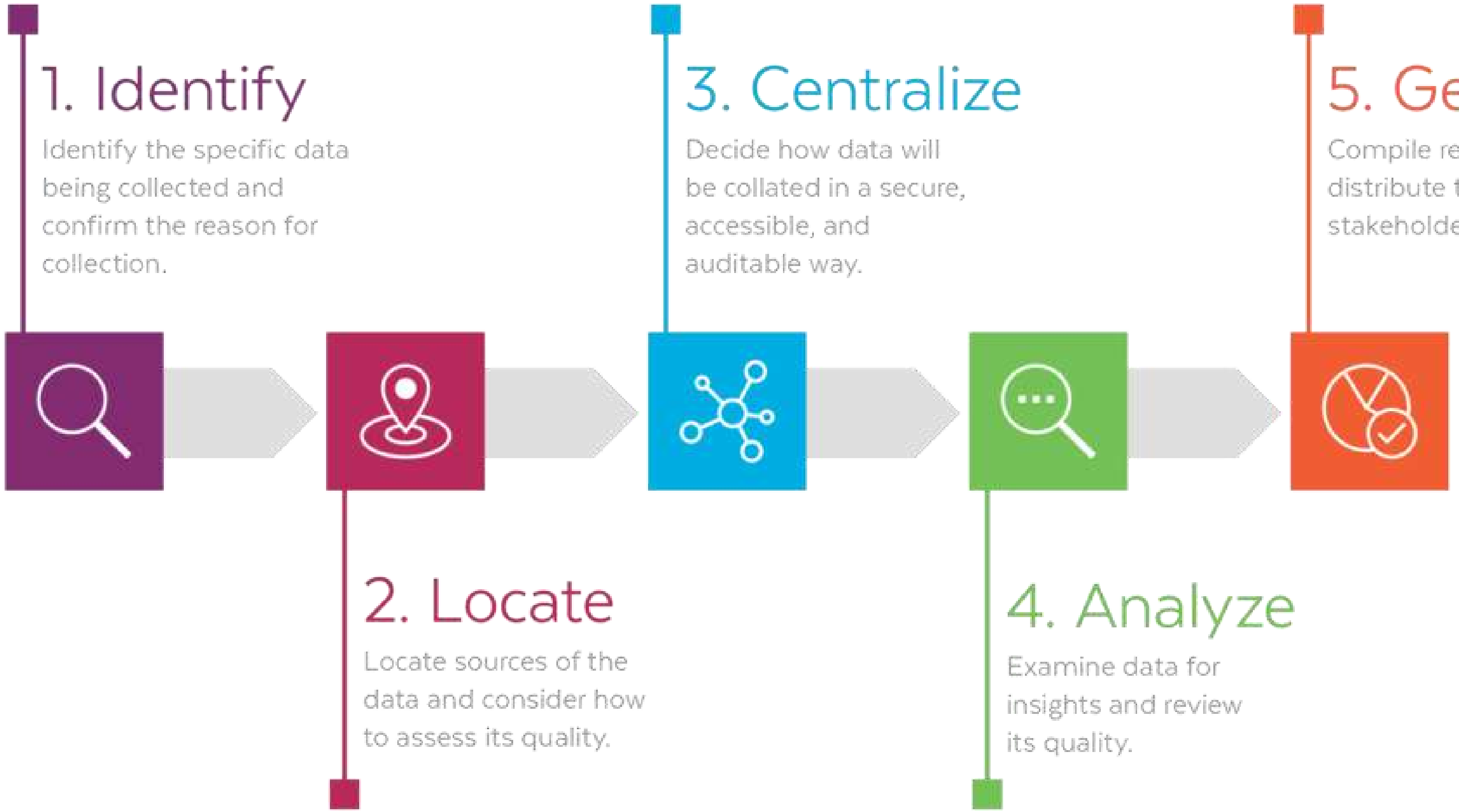
- Obtaining quality data is challenging due to issues like unavailability and inaccessibility. Human error can introduce inaccuracies, and the data acquisition process can be time-consuming.

> “ESG data collection is evolving from a 'nice to have' to a 'must-have' for investors. It's the lens through which they assess a company's resilience and long-term value.”

> “In a sense, ESG data is one of the truest reflections of a company’s business: what’s the company’s real identity and purpose? Who works there? What values, practices, and principles does it (genuinely) stand for? Where do its products and raw materials come from? How does the organization anticipate and manage risk en route to achieving its mission?”
>
> **Source: Brightest**

ESG Data Collection and Management

To gather data effectively and lay the foundation for successful ESG management, companies can follow a few steps to set them up for success.



Common ESG Performance Metrics

E

- Greenhouse Gas (GHG) Emissions, Air and Water Pollution, Deforestation, Water Security, Recycling and Waste Management, Carbon Footprint etc.

S

- Diversity, equity and Inclusion (DEI), Labor Standards, Data Protection and Security, Supply Chain Management etc.

G

- Board Composition, Shareholder Rights, Investor Relations, Conflict of Interest Policy, Compensation etc.

06

ESG & Financial Reporting

Merging ESG & Financial Data

Integrated Reports are a combination of traditional annual reports (which are mostly focused on financial data, corporate structure and governance, risks, and market data) and ESG reports.
The following observations stem from comparing Integrated Reports with ESG/Sustainability Reports.

Pros

- Integrated reports require board approval, promoting collaboration between Finance/IR and ESG teams, leading to comprehensive strategic messaging.

- Such reports provide a unified source for stakeholders needing both ESG and financial data, ensuring broader outreach.

- Adopting integrated reports aligns financial and ESG data release timelines due to regulatory deadlines for annual reports.

Cons

- Due to the concise nature of integrated reports, some detailed ESG elements from sustainability reports might be omitted.

- The dual demands of integrated reporting can strain organizations because of the condensed timeline for producing diverse data sets.

- Transitioning to integrated reporting can increase costs and resource needs, particularly during the initial phase of enhancing ESG expertise.

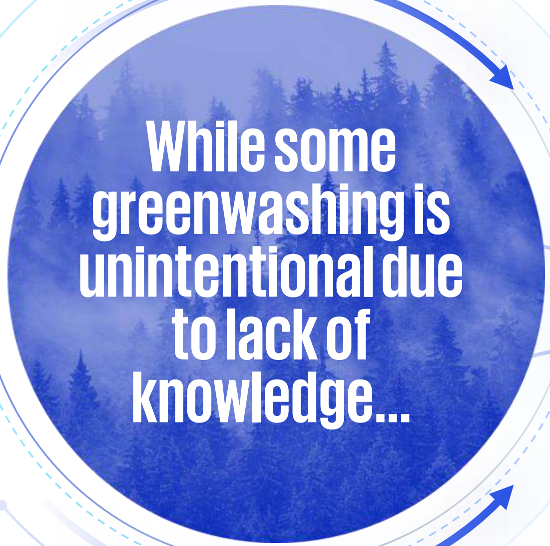
The optimal choice for integrated reporting hinges on your target audience, communication objectives, and the company's existing ESG expertise and resources.

07

Greenwashing

What is Greenwashing?

Greenwashing is when a company tries to convince the public that it's doing more to protect the environment than it really is by providing misleading information on operations/ products.



… it is often intentionally carried out through marketing efforts.

Avoiding the Pitfalls of Greenwashing

Adverse impacts of greenwashing on a company's reputation may include permanent reputational damage, consumer disengagement and broken trust, reduced revenue, reduced capital from investors, negative publicity, and broken relations with employees and other stakeholders.

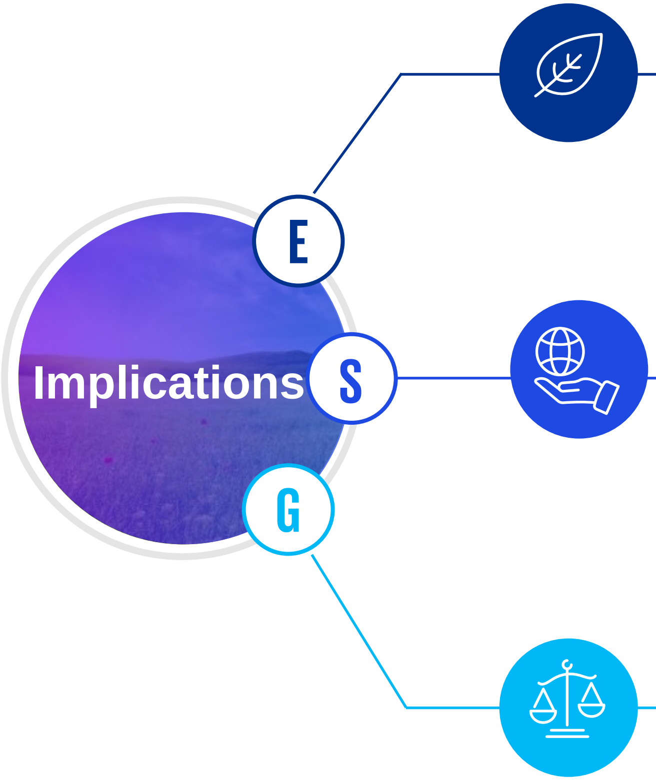
Green Washing Strategies Used in Marketing

Means	Detail
Vague Language	Words or terms with no clear meaning. What does eco-friendly really mean? How is the product friendly?
Green products vs. Dirty company	E.g. energy-efficient light bulbs made in a factory that pollutes rivers Investing in renewable energy project whiles using fossil fuel is classic example.
Suggestive Imagery	Images that present the product as being eco-friendly. Think green leaves and animals.
Irrelevant Claims	Watch out for this one. The entire focus of the campaign will be on an exceedingly small attribute of the business.
“Best-in-class” Boasts	The ‘we are greener than the rest’ rhetoric. The rest might be terrible, and this brand might be just as bad.

Green Washing Strategies Used in Marketing

Means	Detail
Lack of Credibility	Is nuclear energy good for you? Are cigarettes? A company known and used as a conduit for money laundering touting its ESG credentials.
Technical Jargons	Information that only a scientist could check or understand
Imaginary Friends	Made-up third-party endorsements. Paid brand endorsement by celebrities and other public figures.
No Proof	A claim that could be true but there is no evidence present. Green washers are more likely to provide little or no evidence to cover up
Outright Lies	Totally fabricated claims or manipulated data to sell an idea or a product.

Implications of Greenwashing on Businesses



Reputational Risk

Being exposed can damage brand credibility and trustworthiness

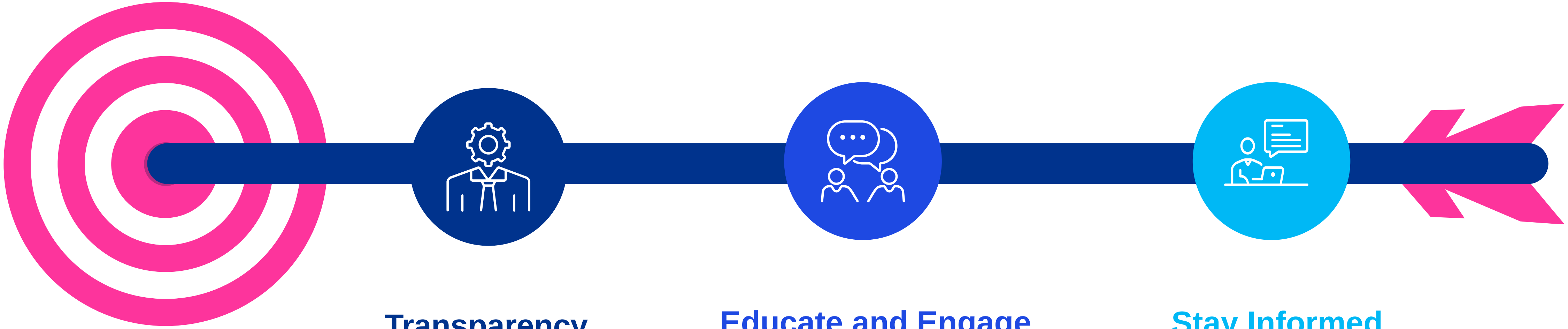
Financial Impact

Potential fines and legal repercussions for misleading advertising or false claims.

Loss of Stakeholder Confidence

Eroding trust with investors, consumers, and partners.

How Businesses can avoid Greenwashing



Transparency

Clearly communicate efforts, challenges, successes, and areas of improvement.

Educate and Engage

Foster an internal culture of genuine sustainability and social responsibility.

Stay Informed

Regularly review and update ESG initiatives to match evolving best practices and standards.

08

Conclusion

As we navigate the evolving business landscape, the importance of ESG for Businesses, along with the audit and accounting requirements of ESG reporting, is undeniable.

It's more than just a trend; it is a transformation towards sustainable and responsible growth. By understanding the nuances of ESG, from genuine integration to the intricacies of audit and accounting standards, and the pitfalls of greenwashing, Executives can position their businesses for long-term success and resilience.

Let’s move beyond just profitability, embracing a holistic approach that values people, the planet, and prosperity together. As we step forward, remember: the future isn't just about what we do, but how we choose to do it and how we report it with integrity and transparency.

09

Appendix

09.1

FAQs on ESG considerations for Credit Guarantee Providers & SMEs

FAQ about ESG considerations for Credit Guarantee Providers

Q: How do audit and accounting requirements for ESG enhance our company's credibility?

A: Proper audit and accounting for ESG underscore your company's commitment to transparency and accuracy, boosting stakeholder trust and enhancing your brand's reputation in the sustainability landscape.

Q: What is the financial impact, both short and long term, of implementing rigorous ESG auditing and accounting?

A: Short-term, there might be costs related to enhancing systems, training, or hiring specialists. Long-term, the benefits include risk mitigation, potential access to ESG-focused funds, and increased trust among stakeholders, often translating to a positive financial impact.

Q: How do we ensure our ESG reports are free from greenwashing and stand up to scrutiny?

A: Robust auditing and adherence to recognized ESG accounting standards ensure the data's accuracy and relevance, minimizing the risk of greenwashing.

FAQ about ESG considerations for Credit Guarantee Providers

Q: What does ESG stand for in the context of Credit Guarantee Institutions?

A: For Credit Guarantee Institutions, ESG refers to the integration of Environmental, Social and Governance non-financial factors into their risk assessment processes, ensuring that borrowers maintain responsible and sustainable practices in these areas.

Q: How can Credit Guarantee Institutions integrate ESG considerations into their operations?

A: Credit Guarantee Institutions can start by including ESG metrics in their risk assessment processes, offering incentives for sustainable practices, setting clear ESG criteria for guarantees, and monitoring and reporting on the ESG performance of their portfolio.

Q: Are there standardised ESG metrics for Credit Guarantee Institutions to follow?

A: While there are global ESG reporting frameworks like the Global Reporting Initiative (GRI) and Sustainability Accounting Standards Board (SASB), there's no one-size-fits-all approach. Credit Guarantee Institutions may need to adapt these frameworks based on their operational context.

FAQ about ESG considerations for Credit Guarantee Providers

Q: How do Credit Guarantee Institutions ensure the authenticity of ESG data provided by borrowers?

A: Institutions can employ third-party ESG audits, leverage technology for data verification, and establish stringent reporting guidelines for borrowers.

Q: How does ESG integration impact the reputation of Credit Guarantee Institutions?

A: Positive ESG integration can enhance an institution's reputation by showcasing its commitment to sustainability and responsible lending. Conversely, neglecting ESG considerations can lead to reputation risks.

Q: Can ESG considerations impact the default rate of borrowers?

A: Yes, companies with strong ESG practices often exhibit lower risk profiles, and they may have a lower likelihood of default compared to those that don't prioritise ESG.

FAQ about ESG considerations for SMEs

Q: How can an SME ensure it's not falling into the trap of "greenwashing"?

A: Transparency and authenticity are key. Rather than making broad claims, be specific about your ESG efforts. Use third-party audits or certifications, and always back up claims with verifiable data and achievements.

Q: Is there a tangible ROI (Return on Investment) on ESG initiatives for SMEs?

A: While some benefits are intangible, like enhanced brand reputation, many ESG initiatives have a direct ROI. These can include operational cost savings, increased sales from eco-conscious consumers, and better access to capital from sustainability-minded investors.

Q: Do consumers genuinely care about a small company's ESG efforts?

A: Yes, more consumers are making purchasing decisions based on companies' sustainability efforts and ethical practices. For SMEs, showcasing genuine ESG efforts can differentiate them from competitors and foster strong customer loyalty.

Conversation Starters

WHAT INFORMATION ARE YOUR STAKEHOLDERS REQUESTING ON THE ESG SPECTRUM?

Have you looked into this type of reporting before?

HAVE YOU CONSIDERED ESG AS A DIMENSION TO ACCESSING INVESTMENTS?

Are you fully aware of the ESG reporting systems, controls and processes that are in place? How does it compare to financial reporting?

How did your board determine which ESG issues to focus on?

Do you have an ESG strategy that supports and drives your corporate growth objectives?

DOES YOUR ORGANISATION HAVE (INTERNAL) ESG TARGETS? WHY AREN'T YOU DISCLOSING THOSE?

How do you balance your company's ESG responsibilities and generate profit at the same time?

Have you considered using your ESG strategy to help increase brand reputation

Can you trust the ESG data that your partners and business units are reporting?

Do you believe ESG is embedded in all critical functions, or does it serve as a nice-to-have?

How are you leveraging ESG as part of your Covid-19 recovery program to create a resilient business?

Do you need key ESG metrics & targets to measure your sustainability performance?

KPMG

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