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RISK ADVISORY UPDATE

Environmental, Social and Governance (ESG)

INTRODUCTION

Over time, consumer behavior has changed and focused on becoming more sustainable. Consumers look to recycle, minimize waste and make greener choices. This behavior also influences decisions around finances and investment choices. As a result, investors want to use their money to finance companies committed to these practices. ESG investing, also known as sustainable investing, has seen exponential growth as investors seek to provide capital for companies whose values on environmental sustainability and social responsibility align with their own.

WHAT IS ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG)

ESG is a framework that helps stakeholders understand how an organization is managing risks and opportunities related to environmental, social, and governance criteria.

Environmental factors involve how much an organization considers the protection of natural resources. These factors include the environment, climate change, energy consumption and use and its overall impact.

Social factors address how an organization treats people, it includes Customer satisfaction, Employee diversity, Labor standards etc.

Governance examines how a corporation polices itself, focusing on internal system controls and practices to maintain compliance. Governance focuses on transparency, industry best practices, organization management and associated growth initiatives.

BENEFITS OF ESG PRACTICES

- **Investment returns and sustainability:** Sustainability funds can achieve similar or better returns compared to traditional funds, according to a 2021 report from Morningstar, a financial services company.

- **ESG can attract consumers for additional growth:** Consumers seek more sustainable product options or services provided by companies that are focused on ESG.

- **ESG attracts and retains quality employees:** It can boost employee motivation and increase overall productivity by giving a sense of purpose.

- **ESG can cut costs**: When ESG practices are incorporated into the fabric of an organization, companies can reduce costs over time, such as operating expenses.

LEGAL REQUIREMENTS

The proposed Business Responsibility and Sustainability Reporting (BRSR) shall be applicable to the top 1000 listed entities (by market capitalization) for reporting on a voluntary basis for FY 2021 – 22 and mandatory from FY 2022 – 23. The filing of BRSR shall be in the manner and form as specified under the provisions of Listing Obligations and Disclosure Requirements (LODR) Regulations.

INTERNAL AUDIT'S ROLE IN ESG REPORTING

Independent, objective assurance and advice is fundamental to the role and mission of internal auditing, which makes its involvement in ESG reporting critical. Indeed, the definition of internal auditing is adding value by, ". . . bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes." 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 internal audit.

Assurance over ESG reporting should include at minimum the following points, which a properly funded, qualified, and independent internal audit function can provide: -

- **A robust policy framework**: Have a clearly enunciated whistleblower policy which is stakeholder friendly, making it easier to comply and to navigate in the event of disputes.
- **Resolution & feedback**: There must be an appropriate resolution & feedback process which is well documented to satisfactorily address issues.
- **Strong communication**: It is crucial that awareness on the presence of the policies and redressal mechanism is undertaken regularly to inspire and empower stakeholders.
- **Confidentiality and protection of stakeholders**: Confidentiality is at the core of good governance as it helps in upholding the reputation of both individuals and the company apart from protecting individuals from any vindictiveness.
- **Establishing boundaries**: It is important to clearly define the scope and limitations of independent offices handling governance issues. While self-governing investigations can be undertaken, issues which are false and frivolous can be discarded and action taken to discourage future offenders.

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