Unlocking Opportunities: ESG Essentials for Accountants

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Corporate Governance—Agency theory

- 1976，Jensen and Meckling:
  - All individuals, including agents, will act in their self-interest
  - As agents, directors are in a position to gain personally, even if at the expense of the shareholders
  - They are in the position because of the powers delegated to them and because of their access to better information than the shareholders
  - As they are in this position, directors will act in their self-interest

Background 1- Governance

Sustainability management

Shareholders → Corporate Governance

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Professional manager (agent)

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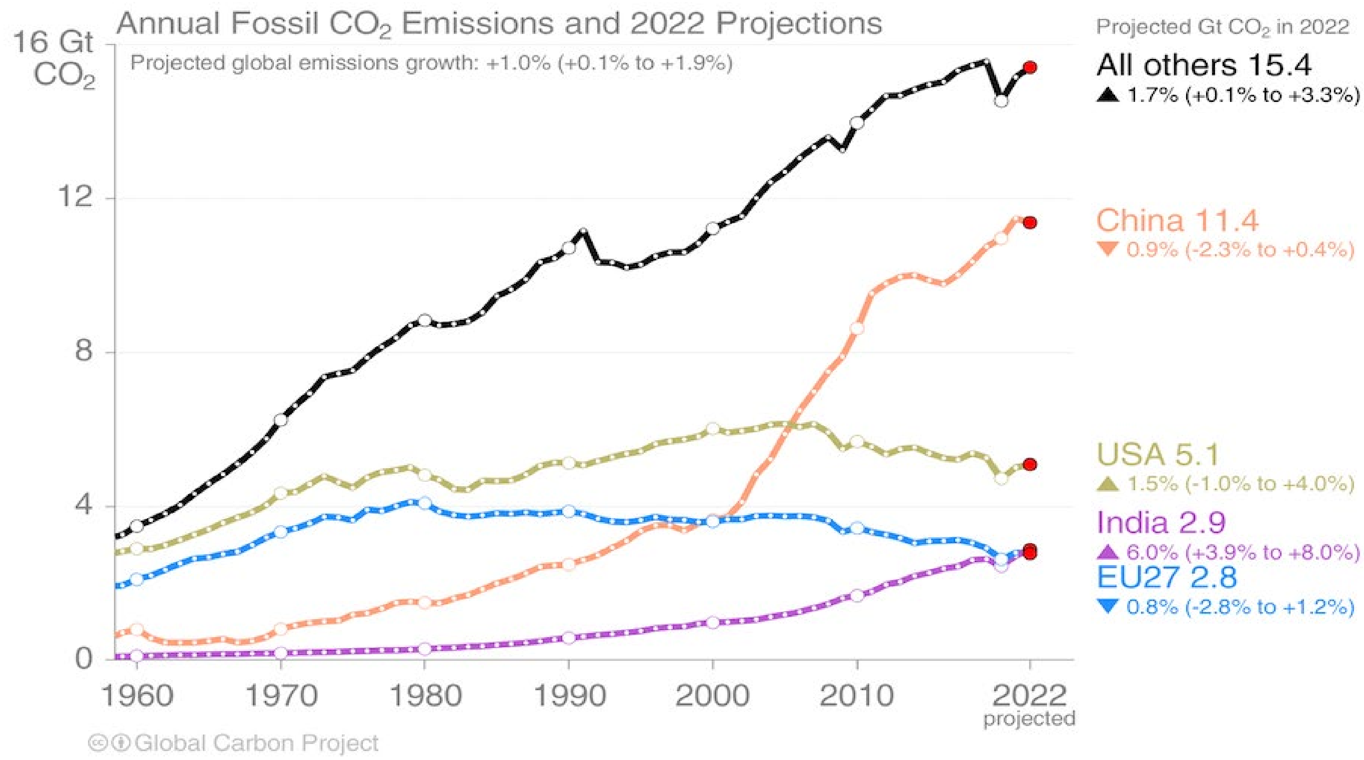
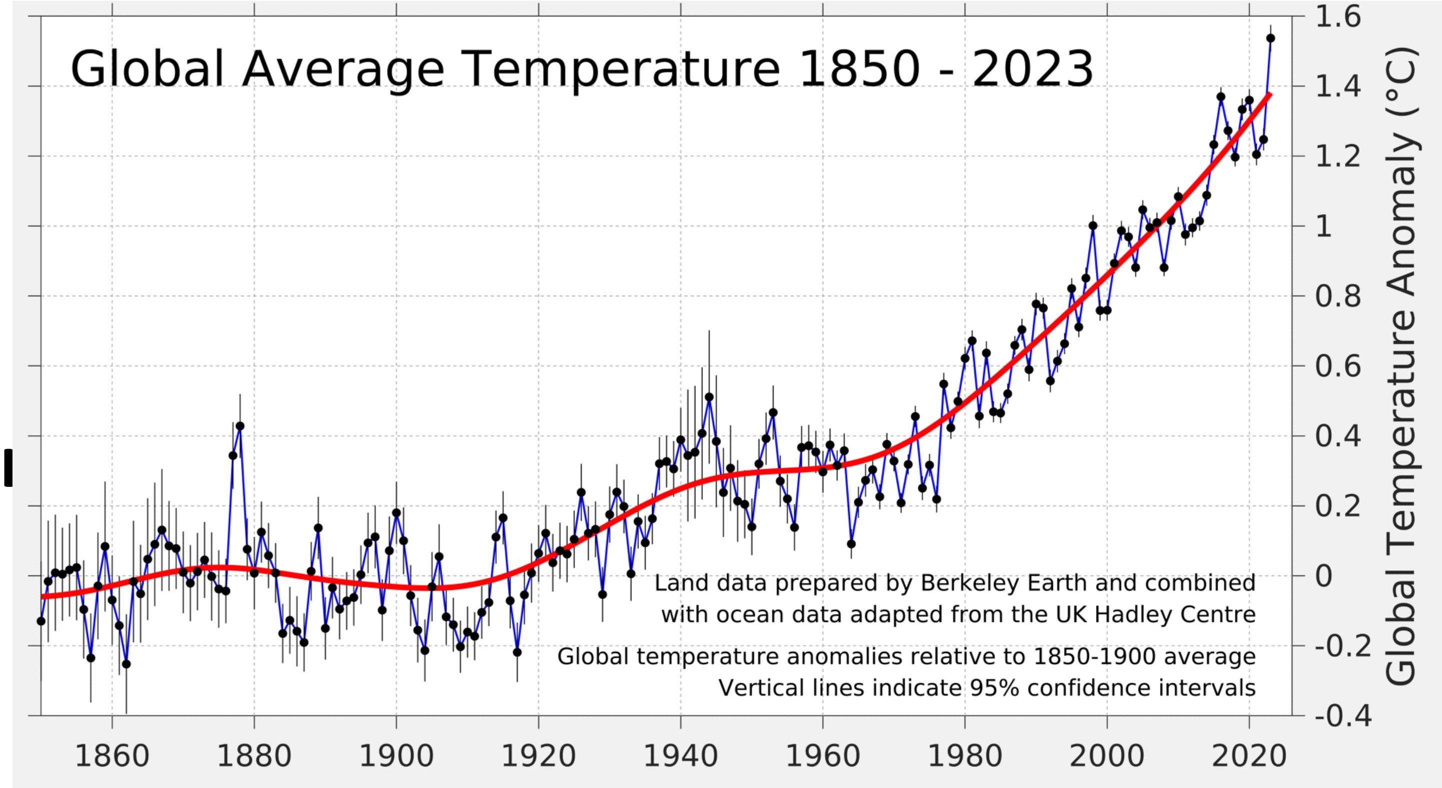
Stakeholders

Background 2- climate change

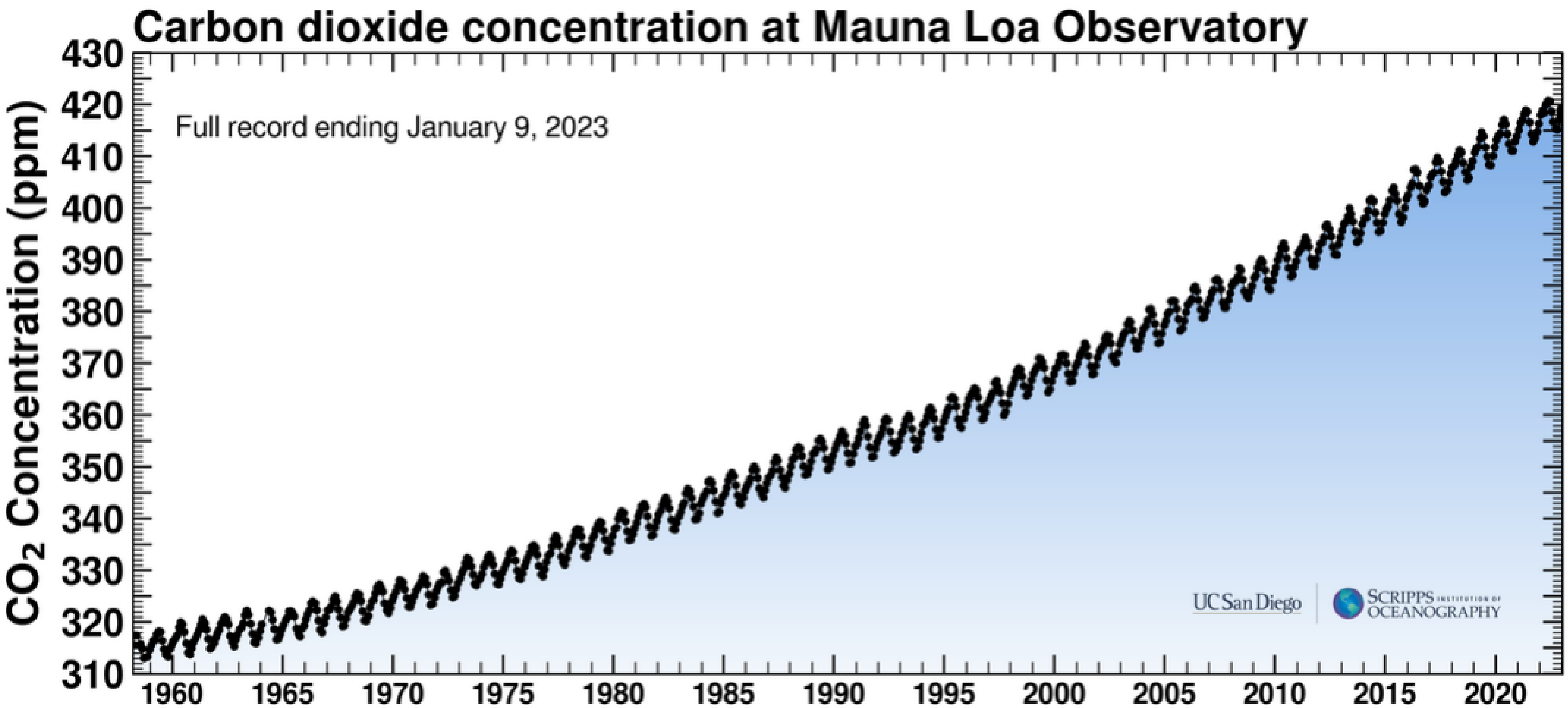
World emission



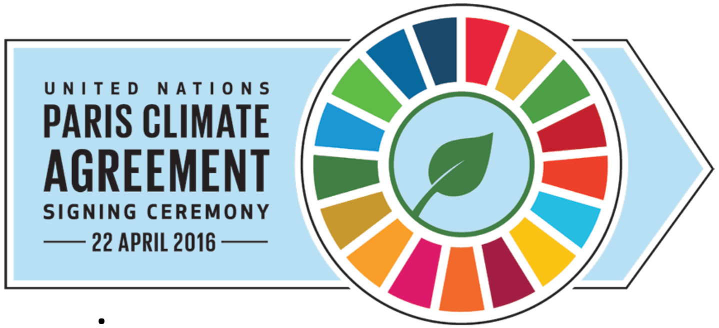
Global Temperatu



CO2 concentration in Atmosphere



The Paris Agreement



- Central aim is to keep a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius
- China has vowed to peak carbon emissions by 2030 and carbon neutral by 2060
- The US has committed to cut emissions 26-28% below 2005 levels by 2025

Background 3 - Problem with conventional financial

- Common parameters:
  - ROI
  - PE ratio
  - PB ratio
  - Market capital
  - Net asset value
  - Dividend rate

Problems

- Not actionable – describe consequences, not cause, describe what happened, not why happened
- Only provide one perspective of performance
- Provide limited guidance for future actions
- May encourage actions that decrease both shareholder and customer value by encourage managers to achieve short-term financial performance

Non-financial information

- Has been debated for a long time:
  - What kind of information is suitable for reporting
  - What kind of information is worth for reporting
  - Can it be quantified?
  - Can it be measurable?
  - Can it be comparable?

GRI topic standards

GRI STANDARDS

- **ECONOMIC**
  - GRI 201 Economic performance
  - GRI 202 Market presence
  - GRI 203 Indirect economic impact
  - GRI 204 Procurement practices
  - GRI 205 Anticorruption
  - GRI 206 Unfair competition
- **ENVIRONMENTAL**
  - GRI 301 Materials
  - GRI 302 Energy
  - GRI 303 Water
  - GRI 304 Biodiversity
  - GRI 305 Emisions
  - GRI 306 Effluents and residues
  - GRI 307 Environmental compliance
  - GRI 308 Suppliers environmental evaluation
- **SOCIAL**
  - GRI 401 Employment
  - GRI 402 Employer-employee relationship
  - GRI 403 Occupational health and safety
  - GRI 404 Training and education of staff
  - GRI 405 Diversity and equal opportunities
  - GRI 406 Against discrimination
  - GRI 407 Freedom of association and collective bargaining
  - GRI 408 Child labor
  - GRI 409 Forced labor
  - GRI 410 Safety work practices
  - GRI 411 Rights of indigenous peoples
  - GRI 412 Human rights evaluation
  - GRI 413 Local communities
  - GRI 414 Social evaluation
  - GRI 415 Public policy
  - GRI 416 Customer health and safety
  - GRI 417 Marketing and labeling
  - GRI 418 Customer privacy
  - GRI 419 Socioeconomic compliance

Task Force on Climate-related Financial Disclosure

G20 Finance Ministers and Central Bank Governors asked the Financial Stability Board (FSB) to review how the financial sector can take account of climate-related issues.

The FSB established the Task Force on Climate-related Financial Disclosures (TCFD) to develop recommendations for more effective climate-related disclosures that:

- could "**promote more informed investment, credit, and insurance underwriting decisions**" and,
- in turn, "would enable stakeholders to **understand better** the concentrations of **carbon-related assets in the financial sector** and the financial system's **exposures to climate-related risks**."

Industry Led and Geographically Diverse Task Force

The Task Force's 32 international members, led by Michael Bloomberg, include providers of capital, insurers, large non-financial companies, accounting and consulting firms, and credit rating agencies.

When ESG meets financial requirement

The Task Force published its final report in June 2017.

The report outlines recommendations to help address climate-related disclosure challenges faced by:

- **Issuers** who generally have an obligation under existing law to disclose material information, but lack a coherent framework to do so for climate-related information, and
- **Investors, lenders, and insurers** who need decision-useful, climate-related information to make informed capital allocation and financial decisions

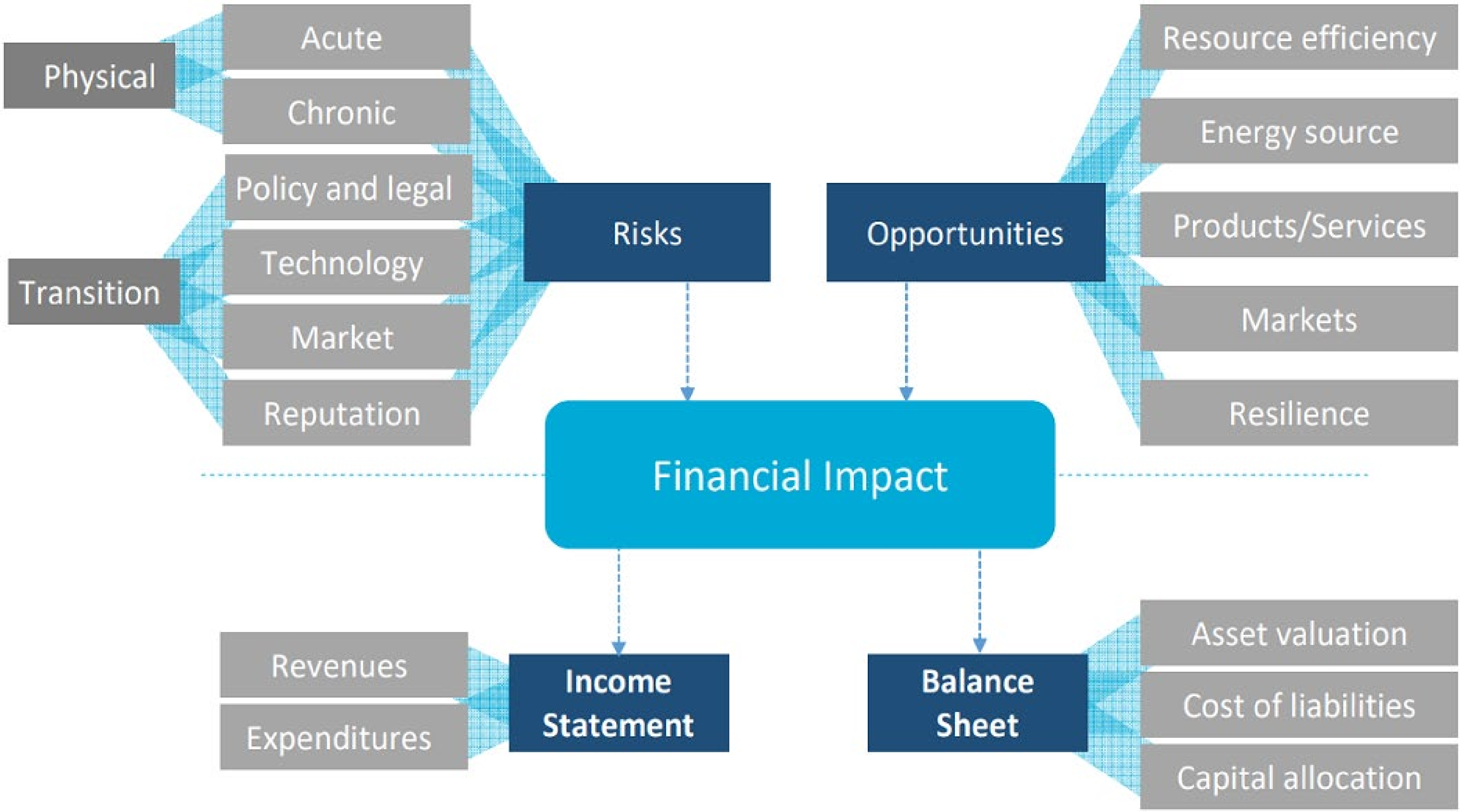
Final Report

Recommendations of the Task Force on Climate-related Financial Disclosures

TCFD | TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES

June 2017

Risk and opportunities



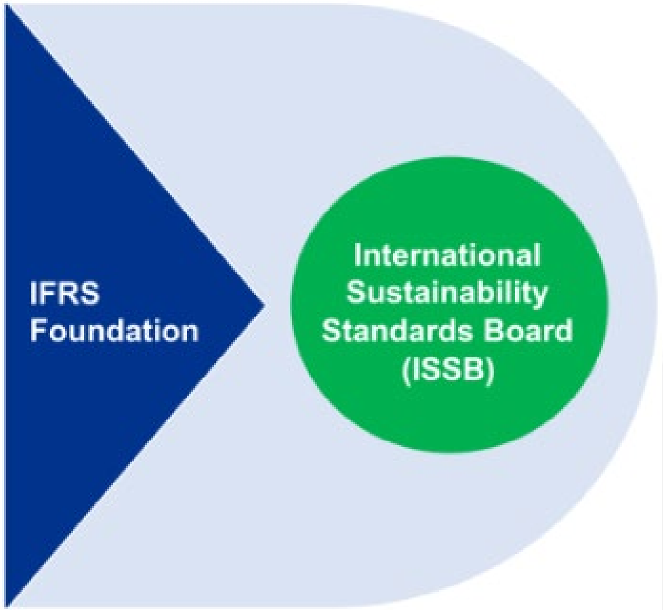
TCFD recommendations

To help identify the information needed by investors, lenders, and insurance underwriters to appropriately assess and price climate-related risks and opportunities.

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the organisation's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material.	Disclose how the organisation identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
a) Describe the board's oversight of climate-related risks and opportunities.	a) Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term.	a) Describe the organisation's processes for identifying and assessing climate-related risks.	a) Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.
b) Describe management's role in assessing and managing risks and opportunities.	b) Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.	b) Describe the organisation's processes for managing climate-related risks.	b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
	c) Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.	c) Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.

IFRS-ISSB

- The IFRS Foundation is a public interest organisation that was established to develop globally accepted accounting standards.
- IFRS Foundation announced the formation of the International Sustainability Standards Board (ISSB) on 3 November 2021 at COP26 in Glasgow

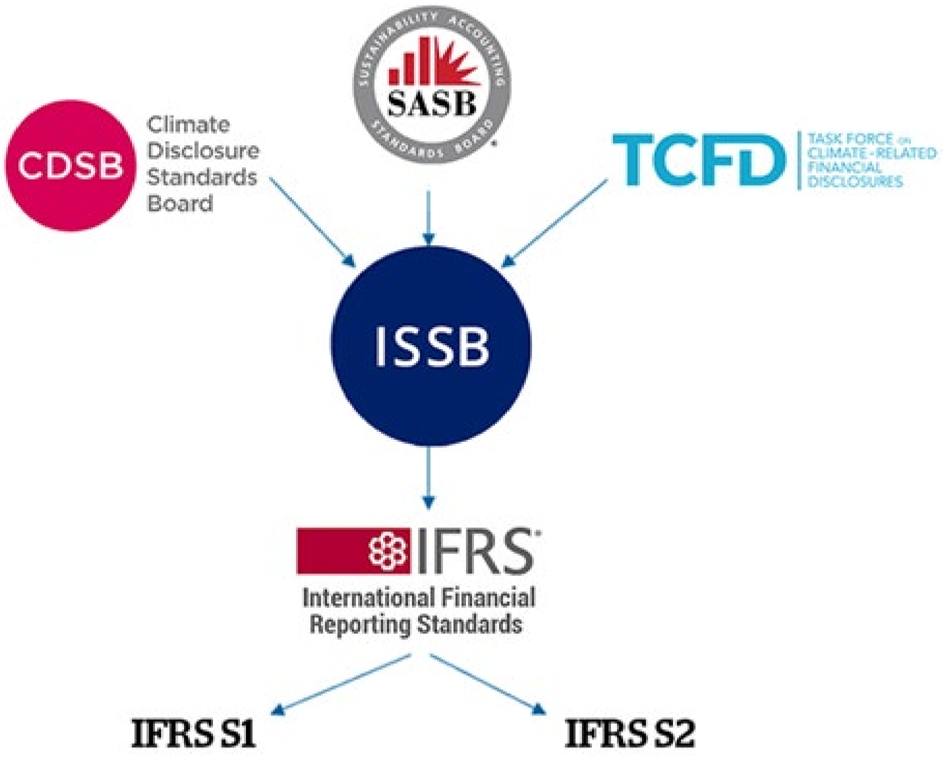


Consolidation of CDSB, SASB and TCFD

- CDSB -- Founded in 2007 during the World Economic Forum, the Climate Disclosure Standards Board (CDSB) was tasked with addressing both environmental and social reporting. In 2022, the CDSB announced it had fulfilled its mission to "fill a gap" in the absence of a globally recognized body for sustainability standards by integrated it into its International Sustainability Standards Board (ISSB) framework.
- SASB -- The Sustainability Accounting Standards Board (SASB) was founded as a nonprofit organisation in 2011 developed standards focused on industry-specific sustainability disclosures, addressing issues such as climate risk and opportunity. To clarify the confusion surrounding ESG reporting frameworks, these standards are now overseen by the IFRS and have been integrated into the International Sustainability Standards Board (ISSB).
- TCFD – Task Force on Climate-Related Financial Disclosure (TCFD) was set up by Financial Stability Board (FSB) under G20 to develop recommendations on the types of information that companies should disclose to support investors make informed decisions on climate-related risks and opportunities. In October 2023, the FSB asked the IFRS to take over the monitoring of the progress of climate-related risk reporting. The recommendations of the TCFD have also been incorporated into the ISSB standard which is due for global roll out in 2024.

Formation of ISSB and issued S1 S2

- The ISSB issued two drafts for comments on IFRS Sustainability Disclosure Standards (ISDS) on March 31, 2022.
- On June 26, 2023, the first two final drafts of ISSB standards were officially released: "International Financial Reporting Sustainable Disclosure Standard No. 1 - General Requirements for the Disclosure of Sustainability-related Financial Information" and "International Financial Reporting Sustainable Disclosure Standard No. 2 – Climate-related disclosures "



Brief content of S1, S2

	IFRS S1: General Sustainability Disclosures	IFRS S2: Climate-Related Disclosures
Objective	Information about **significant sustainability-related risks and opportunities**. Disclosures should be useful to the primary users of general purpose financial reporting in making decisions related to providing resources to the entity.	Information about **climate-related risks and opportunities**. Disclosures should assist users in understanding the use of resources and evaluating strategies, business model, and operational adaptation abilities.
Key Disclosure Topics	• *Governance* — Processes, controls, and procedures to monitor and manage **sustainability-related** risks and opportunities. • *Strategy* — Approach for addressing **sustainability-related** risks and opportunities that could affect business model and strategy over the short, medium, and long term. • *Risk management* — Processes to identify, assess, and manage **sustainability-related** risks. • *Metrics and targets* — Information used to assess, manage, and monitor performance of **sustainability-related** risks and opportunities.	• *Governance* — Processes, controls, and procedures to monitor and manage **climate-related** risks and opportunities. • *Strategy* — Approach for addressing **climate-related** risks and opportunities that could affect business model and strategy over the short, medium, and long term. • *Risk management* — Processes to identify, assess, and manage **climate-related** risks. • *Metrics and targets* — Cross-industry metrics, **industry-based** metrics, and other metrics used to measure **progress toward targets**.

S1 Compliance

Example 1—An entity with a single line of business

IE3 Entity Y is a regional passenger airline company. In identifying sustainability-related risks and opportunities that could reasonably be expected to affect its prospects, Entity Y is required to apply IFRS Sustainability Disclosure Standards in accordance with paragraph 54 of IFRS S1. In addition to applying IFRS Sustainability Disclosure Standards, Entity Y is required to refer to and consider the applicability of the disclosure topics in the SASB Standards. Entity Y concludes that its business model and activities most closely align with the *Airlines* SASB Standard.

54 In identifying sustainability-related risks and opportunities that could reasonably be expected to affect an entity's prospects, an entity shall apply HKFRS Sustainability Disclosure Standards.

S1 compliance - continue

SASB Standards

IG11 As set out in IFRS S1, an entity is required to refer to and consider the applicability of the disclosure topics in the SASB Standards in identifying sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects.

IG12 The SASB Standards are organised by industry. Each SASB Standard contains:

(a) industry descriptions—which are intended to help entities identify applicable industry guidance by describing the business models, activities and other common features that characterise participation in the industry;

(b) disclosure topics—which describe specific sustainability-related risks or opportunities associated with the activities conducted by entities within a particular industry;

(c) metrics—which accompany disclosure topics and are designed to, either individually or as part of a set, provide useful information regarding an entity's performance for a specific disclosure topic;

(d) technical protocols—which provide guidance on definitions, scope, implementation and presentation of associated metrics; and

(e) activity metrics—which quantify the scale of specific activities or operations by an entity and are intended for use in conjunction with metrics referred to in paragraph IG12(c) to normalise data and facilitate comparison.

IG13 The disclosure topics and associated metrics in the SASB Standards are not exhaustive. IFRS S1 requires an entity to present fairly all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects.

The universe of sustainability issues under SASB

Environment
- GHG Emissions
- Air Quality
- Energy Management
- Water & Wastewater Management
- Waste & Hazardous Materials Management
- Ecological Impacts

Social Capital
- Human Rights & Community Relations
- Customer Privacy
- Data Security
- Access & Affordability
- Product Quality & Safety
- Customer Welfare
- Selling Practices & Product Labeling

Human Capital
- Labor Practices
- Employee Health & Safety
- Employee Engagement, Diversity & Inclusion

Business Model & Innovation
- Product Design & Lifecycle Management
- Business Model Resilience
- Supply Chain Management
- Materials Sourcing & Efficiency
- Physical Impacts of Climate Change

Leadership & Governance
- Business Ethics
- Competitive Behavior
- Management of the Legal & Regulatory Environment
- Critical Incident Risk Management
- Systemic Risk Management

Taxonomy of SASB

- SASB takes an evidence-based approach to assess whether sustainability topics are reasonably likely to have material impacts on the financial condition or operating performance of the company. I doing so, this approach considers evidence of interest to investors and evidence of financial impact
- SASB has developed the sustainability disclosure taxonomy

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One example under F & B – Meat, Poultry & Dairy

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Materiality and metric

TOPIC	METRIC	CATEGORY	UNIT OF MEASURE	CODE
Greenhouse Gas Emissions	Gross global Scope 1 emissions	Quantitative	Metric tonnes (t) CO_2-e	FB-MP-110a.1
	Discussion of long- and short-term strategy or plan to manage Scope 1 emissions, emissions reduction targets, and an analysis of performance against those targets	Discussion and Analysis	n/a	FB-MP-110a.2
Energy Management	(1) Total energy consumed, (2) percentage grid electricity and (3) percentage renewable	Quantitative	Gigajoules (GJ), Percentage (%)	FB-MP-130a.1
Water Management	(1) Total water withdrawn, (2) total water consumed; percentage of each in regions with High or Extremely High Baseline Water Stress	Quantitative	Thousand cubic metres (m^3), Percentage (%)	FB-MP-140a.1
	Description of water management risks and discussion of strategies and practices to mitigate those risks	Discussion and Analysis	n/a	FB-MP-140a.2
	Number of incidents of non-compliance associated with water quality permits, standards and regulations	Quantitative	Number	FB-MP-140a.3
Land Use & Ecological Impacts	Amount of animal litter and manure generated, percentage managed according to a nutrient management plan	Quantitative	Metric tonnes (t), Percentage (%)	FB-MP-160a.1
	Percentage of pasture and grazing land managed to conservation plan criteria	Quantitative	Percentage (%) by hectares	FB-MP-160a.2
	Animal protein production from confined animal feeding operations	Quantitative	Metric tonnes (t)	FB-MP-160a.3

Roadmap and Timeline of FSTB
(Financial Services and the Treasury Bureau)

2028

HK Standards apply to large PAEs, including large listed issuers and non-listed financial institutions carrying a significant weight

2027

HKEX to launch market consultation on mandating sustainability reporting in accordance with HK Standards

2026

1 Jan Large Cap Issuers[v] to disclose against New Climate Requirements on a mandatory basis

2025

In 2025 Expected release of a proposed local regulatory framework for sustainability assurance for public consultation by AFRC

1 Jan Main Board issuers to disclose against New Climate Requirements on a "comply or explain" basis

2024

Jan Effective date of ISSB Standards

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Together We Flourish

Definition of PAE (public accountable entities)

As set out in the Inaugural Jurisdictional Guide issued by May 2024 , PAEs are	
1. Entities whose securities are traded in a public market or entities in the process of issuing securities for trading in a public market (sometimes called listed entities or public entities); and	2. Entities that hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses (for example, banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks) and have a significant weight in the jurisdiction, regardless of their ownership structure or listed status.

The Inaugural Jurisdictional Guide makes it clear that PAEs do not include:	
1. Entities whose securities are traded in private markets;	4. Entities that hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses and do not have a significant weight in the jurisdiction; or
2. Entities whose securities are traded in relatively small public securities markets;	5. Other entities such as private entities and entities without public accountability that are often referred to as SMEs.
3. Entities that are generally characterized by small shareholder bases or low liquidity, or that are not subject to extensive corporate governance disclosure requirements;	

Finance met ESG

- TCFD was announce in 2017, which was the first time financial figures needed to be disclosed in the ESG report
- Accountants started to have a role to play in ESG report
- Formulating strategies, implementing new disclosure requirements related to financial disclosure

Assurance in the future

- Involvement of financial disclosure needs Accountants to play a role in the assurance process

Help to apply Green Loans

Green Loan

Green loans can support your various green projects, such as improving energy efficiency, developing renewable energy, green buildings, etc. These loans can finance or refinance (in whole or in part) companies and projects which are in the designated "Green Sectors" and adhere to Green Loan Principles[1].

Product Feature:

Preferential rate granted for different green projects

Sustainability-linked Loan

Loan terms are associated with pre-defined sustainability-linked targets, such as annual carbon emission reduction, annual employee training hours, etc. Corporates will need to follow Sustainability-linked Loan Principles[2], with regular monitoring through progress reports.

Product Feature:

Fixed financial incentives for achieving particular sustainability performance targets

Social Loan

Social loans can empower your diverse social projects that achieve positive social outcomes, such as enhancing healthcare accessibility, constructing affordable housing, supporting microfinancing, etc. These loans can finance or refinance (in whole or in part) social projects which align with the Social Loan Principles[3].

Product Feature:

Preferential rate granted for different social projects

Large tenders, all required ESG

- Larger tenders, both from Government or Non-Government body, needs the disclosure of ESG performance
- Tenders also needs to have input on ESG elements

Green procurement

- Almost all the large enterprise has policy on green procurement
- SME needs to equip themselves

As a supplier

- SME as a supplier, my face ESG ambush anytime
- Example:
    1. Supplier of Yum China, Amazon, etc
- Need consultants to help to engage international standard