# ESG

## A new lens for competitive risk analysis and opportunity for banks and audit firms

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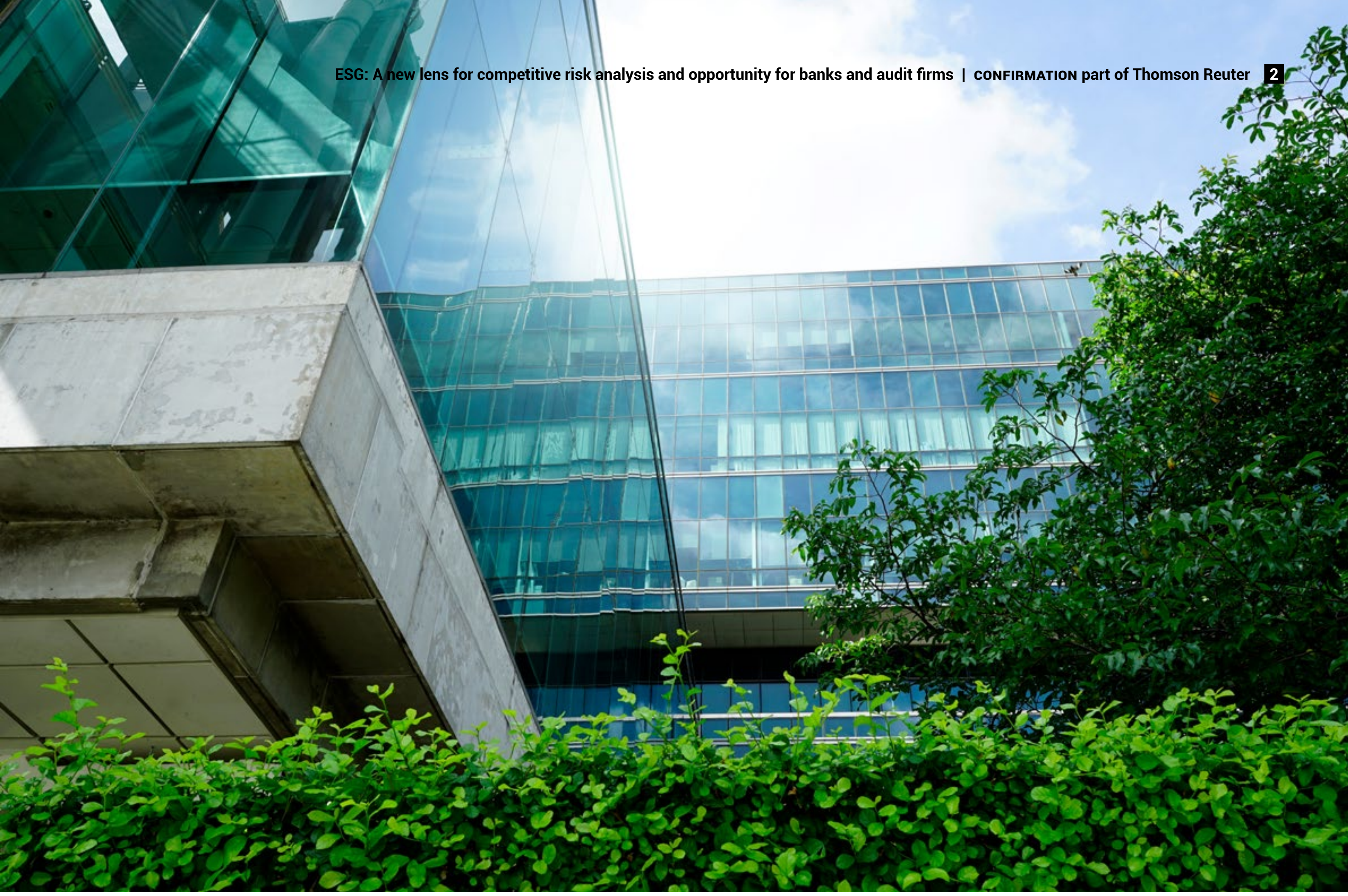


# ESG

The environmental, social and governance (ESG) landscape is rapidly evolving as regulatory scrutiny and public accountability intensify. Banks and audit firms now find themselves operating in a complex ecosystem where strategies and considerations around sustainability best practices extend beyond a traditional 'inward' approach.

No longer is it sufficient for banks and audit firms to focus solely on their own ESG performance. They must broaden their perspective to encompass external factors that can impact their operations.

Indeed, the past decade has revealed the troubling immaturity of certain publicly disclosed ESG data, highlighting a glaring absence of internal controls. This oversight has significantly amplified the inherent risks associated with ESG data, creating a pressing need for a more robust and reliable approach.

However, the opportunity is not lost. It is now up to banks and audit firms to capitalise on this transformative time, leveraging innovative technology and best practices.

They must be proactive and acknowledge that ESG is simply business seen through a new lens of competitive risk analysis and opportunity — and it's here to stay.

# The ESG revolution: Embracing opportunities for banks and audit firms

In striving to meet the triple bottom line, which considers people, the planet and profit, organisations of all kinds are positioning themselves to better meet growing stakeholder expectations, remain competitive, manage risk and contribute to a more sustainable world with their ESG frameworks.

Recent Deloitte research reveals that financial services executives anticipate benefits from enhanced ESG reporting like improved return on investment (ROI) and increased efficiencies (55%), enhanced trust with stakeholders (52%), stronger employee attraction and retention (52%), elevated brand reputation (47%) and risk reduction (55%).

## Let's take a closer look:

**Financial:** In addition to the financial benefits of making ESG investments, ESG management and transparency also have a positive impact on sentiment and volatility. As such, it is recommended they be incorporated into overall corporate strategy and quarterly earnings guidance.

**Employees:** Research demonstrates that people want to work for an employer that has strong values and a commitment to ESG principles, even if it means less pay. In fact, there is a growing body of evidence, indicating an undeniable correlation between talent retention and ESG.

**Branding:** A strong commitment to ESG produces a positive public perception for companies. According to the Institute for Customer Service, there is a direct correlation between an organisation's social stance and its appeal to consumers.

What's more, McKinsey research reveals that consumers are holding banks to higher ESG standards as 14% of total client-driven revenues were controlled by consumers whose banking preferences were influenced by concern about purpose and sustainability. And when it comes to making investments during mergers and acquisitions, 65% of international dealmakers believe ESG is a key consideration.

It's clear that ESG has gone from a "nice to have" to an integral component of long-term success. However, as these initiatives become deeply entrenched into corporate culture, the methods to weigh the benefits and risks of such activities must come into sharper focus.

# ESG risk intelligence: Empowering financial institutions to thrive in a sustainable world

Like any business, banks consume resources and have an environmental footprint. The difference, however, lies in the fact that many also provide financing to infrastructure, building and other projects that impact the environment.

Moreover, their lending policies have a social impact, ranging from the more negative discriminatory lending to the largely positive green building loans. And a bank's governance practices have the profound ability to prevent or flag activity like money laundering or currency manipulation, which can greatly impact a bank's reputation, regulatory standing and revenues.

As such, sustainability is no longer solely an ethical concern. It's rapidly evolving into an economic imperative, giving rise to a new type of risk to consider: ESG risk. Growing investor demand for sustainable products combined with mounting regulatory scrutiny are underscoring the imperative for banks to incorporate ESG risks into their risk management framework.

In fact, a joint study by Deloitte and The Center for Audit Quality revealed that nearly half (42%) of audit committee members at the corporate board level noted an increase in the risk of fraud in companies' ESG disclosures. Even more, 73% of North American dealmakers believe that ESG scrutiny will only increase over the next three years as the landscape matures.

To gain a deeper understanding of this issue, Carey Oven, National Managing Partner of Deloitte's Center for Board Effectiveness, says it is crucial to examine the key components of fraud, known as the fraud triangle framework, within the context of ESG data:

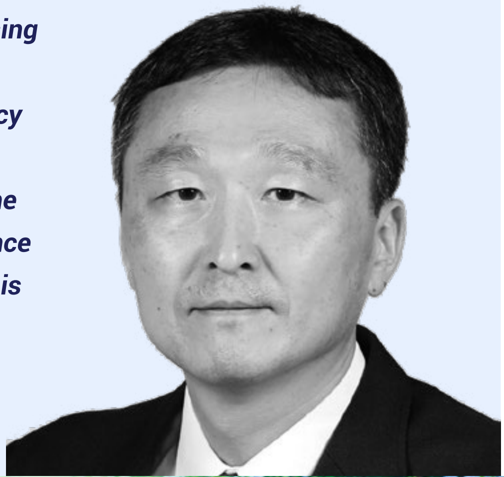
- **Pressure:** Pressure is present around the increasing expectation that ESG data be released to the public.
- **Opportunity:** The transparency, auditability and nature of disclosed data are governed by the controls around that data, the estimates used for the data and the data creation — all of which present additional opportunities for fraud.
- **Rationalisation:** The immaturity in the data's transparency, verifiability and auditability "presents an opportunity for additional pressure and ultimately, rationalisation of fraud".

For example, many companies rushed to issue climate transparency reports in the past decade, yet these disclosures often lacked robust, auditable data. Consequently, the risk of perceiving these ESG numbers as potential fraud has significantly increased.

*From the audit firms' perspective, there is an acute awareness of the potential risks associated with the immature nature of some publicly disclosed ESG data. The lack of robust internal controls surrounding ESG information poses a significant challenge, necessitating the development of more stringent governance mechanisms," says Masaru Yarime, Associate Professor from Division of Public Policy, Division of Environment and Sustainability, the Hong Kong University of Science and Technology*

*"On the other hand, banks are grappling with the increasing scrutiny surrounding ESG data and its impact on their operations. As stakeholders demand greater transparency and accountability, banks must confront the risk of reputational damage and regulatory non-compliance. The integration of ESG considerations into risk and compliance frameworks becomes a critical imperative to navigate this evolving landscape."*

—Masaru Yarime



# Mitigating ESG risks

To mitigate ESG risks in this maturing landscape, banks and auditors must fulfill stakeholder expectations, identify, measure, quantify and monitor ESG risks and meet public net-zero commitments.

Several crucial steps can be taken to address these challenges effectively:

01 **Embed ESG into the risk infrastructure:** Increasingly, financial institutions are finding they must factor ESG into their compliance programs, much like is already performed with anti-money laundering (AML) and Know Your Customer (KYC) requirements.

02 **Continuous monitoring and reporting:** Implement robust monitoring systems to track ESG performance, regularly report on progress and ensure transparency and accountability in ESG-related initiatives.

03 **Engage stakeholders:** Convene stakeholders from various departments, including corporate legal, finance and internal audit to determine the information to be reported in filings and transparency reports.

04 **Capacity building:** Invest in training and upskilling programs to enhance the ESG expertise of employees, auditors and risk management teams, enabling them to effectively identify and manage ESG risks and seize opportunities.

05 **Focus on tooling and customisation of ESG data collection and reporting:** Utilise advanced tools and customise data collection and reporting processes to enhance accuracy and reliability.

Both audit firms and banks share the common goal of mitigating ESG fraud risks. By collaborating and leveraging their respective expertise, they can foster a culture of vigilance, implement comprehensive risk management strategies and enhance data governance practices. Through this concerted effort, audit firms and banks can proactively address ESG fraud concerns, bolster stakeholder trust and contribute to a more sustainable financial ecosystem.

# ESG risk and compliance made easy with Confirmation

As ESG regulatory obligations move from voluntary standards to mandatory requirements, banks and auditors must stay ahead of the curve. Technology plays a compelling role in helping to provide greater transparency and traceability in digitally-transformed business processes and should not be left out of the sustainability conversation.

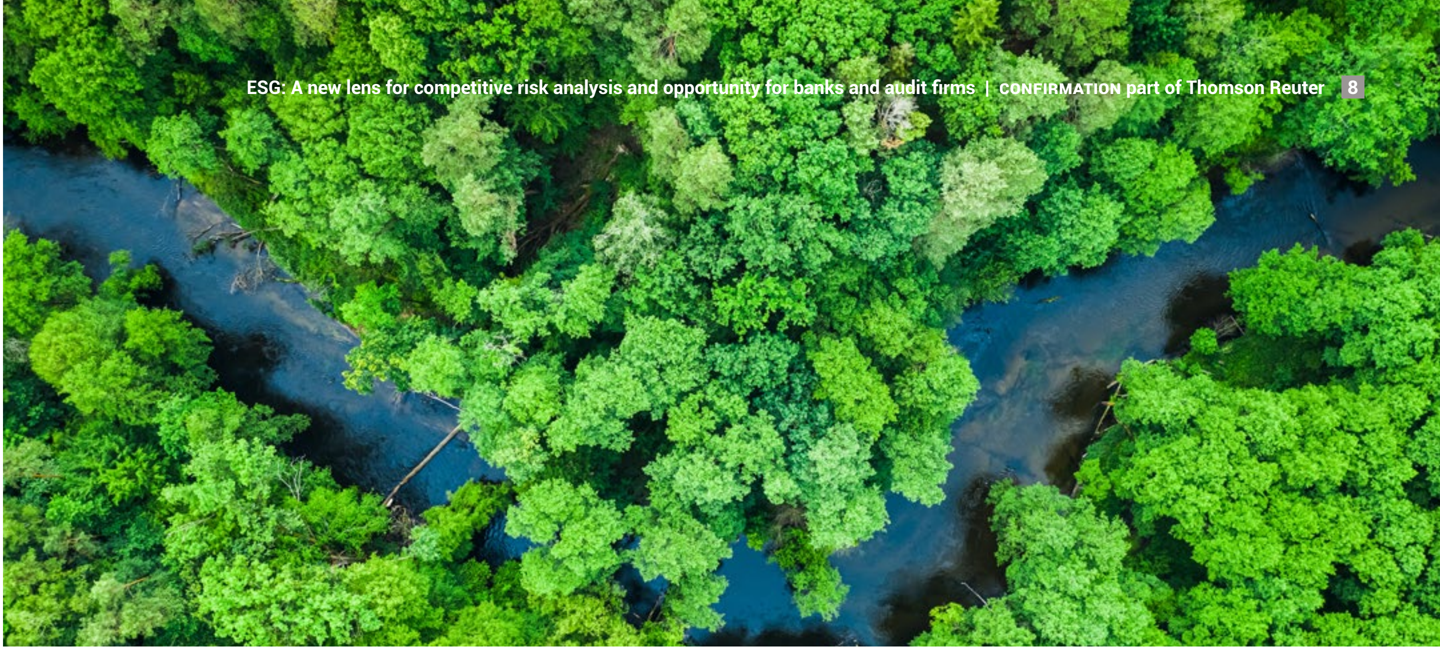
Moving from paper-heavy to digitally-transformed processes and using technology to connect teams and departments are integral to elevating sustainability.

As it relates to paper, specifically, research demonstrates that:

- **2,700** liters of water is used to make 1 tonne of paper
- **50%** of the waste of businesses is composed of paper
- Paper also accounts for **26%** of total waste at landfills
- Demand for paper is expected to double before **2030**
- One tree produces enough oxygen for **3** people to breathe

Confirmation, part of Thomson Reuters, is a powerful ally for banks and audit firms to facilitate the transition from paper-intensive workflows to sustainable digital practices. Trusted by an unmatched global network of banks, Confirmation manages the complete digital confirmation process from end to end with its safe and sophisticated platform, making audit confirmations fast , easy and environmentally sustainable.

> ***Whilst banks and audit firms consider to prioritizing their physical asset utilization, the transition from paper-centric operations to digital environments is not merely advantageous, but absolutely imperative," asserts Kiran Bafna, AEM, Director of Confirmation. "The environmental impact is profound: a remarkable 93% of all paper production originates from our forests. This year alone, deforestation has claimed more than 8.8 million hectares, a rate that underlines the ecological damage and unsustainability of such practices."***
>
> —Kiran Bafna



# Navigating the maturing ESG landscape: A call to action for climate leadership today

Banks and audit firms that fail to act swiftly will find themselves and their leadership teams ill-equipped to adapt to the evolving ESG landscape. As critical issues like climate change, corporate misconduct and shifting market dynamics continue to shape business success, integrating sustainability-related regulatory requirements into banking and auditing frameworks becomes an imperative that cannot be ignored.

The path to success lies in seizing this moment and driving positive change. Those who take decisive action now will not only future-proof their organisations but also cultivate trust, enhance reputation and unlock new opportunities. It's time to embrace the transformative power of ESG and forge a path toward a more sustainable and prosperous future.

*In a world that demands responsible and forward-thinking financial services, banks and auditors should be optimizing and incorporating ESG considerations into their core strategies, says Elizabeth Beastrom, president, Tax and Accounting Professionals, Thomson Reuters.  With an eye towards digitizing operations and proactively embracing sustainable ESG considerations, this shift can help decrease waste, energy and real estate with the added benefit of better accuracy in a fast-paced environment. The time to act is now."*

—Elizabeth Beastrom

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