

Operationalizing the ESG Business Imperative

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OCEG is a global, non-profit think tank and community. We invented GRC.

We inform, empower and help advance more than 100,000 members on governance, risk management, and compliance (GRC). Independent of specific professions, we provide content, best practices, education, and certifications to drive leadership and business strategy through the application of the OCEG GRC Capability Model and Principled Performance®. An OCEG differentiator, Principled Performance® enables the reliable achievement of objectives while addressing uncertainty and acting with integrity.

Our members include c-suite, executive, management, and other professionals from small and mid-size businesses, international corporations, non-profits, and government agencies.

Founded in 2002, OCEG is headquartered in Phoenix, Arizona.

Learn more at oceg.org

ABOUT



ServiceNow (NYSE: NOW) is making the world of work, work better for people. Our cloud-based platform and solutions deliver digital workflows that create great experiences and unlock productivity for employees and the enterprise.

ServiceNow can help you mobilize your ESG strategy, build transparency that leads to trust and a positive reputation, and create value and impact to support business performance. Our platform unifies ServiceNow, partner, and custom workflows across the ESG pillars of your program. These workflows interact with an integrated operational control solution for planning, managing, governing, and reporting on ecosystem-wide activities.

This silo-defying approach aligns your investments. It operationalizes your processes and meshes ESG efforts with other corporate priorities, serving stakeholders as regulations, timelines, and needs accelerate.

Learn more at servicenow.com/workflow/guides/esg



KPMG Impact - Create a more sustainable future while driving measurable growth today.

KPMG believes ESG makes business better. Effective engagement mitigates risk, builds stakeholder trust, creates value and delivers competitive advantage – today. Yet, while the “why” of ESG is clearly understood, many companies are still challenged by the “how” to fully integrate ESG into their business strategy and effectively implement. KPMG IMPACT helps achieve your ESG imperatives. At the forefront of ESG innovation and implementation, we’ve helped companies become ESG leaders. We don’t just talk-- we take action--working closely with you on your ESG strategy, execution, reporting, assurance and transformation. Our holistic solution provides deep experience on priority ESG issues such as climate, financial, social and governance, an integrated framework to advance your organization’s ESG progress and data-driven solutions tailored to your needs. Wherever you are on the journey, we will work side-by side to help your achieve the ESG advantage.

Learn more at visit.kpmg.us/impact

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THE BUSINESS VALUE OF ESG

Environmental, Social and Governance criteria (ESG) have been steadily growing in importance to the investor community, customers, employees, and corporate leadership. More now than ever, addressing ESG practices as part of business strategy is essential, not only to ensure compliance with reporting requirements and investor desire for information, but also to drive and maintain customer and employee loyalty.

Each part of the ESG construct contributes to both societal goals and business growth through sustainable and transparent business practices. The “E” in ESG largely refers to efforts taken to ensure a resource-efficient and sustainable planet through actions to address climate change concerns and use sustainable energy sources, engage in sustainable procurement practices, and reduce waste streams. The “S” for Social focuses on supporting the community where operations are based and making work more equitable, accessible, and rewarding for all people, with actions to prevent exploitation, human rights abuses, and unsafe work conditions. The “G” represents increased calls for more transparent and ethical business practices, as well as oversight that ensures integrity in all aspects of the business.

While some view ESG as merely an extension of earlier sustainability movements, there is a significant shift from the morality-based thinking that drove those efforts to “do the right thing,” toward a view that ESG is beneficial to the business itself from an economic perspective.

Benefits arise as needed resources are preserved, workforces are stabilized, governance is strengthened, and sustainable profitability is gained. Opportunities also exist in creating new and innovative products and services to meet ESG goals, driving new profitability and competitiveness.

THE MISTAKE OF SHORT-TERM THINKING

The failure to address the need for sustainability is a component of short-term thinking. This failure leads to decisions that seek to increase near-term reported profits at the expense of the long-term sustainability of those profits. Put another way, companies are living quarter to quarter, and that is a big mistake.

Simply put, short-term thinking also gets in the way of long-term value creation.

Companies can look proactively at ESG as a source of new opportunity for innovation in products and services and use this drive to adapt their spending and processes for more sustainability and social responsibility.

Organizations often are forced into action by competition, disasters like the COVID-19 pandemic, and environmental factors such as climate change. The later a company engages with ESG factors and risk management, the more limited its options. We have seen in multiple studies that more resilient companies suffer less and recover faster than less resilient organizations. Environmental and social risks demand ever greater resilience.



ESG AND PRINCIPLED PERFORMANCE

The current focus on ESG fits hand in glove with OCEG's concept of Principled Performance – the state of being in which an organization can reliably achieve its objectives while addressing uncertainty and acting with integrity.

The drive for Principled Performance that began in the early 2000's led to development of guidance for integrating governance, risk management, and compliance (GRC) – as presented in OCEG's GRC Capability Model. The Model's emphasis on the need to align business objectives and operations with the risks presented and related controls is equally applicable to the development of ESG capabilities.

The Model sets out a collection of integrated GRC capabilities that enable the achievement of Principled Performance. The same integrated approach is demanded for ESG, and its application will enable outcomes that strengthen achievement of business objectives overall.

Establishment of a strong ESG capability is a key aspect of Principled Performance and a fundamental driver of a strong business, now and in the future.

Forward-thinking investors like Larry Fink of BlackRock, and sustainability-focused corporate governance approaches like that stated in the World Economic Forum's paper *The New Paradigm*¹, encourage the business community to consider the values of stakeholders beyond shareholders and customers. The "S" in ESG for "Social" references these broader societal stakeholders.

Fink advises companies to disclose how they are contributing to and preparing for a "net zero world", where net greenhouse gas emissions are eliminated by 2050, or even sooner in some estimations. The firm, State Street Global Advisors, argues the main stewardship priorities in 2021 will be the systemic risks associated with climate change and a lack of racial and ethnic diversity on company boards. In the aftermath of the COVID-19 crisis, investors in every part of the world will increasingly consider ESG factors to plug the gaps created by the pandemic.

The Environmental and Social elements of ESG will converge, and the green bond market will continue to grow as climate change concerns move to the forefront. The next few decades will see the largest generational wealth transfer in history as trillions in assets transition from Baby Boomers to Millennials. We are already at the start of an era for ESG investing, as Millennials use their sense of responsibility to choose their value-based investments.

CHALLENGES IN ESG

Challenges in ESG echo the challenges that businesses have had in governance, risk management and compliance overall, and the solution is the same – establishing an integrated set of capabilities that provide a clear view and analysis of relevant information, timely opportunity to address arising risks, and management of information that enables complete and accurate reporting to a growing body of internal and external stakeholders.

¹ *The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth*, issued in September 2016 by the World Economic Forum

ESG challenges include:

- Global expansion of requirements for managing and reporting on ESG actions
- Evolving environmental and social challenges to the business
- Growing demand for transparency in governance
- Vast amounts of poor quality ESG data and metrics in siloed tools and processes
- Disconnect between business objectives and ESG concerns

If the organization is to achieve Principled Performance, it must address ESG challenges by building an integrated approach that supports business objectives, addresses uncertainty, and enables the organization to act with integrity.

The Global Expansion of ESG Requirements

For many companies, the ESG requirements of different countries and regional bodies present a challenge as they are subject to what may be conflicting requirements across their global operations. They need to know what is required, and then figure out a way to address multiple sets of regulations that are constantly shifting.

ESG is gaining traction in the United States, where the United States House of Representatives passed the ESG Disclosure and Simplification Act and the Disclosure of Tax Havens and Offshoring Act in June of 2021 which, if enacted into law without change, would require the SEC to establish standardized ESG metrics and require public companies to report on them. These bills as written, enable the SEC to study independent and internationally accepted frameworks for reporting when creating rules for ESG disclosure. In July, SEC Chairman Gary Gensler announced an intent to issue rule revisions regarding how ESG risks are measured and his intention to issue a proposed requirement for climate risk disclosure by the end of 2021.

In Europe, the EU Non-Financial Reporting Directive (NFRD) applies to companies with a 20M Euro balance sheet or 500 employees. The NFRD seeks to ensure that investors have access to adequate non-financial information from companies to be able to take account of sustainability-related risks, opportunities and impacts in their investment decisions. It also aids civil society organizations, trade unions and others to access information from companies' accountability reporting on impacts to society and the environment.

The EU Corporate Sustainability Reporting Directive (CSRD) extends the work of the NFRD to Small and Medium-sized Enterprises (SME). Many SMEs increasingly have been asked for sustainability reporting, including sources of capital or financing. The European Financial Reporting Advisory Group (EFRAG) will be responsible for developing the draft aimed at simplification of reporting.

While much reporting is voluntary, steps are being taken to make reporting mandatory. The UK is set to become the first G20 country to make the Task Force on Climate-related Financial Disclosures (TCFD) mandatory across the economy, as set out in its 2020 Roadmap and Interim Report. In June of 2021, the Group of Seven (G7) countries communicated their support for moving towards the mandatory climate-related financial disclosures that provide consistent and decision-useful information for market participants.

Institutional investors may need to report on an array of new ESG metrics for their portfolio companies if the European Union's Sustainable Finance Disclosure Regulation (SFDR) is finalized in its current form. Most companies are underprepared for this possibility.

This ever-evolving regulatory landscape, with different standards for gathering and reporting information on various focus areas, demands a more formal, structured and efficient approach than currently exists for both monitoring for change and ensuring responsive changes in ESG management and reporting.

Evolving Environmental and Social Challenges

Twenty years ago, environmental concerns focused primarily on regulatory requirements aimed at providing clean water and air and included some consideration of greenhouse gas emissions. Social issues extended to concerns about the immediate impact of pollution on poor communities, perpetuation of low wage jobs and child labor, particularly in global supply chains. While the term “sustainability” came into use in the late 1980’s, its meaning was never very clear to the general population, which eventually came to understand it as conservation of resources.

With the rise of ESG research and writing, the concept of sustainability has moved beyond resource conservation to a broader understanding of the need to build a sustainable business model overall.

Preserving biodiversity, changing energy sources, reusing, and repurposing materials, and protecting the quality and quantity of water are all critical aspects of sustainability that businesses must address not only for societal reasons, but also to preserve and grow the value of the business itself.

The focus today is on building a circular economy that supports sustainability by having economic growth without greater resource use. The ever-growing concern about climate change and the recognition that we need to not only mitigate but also contribute to solutions underscores the connection of ESG to business resilience.

Social issues today go beyond low wages and child labor. For many companies, attracting, developing and retaining a qualified and engaged workforce and promoting a diverse and inclusive work environment have become increasingly material issues under the ESG umbrella. This now extends into preventing the use of modern slavery and protecting human rights in supply chains, ensuring protection of communities from climate change impacts, delivering safe products from safe workspaces, and managing geopolitical conflicts with social considerations. Some companies are deciding not to sell certain products based on their labor or environmental impacts or simply because the product itself, such as semi-automatic weaponry, raises societal concerns.

Companies are already beginning to reinvent product development processes and build new products more sensitive to ESG issues and factors such as sustainable innovation. To ensure long-term success, organizations need to commit to continuously identifying, understanding, and addressing these evolving concerns.

Disconnect Between Business Objectives and ESG Concerns

Despite poor data, ESG is acknowledged by many investors and business leaders to pose actual risks, and it is being integrated into enterprise risk management. In the past, companies only reported on their impacts to the environment. Now, companies must also focus on the environment’s impact on their business, as well as the risks inherent in social and governance issues. This change in focus presents a significant challenge for many boards and executive teams. They must identify, assess and quantify potential risks that go beyond direct financial impacts, such as reputation damage, supply chain disruption and workforce dissatisfaction.

While in the past, leadership would set corporate objectives and then demand risk managers control the threats to those objectives, now strong ESG outcomes are becoming overarching objectives themselves.

This may lead to changes in core business plans and objectives.

ESG addresses significant governance concerns including board diversity and composition, workplace culture, human rights, anti-bribery and anti-corruption efforts, and data privacy. ESG impacts business practices such as product acceptability for gun manufacturers or pharmaceutical companies producing opioids. ESG risks affect decisions about who a company does business with and how information is shared that could generate negative headlines and directly impact the business and its stakeholders.

Given the priority that investors, customers, and employees are placing on ESG, it is time for organizations to review the design of their current ESG capability and level of integration into the business, or to start the design journey. Doing so will require executive-level sponsorship, a plan for change, and budget, which in turn require a compelling business case for ESG

EXAMPLES OF ESG MATERIAL TOPICS



GOVERNANCE

- Board diversity and independence
- Business conduct and culture/grievance mechanisms
- Employee incentives and risk culture
- Equal pay and wage gap
- ESG integration in financial analysis
- Ethical behavior
- Lobbying and public policy engagement
- Operating within the legal/regulatory environment
- Systemic risk management



SOCIAL

- Access to products and services
- Community investment
- Community financial health
- Customer financial protection
- Data privacy and security
- Location
- Human rights practices
- Investor activism
- Responsible sourcing
- Wealth inequality



ENVIRONMENTAL

- Natural Resource Preservation
- Greenhouse Gas (GHG) / Non GHG emissions
- Biodiversity protection
- Supply Chain environmental management
- Waste and Pollution
- Deforestation

EXECUTIVE SUITE ATTENTION TO ESG

ESI ThoughtLab research commissioned by ServiceNow surveyed 1,080 executives across 13 countries in 2021, and found that assessing and managing ESG risks is now a top responsibility for C-suite members

93% of COOs
40% claimed the lead role

90% of CEOs
45% claimed the lead role

76% of CFOs
43% claimed the lead role

BUILDING THE BUSINESS CASE FOR ESG

A strong business case must address the connection between ESG performance and financial performance. Companies can benefit all their stakeholders, including shareholders, employees, customers, and the communities in which they operate, by incorporating ESG into their organizational practices.

Highlight Added Value Opportunities

In all business cases, stakeholders and leadership want to achieve value for the effort. Opportunities for uplift from ESG integration that go beyond the obvious benefits of keeping up with compliance requirements, satisfying customers and investors, and fending off activist outcry include:

- Building brand affinity with current and future consumers who value ESG performance
- Gaining superior access to talent who want an employer that values sustainability
- Identifying threats on the horizon, such as water scarcity, that could impact the organizations' ability to operate in the long-term

The business case should identify the opportunities most relevant to the business that will add to competitive advantage and resonate with leadership.

Identify ESG Priorities

Each organization will focus on different priority ESG issues, depending on size, location, industry, customer base and other factors. Start out by identifying what presents the greatest impact to your company by performing an ESG materiality assessment. For example, a plastics manufacturer should focus more on carbon emissions than a research firm should. A clothing producer will prioritize modern slavery in the supply chain more than a bank will.

Utilize a materiality assessment as a strategic business tool to identify ESG impact on the organization. Organizations can get the most benefit from their materiality process by using it as an opportunity to apply a sustainability lens to business risk, opportunity, trendspotting and enterprise risk management processes. Rather than creating a separate, isolated process, leading companies embed sustainability thinking within existing processes.

ESG MATERIALITY ASSESSMENT

PHASE 1: <i>Define purpose and scope</i>	Define what materiality means for your organization and be clear about your objectives and audience
PHASE 2: <i>Identify potential topics</i>	Refine topics based on what your organization does, where it operates, and how it ranks its risks, taking into account industry resources and solicited internal views
PHASE 3: <i>Categorize</i>	Refine the list of potential material topics by clustering them into categories that may be managed by common controls, are overseen by the same person/role, or potentially affect each other.
PHASE 4: <i>Gather information about the impact and importance of topics</i>	Use a variety of methods such as questionnaires, interviews, workshops and informal conversations to explore each material topic and understand its relationship to the business and stakeholder groups
PHASE 5: <i>Prioritize</i>	Prioritize material topics based on the strategic importance to the business, importance to stakeholders and the social, economic and environmental impact of each topic in the value chain
PHASE 6: <i>Engage management</i>	Test the results of your materiality assessment with key internal audiences to validate the outcome
PHASE 7: <i>Seek stakeholder feedback</i>	Follow up with stakeholders to get feedback on the material topics reported

Poor Quality ESG Data and Metrics

In most organizations, the activities taken to address the component parts of ESG are scattered throughout operations and corporate departments. Data related to social aspects may be maintained in human resources, procurement, government relations, risk management and other groups. Data on environmental aspects may be in legal, environmental, risk management, or compliance in both corporate and localized departments. Governance data may be within legal, finance, corporate secretary offices and board documentation. Rarely, if ever, is this data - even within each aspect of ESG - maintained in a standard way or with a unified database. Analyzing this data to prepare reports demands excessive time just to locate and rationalize.

The constantly changing and non-standardized reporting standards also have contributed to problems in maintaining quality ESG data. For example, the final report on the SFDR Regulatory Technical Standards (RTS), which was released in February 2021, expanded the number of indicators from 50 to 64, including disclosures pertaining to sovereign entities and real estate investments. This one change alone drives a need to reconfigure how the underlying data is collected, analyzed and maintained.

² Statement of Intent to Work Together Towards Comprehensive Corporate Reporting, Facilitated by the Impact Management Project, World Economic Forum and Deloitte



MAP STAKEHOLDER INTERESTS

Map the ecosystem of stakeholders and their interests, incentives, values and viewpoints. Some of these will be in alignment, while others will stand alone but need priority.

Readily reviewable compliance with requirements

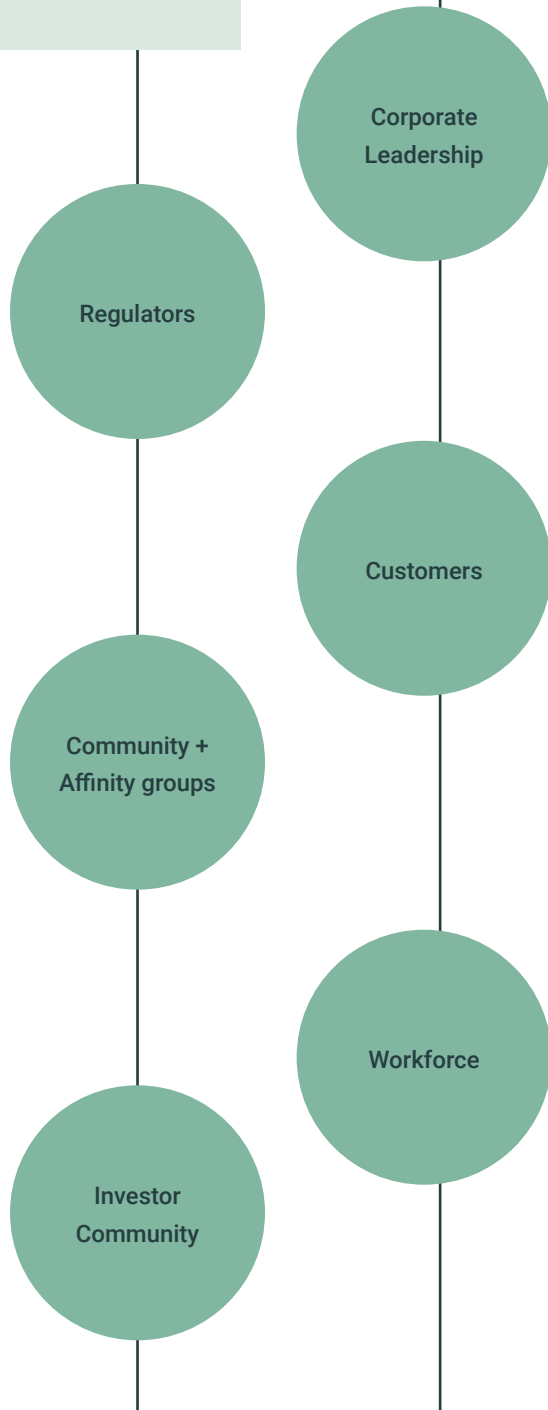
Scrutiny of disclosures will increase as more requirements come into force.

Clear statement of values and alignment of actions

Examine the virtuous cycle of equity, overall health, inclusion, and benefit provided where the company operates, potentially including global reach for an e-commerce business. The better the community does, the better the marketplace becomes for the company.

Profit attuned with investor values

Increasingly, investors are signaling that environmental and social sustainability is as much a priority as sustainable profit.



Alignment with purpose-driven mission, vision and values

Brand protection, profit, financial impact, and risk mitigation continue to be fundamental interests.

Brands in alignment with their values

Companies that incorporate sustainability in their brand and messaging can receive uplift if they perform on these values. In some cases, there is significant overlap with the customer community and investment community.

Transparency of actions reflective of stated ESG values

A company's track record and reputation play an increasing role in where people will work. Employees feel proud to work for a company that is perceived to be part of the solution. Companies with a good track record can obtain and retain talent, and companies with a poor or unknown history are challenged in the labor marketplace.

Perhaps even more striking, some research firms report that the total number of ESG metrics collected and disclosed has increased to approximately 700 in 2021.

Financial metrics alone are not sufficient to describe ESG progress. ESG reporting typically focuses on Key Performance Indicators. These indicators can be aligned with different focus areas in ESG. Examples of KPIs could be greenhouse gas emissions per employee, energy consumption per employee or diversity metrics on the employee population. The lack of standardized KPIs, even within an industry, leads to use of indicators that cannot be readily compared.

Without a standard approach, determining key metrics and targets that matter has become a guessing game. Without clear and consistent metrics, it is not possible to align business strategy and investment to ESG goals or to benchmark against peers.

The organizations behind the various ESG frameworks recognize this problem. Five major ESG standards organizations - the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), the Carbon Disclosure Project (CDP), the Carbon Disclosure Standards Board (CDSB), and the International Integrated Reporting Council (IIRC) - published a report in 2020 where they outline a desire to collaborate².

In parallel, the International Financial Reporting Standards (IFRS) Foundation is proposing to develop ESG standards. 120 countries use the IFRS Standards as their foundation for company financial disclosure and it's likely these countries will require use of the new IFRS ESG standards, potentially eclipsing the various existing reporting frameworks. In the meantime, the challenge remains.

Address How ESG Drives Principled Performance

Principled Performance -- the achievement of objectives while addressing uncertainty and acting with integrity -- is a goal for every well-run business. A well-defined and developed ESG capability contributes to this outcome.

This begins with setting objectives of the organization that are aligned with the values and commitments delivered in its ESG statements. In the business case presentation, suggest a realistic plan that is agreeable to stakeholders with clearly achievable objectives that tie investment and transformation to company goals and values. Each phase of the plan should clearly align budget and organizational changes to the agreed and stated goals of integrating ESG into the business.

In each phase, incorporate clearly defined and measurable metrics enabling the tracking of progress. Create Key Risk Indicators (KRI) and Key Performance Indicators (KPI) aligned to ESG risk factors from the Materiality Assessment. Align internal controls and reporting with the KRIs and KPIs.

Finally, tie outcomes to the proposed changes. These outcomes could include:

- Purposeful culture for ESG
- Championing the value prop of ESG
- ESG integration into business
- ESG integration into risk management/GRC processes, programs, reporting
- Enhanced stakeholder communication
- Building capacity & capability on ESG focus areas

Outline Technology Benefits for ESG

Technology can and should play a significant role in an organization's ESG integration and adoption, and provide the ability to oversee activities enterprise-wide and verify progress against goals. Platforms can assist with gathering and synthesizing information across silos and functional areas, replacing manual processes in key actions such as data

gathering and decision-making executed via email and spreadsheets. This is useful for annual reporting across multiple frameworks and to support strategic planning and management of new initiatives to contribute to the pursuit of ESG goals and business growth. Identifying technology needs and benefits is a key part of the business case.

ESG management and reporting technologies collect information from functional areas and tools, track performance, and provide output aligned with standard sustainability frameworks. Additional features in complete ESG platforms include the ability to store key documents, facilitate communications for governance functions, store and track asset usage, and track KPIs and KRIs. An effective, complete platform has a consistent information architecture and easy ways to integrate data from other data stores or systems in the organization and from third parties. By integrating with enterprise processes and systems of record, such as risk management, HR, IT, cybersecurity, product development, procurement, and customer success systems, the ESG technology can capture more timely and relevant information and facilitate ESG use cases with less disruption and cost.

In addition to governance & reporting, ESG needs to be part of day-to-day work. The technology should allow for automation and coordination of business-line ESG activities – such as management of Health & Safety or Business Continuity – not just overall ESG management and reporting.

Finally, as you consider the business case, factor in the long-term horizon of ESG. Given the rapid changes, increasing regulation, and anticipated expansion of ESG expectations and practices, select a technology platform that can provide operational scale, productive employee experiences, and robust automation features to help empower the team members involved throughout the organization.

Tie It All Together

Each of the aspects discussed add to the strength of the business case, helping to demonstrate how the business can create sustainable, long-term growth and enhance value creation by establishing a mature ESG capability. By incorporating ESG factors into strategic decision-making and investment decisions, the business will move away from short-term thinking and benefit long-term outcomes. By prioritizing ESG action based on what the business does and where it operates, the monitoring and controls put in place will assist in risk management overall. By evaluating and responding to stakeholder needs, the business will drive stronger customer and employee loyalty, community support and investor confidence. Overall, by designing and operationalizing an optimized ESG capability, the business will be better positioned to achieve Principled Performance.

KEY FUNCTIONALITY OF ESG TECHNOLOGY

DATA AGGREGATION	<ul style="list-style-type: none"> • Gather and normalize ESG data (financial and non-financial) across business silos, functions, and lines of business to the enterprise level • Establish Data Integration API • Facilitate gathering information from suppliers in the form of public information or questionnaires
ASSET	<ul style="list-style-type: none"> • Develop asset attribute and utilization tracking • Integrate with IT and enterprise asset management systems
REPORTING	<ul style="list-style-type: none"> • Populate multiple ESG framework reporting formats • Expedite internal performance reporting • Assist with ROI determination for ESG focus areas where applicable
RISK & PERFORMANCE	<ul style="list-style-type: none"> • Track Key Risk Indicators and Key Performance Indicators • Establish alerts for internal controls, triggers, or thresholds
SUPPLIER	<ul style="list-style-type: none"> • Ensure integration with supplier and procurement systems • Implement Sustainability Questionnaires for both onboarding and ongoing monitoring
PROCESS STANDARDIZATION	<ul style="list-style-type: none"> • Define process or workflow documentation or automation • Define internal control workflow for oversight or rule enforcement
REPOSITORY	<ul style="list-style-type: none"> • Provide a central repository for documentation of policy, procedures, roles and other ESG-related data across time • Maintain data confidentiality, integrity, and availability
GOVERNANCE	<ul style="list-style-type: none"> • Facilitate planning, prioritization, funding and assurance of ESG projects • Provide committees with information, insights, and ability to act • Increase frequency and timeliness of visibility through dashboard views
SECURITY & RESILIENCE	<ul style="list-style-type: none"> • Provide role-based access to sensitive information • Build as cloud-based for scale, resilience, and continuity • Integrate with cybersecurity and privacy operations



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