Sustainability in the Finance function - Point of View

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Introduction

This paper explores the impact of sustainability on the Finance function in the areas of data, reporting and value creation.

Globally corporate sustainability is receiving increased attention. Sustainability reporting standards and other sustainability regulations are being developed rapidly. Stakeholders are expanding and now include investors, customers, employees, suppliers, regulators, financiers, insurers, and affected communities.

Business is entering a new era of sustainability transparency and accountability. Sustainability factors present risks and opportunities to business.

The Finance function has a clear and important role to play in sustainability.

How businesses define and meet their goals for environmental, social and governance (sustainability) impact and performance has significant and growing consequences for their value. Likewise the increasing amount of sustainability regulations have a large impact on the organisation.

Chief financial officers (CFOs) are therefore already seeing their role evolve yet again, as value stewardship extends beyond the purely financial to also include sustainability dimensions.

But how will this impact the Finance functions that CFOs lead? How will their role change to support the new requirements arising in a world that not only holds businesses to account for their sustainability performance, but also increasingly rewards them for the positive impact they can make?

Integrating sustainability into daily activities and decision making is no longer just about satisfying regulatory requirements; it is essential to establish and improve a company's future. Companies must therefore approach sustainability holistically as a source of value creation, competitive advantage and resilience.

By executing on their sustainability commitment and reporting transparently, companies can earn greater trust and loyalty among investors, employees and customers, while enhancing value. Robust sustainability data forms the basis both for sustainability decision making and reporting. The demands of stakeholders, particularly investors, are becoming more tangible, with high-level commitments requiring clear action plans and targets. CFOs need to help translate those commitments into action plans with mechanisms to measure, monitor, forecast and, ultimately, communicate. These, in turn, require robust data and verifiable facts ready for decision making, reporting and assurance.

The evidence is unequivocal:

82% of investors think companies should embed sustainability directly into their corporate strategy[1],

86% of employees prefer to support or work for companies that care about the same issues as they do[2], and

83% of consumers think companies should be actively shaping sustainability leading practices[2].

[1] PwC's Global Investor Survey, 2021
[2] PwC's Consumer intelligence Series survey on sustainability, 2021

The Finance function is well placed to address sustainability demands and drive sustainable value creation. As sustainability becomes integrated into the whole business, every business function must be part of the sustainability transformation. The Corporate Sustainability function orchestrates the sustainability strategy and execution activities. The Finance function then embeds that in ongoing corporate planning, budgeting and reporting which brings transparency, and guides the business through key decisions with business insights.

Finance professionals possess the essential skills and capabilities to assist the organisation in navigating its sustainability transformation as described beside[1]:

Transformative catalyst

Who can align a company's strategy, organisation, and culture behind a common sustainability agenda.

Strategic visionary

Who understands and guides trade-offs among people, planet, and profit, bringing longer-term risks and opportunities of sustainability to bear on strategy and the allocation of resources.

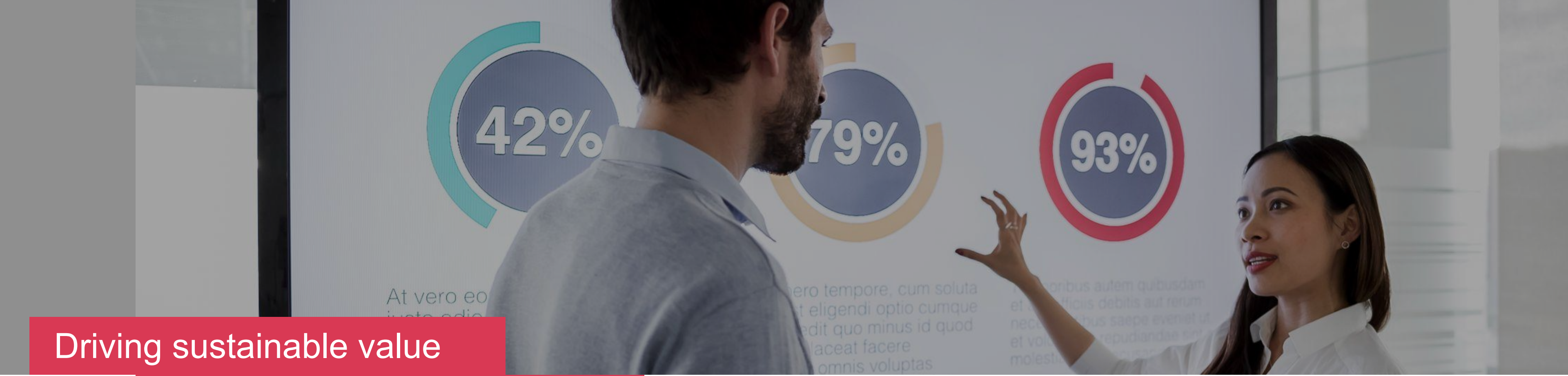
Grounded communicator

Who has data and cross-functional understanding to present a credible business case, grounded in shareholder value, for a company's sustainability program.

Collaborative integrator

Who knows how to build networks among business units, suppliers, vendors, and other stakeholders to uphold a commitment to sustainability including natural and social capital

[1] How CFOs further value creation by leading on sustainability, strategy+business a PwC publication, 2023



Driving sustainable value through business partnering

As the sustainability agenda shifts the emphasis from short-term profitability to considerations of longer-term value and risk, it will reshape the possible creation, maintenance and destruction of enterprise value. For example, PwC's Global Private Equity Responsible Investment Survey 2021 shows that:

- 66% of survey respondents rank value creation as one of their top-three drivers of sustainability activity
- 40% of survey respondents rank value protection as one of their top-three drivers of sustainability activity
- 70% of survey respondents integrate sustainability risks and opportunities into their transformation or value creation plans.

Every business is exposed to sustainability factors that can influence their performance. There are both negative and positive impacts to contend with. For example, lower rainfall could present both negative and positive impacts: production of existing crop variants may be disrupted, while new crop variants may be developed and introduced.

The Finance function can, as Strategic visionary, help the business uncover strategic insights that will help it achieve its targeted results, manage the risks it faces and utilise the opportunities presented to it.

The Finance function can play this role in several ways, as the case study on the following page illustrates.

Financial planning and analysis (FP&A)

Financial planning and analysis plays a vital role in managing performance across all areas of the business consistently and efficiently. These capabilities will also play into the sustainability agenda. The Finance function can help define and manage a convincing long-term path to create value and deliver sustainability goals through rigorous target setting (key performance indicators), integrated business planning/forecasting, performance measurement/monitoring, and analysis.

Scenarios and forecasts

Scenario analysis can help identify the sustainability factors with the greatest likely material impact on the business, and then assess their financial implications. Quantifying the effect of sustainability factors on a business case can support integrated decisions that take a holistic account of profit, employees, customers, and society. And through its forecasting process, the Finance function can help integrate metrics beyond turnover that also include sustainability items, such as carbon emissions, data on social mobility and workforce composition. By taking sustainability into consideration, the planning and performance management process is no longer just about financial performance, but is instead a holistic plan that includes sales and operational plans that require monitoring on a continuous basis.

Case study: A global health, nutrition & bioscience company – Preparing for climate change

Background and challenges

The company wanted to address climate change by addressing its own environmental and carbon footprint. To deliver on its ambition, the company needed more insights into the impact that different energy sourcing and the use of an internal carbon price had on profit, people and planet.

Solution

Using PwC's Responsible Business Simulator[1], the business was able to measure and compare the impact of different types of energy sourcing and the inclusion of an internal carbon price in three dimensions:

- Profit (i.e. energy cost and CAPEX)
- People (i.e. employee engagement, employee recommendation, net promoter score and brand value)
- Planet (i.e. carbon footprint and carbon emissions)

Added value

- The Responsible Business Simulator approach enabled the existing discussion on the use of an internal carbon price, to become more strategic and fact-based.
- It contributed to the process of taking externalities into account in the decision-making process for energy sourcing, which finally contributed to the introduction of an internal carbon price.

The potential future role of Finance

Going forward there is opportunity for the Finance function to embed sustainability and internal carbon pricing into its existing business functions:

- The Financial Planning & Analysis function, located centrally, responsible for setting the planning, budgeting, monitoring and carbon pricing standards upfront and running their generic processes on an ongoing basis.
- The Finance Business Partner function, where partners are located with their assigned business units, responsible for representing the business units in negotiating and agreeing the planning, budgeting and carbon pricing values upfront and using the outcomes from carbon pricing and monitoring processes to help steer the business units on an ongoing basis.

[1] https://www.pwc.nl/en/topics/digital/data-analytics/the-responsible-business-simulator.html

Sustainability data underpins the Finance function's sustainability activities

While sustainability data has to date often been the responsibility of the Corporate Sustainability function in many businesses, the rapid evolution of sustainability reporting frameworks means the baton is now passing to the Finance function. That shift is happening for a few reasons. Investors want greater insight into the data behind sustainability risk assessments. Annual reports must increasingly include sustainability data, and company boards and auditors expect the Finance function to take ownership of that data.

The Finance professionals, as Grounded communicators, can help explain the relationships between sustainability and financial data.

While sustainability data sourcing and calculation has yet to achieve the degree of standardisation that financial accounting took many years to develop, it is progressing fast. The fastest moving theme within sustainability is climate change. This is also reflected in the maturity of the sustainability reporting frameworks. The most mature framework, the GHG Protocol Corporate Accounting and Reporting Standard, supports companies in accounting and reporting about their impact on the climate.

This framework provides requirements and guidance for businesses preparing a corporate-level greenhouse gas (GHG) emissions inventory. Other reporting standards are rapidly maturing such as the standards developed by the ISSB and the ESRS under the European Corporate Sustainability Reporting Directive (CSRD) and require the sustainability data discipline to mature quickly on other sustainability topics as well.

The Finance function is well-placed to take the reins on sustainability data sourcing and calculation as described in the case study on the following page.

Case study: Creating a greenhouse gas (GHG) inventory, in line with the GHG Protocol, for a global coffee company

Background and challenges

Climate is a material topic for coffee companies. On the one hand it's because coffee farming is impacted by physical climate change. On the other, it's because coffee production has an impact on climate change, as it produces GHG emissions. GHG emissions are a common indicator to measure a company's climate impact. Such emissions are quite significant for a coffee company, as all steps in the coffee value chain create emissions as a by-product: agricultural practices, coffee roasting, packaging and transportation. The company in this case study therefore wanted to create a GHG inventory providing the overview of emissions it needed to set targets for emission reduction. However, the company had no experience or knowledge related to creating such an inventory.

Solution

PwC supported the company in setting up a GHG inventory in line with the gold standard in GHG accounting: the GHG Protocol. Together with the client, the following steps were taken:

1. **Setting the scope of the inventory**; e.g. selecting a proper organisational boundary to determine what parts of the business, which sites and what assets should be in scope. This is determined by the relevant reporting standards, if applicable to the company (e.g. CSRD, ISSB).
2. **Identifying what emissions sources are relevant to the company, and to which emission scopes they belong** (also refer to figure on the next page). These can be emissions the company creates itself (Scope 1), from, for example, burning natural gas to roast coffee.

   There can also be emissions related to the production of purchased energy (Scope 2), e.g., electricity purchased by the company which is produced from fossil fuels. Lastly, there can also be emissions in the value chain (Scope 3) that occur due to the activities of the coffee company, which could range from emissions from employee travel, to agricultural emissions produced from coffee bean cultivation.
3. **Calculating the emissions for all relevant emission sources.** This was done by requesting data points from the coffee company and multiplying these by an appropriate emission factor. For example, collecting volumes of natural gas purchased by the company for every factory or office, adding these up, and multiplying these by the emission factor of 0,18254 kg CO2e/kWh (**Department for Environment, Food and Rural Affairs**).
4. **Creating the GHG inventory**: after calculating the emissions per emission source, the emission sources that are under the same scope and category were added up, to create an overview of emissions in scope 1, 2 and 3.

The role of Finance

The project was managed by an interdisciplinary team consisting of the Finance function, Sustainability and Operations. The role of the Finance function consisted largely of collecting data, connecting the PwC team to the relevant stakeholders, and thinking about how to best set-up an annual data collection and reporting process. Moreover, the Finance function will also be responsible for reporting the GHG inventory in the annual report, and presenting the processes and documentation to the external assurance providers.

Added value

The GHG inventory providing the overview of the company's emissions enabled it to set targets for emission reduction.

Starting with compliance and moving to integrated sustainability

Sustainability metrics, along with qualitative and quantitative reporting, are fast becoming business imperatives. But compelling sustainability reporting doesn't come together instantly or easily. It requires collaboration and insights from across the business, with people from different business functions working towards common goals as one team. Finance professionals with their Collaborative integrator skills are uniquely positioned to lead this change.

Finance functions need to adapt to new ways of working, embrace emerging technologies and broaden their focus from the traditional areas of financial reporting to those that are of interest to a growing group of stakeholders.

Many businesses start by assessing the maturity of their data and the technology landscape to support the gathering and reporting of sustainability data. Others want to focus on climate change, diversity, equity and inclusion or other significant areas of reporting.

Finance functions will need to play a pivotal role in ensuring their businesses comply with new sustainability reporting standards and directives. It is no longer sufficient to focus solely on financial profitability or the strength of the balance sheet. In the medium term (2024/2025 for Europe), financial reporting and sustainability reporting will be equally important and integrated.

The Finance function has a key role here, and many companies have already started on this journey.

Robust processes and controls for collecting financial data across the business are already in place, as are the mechanisms for consolidating and disclosing financial information. These competencies can now be leveraged for collecting and collating the data required for sustainability reporting and ensuring there is adequate evidence for assurance as the case study on the following page shows.

While other parts of the organisation may lead when it comes to setting sustainability targets and goals, **the Finance function is essential when it comes to reporting on the impact and progress of sustainability actions, whether through managing financial commitments and budgets, the effect on enterprise value in financial statements, or by ensuring the consistency for all disclosures made in the annual report.**

The interconnectedness of financial information released to the market and enterprise value is imperative for companies to consider and articulate – as was acknowledged by the IFRS Foundation in the decision to form the International Sustainability Standards Board (ISSB).

With growing incidences of climate litigation arising across the world and investors becoming more alive to greenwashing, information reported throughout the broader annual report or separate sustainability report needs to be meaningfully and transparently aligned with financial statements. There is also the growing requirement for sustainability reporting (including strategy, risks, opportunities, targets, milestones and metrics) to be assured, which further expands the role of the Finance function.

Case study: Taking a bold lead on sustainability reporting in the pharma industry

Background and challenges

The company, a global pharmaceutical leader, views transparent, consistent sustainability reporting as an opportunity on several levels. It's an opportunity to deliver on a better tomorrow for its people and for society; to build trust with employees, investors and the public through responsible business practices; and to unlock business value across the company. With a changing regulatory environment on the horizon, sustainability reporting further offers the company a chance to monitor its impact on society and proactively prepare for future disclosure requirements. The company wanted to adopt a new approach to sustainability reporting for internal and external use, establishing rigorous reporting mechanisms that align to its purpose and can aid in day-to-day decision making. It turned to PwC to help design and implement an improved reporting process offering the same level of rigour and importance as its financial reporting system.

Solution

PwC identified that the company's highest priority was producing a sustainability report that its internal and external stakeholders, including employees, customers and investors could trust. To achieve that goal, underlying data needed to be investor-grade, which meant the team first needed to address data controls and governance to the same level of rigour it would use for financial statements, such as those required for Sarbanes Oxley 404 (SOX 404) compliance.

Together, PwC and the company's controls and internal audit teams identified the data source for each metric in the sustainability report and built controls to help confirm data completeness and accuracy. PwC supported the integration of those controls into an existing enterprise system for financial reporting and detailed the data governance structure. Employees were then trained to better manage and monitor the data.

Automation and analytics were key to realising the full value of investor-grade sustainability data. To demonstrate the potential of these technologies, PwC built a proof of concept from a small data sample. After pulling samples of sustainability data from disparate sources, PwC used automation to reduce manual processes, then created custom analytics dashboards to show real-time sustainability metrics

The role of Finance

The Finance function had a leading role to play in sustainability reporting. It was responsible for – and had expertise in –internal and external reporting, as well as enabling data management, enterprise systems and governance structures.

Added value

Proactive sustainability reporting paid dividends in trust, cooperation and awareness among all stakeholders. The technology upgrades enabled delivery of an automated monthly sustainability report, that includes various sustainability metrics for use by internal and external stakeholders, instead of a manual annual report. New business value was created across the organisation by increasing sustainability cooperation and transparency at all levels and by bringing the sustainability mindset to all parts of the business.

Prepare the Finance function…

Beyond process, data and system changes, Finance functions must also consider changes to organisational design, governance structure and how to equip Finance professionals with new skills. These will apply whether a function is adopting a minimum compliance approach or taking a more ambitious route.

Governance structures need to reflect the Finance organisation's expanding sustainability roles and responsibilities and how these are formally incorporated into the organisation. This will include the role of committees and whether whole new ones are required or if sustainability responsibilities can be absorbed into the remit of existing committees.

The organisational structure of the Finance function will also have to be updated for sustainability activities. As most Finance functions are starting their sustainability reporting journey, one of the first questions they need to answer is how the new sustainability reporting activities will be integrated in the Finance structure. In practice we see different solutions. One option is to integrate these activities into the existing Finance reporting teams. In most cases, that means establishing a sub-team for sustainability reporting. Another option is to create a separate team. Some organisations have even defined a new role: e.g. that of Sustainability CFO.

New skills and knowledge are essential for Finance professionals to start adding value to sustainability activities and achieve the right quality of Finance sustainability deliverables. Most Finance professionals do not possess huge experience in the area of sustainability. So to really understand the new sustainability activities, they will need to become knowledgeable about each of the E, S and G topics.

…and get started with your sustainability journey

Develop a vision

Develop a vision of the Finance roles and responsibilities the Sustainability regulations will require. Consider whether the Finance function will be leading the implementation of the regulations or contribute based on its reporting and control skills. Align with other business functions.

Establish governance structure

Establish or join sustainability governance structures company-wide for sustainability oversight responsibility and to secure the right level of executive support.

Create capacity

Make capacity available, either internally or via new hires, for working on these topics and determine if and how to integrate these activities in the current team structure.

Start upskilling

Start with upskilling Finance professionals on the new regulatory requirements including sustainability controls and data, as well as the content of the E,S, and G topics.

Initiate change management

Initiate change management activities supporting strong collaboration between all sustainability stakeholders - the Finance function, Corporate Sustainability function, business units, etc.

Finance functions have started…

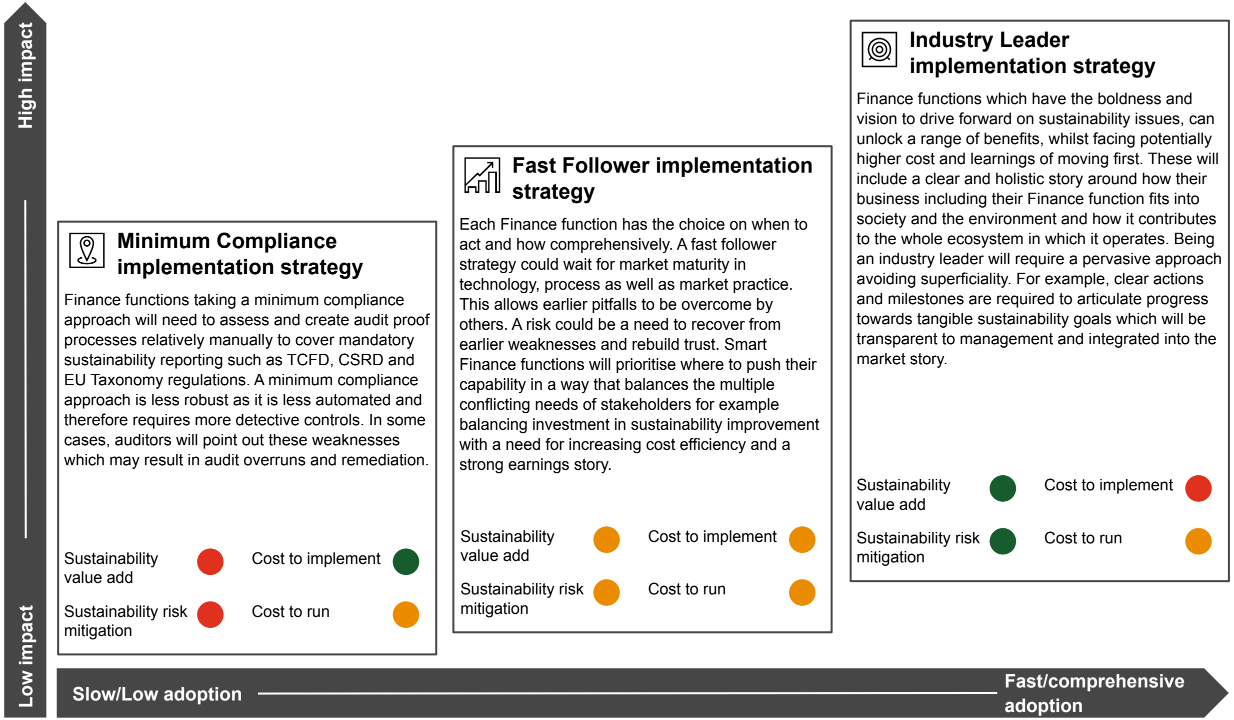
Finance functions have already begun their transition to sustainability enablement for example in addressing sustainability reporting requirements. However as sustainability issues have moved up the business agenda boards are now setting clearer strategies on sustainability for the whole organisation. The Finance function is uniquely positioned to apply its skills for example managing data quality, disciplined process, controls and integration with performance.

This will help the company accelerate on the journey it needs to develop its capabilities.

Each Finance function will determine which level of operational maturity to target to help meet the company's sustainability aspirations.

…and can select different implementation strategies

To achieve its target level of maturity, the Finance function can adopt one of three implementation strategies. Each approach presents advantages and disadvantages in terms of cost to implement and cost to run, as well as impact on value and risk through effective management of sustainability risks and opportunities.



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List of abbreviations

CFO – Chief Financial Officer

CO2e/kWh - Carbon dioxide emissions generated per kilowatt-hour of energy generated

CSRD – Corporate Sustainability Reporting Directive

DEFRA – Department for Environment, Food & Rural Affairs

FP&A - Financial Planning & Analysis

GHG – Greenhouse Gas

IFRS – International Financial Reporting Standards

ISSB – International Sustainability Standards Board

kWh – Kilowatt-hour

TCFD – Task Force on Climate-Related Financial Disclosures

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