Board Matters Quarterly

Issue 1, 2022

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Board Matters Quarterly

Board Matters Quarterly offers thought-provoking perspectives and insights into leadership and governance issues for boards and audit committees, supporting them to navigate the increasingly complex business environment.

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How focusing on enhanced corporate reporting now can build trust and long-term value

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Leveraging data and technology to turn risk into confidence

How focusing on enhanced corporate reporting now can build trust and long-term value

With two challenging disruptors, namely the COVID-19 pandemic and the climate crisis, and their impact on business performance and sustainability, ESG (environmental, social and governance) information has now become as important as mainstream financial information. Hence, boards and C-suite executives need to accelerate the transformation of their corporate reporting to build stakeholder trust and develop long-term value.

Regulators and policymakers in Malaysia and the region are accelerating the development of guidelines and regulations to support sustainability objectives. Among the key policy initiatives to drive ESG locally include:

- Bank Negara Malaysia's Financial Sector Blueprint 2022 – 2026 (FSB3), which identified finance for sustainability as one of the three strategic thrusts to facilitate an orderly transition to a greener economy
- The Securities Commission's revised Malaysian Code of Corporate Governance (MCCG) 2021 which incorporates ESG areas of focus
- The Ministry of Finance's 12th Malaysia Plan which includes objectives to advance sustainability and promote the green economy through setting priorities on enhancing green finance and incentives, driving investment in renewable energy and promoting the circular economy

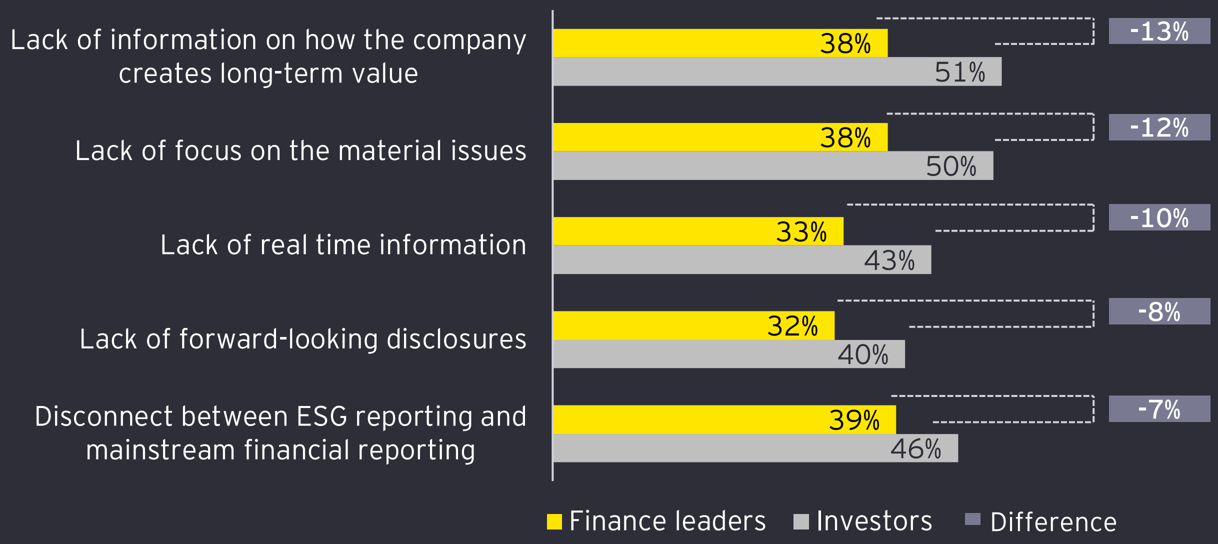
With the increasing regulatory focus on ESG, organizations will need to deliver an enhanced reporting approach to bridge the disconnect between corporates and investors. The *EY 2021 Global Corporate Reporting Survey* highlighted the need to focus on three areas to hasten the delivery of an enhanced reporting approach:

- Accelerate the pace of change in corporate reporting to close the investor disconnect
- Rethink finance's approach to talent and spur C-suite collaboration to drive a cohesive ESG approach
- Advance data analytics to build an enhanced reporting future

1 Accelerate the pace of change in corporate reporting to close the investor disconnect

The *EY 2021 Global Institutional Investor Survey* identified that investors, who apply a structured and methodical evaluation of companies' non-financial disclosures, have more than doubled, from just 32% in 2018 to 78% in 2021. At the same time, the *EY 2021 Global Corporate Reporting Survey* findings show that investors are generally more concerned about the usefulness and effectiveness of companies' ESG reporting. The top three gaps identified include the lack of information on how a company creates long-term value (13%), the lack of focus on material issues (12%) and the lack of real time information (10%).

Investors are more concerned than finance leaders about the usefulness and effectiveness of companies' ESG reporting



Question: Thinking generally about the ESG reporting your organization discloses, which of these aspects challenges its usefulness and effectiveness?

Note: Data on investors surveyed were extracted from the *EY 2021 Institutional Investor Survey*
Source: *How do you transform data into insight? Eighth Global Corporate Reporting Survey, EY, December 2021*

There needs to be greater focus on enhancing the credibility of information provided and instilling the same levels of precision and control in ESG reporting as in financial reporting. This would help build a strong connection between an organization's financial and ESG reporting to help measure the true costs and opportunities for the business. In doing so, it would help businesses to rethink how they use ESG data to inform strategic choices, drive innovation and communicate how they create long-term value.

To further support the transition towards the green economy, the International Financial Reporting Standards (IFRS) Foundation announced the establishment of a new board – the International Sustainability Standards Board (ISSB) at the 2021 United Nations Climate Change Conference (COP26). The ISSB is tasked to create a global baseline of sustainability disclosure standards to meet investors' information needs and in turn, provide the much-needed consistency and comparability to ESG reporting standards.

Similarly, in Malaysia, the National Annual Corporate Reporting Awards (NACRA), jointly launched a new framework with Bursa Malaysia, the Malaysian Institute of Accountants (MIA) and the Malaysian Institute of Certified Public Accountants (MICPA) in early 2020. Themed "Towards Accountability & Excellence", the framework aligns the assessment standards for annual reports with current reporting requirements and the latest global standards, to ensure continuous enhancement in the transparency of disclosure and the quality of Malaysia's corporate reporting.

While it takes some time for standards to be developed and national regulators to decide when and how to adopt them, boards and senior management teams can seize an advantage by getting ahead of the game, which could ultimately result in better systems, processes, controls and most importantly, improve the quality of data reported.

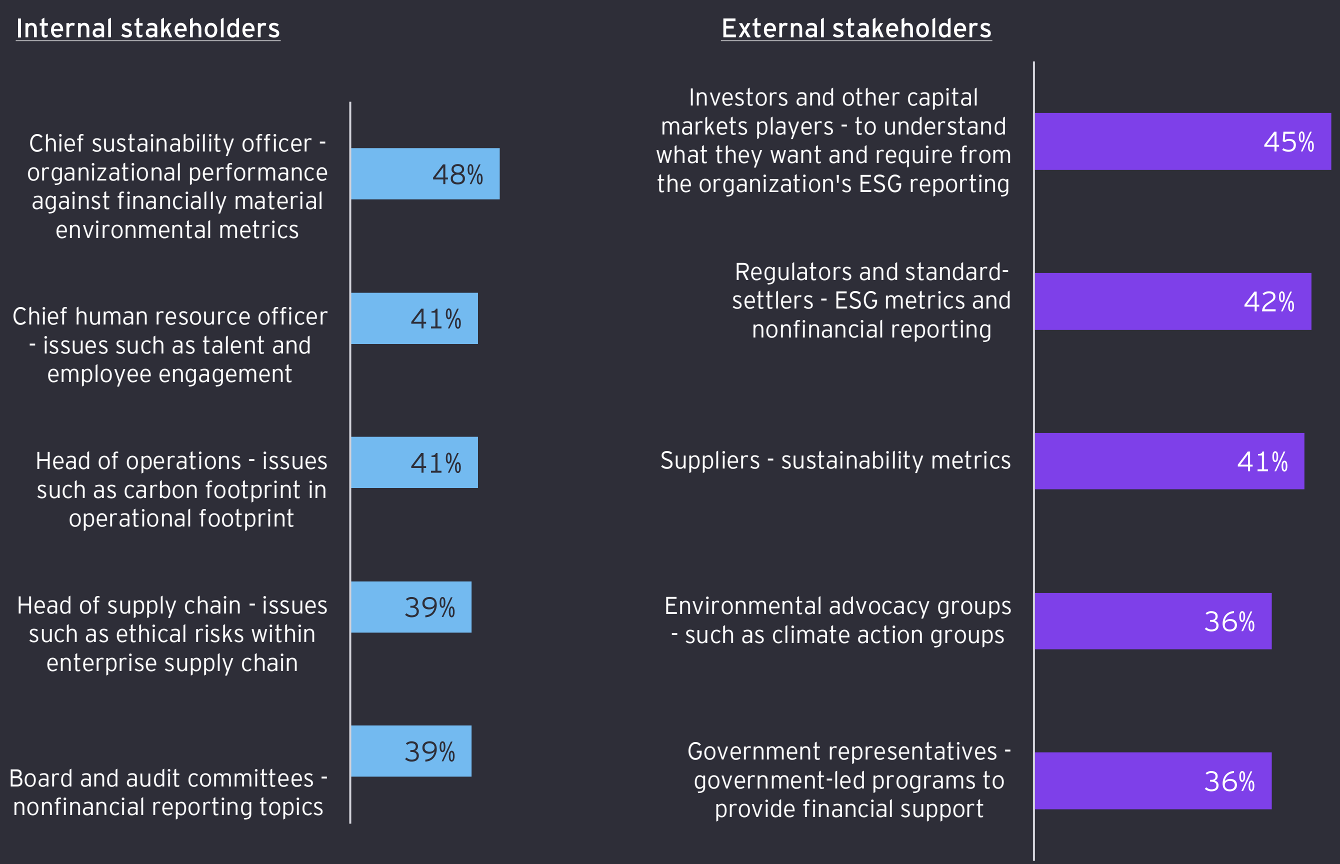
2 Rethink the approach to talent and C-suite collaboration to drive a cohesive ESG approach

The series of cataclysmic events in the last two years, has disrupted the traditional working models for the long-term, bringing new expectations, changing people's behavior and encouraging the digitization of processes.

Business leaders are actively looking to build an agile operating model that places people at the center of decision making, including offering flexibility in work experiences that is critical in attracting, retaining and motivating future talents.

Collaboration is also vital. A significant amount of ESG data is owned and controlled by different business functions. This demands greater cooperation and collaboration between finance leaders and other leaders and functions within the organizations. as well as strong connection and consistency between non-financial information and financial reporting disclosures into a coherent reporting framework. This integrated approach would allow corporates to demonstrate how ESG can be embedded into the wider culture of the organization.

Finance leaders are working with a broad cross-section of stakeholders



Question: Over the past 12 months, have you had any significant interactions with the following internal and external stakeholders in terms of measuring or disclosing nonfinancial or ESG performance or risks?

Source: *How do you transform data into insight? Eighth Global Corporate Reporting Survey, EY, December 2021*

3 Advance data analytics to build an enhanced reporting future

Since the start of the COVID-19 pandemic, many organizations including large companies and micro, small and medium enterprises (MSMEs) have accelerated their digitalization efforts and technology innovation.

Over the next three years, finance leaders surveyed noted that the top three main priorities in terms of technology investments are advanced analytics or predictive analytics (39%), cloud-based enterprise planning and forecasting tools (38%) and artificial intelligence (36%). These capabilities will help organizations to structure, synthesize, interpret and derive insights from large volumes of data, and create credible and useful ESG reporting.

Additionally, a more agile approach to scenario planning and strategic modelling capabilities can be achieved by shifting away from a traditional data analytics method to more advanced approaches, which include predictive and prescriptive analytics

Next key actions

Some key actions for boards and C-suite executives to build trust, enhance transparency and reporting insights:

- CFOs and finance leaders should assess their organizations' current approach to ESG performance measurement and reporting standards, to better understand what is material to them and how they can move forward to drive long-term value.
- Collaboration with boards and C-suite executives across functions to advance ESG and sustainability performance as an important strategic objective. This includes linking ESG and long-term value and encompassing both strategic growth and risk management.
- Driving innovation and transformation:
  - Build more agile operating models
  - Set a technology roadmap for transforming financial analytics
  - Provide enhanced and trusted reporting, including the use of advanced tools (e.g., artificial intelligence)
  - Develop a future talent strategy based on continuous and dynamic learning to attract and motivate the next generation of leaders

With challenging externalities, investors are propelled to place higher value on ESG disclosures and this will accelerate the transformation of corporate reporting. For businesses and organizations, the reality to build transparency into ESG performance in building and securing trust with investors and stakeholders is not a future option but an integral prerequisite.

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Leveraging data and technology to turn risk into confidence

The *EY Global Board Risk Survey 2021* reveals that despite its significant importance, the risk management efforts of organizations currently fall short of board expectations.

Why the gap?

- Eight in 10 boards believe improved risk management will be critical for their business to protect and build value in the next five years.
- At the same time, 55% say risk management has difficulty keeping pace with the changes in business strategy.
- Fewer than 20% of boards believe their organizations are highly effective in disaster response and contingency planning or their understanding of how risks are interconnected.

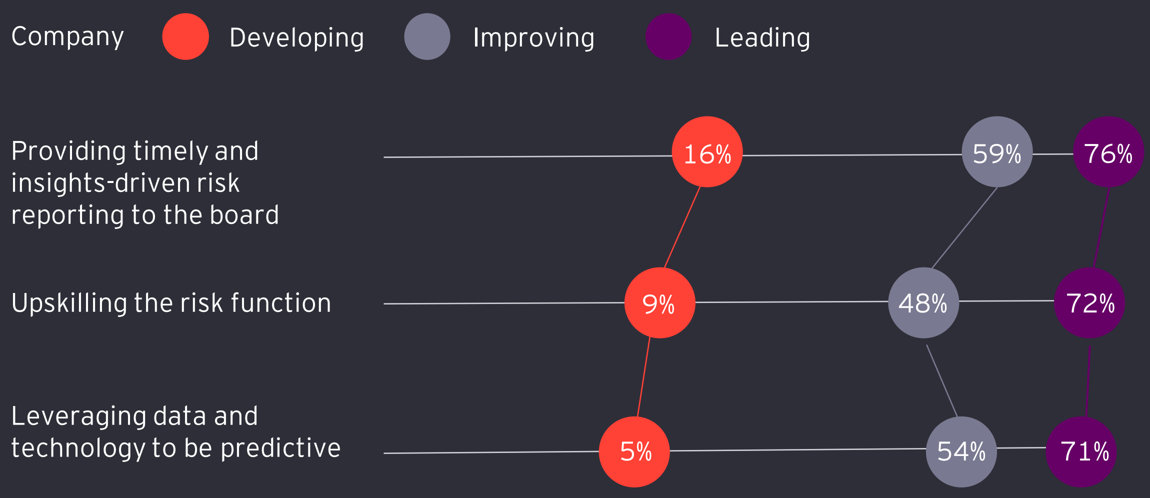
The EY survey of more than 500 board directors around the world identifies two key drivers of effective risk management:

- the extent to which technology is used to identify and manage risk; and
- the breadth and depth of risk reporting to the board.

In fact, 71% of risk management leaders – those organizations deemed highly effective at risk management based on our analysis of the survey data – use data and technology effectively, compared with just 5% of risk management laggards, who might still be developing their approach.

Leading companies are more effective at taking a data-driven approach to risk management

Percentage of respondents reporting their organization is effective at a given activity



Source: *EY Global Board Risk Survey 2021*

However, despite their importance, fewer than one in five boards say their organization's risk management is highly effective at leveraging data and technology or delivering timely, insight-driven reporting to the board. In parallel, just 49% of CEOs say their risk-assessment processes are adequately data-driven.

Boards can catalyze change by requiring that management has adequate controls and processes in place to monitor and manage risks and encourage capitalizing on newly available data and technology as a priority.

Some key steps to take:

1. Drive awareness at board level of the role that technology and data can play in enhancing risk management
2. Allocate sufficient budget to invest in technology and develop or acquire a workforce with the skill sets required to manage it
3. Hold management accountable for their use of data and technology in risk-management activities
4. Require that management have a strategy for leveraging data and technology, with a particular focus on skills
5. Work with management to ensure risk reporting is forward-looking and predictive, covers emerging and atypical risks, and includes internal and external data

Understanding and detecting risk: what tech can do

Automation technology can be used to process low-value manual tasks, such as risk-model verification and simple data processing so risk professionals can focus on value-adding activities, such as evaluating new business models or assessing threats associated with their organization's deployment of new technology. Data collection and monitoring can also be automated, so that it occurs in real time, flagging potential issues to risk and business teams much sooner than would be achievable with a purely manual approach.

Artificial intelligence (AI) can also assist businesses in modeling and understanding connections between risks, for example, by using it to automate basic risk research; identify important risk statements in unstructured documentation; and undertake casual analysis to identify risk interdependencies. These insights are then presented in easy to comprehend formats via dashboards to senior management and boards. Importantly, an improved understanding of the intricacies of risk helps to develop more effective mitigation measures.

Finally, software platforms can also be utilized for risk-management tasks such as data collection and continuous monitoring. By housing key risk and compliance data from multiple parts of the business in a single source, the data can be made easily accessible for everyone, including boards.

Tech is a priority, but hurdles remain

Encouragingly, 69% of businesses plan to increase their level of investment in data and technology for risk management in the next 12 months. And, when presented with a series of initiatives that enhance enterprise resilience, boards identify the use of data and technology as their top priority.

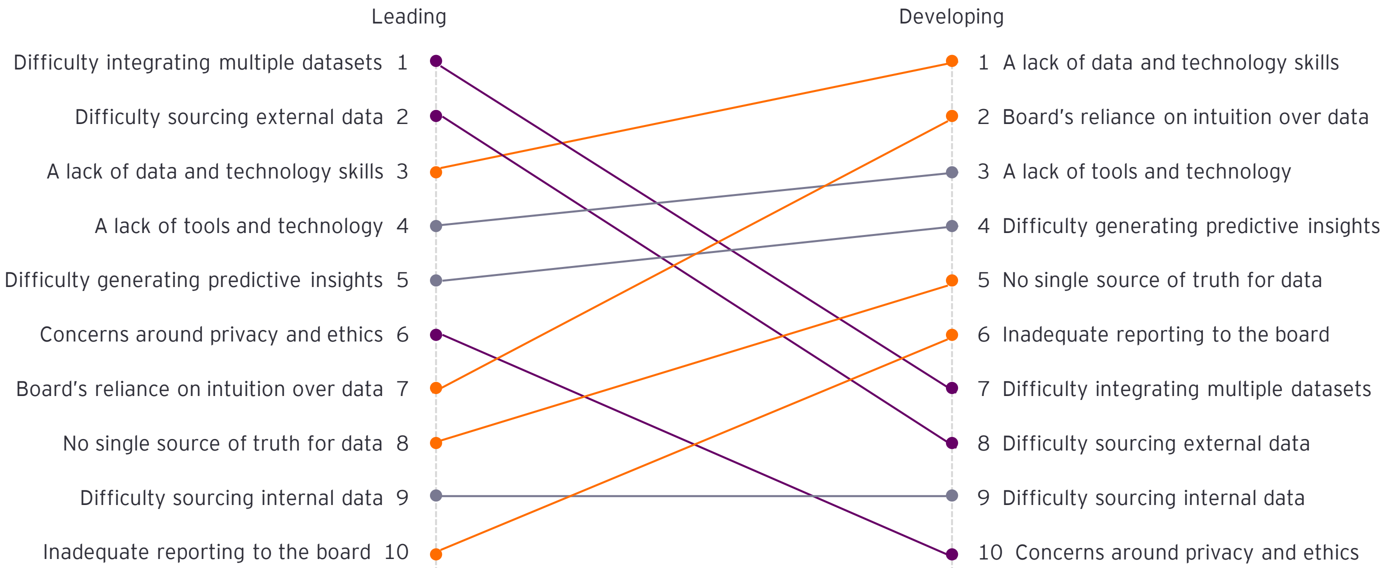
As they ramp up investment in technology, businesses will have to address a number of challenges, which are dependent on their level of maturity. For those at the beginning of the journey, our research shows the main obstacle is a lack of the necessary skills to utilize data, technology and analytics effectively. Depending on the ability to hire within, organizations may want to outsource this process to businesses with existing expertise in the area.

Businesses will also need to upskill non-technical roles to help these workers take advantage of emerging tools and data. They will also need to think carefully about how humans and technologies, such as AI, can work together effectively.

For more mature companies, who today already effectively leverage data and technology, one of the top challenges our research found is integrating multiple datasets from disparate sources, so that risk analytics and reporting form a cohesive and comprehensive picture.

Concern and obstacles to being data-driven differ by company maturity

Ranking of the greatest obstacles to more data-driven risk management



Source: *EY Global Board Risk Survey 2021*

Forward-looking and focused on new threats: how risk reporting needs to improve

In fact, risk reporting to boards also has much room for improvement. Fewer than 20% of boards are extremely confident in risk reporting on a number of specific areas.

Leading companies are significantly more confident in their risk reporting to the board
Percent of respondents that are confident

According to the EY survey, boards' top priorities are that reporting:

- Is forward-looking and predictive
- Covers emerging and atypical risks
- Includes external and internal data
- Covers risk-mitigation initiatives and processes
- Includes competitive intelligence and peer benchmarks

Yet boards must resist the temptation simply to ask for more and more reporting. After all, if it is not properly ordered and prioritized, an abundance of information can sometimes muddy, rather than clarify, the picture.

While management can design and develop a strategy for employing technology to monitor and mitigate risk, boards need to oversee that it's used to its full potential. This may require boards to quickly move up the learning curve in terms of understanding all the benefits that technology can deliver.

Source: EY The Board Imperative Series

Questions for the board to consider

The board has a vital role to play in ensuring that data and technology are employed to facilitate risk management. Here are some questions to consider:

1. Does your board understand the role that technology and data can play in enhancing risk management?
2. Have you allocated sufficient resources for risk management technology?
3. Are you holding management to account for how they use data and technology for risk management?
4. Is there a strategy in place to overcome the expected obstacles to implementing a data and technology-driven approach to risk management?
5. Has the board clearly defined what is required of management in terms of risk reporting?

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