

Sustainability risks

Fitness check for executive and
supervisory boards



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Identify and manage your sustainability risks

What is the challenge?

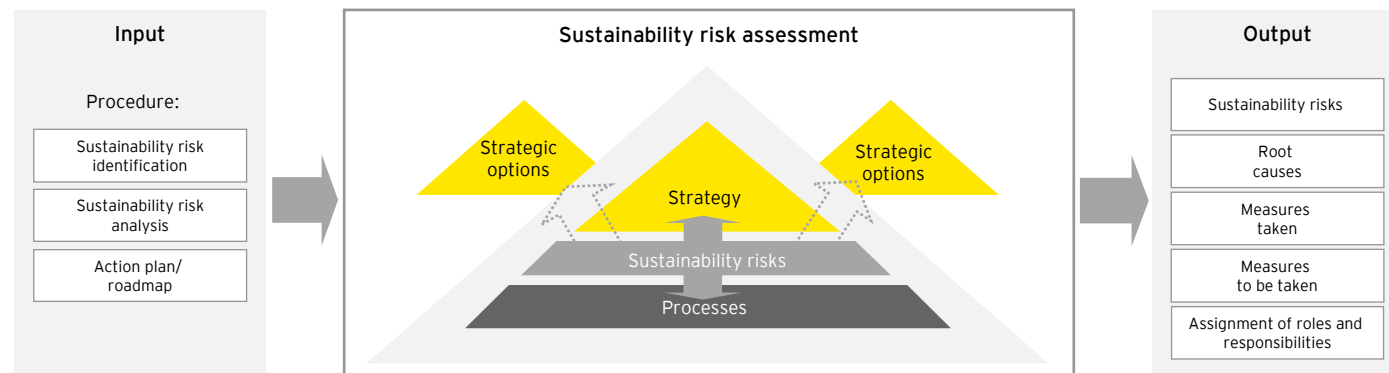
Public pressure has increased on companies to contribute to sustainable development. Companies are expected to practice environmentally, socially and ethically sound business behavior. This is the case for the wide variety of topics that are associated with the four areas of sustainability – environment, ethics, social and economic. Likewise, regulators around the world have steadily increased sustainability regulations. Due in a large part to these reasons, sustainability has become a critical business issue. It requires the systematic assessment and management of present and future sustainability risks.

Sustainability risk management has been a topic on the business agenda of many companies for quite a while. Most companies have some processes in place to mitigate the risks associated with their sustainability goals. However, the challenges around sustainability are often not systematically addressed and managed. This is especially the case with regard to the identification of material sustainability risks as well as to the assignment of risk responsibility and the definition of roles in this area. Risk management is also concerned with the definition of cost effective actions to address the material sustainability risks the company is facing.

What are the key questions to answer?

1. How can your sustainability risks be systematically analyzed and addressed?
2. How can you implement concrete, cost effective measures to address the identified sustainability risks?
3. How do you assign roles and responsibilities for material sustainability risks?

Starting point: Sustainability risk assessment



This sustainability risk assessment provides the basis for identifying sustainability risks that are material to your company. It will also help you to define concrete measures to address the identified sustainability risks, including the assignment of roles and responsibilities.

As outlined above, a sustainability risk assessment consists of risk identification, risk analysis and action planning. The first question to answer is: which sustainability risks could have a material impact on the achievement of your business strategy and goals? This assessment is based on the sources of risk and their impact on business goals. The basis for the sustainability risk assessment will be the individual risk assessments by the executive and supervisory boards and/or other functions which are involved in the risk evaluation.

The individual self-assessments will be consolidated and the risks prioritized in a report, which will form the basis for an action plan/roadmap. This procedure is based on our well-established risk management methodology and builds on your existing corporate risk management processes and function (a potential timeline for such a risk assessment is shown on the opposite page).

A sustainability risk assessment provides the basis to define/redefine your company specific sustainability risks, by gaining a detailed overview of risks which might affect the achievement of your business strategy and goals. The assessment will show existing gaps in addressing material sustainability risks and provide the basis for management-oriented measures and corresponding key performance indicators (KPIs).

Your benefits

A sustainability risk assessment, as outlined above, has numerous benefits. They can be classified into the following categories: revenue and market share, asset and capital management, earnings and operating margins, and reputation and brand.

Revenue and market share

- ▶ Credibility in the marketplace can be gained based on your sustainability performance
- ▶ Know and respond better to market demands by actively addressing stakeholders' expectations related to sustainability
- ▶ Differentiate yourself from your competitors based on sustainability attributes

Asset and capital management

- ▶ A detailed overview of risks which might affect your assets can be put together based on a systematic sustainability risk assessment
- ▶ Your sustainability risk management can be used as a way to gain better access to capital

Earnings and operating margins

- ▶ Risk management costs can be reduced and ad hoc additional costs diminished
- ▶ Ownership of operational tasks associated with key sustainability risks can be clarified based on a well defined action plan
- ▶ Efficiency can be increased and resources saved by addressing sustainability

Reputation and brand

- ▶ A risk overview for your company can be put together
- ▶ Your strategic positioning can be defined and the reliability of your reporting enabled
- ▶ Compliance with laws and regulations can be increased and the potential for reputational damage reduced

A task for executive and supervisory boards

Companies have increasingly been criticized for their failure to anticipate the impact of sustainability risks on the achievement of their business goals. While executive and supervisory boards understand the importance of sustainability, the information they have regarding sustainability risks is often incomplete. This is mainly due to having an uncoordinated and decentralized approach to sustainability risk management. Many executive and supervisory boards need to assume more responsibility in this area. The supervisory board has to be involved in sustainability related strategic risk issues. The executive board has to implement a process for assessing and handling operational risks related to sustainability. Furthermore, the executive board needs to report the findings to the supervisory board. A sustainability risk assessment will help the executive and supervisory boards meet the challenges they are facing. These challenges are to understand: (a) the various sustainability topics, (b) the scope and driving forces related to these topics, (c) success factors and hurdles in addressing sustainability risks, (d) major influencers in the business and political environments, and (e) how to define a pragmatic approach for the future and ensure completeness of relevant matters.

Market expectations and observations

Our business risk report identified the 10 most important business risks for global companies. Out of the top 10 business risks identified, 4 are related to sustainability:

- ▶ Regulation and compliance, such as political restrictions for oil and gas reserves
- ▶ Radical greening, notably the pressure on companies to respond to climate change challenges
- ▶ Managing talent and the global competition for talent
- ▶ Reputation, with the primary cause being compliance failures

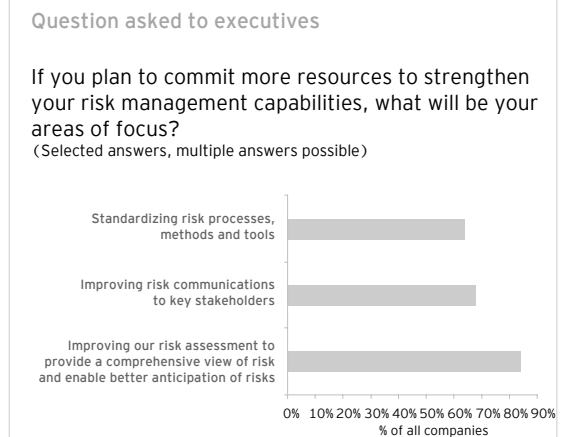
Source: Ernst & Young *Business Risk Report* (2009), conducted with Oxford Analytica. A survey of leading global firms within 11 sectors.

Our study, *The future of risk*, identified the following key risk areas related to sustainability:

- ▶ Risks based on economic, social and political market dynamics
- ▶ Compliance such as code of conduct (e.g., ethics)
- ▶ Operational related to environmental and other hazards (e.g., natural events)

Furthermore, the study revealed that several areas targeted for strengthening risk management capabilities are sustainability-related (see graph).

Source: Ernst & Young study *The future of risk* (2009). A Survey on Fortune 1000 companies.

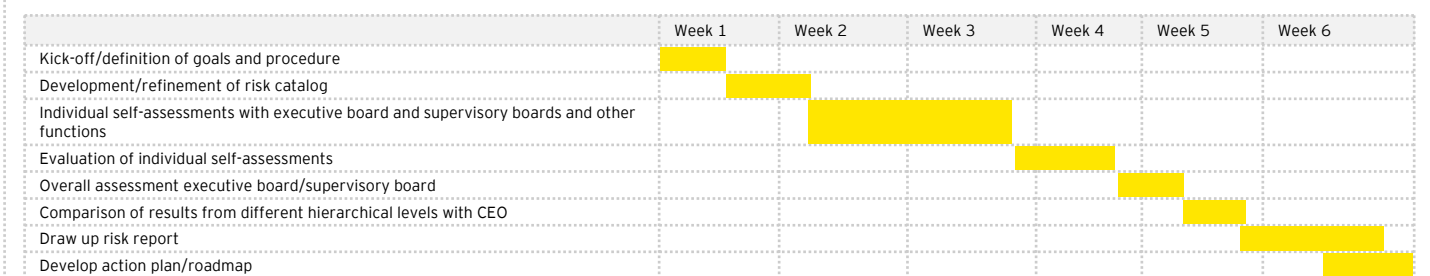


The results of these studies show that sustainability risks are of increasing strategic importance and require systematic management.

Fitness check for executive and supervisory boards

1. Do you have an overview of the most important sustainability issues that can influence the long-term success of your company?
2. Do you have procedures in place to identify the sustainability risks that are material to your company?
3. Are your identified sustainability risks objectively reflected in your internal reporting?
4. Do you have a long term view of the impact of sustainability trends/issues on your strategy?
5. Do you have the information you need to make decisions in the area of sustainability?
6. Are KPIs and the assignment of risk responsibility clearly defined?
7. Do you have the necessary skills within your company to manage sustainability?
8. Do you have procedures in place to generate reliable internal and external reporting?
9. Are your identified sustainability risks objectively reflected in your public reporting?

Possible procedure for a sustainability risk assessment



Why Ernst & Young

We are very experienced in the field of sustainability-focused advisory and assurance services and have worked with numerous international firms to address sustainability issues. Our professionals have extensive knowledge regarding strategies, processes, performance measurements and external reporting. Our methodology for the assessment of sustainability risks is based on our approach to enterprise risk management and is therefore, compatible with various risk management procedures. Additionally, we play an active role in national and international organizations, which focus on the development of criteria and standards in the area of sustainability. We can therefore keep you up-to-date on current trends and developments. Furthermore, we can offer you global reach and scale through our worldwide network of sustainability professionals. We would be happy to meet with you and further discuss your sustainability needs. Please find our contact information on the back cover.