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Message to CEOs:

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PSPK 1 and 2: Freeing Companies From a Burden; Empowering Companies to Create Competitive Advantage

For more than 15 years, sustainability reporting practices have evolved through various standards, frameworks, and guidelines developed to meet different information needs, with objectives, users, scopes, and approaches to materiality that are not always the same. This diversity reflects the growing demand for sustainability information, but in practice it can also create fragmentation for companies that must navigate multiple disclosure requirements. When this complexity is addressed primarily as a compliance exercise, management attention may become focused on fulfilling reporting requirements, while the connections between sustainability-related risks and opportunities, corporate strategy, financial performance, and value creation may not always receive sufficient attention.

In this context, the issuance of the IFRS Sustainability Disclosure Standards—comprising IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures*—introduces a more focused approach to information about sustainability-related risks and opportunities that could reasonably be expected to affect the company's prospects and that is relevant to the primary users of general purpose financial reports. This approach gives companies an opportunity to reduce the burden of continuously reporting sustainability matters that are not relevant in their Sustainability Reports. This can be achieved

by focusing on material information rather than treating all sustainability matters as a uniform checklist of disclosures.

However, changes in the reporting framework do not in themselves change how companies view sustainability. Inertia, or reluctance, may persist when sustainability reporting is treated primarily as a reporting compliance obligation rather than as part of the strategic decision-making process. Under such an approach, the connections between sustainability-related risks and opportunities and strategy, business model, resource allocation, and financial performance may not be fully leveraged.



In Indonesia, OJK is currently revising OJK Regulation No. 51 of 2017 (POJK 51/2017). Under the proposed regulatory framework, the Sustainability Report would include a section prepared with reference to the Indonesian Sustainability Disclosure Standards (Standar Pengungkapan Keberlanjutan/SPK), comprising

PSPK 1 and PSPK 2, as well as disclosures on other sustainability matters in accordance with regulatory requirements. These two sections of information may serve complementary purposes. SPK focuses on information about sustainability-related risks and opportunities that could reasonably be expected to affect the company's prospects and that is relevant to the primary users of general purpose financial reports, while regulatory requirements may also encompass sustainability information needed for broader policy objectives and a wider range of stakeholders.

This development provides an increasingly clear signal that sustainability reporting is not only part of regulatory compliance, but is also becoming more closely connected to information used to assess a company's prospects and resilience.

SPK prioritizes the sustainability aspects that are the most practical to measure and have an obvious and transparent link to financial measurements; i.e., greenhouse gas (GHG) emissions. Many countries, including Indonesia, have established GHG trading markets. In addition, regulations regarding carbon taxes are already in effect in many other countries.

SPK provides requirements for industry-based metrics. Therefore, these standards allow boards of directors across different industries to determine their sustainability targets and sustainability aspects are relevant to respective companies, while still complying with the requirements of SPK, as well as applicable regulations.

It is important for CEOs to recognize that **sustainability reports are a corporate communication tool** used to explain how the company analyzes sustainability-related risks and opportunities as part of its overall corporate strategy. The linkage between the company's ESG or sustainability targets and the sustainability

strategy is crucial. Few companies—even those that have won numerous sustainability awards—have clearly articulated this alignment.

Understanding the linkage between sustainability and the company's overall strategy **will serve as a driving force (energizer)** for the entire company's organization to embrace sustainable practices—which is the ultimate goal why the sustainability report is required—and to open the minds of business players that business can operate responsibly while simultaneously increasing their company's value.

Below are some tips for the CEO to implement PSPK 1 and 2:

1. Where do we start? A top-down approach first.

The most important and most difficult task for a company to implement sustainability is to understand the direction of its sustainability strategy and how it relates to its operational targets. It is important to keep in mind that the company's sustainability strategy should be integrated into its operational strategy to ensure that the company has the energy and enthusiasm to implement sustainability activities.

Let us start by asking these questions:

- 🍃 What are the sustainability consequences of your company's Mission and Vision?
- 🍃 What is your company's tagline, and how do you recognize the sustainability aspects that align with this tagline, your company mission, and your company vision?

Find any linkages that can connect these to your Sustainability Mission and Vision. Please keep in mind that, as a for-profit company, sustainability is only a part of what creates your company. It is not that your operating direction comes under your sustainability purposes.

2. Conduct a holistic review of the interrelationships between your company's overall risks and opportunities and your sustainability-related risks and opportunities identification.

In connection with a public offering of shares, issuers are required by OJK regulations to disclose risks factors as well as information regarding business activities, trends, and business prospects in the prospectus—which can be viewed as the company's operation-related risks and opportunities. In fact, companies with good corporate governance will have a regular cycle to analyze operation-related risks and opportunities. The determination or review of risks and opportunities analysis is conducted by performing external condition scanning combined with the analysis of organization's internal strengths and weaknesses.

External condition scanning will include technology changes affecting the company, the geopolitical situation, the general economic condition, industry dynamics (including competition), social and cultural changes, and the legal and regulatory environment. Scanning of organizational strengths and weaknesses will include analysis of financial strengths or weaknesses, the human capital structure and systems to meet organizational challenges, the robustness of the organizational system, and policies and procedures. This comprehensive analysis will generate the risk and opportunities mapping for the entire company.



PSPK 1 outlines a framework for disclosing of sustainability-related risks and opportunities and promotes their integration into company's overall risk management process. Based on experience and observations of current business practices, there is a tendency for company's analysis of sustainability-related risks and opportunities to be completely disconnected from its overall risks and opportunities.

Mapping that describes the linkage between sustainability-related risks and opportunities, as a further description of the overall company's risks and opportunities, is essential.

For example, a company may list the risk of high energy prices or the high cost of transportation/logistics as one of its top operational risks; however, the risk of high GHG emissions is considered low. Although this is possible, an explanation of why the linkage is as such needs to be communicated and explained to potential investors. Another example is the considered good opportunity to increase the reserve of a mining area without considering that the reserve's location area is near a national park.

There is no sustainability-related risks and opportunities that are ranked the highest in your company stand alone without a clear linkage to your overall company's risks and opportunities.

3. Determine the target and the roadmap to achieve the sustainability target, and plan the journey.

Unlike other sustainability standards that require companies to report hundreds of sustainability aspects which tend to be checklist-based, SPK requires company to disclose material information regarding sustainability-related risks and opportunities that could reasonably be expected

to affect the company's prospects, namely cash flow, access to financing, or the cost of capital over the short, medium, or long term. This means that the board of directors determines its own direction, its own targets, and its own roadmap on the company's sustainability journey. There is no rigid formula that everything, whether relevant or not, must be disclosed.

Materiality relates to the information disclosed. Information is material if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users of general purpose financial reports. Primary users include investors, lenders, and other creditors, both current and potential. This definition is also commonly known as the "*outside-in*" approach with single materiality. SPK does not require the application of double materiality.

Sustainability-related risk and opportunities, as well as relevant disclosure topics and metrics, may vary across industries. To help identify these sustainability-related risks and opportunities, PSPK 1 requires companies to refer to and consider the applicability of the disclosure topics in the SASB Standards. The IAI Sustainability Standards Board is developing Industry-Based Guidance on Implementing SPK by referring to these international guidelines and adapting them to the Indonesian context. In the **Exposure Drafts for the Revision of SPK**, companies are required to first refer to and consider the applicability of these Industry-based Guidance. If guidance are not yet available for the relevant industry or activity, the next reference is the SASB Standards.

The board of directors may use these guidance as a tool to identify sustainability-related risks and opportunities and link them to the company's overall risk and opportunity analysis. Companies need to assess the applicability of topics and metrics based on their business model, activities, and the company's facts and circumstances; not every topic or metric automatically requires

disclosure. The analysis should also include risks and opportunities not covered in the guidance but that could reasonably be expected to affect the company's prospects. Companies then determine the material information that needs to be disclosed regarding those risks and opportunities in accordance with the requirements of the SPK.

Basically, the board of directors can review the Industry-Based Guidance on Implementing SPK or SASB Standards, after assessing their applicability, analyze whether it is necessary to exclude risks and/or opportunities that are irrelevant or immaterial to the company, or add additional risks/opportunities to monitor. Aligning these choices with overall company's risks and opportunities.

The board can also ask the finance department to prepare a quantification of the financial impact of the mitigation of the sustainability risks/opportunities. Use the 80/20 principle: what are the 20% of actions that contribute most to sustainability, which will have an 80% impact on the company in mitigating risks or exploiting sustainability opportunities, and also have a material impact on the company's value (in the form of cost efficiency, increased revenue, increased profit, or an increase in the company's market capitalization value in the stock market).

Choices made by the board will provide direction to the company, so that the organization marches to the same tune and does not go astray without a clear target.

4. What you can see and what you can measure, you can focus on.

Overall company's strategy will include the strategy to mitigate the sustainability-related risks and opportunities of company. As now sustainability strategy is linked to your overall company's strategy, it will be much easier to determine the company's sustainability target. It

is part of overall company's target, not standing alone.

It will also be much easier for the entire organization to further translate the sustainability target and strategy to its individual division or department, or even to an individual manager's target and strategy.



The answer to the question of *what's in it for me* is now clear.

Linking sustainability targets and strategy to the overall company's targets will energize the whole company to work toward achieving the targets. The CFO who is tasked—not burdened—with collecting the data to monitor the progress of target milestone achievement will get the support of all divisions and departments—everyone in the organization—to achieve sustainability and the overall company's target and implement the strategy.

5. Delegation to the second-rank officers or consultants.

Many boards would love to surrender the task of determining the top sustainability risks to consultants (which generally cost a lot), as has been done in previous years, thereby lessening the work burden on the board. While this practice is acceptable if the consultants understand the key success factors of the company and the industry risks and opportunities, in practice not many, if any, sustainability consultants understand

the typical industry risks, moreover the strengths and weaknesses of the company. The board of directors is supposed to be the party that understands these aspects the best, and it is the ultimate party responsible for ensuring the company survives and flourishes within the industry.

Delegating this job of determining the company's target and strategy to a party that does not possess the same level of competency and accountability as the company's board itself will result in subpar engagement, which will not optimize the company's value.

This does not mean that having a sustainability consultant will not generate added value for company. The key success factor is how to work together with this consultant. The board possesses an understanding of the overall company strengths and weaknesses and the industry dynamics in which it operates. The sustainability consultant possesses the technical knowledge of how to report sustainability and what measurement is usually used by the industry. Collaboration, not delegation or, worse, abdication, is the keyword.



Based on experience and observations in business practice, it is easier for the board to learn and understand the company's sustainability aspects than for the consultants to learn and understand the company's overall operations. Delegating

the job of determining the sustainability target to this type of consultant will mean abdicating board responsibility. In general, boards have to understand that tasks and jobs can be delegated, but responsibility and accountability cannot.

The board of directors may want to engage a consultant or delegate further duties to your second-rank officers only after the board of directors provides direction and sets overall targets. The responsibility for further application will lie with the internal company's team rather than with the consultants. The consultants will support the team by providing sustainability input and ensuring that deadlines are met.

6. Which board members should be involved in analyzing sustainability-related risks and opportunities, sustainability targets, and the roadmap?

The answers will definitely be the same as the answers to who are the most important members in determining the overall company's risk and opportunities, the operating strategy and targets, and the roadmap to achieve the targets.

The three most important members of the boards of directors—are the CEO, the CFO, and the COO.

Depending on which industry of company is in and the overall risks and opportunities that already identified, it may want to include a Marketing Director, a Human Capital Director, a CIO (Chief Investment Officer), or your Information Technology Director.

The CEO has the job of leading the whole company. The CFO is responsible for quantifying the target, preparing the system to monitor achievements, preparing the sustainability budget, and reporting progress. Quantification may be in terms of financial or nonfinancial quantification. The measurement units, such as tonnes of CO₂ equivalent, the volume of water

usage, or the quality of the wastewater, should also be quantified using nonfinancial measurement targets.

The CFO also has an important role in ensuring connectivity between sustainability information and financial statement, including the consistency of data, assumptions, and financial impacts used in both sets of reporting, as well as in establishing an adequate internal control infrastructure over sustainability reporting (*internal controls over sustainability reporting/ICoSR*).

The COO is a very important person to determine and to drive the sustainability efforts. He or she will be the one to understand the biggest company-wide risks and opportunities related to the operation of the company. He or she will need to expand his or her knowledge of which part of the company's operation can generate the “*biggest bang for the buck*” in the Company's sustainability journey. Without a supportive COO, your organization's energy to determine the relevant sustainability risks, opportunities, strategy, targets, and unit of measurement will not be there.

7. The benefit to the company

The trend toward sustainability disclosures requirements is a global trend, the government of each country has declared its commitment to its Nationally Determined Contribution to reduce GHG emissions. Private companies are also required to meet international sustainability disclosure standards. Banks are required by the Basel Committee on Banking Supervision (BCBS), although this is still voluntary for the time being, and by the OJK to disclose climate risks. Sooner or later, companies that are not prepared to implement sustainability measures will face challenges in accessing financing.

Sooner or later, banks will view companies that do not disclose sustainability information in

accordance with international standards as higher-risk borrowers, resulting in higher borrowing costs (cost of funds). Conversely, companies that are progressive in their sustainability activities, which create competitive advantage, for themselves, will benefit from lower financing costs.



Currently, sustainability-linked loans are offered by banks with more favorable terms and conditions than those of traditional loans. These types of loans are not necessarily beneficial for all companies. It is the CFO's responsibility to understand and analyze the terms and conditions of these loans.

8. Will the early, full implementation of SPK be beneficial for our company, or should we focus solely on the climate first?

This will depend on a company's need to communicate with your prospective investors or financiers. If there is material information regarding non-climate risks and opportunities that is important to potential investors or fund providers, the board of directors should consider the benefits of disclosing such information earlier. Although, PSPK 1 permits disclosure limited to climate-related matters during the transition period, this reporting flexibility is not a reason for the board to neglect the risks and opportunities – other than those related to climate—that could

reasonably be expected to affect the company's prospect.

For example, a company may face risks other than climate-related risks that are expected to affect its prospects (such as human rights risks), while material information regarding those risks has not yet been disclosed because the company is using the transitional provisions to disclose only climate-related information (for example, disclosing only GHG emissions).

Although permitted by the SPK, this choice may prevent prospective investors or fund providers from obtaining the information they need to adequately understand the company's prospects, and they may view this as an irresponsible action on the part of the board of directors.

It is important to note that the transition relief for climate-related disclosures does not mean that SPK becomes a climate-only standard. When a company applies this relief and discloses only climate-related information, other relevant principles and requirements in PSPK 1 continue to apply, including, for example, those relating to materiality and connected information.

Board members who recognize the importance of this information should consider disclosing it earlier so that the company's communications with investors or lenders better reflect the risks and opportunities the company faces.

After doing the exercise mentioned above, a company's board of directors can already understand and determine the top sustainability-related risks and opportunities, the strategy to mitigate the risks, the sustainability target and the roadmap, all of which are integrated well into the company's overall risks and opportunities, strategy, and target.

Conclusion

In conclusion, direct board involvement and a top-down approach are crucial early in the company's process. This identifies sustainability-related risks and opportunities, determines mitigation strategies, sets sustainability targets, and energizes the organization to implement efforts that increase company value over the short, medium, and long term.

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