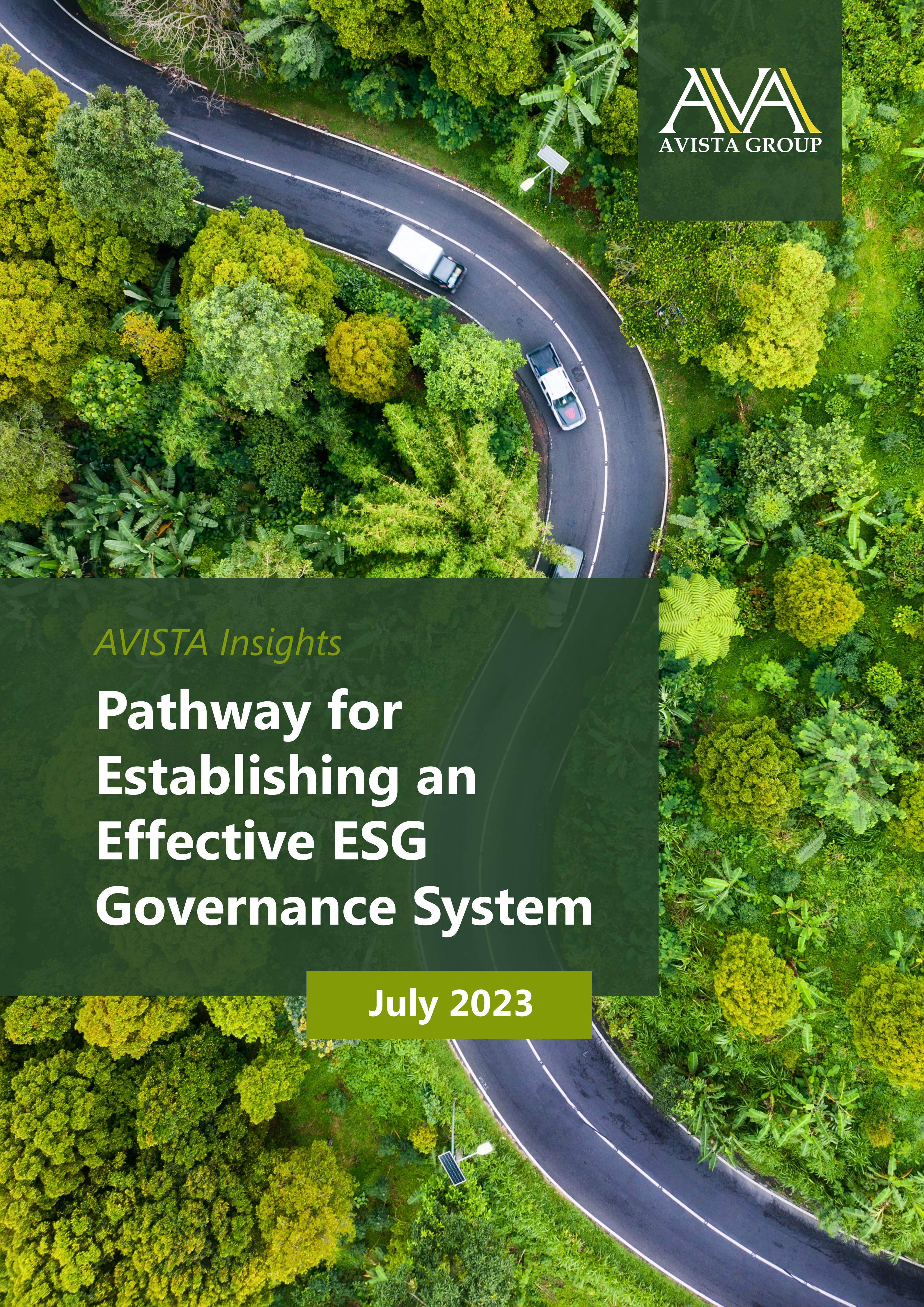


AVISTA GROUP

AVISTA Insights

Pathway for Establishing an Effective ESG Governance System

July 2023

Introduction

Since the publication of the Listing Rules for ESG disclosure requirements in 2021, the Hong Kong Stock Exchange ("HKEx") continuously introduces and updates ESG-related disclosure and governance guidelines. In April 2023, HKEx proposed additional climate-related information disclosure and corporate governance requirements of the Listing Rules[1], and released a public consultation paper with the aim of further enhancing the ESG disclosure practices of Hong Kong listed entities,starting from 2024. It is crucial for Hong Kong listed entities to recognise the importance of ESG compliance requirements and strive to improve their ESG governance practices.

In light of this context, leveraging our extensive experience in delivering professional internal audit and ESG consulting services to diverse listed entities, we would like to present a viable pathway for establishing an effective ESG governance system, serving as a valuable reference for company directors.

[1]https://www.hkex.com.hk/News/Market-Consultations/2016-to-Present/April-2023-Climate-related-Disclosures?sc_lang=zh-HK

Key Points for Establishing ESG Governance System

Summarising the current corporate governance and risk management framework, we suggest that companies can build an ESG governance system tailored to their unique development and operational models from three perspectives, including **1) Governance Structure, 2) Culture, and 3) Process Mechanisms.**

Figure 1. ESG Governance Elements

1 Establish a well-defined ESG governance structure

Establishing a well-defined ESG governance structure empowers companies to effectively manage ESG matters. By clearly defining the roles and responsibilities of key personnel, ESG-related processes can be conducted in an orderly and efficient manner.

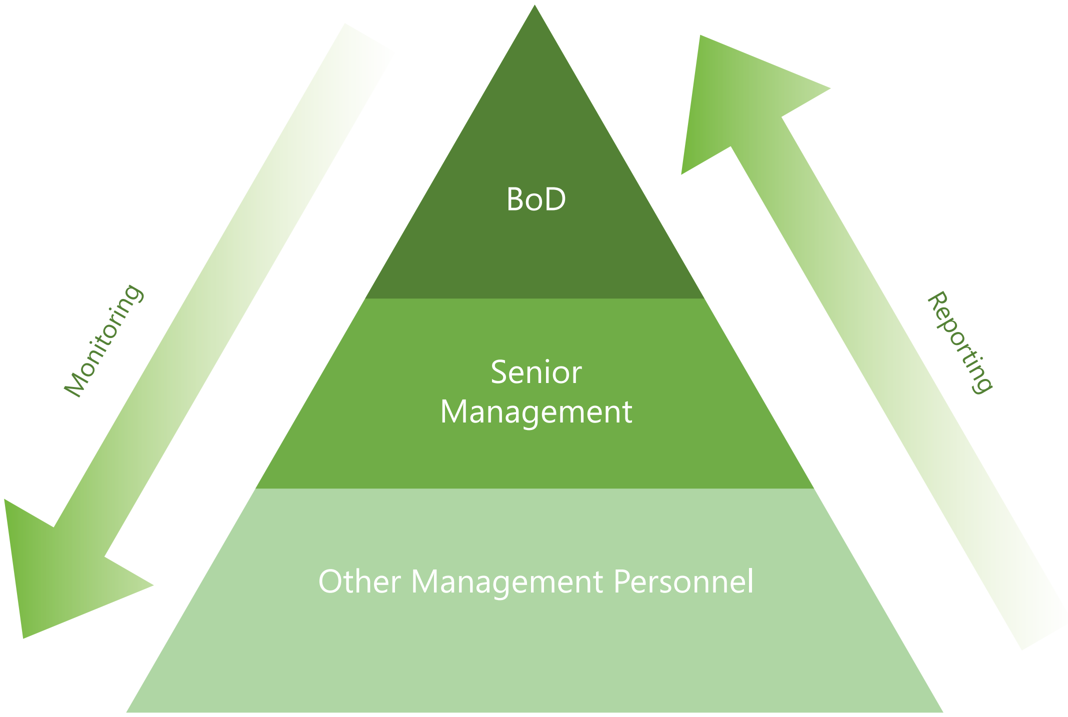
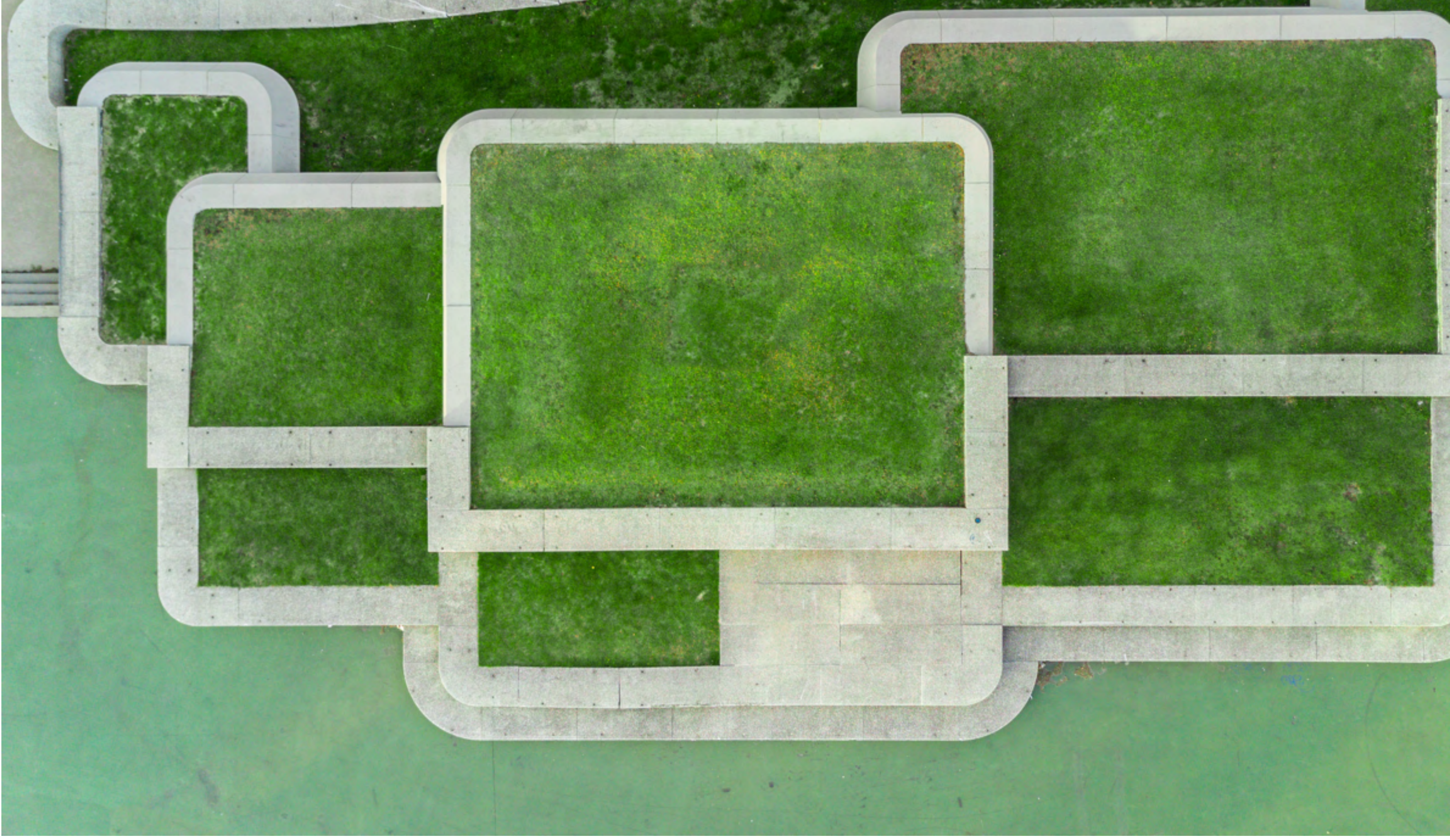


Figure 2. ESG Governance Structure.

Board of Directors (**the** "**Board**"/"**BoD**"**):** Being the ultimate responsible body, the Board plays a leadership and oversight role in the ESG governance system. Through regular board meetings, the Board reviews and approves ESG goals and strategies, and assesses the progress and effectiveness of ESG-related initiatives.

Senior Management: They are responsible for formulating feasible work plans for ESG-related initiatives, and regularly reporting the outcome and progress to the Board to ensure smooth execution.

Other management personnel: Responsible for executing assigned tasks in accordance with the established ESG work plan, identifying and monitoring ESG-related risks, regularly reporting to Senior Management, and collecting ESG-related information and data for ESG reporting and disclosures.



2 Establish a corporate culture that values ESG governance

Culture plays a significant role in shaping the ESG governance system. A corporate culture that values ESG governance can influence employees to incorporate ESG factors into their decision-making and actions, enabling sustainability to be integrated into the company's operations.

Lead by example to demonstrate the emphasis on and commitment to ESG
Management behavior and mindset can greatly impact the entire enterprise. They can demonstrate the emphasis on and commitment to ESG through their daily management practices that emphasises environmental protection, social responsibility, and good corporate governance, thereby inspiring employees to act in a similar manner and attitude in daily operations.

Establish an ESG-linked reward mechanism
Economic incentives (such as cash bonuses, promotions, recognition or professional development opportunities) are effective in encouraging management and employees to put corporate ESG governance system into practice. Continuously rewarding outstanding ESG work practices can help companies gradually establish a strong ESG governance culture and foster collective commitment among employees.

3 Establish appropriate mechanisms to monitor ESG-related matters

When formulating written systems and procedures to govern ESG-related matters, in addition to adhering to the principle of segregation of duties ("SoD"), we recommend considering the following elements.

ESG data quality

Companies must establish appropriate data collection, verification and monitoring processes for each significant ESG performance indicator to enhance the accuracy and reliability of publicly disclosing ESG data. For example, regarding Scope 3 carbon emissions, companies can first classify emissions sources by operational activities. The relevant responsible departments then assess the carbon emissions before conducting relevant operating activities and record the emissions in daily operational documents (e.g., invoices). Companies can formulate a register for all recorded Scope 3 emissions, with regular review of its completeness and accuracy to improve the overall quality of the ESG data.

Risk and opportunity assessment

Companies are recommended to regularly perform ESG-related risks and opportunities assessment, and conduct qualitative and quantitative analyses. Companies should also evaluate the short, medium and long-term impacts of ESG risks and opportunities on their financial condition in accordance with applicable accounting standards. If necessary, companies may consider seeking professional advice from ESG and financial experts.

ESG goals and commitments

Companies are advised to assess and establish achievable ESG goals and commitments, work plans, and timetables based on the operational objectives, risk assessment results, policies and market trends. Regular variance analysis should be conducted, and timely progress reporting should be provided to the Board.

ESG internal audit

The internal audit process is particularly critical in ESG governance. Companies are recommended to incorporate significant ESG-related operation processes into the scope of regular internal audit supervision. Being supervisors, internal auditors timely identify risks by checking for vulnerabilities in program design and execution, ensuring the effective functioning of ESG governance-related internal control systems.

Conclusion

In recent years, HKEx has placed greater importance on ESG. The consultation paper issued in April demonstrated that HKEx is accelerating efforts to improve the quality of ESG disclosures by listed companies. Therefore, companies should consider allocating more resources to enhance their ESG governance framework to better adapt to the future regulatory requirements for ESG compliance.

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About AVISTA

AVISTA Group ("AVISTA") is a leading professional advisory firm. We are experienced in performing a full range of Valuation Advisory, Risk Management Advisory, ESG Advisory, Corporate Advisory, and Property Consultancy services for various purposes.

We have offices in Hong Kong, Shanghai, Beijing and Shenzhen.

The AVISTA professional team comprises more than 100 professional consultants, each with different areas of expertise and detailed familiarity of financial reporting standards and regulatory standards. Our team of experienced professionals come from globally-renowned valuation firms, consulting firms and international accounting firms with global qualifications such as CFA, CPA, CPV, FRM, MRICS, FCCA and so on.

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