The fundamentals of ESG reporting and verification

LRQA

Contents

The new normal

ESG reporting and verification

ESG - or Environmental, Social, Governance - reporting is the new normal. It is a standard requirement for any organisation operating in today's business environment and is therefore rapidly becoming a strategic business priority. The requirements are broad and can vary, depending on the country or countries of operation of the organisation, and also the sector. We take a look at the standards used and some frequently asked questions around the subject.

The rules of ESG reporting

Requirements

Diagram 1 provides an overview of some of the main reporting requirements used today, including: the origins of the ESG goals; reporting frameworks; more specific standards; and legal requirements.

The broad goals of ESG reporting requirements have been established by international mechanisms, such as the the UN Sustainable Development Goals (SDG's), which provide a plan for global cooperation for sustainable development, or the Paris Climate Agreement, requiring all nations to reduce GHG emissions to limit global temperature rise to 2°C.

In order for businesses to maximise their contribution to these goals many supporting frameworks, standards and regulations have and continue to be developed, providing greater detail, guidance and requirements for how organisations can together achieve those goals.

The frameworks detail the 'how' to report both a company's ESG strategy and its progress against that strategy, and the standards detail the 'what'.

Popular frameworks include: the Global Reporting Initiative (GRI), which provides for the reporting of all ESG elements; and the CDP which provides for the reporting of environmental related elements.

ESG reporting

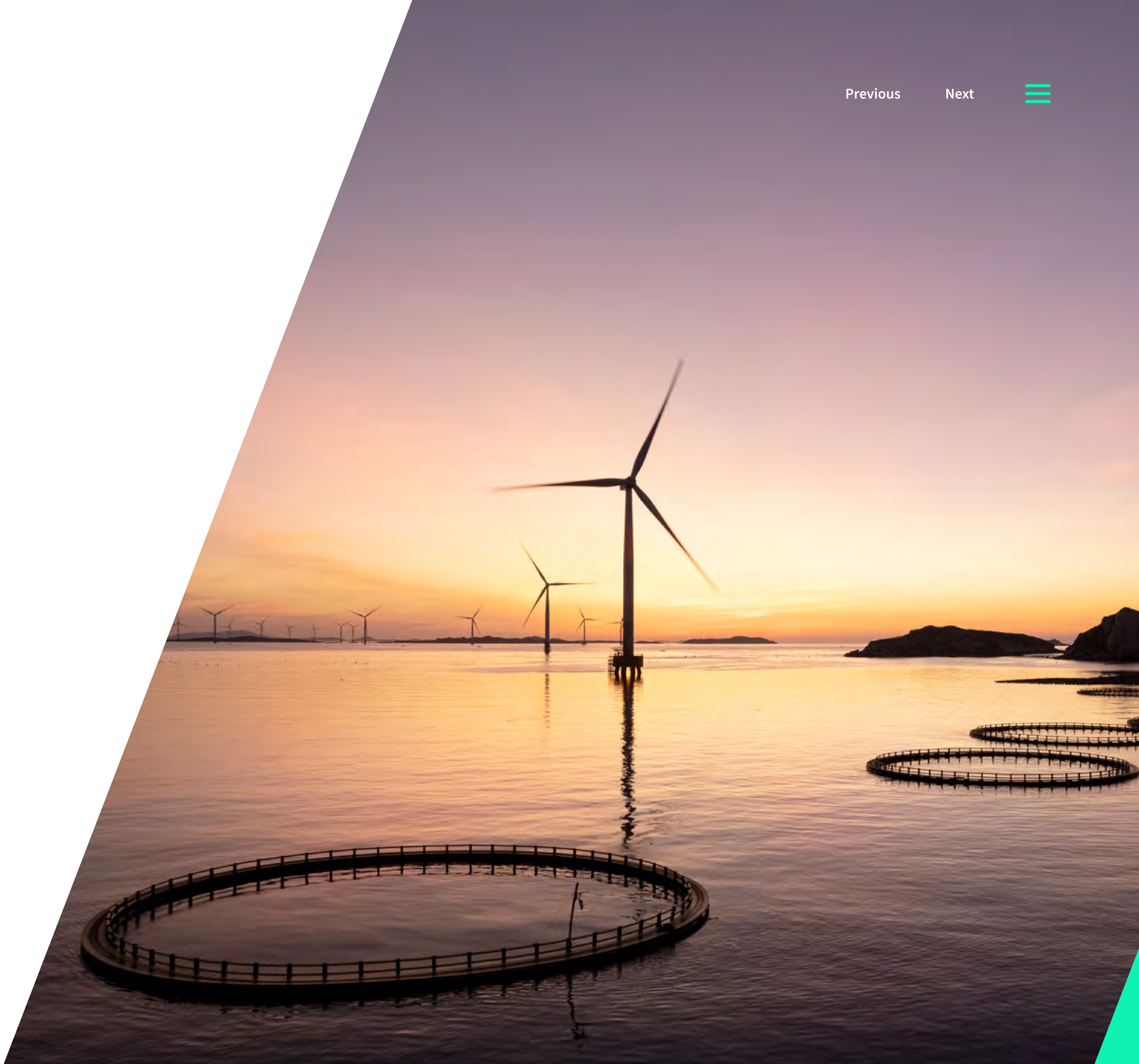
Diagram 1.

Industry specific and guidance standards

In addition, there are frameworks that have originated more from the focus of the financial stakeholders, such as the SASB standards which enable organisations to provide more industry-based disclosures; the Task Force on Climate Related Financial Disclosures (TCFD) which requires reporting of climate related risks and opportunities; and the Science-Based Targets Initiative (SBTi) which provides the means by which organisations can set appropriate goals and targets to achieve their contribution to a net-zero future.

In further support of these goals and frameworks, is no shortage of standards which provide further guidance on the 'what' to report. There are many in the area of ESG, but those related to climate change are the furthest developed. Just a few examples, and the main standards used by organisations for climate related reporting are: ISO 14064-1; and the World Resources Institute's Greenhouse Gas Protocol, which assist organisations in reporting their greenhouse gas emissions across all scopes. In addition, there are other more specific climate related standards, such as PAS 2060 which relates to demonstrating carbon neutrality, and ISO 14067 and PAS 2050 which relate to product claims for the carbon footprint of goods and services.

All of the frameworks and standards listed above are voluntary, however we are now increasingly seeing regulations requiring mandatory reporting of ESG elements. Many of which are based upon the frameworks and standards previously mentioned.



Mandatory reporting

The UK led the way with mandatory climate reporting for all limited and large private companies through the use of the TCFD.

In the EU, the Corporate Sustainability Reporting Directive (CSRD) will require from 2025 the disclosure of environmental, social and governance information on an annual basis.

Companies will have to report according to European Sustainability Reporting Standards, including environmental matters, climate risks, social matters, human rights, anti-corruption & bribery and board diversity for example, and to have the reports independently verified.

In the US, the Securities and Exchange Commission (SEC) have proposed a mandatory rule on Climate Risk Disclosures. If implemented, the rule will mandate that along with reporting financial performance, publicly traded companies in the US will also be required to annually report how they govern their climate related risks, their risk management approach and strategy with respect to climate related risks, together with reporting specific metrics related to their greenhouse gas emissions, including their Scope 1 and 2 emissions, material Scope 3 emissions, and any targets and goals that have been established. It also requires independent verification of these reports.

Best practice in ESG reporting

With such complex reporting requirements available to organisations, it can be difficult to know where to start. First and foremost the organisation must identify what is material to it and therefore what is material to be reported.

The SASB standards have reviewed various industrial sectors, and surveyed investors, to understand what is material to each industry, they therefore provide a good source of guidance for this.

In addition, the importance of obtaining an organisational specific external viewpoint should not be underestimated. Companies internal reflections regarding what is material may not be in line with the opinion of other stakeholders. It is therefore important to engage with key stakeholders to confirm their expectations regarding the material issues to them.

Finally, an internal analysis of those ESG elements which pose the greatest risk or opportunity are also those that are material, such as the largest contributors to greenhouse gas GHG emissions, the areas of poorest performance in relation to diversity, or the cause of most health and safety near misses.

Once the material issues are identified, best practice to achieving progress and reporting on that progress is then to look to the internal processes for collecting and ensuring that the data is accurate and complete.

Successful companies are recognising that ESG data is now being treated equally to financial data by those external to the organisation, and are therefore treating it equally internally, by subjecting ESG data to the same level of rigour as financial data, and applying the internal systems and processes of quality assurance and control, audit and review to make sure that the ESG data is complete and accurate.

Best practice

Best practice is also to fully embed ESG with the core business management systems and existing reporting requirements, such as Environment, Health and Safety (EHS). Companies that have management systems that are potentially certified to or informally based around international standards such as ISO 9001 for quality, 14001 for environmental management or 45001 for occupational health and safety are able to utilise these strong systems for data collection and quality assurance, and apply them to any element of ESG, whether that be employee welfare, gender and race equality, human rights, business ethics and political influence for example.

Once the internal processes are established, organisations can then look at the external focus; consider the appropriate frameworks or standards to use, or that may be required for reporting, and engage with an independent verification body to assist in ensuring the organisation is correctly applying a best practice approach and to have the data and reports verified.

Table 1 shows the current spread of standards used by those surveyed and the popularity of GRI and CDP.

Commonly adopted frameworks

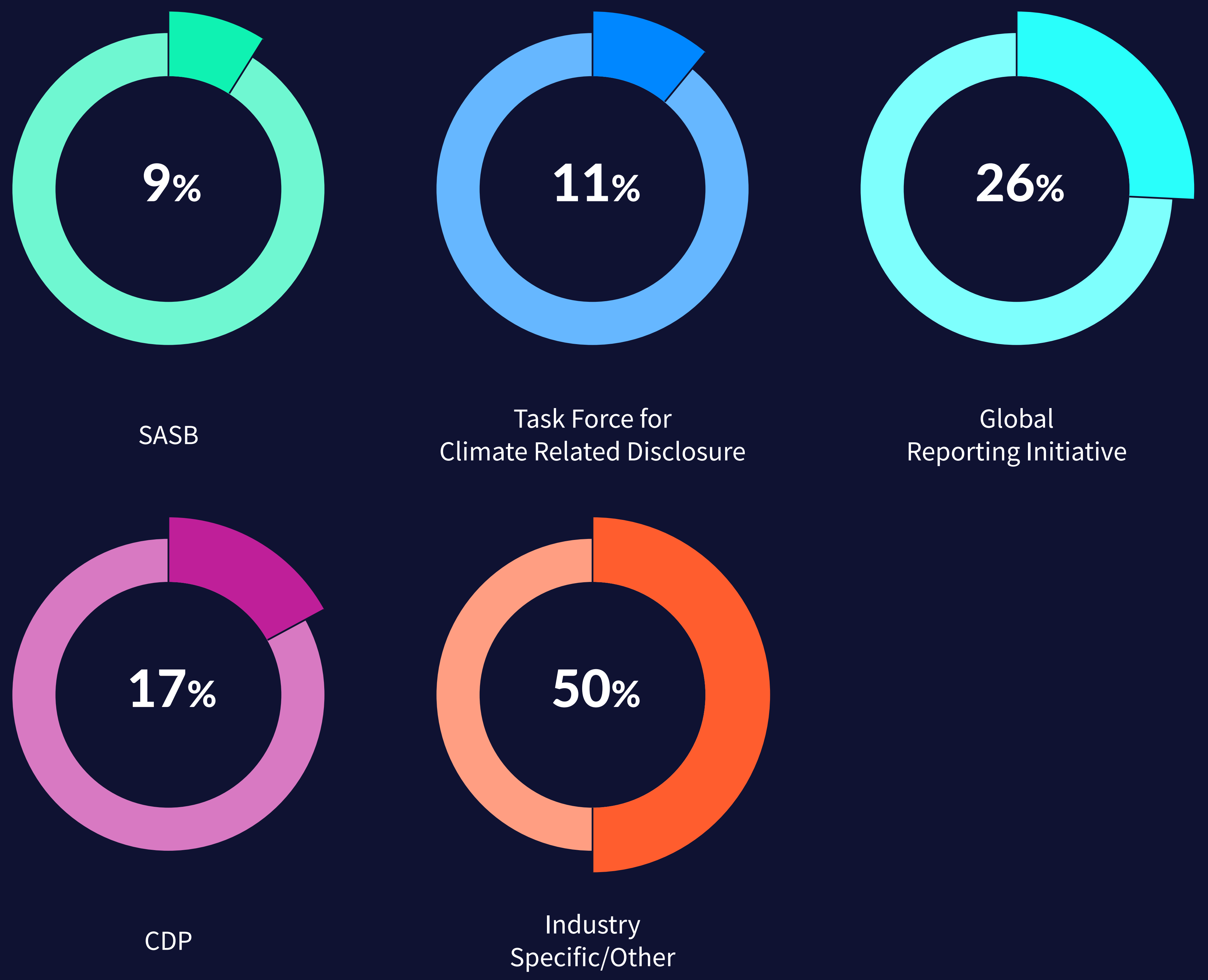


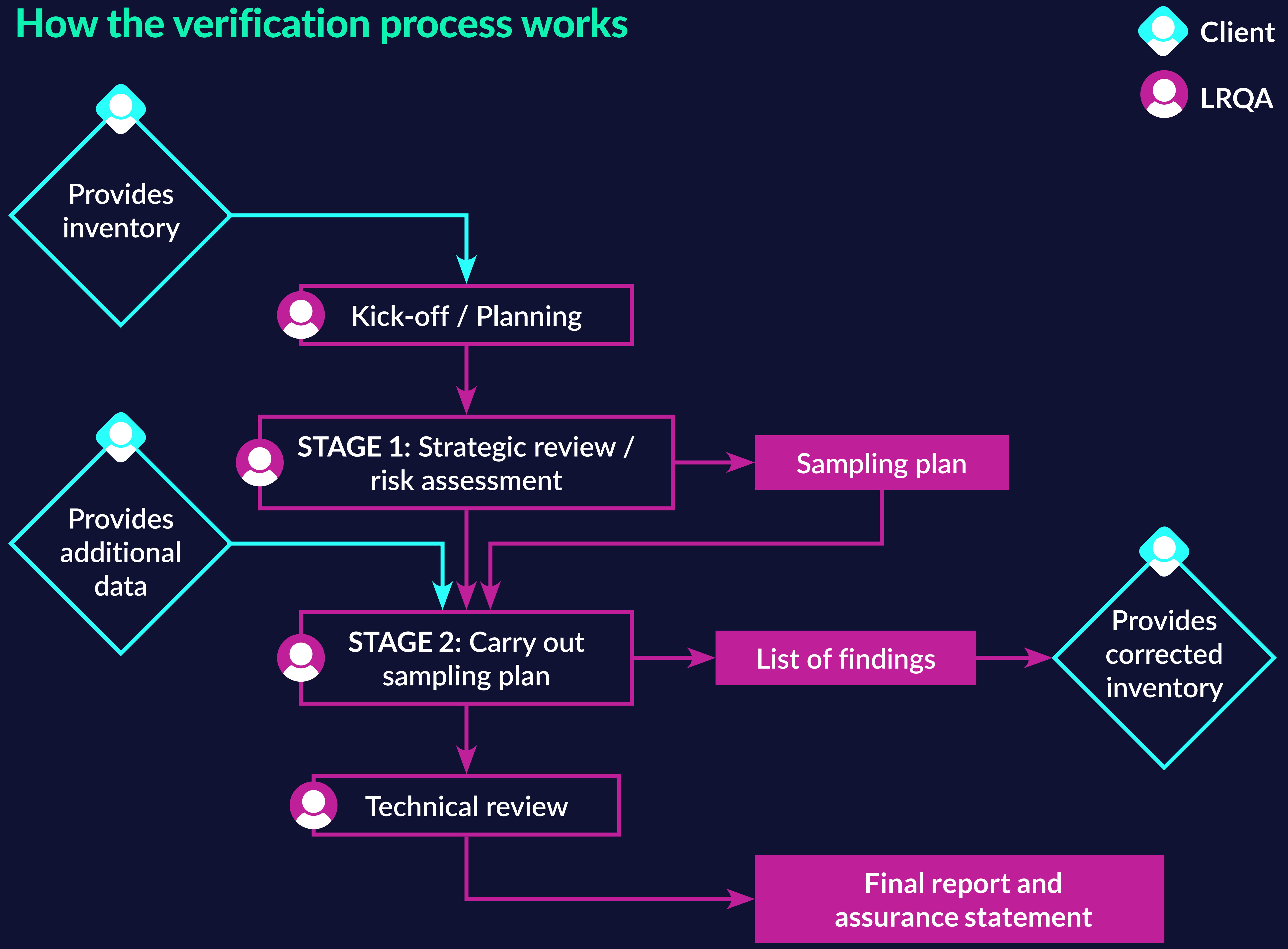
Table 1.

The verification process

The verification process is one which is also defined by international standards. Accredited verification bodies are independently assessed to ensure that they are following internationally defined processes and that they are competent. It is important to find a verification provider that is accredited for the reporting standard used. Many frameworks, such as the CDP, can provide details of verification partners, and the national accreditation bodies such as the UK Accreditation Body (UKAS) and in the US, the ANSI National Accreditation Body (ANAB) can provide details of those accredited per standard.

The verification process can be explained by the diagram adjacent and is the same regardless of the ESG aspects being covered. It starts with the client providing the verifier with a report or data set that is to be verified. That is then used by the verifier to start the planning phase of the verification. This requires the verifier to complete a strategic review and risk analysis in order to understand the extent of the verification task, and identify which are the biggest contributors to the data reported, where the most complex data gathering and calculation is undertaken and therefore which areas are the biggest risks to the verification. This enables an appropriate verification plan and sampling plan to be established, ensuring that all contributing factors are verified, but that the time is apportioned to manage the risks of error appropriately.

How the verification process works



Implementation

The implementation phase is where the plans are implemented and the data and calculations cross-checked. It is likely at this stage that findings will be identified, such as calculation errors or transposition errors, the correction of which then provides opportunities to improve the accuracy of the data and to improve the processes in the future and prevent their recurrence.

Once the findings are addressed, accredited verifiers are required to undertake an internal technical review process. This ensures that all of the correct steps have been followed, as required by the international standards, and once completed a final report and assurance statement is issued.

The verification process is usually applied annually, but can be applied at a frequency most suitable for the organization.

It is important to remember that the verification body is there to help ensure that the data and information is complete and accurate, and can provide best practices regarding how the data gathering systems and processes can be improved upon.

Table 2 shows the current spread of reporting and verification situations of organisations surveyed, and shows a reasonably even split between those just starting and those more established.

What approaches are organisations taking to ESG reporting and verification?

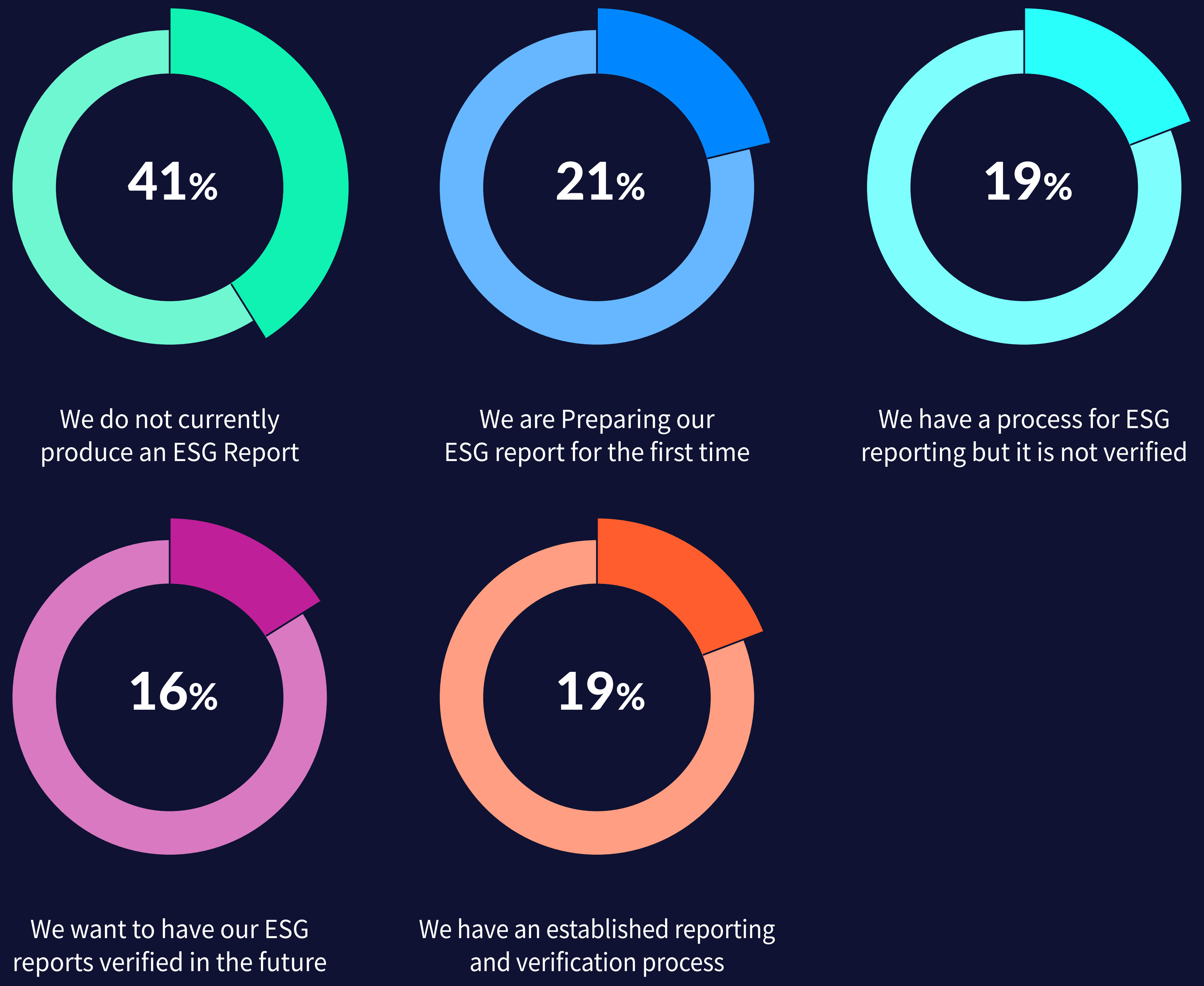


Table 2.

Key verification terms and where to start

Key verification terms

The verification process uses a number of unique terms, such as limited assurance, reasonable assurance and materiality.

The level of assurance dictates the depth to which the verification plan and data / information sampling plan must go to determine if there are any material errors, omissions, or misstatements. This depth of sampling is dictated by the relative degree of confidence that LRQA requires to make a conclusion on an assurance engagement.

Reasonable assurance reduces LRQA's assurance engagement risk to an acceptable low level and is the basis for a positive form of expression of LRQA's conclusion. This means that LRQA's assurance processes for reasonable assurance are more detailed and involve a greater depth of verification than limited assurance.

The focus for a reasonable assurance engagement is to conduct systematic and comprehensive evidence gathering procedures to confirm that the data and information provided, and statements made by the client, are materially correct.

Limited assurance reduces LRQA's assurance engagement risk to a level that is acceptable, but where that risk is greater than for a reasonable assurance engagement, and is the basis for a negative form of expression of LRQA's conclusion. A limited assurance is distinguishable from a reasonable assurance in that there is less emphasis on detailed testing of data and information.

The focus for a limited assurance engagement is to conduct systematic and sufficient evidence gathering procedures to confirm that the data and information provided, and statements made by the client are not materially incorrect.

Indirect scope 3 emissions: Where to start

Scope 3 emissions, also described as indirect emissions, include the categories of emissions that are not under the direct control of the organization, for example those from transportation (of raw materials and product), those from the use of the product, and those from the product treatment at end-of-life.

Quantifying and addressing such categories of emissions requires close engagement, cooperation and collaboration across the value chain. Internally, addressing upstream emissions will require the involvement of procurement, R&D and design and externally engaging with the supply chain. Engaging all parties from the outset is essential to obtain accurate data for initial quantifications and to move forward with mutual opportunities to innovate in this area.

Data across the whole value chain can be difficult to obtain, for such data it is possible to use an estimation approach, such as the use of spend-based emission factors provided by tools like the Greenhouse Gas Protocol GHG Emissions Calculation Tool.

Once quantified, the greatest contributors to total emissions can be identified. It is these material emissions that should be focused upon first, as these can potentially present the greatest opportunities for emission reduction.

Avoiding greenwashing

Greenwashing is defined as the communication of misleading environmental claims or information, and is becoming more common. With societal expectations now so high in relation to organisational environmental performance, it is increasingly important to be clear and accurate in communications of all kinds.

Companies are now expected to actively and verifiably demonstrate how they are impacting on sustainability, and to give a balanced picture of their successes and challenges or failures in this area.

There are standards to help organisations make their communications clear and accurate, such as ISO 14020 and the UK Competitions and Markets Authority Green Claims Code.

In simple terms however, any claims must: be truthful and accurate, be clear and unambiguous; not omit or hide important information; only make fair and meaningful comparisons; consider the full life cycle of the product; and be substantiated.

Any such communications, whether a full report or single sentence claim, can all be verified by an independent provider, to provide readers with assurance that what is being stated can be relied upon.

The breadth of ESG subjects, coupled with the complexity of reporting frameworks and standards available, and the rapidly evolving regulatory requirements, makes ESG reporting a real and present business challenge. Ensuring your organisation understands what is required of it from all stakeholders, regulatory and otherwise, and embeds its reporting requirements into core business processes is fundamental to setting it on the right path to success.

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About LRQA:

Bringing together unrivalled expertise in certification, brand assurance and training, LRQA is one of the world's leading providers of food safety and assurance solutions. Working together with farms, fisheries, food manufacturers, restaurants, hotels and global retailers, we help manage food safety and sustainability risks throughout supply chains and have become a leading global assurance provider.

We're proud of our heritage, but it's who we are today that really matters, because that's what shapes how we partner with our clients tomorrow. By combining strong values, decades of experience in risk management and mitigation and a keen focus on the future, we're here to support our clients as they build safer, more secure, more sustainable businesses.

From independent auditing, certification and training; to technical advisory services; to real-time assurance technology; to data-driven supply chain transformation, our innovative end-to-end solutions help our clients negotiate a rapidly changing risk landscape.

Get in touch

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