Checklist: Assessing Your ESG Approach

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Case studies and media coverage tend to highlight either dramatic failures (intended to demonstrate the financial impact of not doing ESG well), or global ESG leaders. Executives, counsel and boards inundated with success stories about world-leading companies sometimes develop a belief that ESG is only doable for those companies. Smaller companies can develop ESG envy; others throw their hands up in overwhelmed frustration. ESG leadership, however, is not the same thing in every sector, geography or investor context, nor is it static.

When considering your company's approach to ESG, some things may be ripe for change, others perhaps not. Here are a few things to think about.

1. **Evaluating ESG issues relevant to the company.** The concept of ESG is highly dynamic, so what was not relevant (or perhaps even known) previously may be important in the present or for the future. How a company approaches ESG must reflect the issues that are relevant to the company and how those fit into/impact business strategy and operations. Information from internal sources can be used to identify the issues, as can external sources such as customers, regulatory developments, investor activity, peer companies and NGOs.

2. **Determinations of primary audience and materiality**. ESG covers an array of topics of interest to a wide spectrum of stakeholders. Traditional "materiality" has its basis in investor perspectives but the rise of ESG expanded the concept to a broader stakeholder view. Yet in reality, audiences have differing levels of importance to companies. Therefore, ESG matters also have differing levels of importance since audiences form the foundation of "materiality."

   Whether you are establishing an ESG program for the first time or reviewing an existing one, conduct a thoughtful and multi-departmental assessment of audiences and their relative importance to the company. Keep in mind that even your closest

peers/competitors may have different views of their audiences, so it is best to not simply rely on results of their assessments.

It may be tempting to skip this and attempt to address all stakeholder needs. However, this quickly becomes an almost impossible task and creates internal tensions and conflicts that waste time, energy and money. As an example, larger companies commonly receive over 100 ESG questionnaire requests each year, all using different formats and asking for different data. Prioritizing requestors helps focus energy and expenses where they are most appropriate, and avoids wasting both where unnecessary.

3. **Reporting framework selection, including regulatory filings**. The alphabet soup of ESG reporting frameworks is a major point of confusion. Generally speaking, they fall into two overarching categories: those with a basis in ***corporate financial costs and opportunities***, and those with a basis in ***impact of company activities on the planet and human beings.***
    a. Examples of financial-based frameworks are the Sustainability Accounting Standards Board (SASB), Task Force on Climate Related Financial Disclosures (TCFD) and the International Financial Reporting Standards Foundation (IFRS).
    b. The most common impact-based framework is the Global Reporting Initiative (GRI).

    There are others in development, such as ISO and industry-specific frameworks (e.g., mining and precious metals). Regulators in the EU, UK, US and Canada for instance are also working to develop broad ESG disclosure frameworks. None are seen as meeting all needs and many stakeholders question the viability of the "one size fits all" model.

    As a result, companies pull elements from multiple frameworks in crafting their position, policies and disclosures — reflecting results of their audience and materiality assessments. Just because a competitor or peer company chooses one framework does not mean you must follow suit if that doesn't make sense for your specific situation.

4. **Selecting performance metrics.** Regardless of the framework selected and audience determinations, performance metrics are a

critical part of ESG programs and communications. Usually disclosure frameworks offer complementary metrics, but they may not be optimal. For instance, some are presented in units of measure that are relative rather than absolute — energy intensity, injury rates and water use are common. Increasingly, these are seen as greenwashing and demand for absolute values is growing.

It is also best to explicitly address M&A and divestiture activity and unusual events that impact the data and trends. For instance, manufacturing operations energy use/GHG emissions downturns during 2020 -2021 may have been a result of widespread, but temporary, operational shutdowns due to COVID. Likewise, an acquisition may increase emissions or water use and should be clearly explained.

5. **Data collection, validation and reliability.** ESG data generally originates from operating facilities owned/operated by the company or suppliers. Many steps exist between its origin and the point at which it is publicly reported, forming the basis of investor ratings, media coverage and artificial intelligence scans. ESG information produced by companies is rarely subjected to internal controls, verification and monitoring to the same level as financial information. Meaningful errors and omissions are common, and it can be quite difficult to put the genie back in the bottle.

   Companies should implement appropriate internal controls procedures on ESG data and information to ensure its accuracy. Engage your internal audit group, possibly supplemented with in house subject matter experts in environmental, safety, supply chain and other functions who understand the technical aspects of the data meaning and contexts. If you find it necessary to engage a third party, make sure you carefully screen vendors to make sure they have technical expertise for understanding what they are to assess.

6. **Corporate culture, training and awareness.** Motivating employees to move from a long-standing shareholder-centric culture to something different takes time and on-going reinforcement. Senior leaders must be fully committed to changing the tone of the company and how employees think about their jobs. Some ideas include:

a. Introducing ESG-based staff performance metrics tied to annual reviews, bonuses and promotion criteria
b. Adding new employee training topics related to ESG performance
c. Break down functional siloes — supporting cross functional/departmental interactions
d. Launch awards and recognition programs aligned with ESG initiatives/metrics.

7. **Leadership messaging internally and externally**. Employees emulate decisions made by executives and Boards. Leadership must continuously communicate the importance of ESG success internally through a combination of messages and actions. Ongoing communications from executives are necessary to reassure employees of the sincerity and seriousness of ESG initiatives.

   Executive actions must be consistent with rhetoric, otherwise neither will be taken seriously. Tough decisions may be necessary in personnel, capital allocation, market position and ROI time horizons. Boards may be in a similar situation given their role is to hold management's feet to the fire.

Of course, some aspects of your corporate approach to ESG may be fine as they stand. Among aspects that may not need to change:

1. **Your general approach or philosophy**. To be blunt, not every company has to take a leadership position with regard to ESG. Each company deals with pressures from a variety of stakeholders including customers, regulators, investors and the general public. It is not unreasonable to expect that some companies may operate within a context that does not yet require advancing ESG initiatives beyond a certain minimum.

2. **Determinations of primary audience and materiality.** Yes, this is in the above list as well, but it is quite possible that the ESG context in which your company operates has not changed. If that is the outcome of a considered and thoughtful review, that is fine. It may also speak to the quality and thoroughness of your previous assessment.