Five Ways to use 2021 ESG Budget

To Prepare for Successful 2022

Environmental, Social and Governance (ESG) issues are in the spotlight, driven by factors including COVID-19, dramatic evidence of climate change, lack of workplace diversity, and demands from capital markets and customers. ESG challenges now aren't the same as when our 2021 budget was approved. Why not steer remaining budget towards the challenges looming for 2022. Here are five quick wins to position your organization to meet the challenges for 2022 in these areas:

1. ESG audits
2. ESG in the value chain
3. Reporting and Disclosures
4. Greenhouse Gas (GHG) Emissions Inventories
5. Cross-functional team

Read on for: what is it, why do it, what could happen if you don't?

1. ESG Audits: Clean-up and Lessons Learned

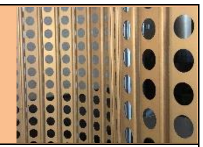
What?	Review ESG audit data, recommendations, suggestions, and report content. Identify trends and patterns, and plan for 2022 ESG audits.
Why?	Companies undergo dozens of audits with ESG content. This includes management sponsored audits, and audits sponsored by customers and other business partners. Some audits are strictly ESG; other ESG content lurks in quality and other audits. Audits often result in a patchwork of findings and suggestions. Each auditor (and company department) may have their own pet issue. Are the findings consistent with audit objectives, business strategy – or each other? Regulations, standards and ESG frameworks are changing. So are investor and customer expectations. Audit reports can signal future expectations.
Risk	Failing to address critical recommendations can risk fines, penalties, or actions by other stakeholders – lost customers, increased insurance premiums, etc. Responding to audit findings at face value will satisfy the auditor. If the company stops there, they risk missing patterns of non-conformance or root causes that could signal even more widespread problems including fraud. They also risk missing opportunities to improve efficiencies and performance on future audits. Companies risk pouring resources into trivial suggestions to appease an insistent auditor, at the expense of less obvious, more higher risk observations. Regulations, standards, frameworks, and stakeholder expectations for ESG are increasing. Companies that miss these cues are destined for even more findings later.
Effort	Consolidate, characterize, and analyze findings and recommendations relevant to ESG arising from audits throughout the supply chain and value chain. Identify commonalities, aberrations, risks and improvement opportunities. Prepare a plan to improve processes to evaluate potential audit findings, corrective actions, and related compliance, risk and audit processes. Independent ESG specialists can help establish priorities and efficiencies and prepare for that's next.

2. Map ESG Across Your Organization's Value Chain.	
What?	Evaluate ESG requirements, risks and opportunities throughout the life cycle of products and services. 
Why?	Compliance and risk frameworks increasingly extend into supply chain and value chain – beyond strict <u>control</u>, and into areas the organization can exert <u>influence</u>. Laws, regulations, management and reporting frameworks oblige companies to understand, manage and disclose these risks. Examples: U.S. federal government has mandated climate change and ESG standards and consideration for suppliers of goods and services.
Risk	Recent events have demonstrated how ESG can disrupt operations, sales, and can create new compliance obligations. Companies risk noncompliance or enforcement with compliance obligations, disrupted operations, or loss in revenues. Companies risk reputational from high-profile situations with suppliers, such as products made using forced labor, containing non-compliant or harmful substances, or other ESG risks.
Effort	Review compliance and management frameworks with existing life cycle aspects (ISO, product conformity, labor and human rights). Develop a control and influence map for ESG topics. Evaluate third party risk management (TPRM) programs and the extent of risk mitigation for dynamic ESG requirements. Evaluate systems and controls to reduce likelihood of greenwash or fraud. Build ESG competence and capacity, via training, formalizing procedures, or other improvements.

3. Evaluate your readiness for ESG Reporting and Disclosures.

What?	Identify, analyze, and evaluate ESG data within your organization, and your readiness to report or disclosure.
Why?	ESG reporting and disclosure standards and stakeholder expectations changed in 2021. Stakeholders want more data and information, and more confidence in its accuracy. Expectations include more content involving plans, programs and goals; these forward-looking statements go beyond traditional backward-looking reports. There is a growing chorus asking for external assurance of ESG reports and disclosures. Many ESG programs are not robust enough for assurance.
Risk	Companies risk having incomplete or inaccurate information for key topics. They may have <u>no</u> information on topics that have more recently caught stakeholders' attention. Companies risk reporting different data to different reporting channels, posing risk of inquiries, adverse publicity, enforcement, or stakeholder confusion. Companies can lag competitors with ESG reporting requirements by customers, risking competitive disadvantage. Companies risk shareholder proxy filings on ESG topics, falling out of "green" investment instruments, or raise other flags with capital markets or other stakeholders.
Effort	Evaluate readiness to report/ disclose to applicable standards and frameworks. (TCFD, SASB/ VRF, GRI, sector and topical frameworks). Evaluate completeness and data quality. Perform or review your materiality assessment to prioritize ESG topics. Consider structured comparison with peer companies and competitors. Strengthen systems and controls to prepare for external audits or assurance.

	4. Greenhouse Gas Emissions Inventory Review and/or Validation Audit
What?	Review Greenhouse Gas (GHG) emissions inventory processes and controls. And/or conduct a GHG emissions validation audit.
Why?	Climate change has the attention of governments, international bodies, standard-setters, capital markets, consumers, and the generation of prospective employees. NGOs, financial regulators and the capital markets all call for public reporting and disclosures. TCFD and other frameworks call for GHG Emissions reporting and disclosures. Stakeholders know that companies have substantial impact on Scope 3 emissions. Even though these are largely out of an organization's control, companies can – and are increasingly expected to exert - influence to reduce the emissions throughout the product's/ service's entire life cycle.
Risk	Companies risk unwanted questions or publicity for incomplete, inadequate reporting and disclosures of GHG emissions. Companies risk having to recalculate inventories from prior years if errors are identified. Companies risk the need to make notifications to capital providers or other stakeholders. Companies risk being unprepared for verification audits, if required by regulators, shareholders or customers.
Effort	Compare GHG emissions inventory and supporting processes with the GHG Protocol or other standard framework. Evaluate processes, systems and internal controls supporting compilation and reporting of GHG emissions inventories. Ensure these are documented and "audit-ready." Verify sources of key factors and evaluate processes and controls for maintaining them. Review internal and external communications and reporting of GHG emissions inventory and program management.

	5. Grow your ESG Cross-Functional Team. 
What?	Refresh your ESG cross-functional team to anticipate the requirements of 2022 and beyond.
Why?	There is no standard “home” for ESG. The underlying topics have been managed in many departments. Current and emerging requirements for compliance, risk management, reporting and disclosures demand more structured collaboration among functions.
Risk	Many newer ESG leaders are passionate and committed to making change. They may still be new to the field, the business, enterprise risk, or external reporting and disclosures. Without cross-functional teams, those responsible for ESG topics in any department (Environmental, Finance, HR, Operations, Quality, R&D, Safety, etc.) may not realize how their ESG efforts overlap with other functions. This can impact compliance, risk management and reputation. When cross-functional teams do exist, they may be comprised of volunteers interested in the topic. There are risks if the right departments are not involved (IT, Legal) or do not understand how they fit. Many people with ESG roles and responsibilities do this as an auxiliary responsibility. They already had full time jobs. Management may assume more availability than is the case. This puts the effectiveness of ESG programs at risk.
Effort	Identify the organization’s compliance, risk, reporting and disclosure requirements – including how they have changed in the last two years, and anticipated changes in the next two years. Formalize how the company receives input, assigns roles and responsibilities, and communicates to key stakeholders on ESG. Compare the qualitative and quantitative resource needs to manage ESG requirements and risk, both at the organization and functional levels. Establish or refresh your ESG cross-functional team to enable more coordinated, nimble management of dynamic ESG requirements and risk.

About the Authors

Doug Hileman helps clients with ESG compliance, risk management, reporting and auditing. His experience extends to a range of ESG regulations. He has experience with ISO management systems frameworks, COSO internal controls and risk management, GRI, OECD, accounting rules, and SASB. He was the senior environmental management and environmental auditing specialist on the Volkswagen Monitor Team. He is active in the Institute of Internal Auditors, where he has presented on ESG issues for over a decade and has authored guidance documents available to over IIA 180,000 members worldwide. See www.douglashileman.com.

Alexandre Rossin is a special contributor to this document. Alexandre Rossin helps clients with ESG programs, including ESG evaluations and controls for green investment instruments, and environmental compliance and risk management. He draws from over 20 years of experience in climate change-related efforts, including contributions to the leading international protocol, developing and reviewing greenhouse gas (GHG) emissions inventories, and external audits of ESG reports and disclosures. Mr. Rossin is fluent in English, Portuguese, and Spanish.