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Measuring ESG to manage and drive sustainable change

By Michele Edwards, Marnie Gucciard, and Anita Woodhouse

Long before the acronym "ESG" (environmental, social, and governance) was coined, select organizations around the world reported on sustainability efforts every year. Whether related to the elements of environmental, social, or governance efforts, the subsequent reporting was largely self-governed.

Those days of self-governance are ending: the U.S. Securities and Exchange Commission (SEC) and global regulators are taking steps to protect investors and ensure that standards are better defined and upheld. Consistency and clarity are the goals, safeguarding that organizational ESG reporting is not misleading or fraught with misrepresentations for investors and other stakeholders.

Driving the change

Enforcement actions by regulators across the globe—including the United Kingdom Competition and Markets Authority and the SEC, along with civil suits and complaints by non-governmental organizations (NGOs) alleging "greenwashing"—continue to make headlines. Increased stakeholder expectations and scrutiny are adding to the mix—whether from customers, employees, or lobby groups, this adds to a heightened level of activism and demands greater transparency and integrity of action.

What actions can organizations take to get ahead of looming regulations? In a bid to end "greenwashing"[1] and "greenwishing,"[2] or the appearance thereof, companies need to develop, measure, monitor, report, and audit ESG metrics to gain confidence that they are not making misrepresentations and are indeed meeting the requirements and scrutiny of global regulators. Organizations should leverage their compliance teams, internal audit, and other relevant control functions to lead the design, implementation, and monitoring of processes and internal controls to ensure that the data being reported related to ESG metrics is accurate and complete. Together with the business, the control groups should also review company policies along with any related disclosure made.

Consistency

- Do you need a glossary with definitions to make sure everyone understands the terms the same way?
- Where calculations are occurring, is everyone using the same methodology?
- Is everyone capturing the data the same way?
- What is the unit of measurement being used?

Evolution and current regulatory landscape: ESG is here for the long haul

The desire for businesses to "do good" or go beyond profits has existed. Over the course of recent history, efforts have evolved and manifested in different ways, including:

- **Corporate social responsibility (CSR):** How organizations develop and communicate their activities which are designed to have a positive impact on society. With roots in the idea that businesses operate with a license from society, CSR is driven by the organization, while ESG is how external parties evaluate an organization based on how it handles these three elements (environmental, social, governance).
- **Sustainability:** Focuses on operating in a way that preserves resources for long-term use. Beyond environmental impacts like climate change, pollution, deforestation, and rising water levels—among others—sustainability encompasses how businesses impact people and communities and their continued economic viability. Essentially, an organization's CSR strategy and how third parties rate their ESG strategy are different ways of viewing how it supports and focuses on sustainability.
- **Socially responsible investing:** Organizations or individuals invoking socially responsible investing seek financial returns while aligning their investments with their moral and social values. ESG, as it is known today, has roots in socially responsible investing.

While the nomenclature has varied, the core principles behind these movements have resonated and continued to evolve in the mind of consumers and investors alike. As such, they have also grabbed the attention of another key stakeholder: global regulators.

Regulation looms

After years of near self-governance and nonstandardized approaches to nonfinancial reporting, greenwashing and greenwishing have emerged on the radar, and regulators have tightened their scrutiny; they are making changes to ensure standards are more explicit.

Regulators are developing rules to protect consumers and force clarity to help investors make informed investment decisions in a sea of potentially misleading or confusing data and reporting. While the SEC's proposed standards and European Union's (EU) Corporate Sustainability Reporting Directive suggest similar enhancements to ESG disclosures, the SEC's rulemaking remains in discussion, and the EU's Directive is expected to be adopted in late 2022, with subsequent rules planned through 2050.[3]

The EU Directive will require public sustainability reporting by impacted companies accompanied by an assurance report covering disclosed data. This directive is far-reaching and will impact not just EU-based companies but also those foreign companies that meet an activity volume threshold in the EU. The countdown is on for companies to get their house in order: once adopted, the rule should be in effect in 2024 for most companies.