



Guidance on improving the quality of ESG information for decision-making

Developing a roadmap
for companies

Contents

FOREWORD | 3

INTRODUCTION | 4

1

THE BUSINESS CASE | 7

2

SETTING AN OBJECTIVE AND DEVELOPING A ROADMAP | 10

3

UNDERSTANDING THE IMPROVEMENTS YOUR COMPANY NEEDS | 12

4

MAKING CHANGES TO IMPROVE DATA QUALITY | 15

5

REPORTING ON INTERNAL CONTROLS | 24

6

MONITORING AND ONGOING IMPROVEMENT | 27

7

ASSURANCE | 32

8

CONCLUSION | 36

APPENDIX | 37

GLOSSARY | 40

REFERENCES | 42

Foreword

The debate today around using and reporting on environmental, social and governance (ESG) information^a has shifted from relevance to reliability.

Investors are increasingly asking for investment grade ESG data and the financial system is slowly shifting to support the United Nations 2030 Agenda for Sustainable Development and the Sustainable Development Goals (SDGs). Simultaneously, the EU Commission has launched an Action Plan on Sustainable Finance and the EU Non-Financial Reporting Directive has been enacted across Europe. All of this demonstrates that ESG disclosures are becoming mainstream.

As ESG considerations become more integral to business and investor decision-making, the quality of data becomes increasingly important. There is a need for users of that information to have confidence in it and rely upon it; whether that is internally for management or externally for providers of capital and other stakeholders.

The significance of financial information, compliance requirements and scrutiny from regulators means that there is little debate about the need for robust data and accurate information. Assertions around completeness and accuracy of financial information are routinely made by management to their stakeholders and external assurance is generally required of all large listed public companies. As of today, the same rigor does not apply when it comes to ESG information.

The evolution of ESG information has been rapid but much of reporting today is either voluntary or, if required by legislation, not standardized which means that users of this information face challenges when making comparisons. We see a clear need to move towards better alignment between the way that financial and ESG information are treated to enable integrated performance measures and a shift in the financial system to reward sustainable companies.

To support this, the World Business Council for Sustainable Development (WBCSD) and FSR - Danish Auditors have published this guidance, which provides practical suggestions on how companies can improve the quality of, and confidence in, their ESG information by considering the basic building blocks of internal controls.

As companies are at different levels of maturity, the guidance offers a roadmap of continuous improvement through internal control measures and assurance provisions to provide reliable ESG information and ultimately achieve ESG investment grade data.

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^a ESG information is sometimes referred to as non-financial, pre-financial or extra-financial information and in most cases, it will be a subset of information that sits outside of the audited financial statements.

Introduction

Reliable information is vital for good business. Information supports management in making decisions that help the company achieve its strategic objectives. It provides investors and other capital providers with knowledge of how resources are deployed in the business as well as the company's broader value creation model.

Introduction

As ESG information starts to inform a company's strategic objectives, access to capital and its cost, companies recognize that piecemeal data collection coupled with ineffective and partial control procedures are not sufficient. These shortcomings pose a risk, which could impact the company's intangible assets such as brand and reputation.

As a result, C-Suite executives, boards and investors are starting to challenge the ESG information provided and question whether it can be trusted and qualified as investment grade.

The London Stock Exchange Group's characteristics of ESG investment grade data

- **Accuracy:** deploy rigorous data collection systems
- **Boundaries:** align to the fiscal year and business ownership model
- **Comparability and consistency:** use consistent global standards to facilitate comparability
- **Data provision:** provide raw as well as normalized data
- **Timeliness:** provide data to coincide with the annual reporting cycle
- **External assurance:** consider strengthening the credibility of data by having it assured
- **Balance:** provide an objective view, including both favorable and unfavorable information¹

There are no short cuts to achieving reliable ESG data. While it may seem self-evident that internal controls are necessary to provide reliable information for decision-making, we know from extensive work by WBCSD and others that ESG information is often not subject to the same level of internal control or rigor as financial information. Where processes are compromised or incomplete, the risk of a material misstatement is significant and may impact decision-making.

By way of introduction to this guidance, is it useful to revisit the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) definition of internal control:

"Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance."²

This guidance outlines the business case for better ESG information and provides organizations with some fundamentals to ensure that ESG information can be relied upon for decision-making by both internal and external stakeholders.

We suggest companies develop a strategic roadmap to achieve their own objectives in pursuit of improving the quality of ESG information.

By helping companies understand the maturity of their data collection, control environment and activities, it will allow them to understand the changes in data and processes that are required to collect and report better and more useful information, eventually moving towards ESG investment grade data. It builds on the conceptual issues outlined in the work done by several accounting experts; Leveraging the COSO Internal Control-Integrated Framework to Improve Confidence in Sustainability Performance Data (2017).³

NAVIGATING THE GUIDANCE

This guidance has been developed primarily for large listed companies, but many of the tools and processes will be equally relevant for smaller organizations as well as public enterprises and non-governmental organizations (NGOs). The tools are framed within the five elements of the well-established COSO Internal Control Framework, though there may be other frameworks or approaches utilized by companies in practice.

It is important to note that companies are at different levels of maturity when it comes to the quality of their ESG data and internal controls. This guidance was developed to support companies along this maturity scale. For those companies who already have an established control environment and a process for controlling their ESG data, chapters 4 and 6 may provide additional tools to continue to improve your process.

Introduction

For those companies who have not yet begun their journey, or are in the early stages, Chapters 1 and 2 will provide you with the business case and background for embarking on this journey. Chapter 3 provides a series of questions to help determine and prioritize the areas of improvement. It's all about "getting your house in order" to yield financial and operational benefits.

Once the foundations have been established, Chapters 4, 5 and 6 will provide practical tools that you need to begin improving your controls and the quality of your data.

That said, internal control is not a linear process. It is iterative, and irrespective of your position on the maturity scale, the process will continue to evolve. It may develop faster for some data sets compared to others because of complexities in measuring or collecting data. This guidance is designed to support that evolution towards more robust ESG data.

ASSUMPTIONS MADE IN DEVELOPING THE GUIDANCE

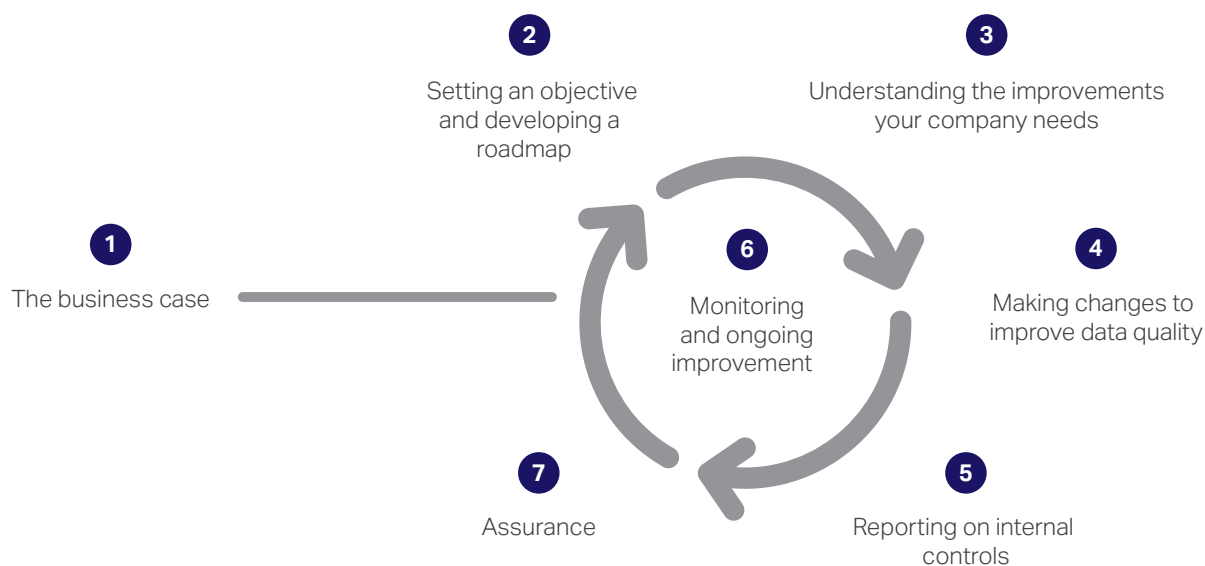
It's not possible in this document to cover all aspects of internal controls and approaches to improving the quality of ESG information.

The reference list at the end of the document provides some resources that may clarify aspects not dealt with here.

Read this guidance with the following assumptions in mind:

- The focus is on controlling quantitative ESG information (and related historical data); although the same principles are likely to apply to qualitative statements
- The reporting entity^b has established its material topics and selected the appropriate ESG metrics to apply and understand performance in these areas^c
- The data boundaries have been determined for each reported element. These may be consistent with the financial statements to facilitate comparison between financial and ESG data – for example, comparing GHG Emissions with turnover can be useful for internal management as it helps to understand the impact of production on emissions. Other boundaries may be used where the information is meeting the needs of stakeholders (for example, human rights issues in the supply chain may extend beyond the traditional boundaries of the financial statements)
- There is a commitment from senior management to improve the quality of ESG information. Without such a commitment, it will be difficult to secure the resources and provide leadership to drive forward the improvement process.

Figure 1:
The stages of improving ESG data quality



^b For the purposes of this document 'reporting entity' refers to the accounting concept of entities controlled by the parent forming the "group" – it typically represents the boundaries of the group for statutory reporting purposes.

^c For more information on materiality, metrics and disclosure, see WBCSD's [ESG Disclosure Handbook](#) and FSR – Danish Auditors, NASDAQ Copenhagen and CFA Society Denmark have also launched a [ESG key figures in the annual report](#)

①

The business case

To be resilient, successful and sustainable, companies must understand the impacts and dependencies of their business models. They must manage risks and take advantage of opportunities in their operating environment. This demands comprehensive information which starts with reliable data flowing through the business to support internal decision-making.

① The business case

Research has shown that even in countries like Denmark where there has been strong support for ESG reporting, the practices are still not at a level where they compare with financial reporting practice.⁴

Companies need to improve the robustness and reliability of their reporting

Research on 50 large Danish companies' annual sustainability reports showed that all companies include ESG data but:

- Only 58% clearly define which parts of the company are included in the reporting – of these 16% apply the same boundary as the financial annual report
- Only 46% clearly refer to accounting policies describing the sources and methods applied to calculate KPIs
- Only 60% include data from prior years for comparison
- Only 36% clearly explain positive developments in the company's KPIs – and only 20% clearly explain negative developments in the company's KPIs
- Only 22% refer to a published third party assurance statement⁵

Trust in business is low and investors lack confidence in the information that is reported.⁶

Without robust data and rigorous internal processes, companies may not have the capacity to identify, manage and mitigate risks. There is increased demand for better and more reliable information to allow investors to make better capital allocation decisions and hold management to account. For many businesses, establishing an appropriate control environment and undertaking control activities enables them to collect and consolidate more reliable data to ultimately report better quality information to capital providers. This should result in capital flowing to businesses that can evidence their focus on long-term value creation and the resilience of their business model.

Responsibility for the integrity of reported information rests with the directors of the company. In some jurisdictions, the board is responsible for signing off on ESG information reported in the annual report, indicating it is material and can be relied on for the purposes of decision-making.

It's also important to note that while data may be calculated and analyzed in different ways for different stakeholders, it's key to have one set of numbers, the source data should be the same and should be subject to rigorous controls to improve its completeness and accuracy. WBCSD research has demonstrated that this is not the case and there are significant discrepancies between information on risks reported in different publicly available reports.⁷ This may expose the company to potential litigation and confuses users of those various reports trying to understand what's material to the business.

DRIVERS OF BUSINESS VALUE

While drivers for improving the quality of ESG information may originate from different sources such as management, investors or regulatory pressures, there are financial and operational benefits that can be realized from these activities. A consistent approach may also lend itself to an effective and engaging on-boarding processes with new colleagues while allowing for consistent data management throughout the organization. This is likely to reduce errors and corrections in the information and helps avoid material misstatements.

Possible value drivers

- **To establish one set of numbers:** while ESG data may be calculated and analyzed in different ways for different stakeholders, it is key to have one set of numbers that the organization can rely on. This happens when the source data is always the same and subject to rigorous controls to improve its completeness and accuracy.
- **To improve transparency:** a streamlined process can help clarify responsibility, strengthen accountability for the process and document solid evidence for internal and external auditors. Processes and accounting policies should be externally disclosed as part of the reporting practice to provide investors and other stakeholders with better information.

① The business case

- **To apply integrated performance measures:** integrating ESG into business processes to manage risks, and appropriate governance and internal oversight can provide the basis for integrated performance management. It is an input to support decision-making, remuneration and accountability.
- **To access a lower cost of capital:** the integration of ESG issues into the wider business model, strategy and organizational processes can bring financial benefits including a lower cost of capital.⁸

RISK AND PERFORMANCE MANAGEMENT, GOVERNANCE AND INTERNAL OVERSIGHT

Achieving high quality data is not an end in itself. Data should be integrated into business processes to manage risks and provide the basis for integrated performance management. It should also enable appropriate governance and oversight.

The quality of data and usefulness of information are the foundations for robust and effective risk management. WBCSD and COSO in 2018, launched guidance on [applying enterprise risk management to environmental, social and governance \(ESG\) related](#), to encourage companies to improve internal decision-making and external disclosure.¹⁰ Without relevant, reliable and timely information, management cannot effectively identify and evaluate the risk profile of the business.

The CFA Institute notes that the lack of robust ESG data means “market inefficiencies develop, alpha opportunities are missed, there is inadequate portfolio risk transparency and capital is inefficiently allocated, among other outcomes.”¹¹ Trustworthy data and the internal control environment are fundamental inputs to effective enterprise risk management process.

The governance of an organization also relies on the effectiveness of its internal processes. The audit committee typically reviews the effectiveness of the audit and internal control processes for matters relating to financial information. This oversight should extend to the quality of, and processes for, managing ESG information.

The EU non-financial reporting directive calls for non-financial KPIs

The EU non-financial reporting directive requires large companies to publish a statement which discloses non-financial information and key performance indicators (KPIs) that are relevant to the business.⁹

Companies are expected to report KPIs that are material to their business, and they should be consistent with metrics used by the company in its internal management and risk assessment processes to make the disclosures more

relevant and useful, and to improve transparency. The directive also says that disclosing high quality, broadly recognized KPIs could improve comparability for companies within the same sector or value chain. Furthermore, considering their specific circumstances and the information needs of investors and other stakeholders, companies are expected to provide a fair and balanced view by using general, sectoral and company specific KPIs.

②

Setting an objective and developing a roadmap

The decision to improve the quality of data requires an understanding of how that data is to be used. This will help determine the degree of precision and the direction of travel.

② Setting an objective and developing a roadmap

SETTING AN OBJECTIVE

Companies have different internal and external stakeholders and reporting needs. A business purpose needs to be a heart of the objective to improve the quality of information. The objective set should be supported by and flow from the company's business model and how it creates, captures and distributes value along with the assessment of materiality.

Developing a strategic roadmap will be helpful in planning how to achieve the objective. By considering ambition, status quo, resources and skills, the strategy should be realistic, practical and engage the appropriate personnel from across the organization as sanctioned by senior management. As part of this roadmap, it is important that companies consider how their data governance can be strengthened to mitigate against any material misstatements.

WHY SET AN OBJECTIVE?

The decision to improve the quality of data requires an understanding of how that data is to be used. This will help determine the degree of precision. Whether it be for compliance purposes or investor decision-making, all reporting should have a purpose and should be evidence for key stakeholders to demonstrate the company's performance. Once information is in the public domain, the reporting entity becomes accountable for the information it discloses.

The materiality of information is determined by reference to entity-specific issues and their relevance for intended users. For example, for a beverage manufacturer, the availability of clean water is necessary for

the successful operation of the business model. Having relevant and reliable information about water availability is likely to be essential for decision-making. Whereas other information may not be material to the business model. Involvement of finance, legal and investor relations teams will be critical to ensure the objective is fit-for-purpose.

It is important that the objective has buy-in from senior management and ideally is sanctioned by the board as part of the company's overall approach to reporting and transparency. Once set, the objective should be socialized with key personnel who are responsible for collecting, reviewing, consolidating and reporting data.

DEVELOPING A ROADMAP FOR IMPROVEMENT

Once an objective is set, a plan needs to be developed to set out how the objective will be achieved. Depending on the nature and size of the group, it is likely that this roadmap will need to span over several reporting cycles. Ideally, the best way to develop this is by engaging internal stakeholders in the reporting supply chain to address key challenges and opportunities. An integrated approach that considers all value drivers in the organization will help to devise a roadmap that looks at implications for value creation over the short-, medium- and long-term.¹² It is important to consider the purpose of the exercise and to understand why the company is pursuing a plan to improve the quality of ESG data to support decision-making. Engaging employees is critical as it reinforces the importance of the process and the desire for high quality data.

To identify areas of improvement a company may:

1. Conduct a review of how data is governed using the three lines of defense model (see Appendix 3), as well as addressing ways data could be strengthened.
2. Consider the current quality of ESG-related information by reflecting on the gap analysis questions in Chapter 3.
3. Assess the current state of controls and seek input from the internal audit team and external assurance provider (as set out in their management letter) on how the controls can be improved.

To prioritize what to improve a company may:

1. Review the resources available to implement the changes and whether any changes are required to systems or processes.
2. Consider an appropriate and manageable timeline aligned to the already established internal control and reporting cycles.

Progress against the roadmap needs to be reviewed annually and developed so that it builds in learning from each improvement phase. Similarly, the quality of the data itself needs to be improved and explained to internal stakeholders. Because of this, it's important to define clear roles and responsibilities for executing the roadmap. This cultural aspect is a key driver for change. If information is not used for decision-making, improving the quality of data is likely to become a neglected exercise and fail to gain the traction and prioritization needed.

3

Understanding the improvements your company needs

Companies should understand the driver or the goal for improving the quality of data within their own organization. The following questions provide the foundations to carry out a gap analysis to progress conversations with management.

③ Understanding what improvements are needed

There are two challenges: the quality of the data and the quality of the reporting processes. Both can be complex and time intensive. By establishing some key operating processes, your organization will be better equipped to improve data quality and internal control processes. The questions included below are suggestions and not exhaustive.

RESPONSIBILITY AND REPORTING STRUCTURE

It's important to define the responsibility for data collection and put the reporting structures in place to ensure that those responsible for collecting data know where to find it.

Responsibility can be defined at many different levels, so it's critical to determine how these responsibilities should be cascaded through the organization. At the end of the reporting period, it would be appropriate to ask the individuals responsible for providing the data to sign an internal management statement, which provides accountability for the information reported.

- Have you determined who is responsible for the metrics?
- Have you determined who is responsible for reporting to the group level?
- Is this done at the business unit or country level?
- Have you asked the individuals who are responsible for data collection to sign an internal management statement?

DEFINITIONS

All metrics should be defined. There needs to be a clear explanation of what should be included in each metric. This ensures the person responsible for data collection knows what to report; for example, how is waste calculated across the group?

- Have you defined the individual indicators/metrics?
- Are the assumption and estimation methods described?
- Have you defined how metrics should be calculated?

SCOPE

Before any data can be collected, the scope of the indicators needs to be defined at group level – it is a key accounting policy so that the “completeness” of the data is understood by decision-makers.

While the scope of each indicator doesn't need to be the same, those responsible for the data need to understand what should be included for the purposes of reporting to the group. There should be a justifiable reason for adopting a different scope – it may be that the measure is looking specifically at supply chains which extend outside the group. It is also important that where the scope of data differs, this fact is made clear to users so that it does not deliberately mislead them. For example, will data from operations in all countries be included? Will data from all subsidiary companies be included?

- What is included in the scope for each indicator/metric?
- Are you assuming any other responsibility beyond the activities for which you are legally and financially responsible for (such as Scope 3 GHG emissions)?
- Have you excluded any countries or activities? If so, why?
- If relevant, are administrative operations considered alongside production facilities?

SIGNIFICANCE TO YOUR BUSINESS MODEL

When assessing the completeness of data, it is important to consider the significance of that measure to your business model. Naturally, a higher level of completeness would be favorable, but often 100% coverage is not feasible - or the percentage difference will not be significant enough to have an impact on the figure or the decisions made based on that figure.

It is therefore important to determine the appropriate percentage of completeness, and if required, the remaining percentage that will be estimated. The level of significance may depend on the link between the individual metric and the wider strategic targets of the business. If the company has chosen to use the financial boundaries for ESG information, 100% completeness is desired, if not then a lower level of completeness may be appropriate if it is meeting the needs of the stakeholder.

③ Understanding what improvements are needed

On an annual basis, management should revisit the completeness of measures to ensure they are still appropriate. For example, a retailer may include all large stores in scope for waste calculations, but smaller convenience stores may be excluded. The figures for these stores would then be estimated. This could be justified where, say, data for the larger stores, accounts for 90% of all stores and the percentage of smaller stores is not significant enough to affect the total figure or impact decision-making.

- Have you considered the significance of individual metrics to your business model?
- Have you defined the percentage measure of completeness for each data point, including the percentage that will be estimated?

REPORTING FREQUENCY AND FORMAT

It is key to determine the frequency and format of the reported information. It is also important to consider the audience for this information. If it is for management reports and strategic targets, the reporting frequency is likely to be higher. The format of the data is important because local legislation, tradition, and monitoring systems can vary.

- What is the purpose of reporting and monitoring the data? Is it for management decision-making or external reporting? This will help determine the frequency.
- How often should the data be reported? Should it be annually, bi-annually, monthly?

- What should the format of the data be?
- Is the data quality assured and consolidated?

INFORMATION FLOWS AND IDENTIFIED RISKS

Data collected throughout an organization needs to be consolidated at the group level to be useful for management for decision-making. As such, there must be a defined data trail which demonstrates the flow of information from the source to the consolidated group figures, including the identification of data sources.

Once the data trail has been determined, it's possible to define the steps in the process where there is risk of error. Risks may arise from manual transfers, conversions, consolidations and calculations, as well as risks related to data sources, completeness, ownership, time period and classification.

- How is information provided? For example, by computer systems, invoices, individual readings or external data providers?
- Have you recorded the flow of data from the initial source to group level and the point at which it is useful for decision-making?
- Have you defined the tolerable error for each ESG metric?
- Have you identified the steps in the data collection process that may pose a risk to data quality?
- Do you consider the current information flow and risk identification to work well in practice and support the achievement of the overall objective?

ESTABLISHED CONTROLS

Once the possible risks have been identified in the data trail, it is necessary to describe and set up controls to ensure data quality. This will help management when reviewing the data to ensure that appropriate measures have been taken to reduce error. The controls are likely to be a mix of manual, automated, preventive and detective measures. They should include several input controls to monitor and validate the data at the beginning of the transaction.

- Have you defined and described the controls in place to mitigate the identified risks?
- For each control, have you determined the responsibility, frequency, content and placement of documentation for implementation?
- Is this done at local or group level?

④

Making changes to improve data quality

There is a need to ensure that the appropriate processes and activities are in place to avoid or mitigate against a material misstatement. While there is no “one-size-fits-all” approach, there are some processes and leading practices that can support the improvement in data quality. Companies may need to consider developing other tools to support the improvement strategy.

④ Making changes to improve data quality

The process, whether following a specific framework or defining individual processes, must be controlled and consistent across the whole business. By following one process, there is a greater chance of improving data quality. This includes maintaining oversight but also ensuring that the people responsible for collecting and processing the data are doing so in a manner that can then be analyzed across the group.

The data itself can be collected through several different systems - providing the same process is followed - but it's still recommended that all data is consolidated into one central system. This helps facilitate external reporting and assurance.

DATA

Data is a fundamental building block in the management of an organization. It's a record of events and transactions that occur in the business. It forms the basis for all manner of analysis, progress and performance calculations within the business. ESG data can link directly to revenue comparison measures, and it's used to complete sustainability questionnaires. It can also help management make decisions on the strategic direction of the business. In addition, if reported externally, it can inform investors on how the business is using its available resources to generate value over the long-term for a range of stakeholders.

Financial information published by a company must provide a "faithful representation," this means that it must be neutral, free from error and complete. It must also faithfully represent the phenomena that it purports to represent. This should be true of ESG information too.

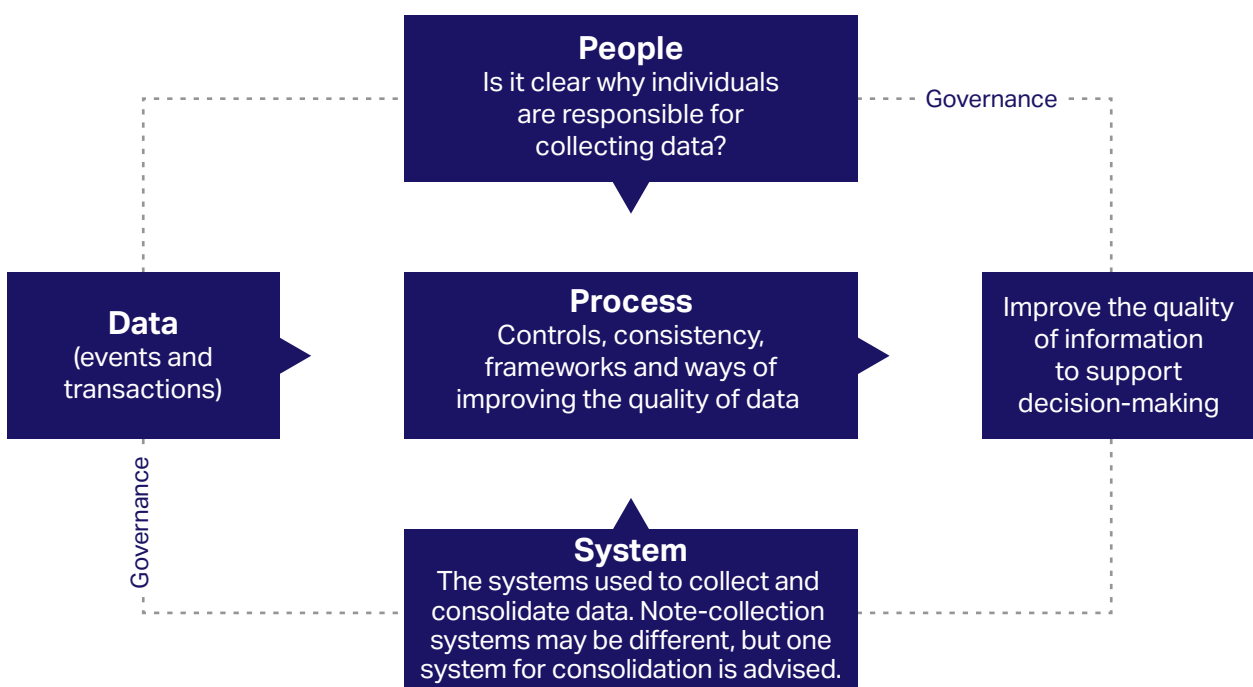
PEOPLE

Culture is key in improving any process. The process of controls involves cooperation from people so it's important that the organization has a culture that defines the importance of controls and good quality ESG information.

Those responsible for collecting data need to understand the purpose, their responsibility and accountability for that data being correct. It's also key that management is on board – better ESG information can be a hard sell if the tone from the top does not dictate the need for good quality information.

It's easier to improve in environments that foster open and transparent communication. If collecting robust ESG data is seen merely as a technical exercise to satisfy the group reporting requirements, it's likely to be ineffective in changing the behaviors of those responsible.

Figure 2:
The inputs to improving the quality of ESG information



④ Making changes to improve data quality

Management should focus on establishing a culture that underscores the importance of ESG information so that it is given the same attention as financial information.

Much of what is suggested in this guidance as a method for improvement is already carried out in the finance department for financial information. Aligning the controls for financial and ESG information may provide efficiencies in the process. While this may not be the best method for all companies, it is necessary to recognize what works for them. Aligning sustainability and financial teams is a good place to start, but there needs to also be acknowledgment for the required subject matter expertise when dealing with ESG information.

In addition, a **sign-off letter** may help to provide accountability for data that is collected from across the group. Accountability and responsibility for ensuring that data is correct reinforces the control environment. If the organization can hold individuals accountable for their data and processes in pursuit of the overall objectives, it will allow for more accurate and reliable information. The sign off process may be done through workflow system or a lower specification set up, but the premise is that all data is recorded with an audit trail.

The system and framework used are likely to define the way in which data is stored and collected. Companies may choose to use one single system or multiple systems. What is key is that all subsidiaries and those responsible for collecting data follow the same process. In assessing the maturity and determining the journey of improving the quality of ESG information, companies may choose to align to a specific framework. COSO offers a way of designing the internal control environment using five core elements and 17 principles. Companies may also choose to use ISO standards or design their own approach. Again, it is important that the company can justify its use of a different framework to that used for financial information and reporting.

COSO Internal Control Framework

Issued first in 1992 and revised in 2013, the COSO Internal Control Framework aims to enable “organizations to effectively and efficiently develop and maintain systems of internal control that can enhance the likelihood of achieving the entity’s objectives and adapt to changes in the business and operating environments.”¹³ The framework is designed to assist management and other stakeholders in their respective duties for managing and monitoring internal control. It provides a concept and structure that can be provided to any entity, a principles-based approach which allows for judgement, minimum requirements for

an effective internal control system and a way of identifying and analyzing risks to allow management to respond in an appropriate manner.

The framework consists of five components:

- 1. The control environment** – sets the standards and processes of the organization
- 2. Risk management** – the process used alongside monitoring and improvement activity to ensure that the internal control process is effective.
- 3. The control activities** – the policies and procedures to help achieve the objective of improving the quality of non-financial information

4. Information and communication – the process of sharing timely, relevant and reliable data horizontally and vertically throughout the organization

5. Monitoring activities – a method of ongoing evaluation to ensure that the controls and processes are effective and efficient in achieving the overall objective

More detailed information on the COSO internal control framework can be found in Appendix 1 and 2.

④ Making changes to improve data quality

PROCESS

Below we outline a number of different processes that may be applied to improve the quality of ESG data.

Establish a control environment

The control environment sets the standards and the processes of the organization. This process is often dictated by the board of directors who are responsible for establishing the culture and standards of conduct. Therefore, senior management or board buy-in is important in changing internal control behaviors.

Before data can be collected or controlled, there are several elements that need to be defined. These include the objectives set by the organization, the management structure, organizational values and scope of the process. Data points and calculation methods should also be defined prior to carrying out the collection and consolidation processes.

The chart of accounts

In addition to setting the culture and defining the drivers of change for improving the quality of ESG information, establishing a **chart of accounts** may also provide a framework for collecting data in a systematic way.

The chart of accounts uniformly collects data from all entities within the group in a form that can be consolidated and reduces the risk of inconsistent data.

The chart of accounts acknowledges that subsidiaries within the group may collect information in different ways, but it sets a minimum requirement for what is expected for reporting at the group level. By defining the specific data, time period and the appropriate format, the group will more accurately be able to reconcile data from across the individual entities, this will allow for a more reliable representation of performance and progress throughout the organization. At an entity level, it is recommended that data is collected in the rawest form to allow for complex calculations at the group level. This helps to minimize the risks of local entity miscalculations. The chart of accounts might define that "water consumption" is measure collected by the group, for example.

Chart of accounts

Account number

82100

Account name

Water consumption (m³)

Account type

Input

The group ESG data manual

To provide more information and context to what the chart of accounts means to all subsidiaries across the entity, it's helpful to develop a **group ESG data manual** or a **scoping document** to define the parameters and details to provide the necessary and relevant data.

The group ESG data manual will create a common understanding of how items are defined and provide the relevant data collection policies to reduce inconsistency.

This will include the type of data and appropriate form of evidence. It may also be necessary to explain the business need for collecting the data and to explain the importance of the group level calculation. The responsible parties must also ensure that their roles are defined, a process with deadlines is in place and each person is aware of their data collection and reporting duties.

It is helpful for organizations to develop and share a manual which includes all these definitions to help with a unified and efficient reporting process across the group. If entities are aware of their obligations to provide the group with data, this can help ensure that data received is accurate and timely. The manual is like a group's Accounting Policy Manual but addresses ESG reporting policies and principles. Ideally, over time both manuals should be consolidated into a single manual to cover all data.

④ Making changes to improve data quality

The group ESG data manual may also include key assumptions and policies to improve the transparency of reported information, this may also be repeated in the external disclosures made by the organization in the annual, sustainability or integrated report. This will provide users of the information with greater understanding on how it has been collected, calculated and reconciled throughout the entire organization. Investors and analysts will be able to evaluate, compare and normalize the data with other companies where necessary.¹⁴ The group ESG data manual will also provide further evidence of a systematized process to a third-party assurance practitioner.

The manual would typically cover the following elements:

- The standards, regulations and governance structure
- The roles, tasks and responsibilities including those with responsibilities to sanction changes to the manual and those of local management, business unit and group level
- The reporting structure
- The data boundaries and consolidation procedures
- Information regarding entity-specific reporting and how is data consolidated at the group level. (For example, does the company follow the financial reporting consolidation principles set out in IFRS 10 Consolidated Financial Statements and IFRS 11 Joint Arrangements?)¹⁵
- The rules that are applied to data for consumption, emissions and incidents in relation to owned assets, leased-out assets and leased-in assets. (For example, does the company follow how leases are defined for financial reporting purposes set out in IAS 17 Leases/IFRS 16 Leases?)¹⁶
- The treatment of data from assets held for sale and discontinued operations
- An explanation of any deviations from local requirements (for example regulatory requirements in a specific jurisdiction may differ from those for the parent company and where the group accounts and reports are issued)
- The reporting deadlines for all data collection points
- The verification processes of the data
- Any evidence requirements and related storage demands
- The overall control procedures and requirements for the reporting entities, business unit and group
- The chart of accounts
- The data definition per account. Such definitions might include name, definition, unit of measurement, methods of collecting the data from which sources and, if relevant, the source of the reporting requirement (e.g. Global Reporting initiative (GRI standards).

See below the example of the information included for the number of full-time equivalents with a reference to the relevant GRI standard.

Figure 3:
Example for FTE in the group ESG data manual

Number of full time equivalents (FTEs)	
Formula	FTE = (total number of compensated hours/normal hours for a full-time employee) per country
Unit	#
Explanation	FTEs should be comparable with the gross staff cost before potential capitalization, hence compensated hours drive the number of FTEs. Normal hours vary per country. Hence FTEs should be calculated per country, and then consolidated to corporate group data. Temporary workers should not be included in FTEs, as the compensation of these is not included in staff cost.
References	GRI: 102-7

④ Making changes to improve data quality

Office standards

The group ESG data manual may also include information relating to the processes and calculations required at different sites across the organization. For example, **office standards** are a proxy for consumption at a site with no production. It is recommended that they are calculated according to geographical region to avoid anomalies. This information provides a control to compare data that has been reported.

Office standards are ideally based on historical information. By understanding the company's electricity, water and waste used per one full-time employee in a number of different regions, it can help to check the data reported by local entities to the group.

It is important to note that these standards cannot be used at production sites, warehouses or other sites with unique activities. Figure 4 is illustrative of the information that might be included in the group ESG data manual to demonstrate utility and other usage of one employee.

Data collection in subsidiary companies

When an item is defined in the chart of accounts and group ESG data manual, it's more than just a code, it will also address the indicator, completeness and accuracy.

Water consumption as included in the chart of accounts above may be recorded differently in two subsidiaries of a company. For example, large amounts of water are used by a company in the preparation of canned food.

The company has three production plants in City A, City B and City C. At each location, water consumption is measured in a different way. In City A water is collected by pump readings from a reservoir, and in Cities B and C it is collected by meter readings. The group ESG data manual will need to include the local translations of requirements to ensure accurate data is collected. The water usage at each plant will be based on the various sources of evidence and then aggregated to report against a standard unit of measurement for water consumption at group level, for example cubic meters per ton of production.

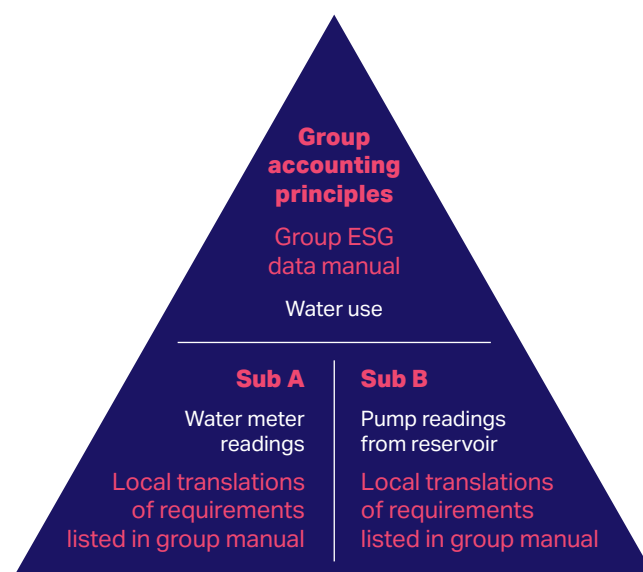
Management may also consider whether the relevant utility bills have been included for the period, if the pump readings are accurate and if estimates have been made. Internal controls over this information will provide a systematic way of addressing these and other data quality issues.

Figure 5 provides a visual representation of how the group ESG data manual can be used at different levels throughout the organization.

Figure 4:
Illustrative example of office standards

Office Standards - per FTE				
	Electricity (kWh)	Water (m ³)	Non- hazardous waste (tonnes)	Exposure Hours (hours)
EU & EFTA	1765	10	0,5	1890
Other Europe and Eurasia	1860	10	0,3	1880
Asia & Pacifics	2680	40	0,3	1890
Middle East	2920	10	0,25	1825
North America	5860	30	0,35	1970
Central & South America	1620	25	0,3	1675
Africa	2965	40	0,3	1685

Figure 5:
An example of how the group ESG data manual may be applied by subsidiaries



④ Making changes to improve data quality

The control activities

The control activities are the policies and procedures to help achieve the objective of improving ESG information

By having a process around **controlling data at the group level**, it allows the data received from subsidiaries to be compared and consolidated.

Controls help to manage the accuracy and completeness of the dataset and aid a more efficient and effective year-end reporting process.

When defining the control procedures at the group level, it's advisable to define what to control, when to control and who should perform the controls, as well as evidence that the control procedures have been carried out.

In accordance with risk assessment and control activity components of the COSO framework, the control environment cannot exist without control activities - which involve the process, consolidation and risk assessment that must be carried out by the organization.

Often, personnel at the group level will only have access to reported data and explanations provided by entities within the group and not the source data. To assess whether the reports represent valid and complete data sets according to the data definitions in the group ESG data manual, personnel at the group level will need to carry out various checks on the data supplied.

Below is a list of checks that may be helpful. Their relevance will depend on which indicators are reported at the group level. Ideally, all entities that report financial data, should also report ESG data.

- If sign-off letters are used, local management should have signed off their individual datasets and provided an explanation for any changes
- Entities with staff-costs should also report Full Time Equivalents (FTEs) – divided by gender and job-level
- Entities with FTEs should report electricity, water and waste – as a minimum – regardless of business or geography
- Entities with FTEs should also report on health and safety data – as a minimum - exposure hours of being injured – regardless of the business
- Entities in areas that require heating during some parts of the year should report on heating consumption (for instance, district heating, heating oil, gas and wood)
- Fuel cost should align with the fuel consumption
- The country-split of the electricity and district heating/cooling consumption is more useful than the individual entity's geographical placement. For example, it is highly unlikely that a Swedish entity buys its electricity from a South African utility provider. The country-split of electricity and district heating/cooling determines the CO₂ emissions converter
- Fuel consumption should match the various owned/leased asset types – consumption from assets leased out should not be included in Scope 1 CO₂e
- The reported bribery and facilitation payment cases matches at least those raised by the Internal Audit reports
- The coverage data from the procurement department on their due diligence activities should match what can be pulled from financial data
- The board's attendance rate should match the board's protocol
- It should be decided if the data will be consolidated using the financial system or if a stand-alone system is used for ESG data. It's recommended that there is one system for data consolidation. Companies should take care with cross-ownership and changes in minority-shares of subsidiaries during the year to understand implications for reporting as these differ between subsidiaries and associates¹⁷

This not intended to be an exhaustive list of checks but an example of what can be carried out and developed at the group level considering control objectives, depending on which indicators are reported, and which systems are available.

If office standards are defined in the group ESG data manual, these can easily be used for basic checks of the reported data. This can also happen through automated data validation checks in the reporting system, where incorrect data is flagged before submission to the group.¹⁸ These checks may reduce the possibility of incorrect data and limit the time needed at group level to carry out data checks and follow up with entities in the group.

④ Making changes to improve data quality

Consolidation systems

It's important to have a structured process for collecting and aggregating data so that it can be used for decision-making and reporting. While the systems in place across the organization may vary, one aligned process improves efficiency and effectiveness of reporting ESG information.

Using a consolidation system to collect and report data will ensure completeness of information, allow for audit trail, minimize the time and cost of collecting data and increase the level of management oversight.

Consolidation systems are most successful when used with an established chart of accounts and group ESG data manual – the more automated a system is the less likely that errors will occur. The consolidation system at group level may be the same as that used for financial reporting purposes or be a standalone ESG system.

It may be possible to use the financial consolidation system to help ensure that the data is complete and useful both internally and externally. All entities will be able to report financial and ESG data and it will be consolidated in one system. There have been some examples of organizations already implementing consolidation systems for ESG data, these organizations have seen a positive result operationally and financially. However, the migration of data systems can be time-consuming and requires the user

of those systems to have a sound understanding of both financial and ESG data. It is important for the organization to select a system that is appropriate for them and operates well within their existing processes.

Utilizing the financial consolidation system for ESG data may result in the following benefits:

- Cost benefits from using a common platform for reporting
- Lower implementation costs: As the company has already bought the software, employees are already being trained how to use it – there are user manuals, documentation and IT audits in place. The only additional cost for the company may be the expansion of user licenses and getting someone (internally or externally) to expand the system's metadata. But in most cases, large companies will be able to do the simple metadata expansion themselves through their technical teams, and it should be possible to do this within a short time-frame
- Access control is already in place, and the system is already available to all entities within the group
- If financial boundaries are being used for ESG data collection, it is helpful to use one consolidation system to avoid duplication and a separate chart of accounts. This is, however, an advanced step in controlling data and many companies still use separate systems.

- The company can immediately integrate controls and KPIs when financial and ESG data are stored in the same database. It may be possible to create input-rules to minimize or prevent simple reporting errors. For example: If an entity reports staff cost, then the entity should also report the numbers of employees by gender.
- Using a single consolidation system can help to minimize the challenges of using a standalone application. Spreadsheets can be very useful tools in many situations, but they cannot provide an audit trail, and all cells can be changed continuously. This can leave the data vulnerable and subject to an increased risk of error. Spreadsheets may also have issues with cross ownerships functionalities.¹⁹

Mitigating the risk

Without assessing and prioritizing the possible areas of a material misstatement it can be hard to determine where to focus resources. By carrying out a risk assessment, management can appropriately allocate resources to the risks that pose the highest likelihood for a material misstatement.

A risk assessment tries to address the risk of reporting incorrect data to determine the areas that may be susceptible to error and to allocate efforts accordingly.^d

^d This is different from the enterprise-wide assessment undertaken as part of the entity's enterprise risk management and materiality assessment – these issues are not covered in this guidance.

④ Making changes to improve data quality

The risk assessment consists of two inputs – the quantitative impact from the reported indicator, and the likelihood of incorrectly reported information.

To be able to assess the quantitative impact, the indicator needs context, so it is possible to determine, whether the impact is low, moderate or high. Carrying out financial risk assessments is often straight forward, as one can use the revenue, total assets or cash flow from operations - for example - as the context for the individual line item in the financial report.

With ESG data, the context may not be so straight forward. In those situations, the risk assessment will include more complex information, such as which systems and what industry the company operates in. It may be possible to use financial information as a context for ESG data; for example, the number of full-time employees can be compared with the staff cost in relation to the revenue. Or the consumption/combustions of heating sources can be compared to the cost of heating in relation to the revenue.²⁰

When assessing the qualitative risk of indicators, it's recommended to follow two steps. First, the indicator should be evaluated for its inherent risks, and second, the company specific risks should be added. All financial and ESG data has an inherent risk of being incorrectly reported, which can be reduced or increased given the group's systems and habits.

Inherent risk is defined as the risk to an entity in the absence of any direct or focused actions by management to alter its severity.²¹

In relation to internal controls, it's normally straight forward to reconcile a bank account: the inherent risk is low – but if a company has a history that shows they are not good at this, the qualitative risk would be raised to moderate or even high.

The inherent risk is typically dictated by the indicators' data types. For example, the use of fuels, which are documented via invoices of purchased gas or oil, or FTEs documented via the pay slips of compensated hours, have a low to moderate inherent risk. Whereas, in an indicator such as waste or internal training hours, where the evidence is often more complex, there typically is no third-party written documentation, making the inherent risk moderate to high.

Once the quantitative impact and the qualitative assessment (likelihood) has been determined for each indicator, it can be plotted on a traditional risk heat map to help management to decide which indicators need to be controlled.

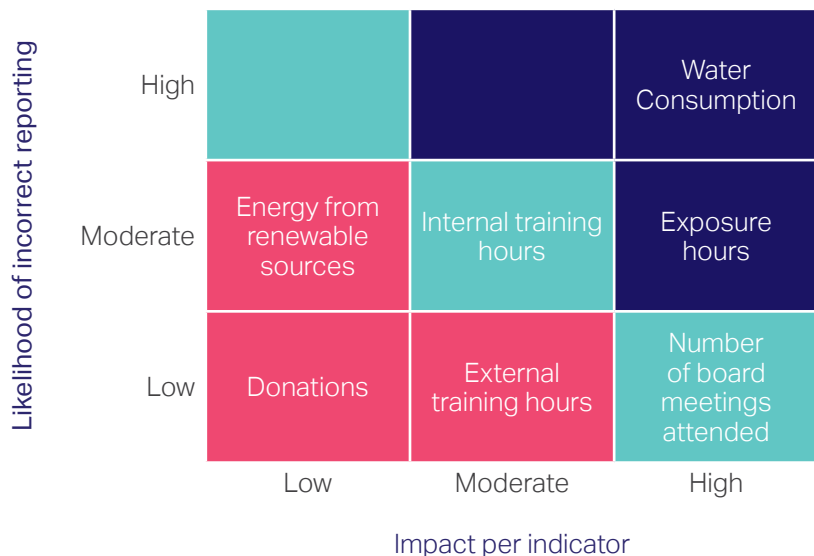
Management can choose to allocate resources accordingly. Indicators in the top-right quadrant should be included, but management may also include other indicators if the risk appetite is lower and resources allow. Figure 6 provides an example of what this may look like for several suggested indicators.

The risk assessment should be done at the group level. However, in many diversified companies, the entities within the group may also carry out their own risk assessments, so that they spend their time controlling the appropriate metrics. The group should, in those cases, ensure that the risk assessments from all the reporting entities match the group's risk assessment, which supports an efficient control environment.

The level of resource dedicated to controlling an individual metric may also be aligned to the tolerable error for that metric. For more information on tolerable error see page 26.

Figure 6:
Example risk assessment

What is the risk of incorrectly reporting an indicator?



5

Reporting on internal controls

Reporting should be aligned with the business' needs and management need oversight of data to ensure appropriate controls are embedded at all levels.

5 Reporting on Internal Controls

The COSO framework explains the need for information to be shared and reported inside and outside the organization. At several different levels within the organization, there is a responsibility to use the information collected and analyzed throughout the internal control process to make decisions on the efficiency and effectiveness of the control environment. The Internal Audit function and Audit committee are responsible for using the information in an appropriate way.

By communicating and reporting processes and data externally, users of that information can have a better understanding of how the business is mitigating risks and managing internal processes to successfully achieve the organization's objectives.

Without robust processes and reliable data, management will not be able to mitigate potential risks to the business which may impact the organization's ability to be successful over the long-term.

The board must be aware of the internal control environment and have confidence in the reliability and usability of the ESG information presented to them. Regular monitoring of this data and process is essential before it can be used to make decisions.

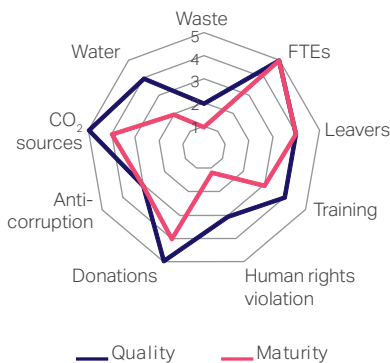
Internal Audit teams have a duty to regularly monitor control processes and activities throughout the organization and improve or comment upon their efficiency and effectiveness. However, in some cases, their work program may not include ESG data.

This will need to change if management wants to provide assurance to the board. The process should be regularly evaluated to ensure that risks are not limiting the organization's achievement of its objectives. Following this, the Audit Committee should have the opportunity to review the effectiveness of the internal controls over the ESG information so that it is able to advise the board and challenge management (if necessary).

The example in Figure 7 illustrates what may be included in the Internal Audit report for an individual business unit. It is likely that this type of report would be presented to the Audit Committee as part of the overall conclusion on the quality of the ESG data.

Figure 7:
An example of a report prepared for the audit committee for business unit X

Business Unit X - Control Environment



Key
Quality is how well designed the controls are
Maturity is how well implemented the controls are
Both scales are from 1-5 - the demand is 4 for both

Development	Plans
X has brought a new subsidiary in October - not all controls are in place yet	ERP system implementations to be finalized in March next year
X had worked hard on making sure especially the CO ₂ sources, FTEs and donations are well implemented - which has been a success	New BU compliance officer to be hired as soon as possible
X is implementing a new ERP system - not finalized yet	Better implementation of the remaining controls during next year
BU compliance officer is leaving	
Observations	Conclusions
X had a human Rights incident in country Y - Internal Audit is still investigating the implications	Internal Audit is concerned about the lack of management and implementation of the "difficult controls." Internal Audit stresses the importance of skills of the coming BU compliance officer
	Internal Audit concludes that due to the work of the second line of defense, the data for X is still be considered to be reasonable, valid and complete

⑤ Reporting on Internal Controls

AVOIDING A MATERIAL MISSTATEMENT

A material misstatement, in financial terms, is information that is reported in the financial statements that is significantly incorrect and, as a result, may impact the decision of the individual who is relying on that information, usually in relation to investment. The same definition can be applied for ESG information: if any information publicly disclosed by a company is incorrect and could be relied upon by a user for decision-making, it could become a material misstatement.

The purpose of improving the quality of ESG information is to avoid this, whether the information is being presented to management or to a user external to the organization. If the decision of the individual relying on that information is impacted as a result of the incorrect information, this may have implications for the business in terms of trust and transparency. This is particularly important if you are seeking an assurance opinion on your disclosures and metrics.

The extent to which data or information may be incorrect is dependent on the tolerable error accepted by management and set for the different metrics used across the company to communicate performance. Tolerable error is the amount of error that would be accepted before the company suffers a material misstatement and must re-state data points or information.

The tolerable error for each indicator should be included in the group ESG data manual. It is appropriate to consider the materiality of the indicator to your business when considering the tolerable error percentage. Social metrics are likely to have a lower error percentage for example, health and safety incidents or fatalities is likely to be 0%; whereas environmental metrics may be higher because a 5% deviation in the figure for CO₂ emissions may not impact decision-making. The tolerable error percentage is also directly linked to the impact that an incorrectly stated number may have on the individual using that information to decide.

⑥

Monitoring and ongoing improvement

The COSO framework stresses that training, engagement and improvement are integral activities for monitoring the effectiveness of the internal control environment and activities.

⑥ Monitoring and on-going improvement

Those responsible for internal control data collection, consolidation, review and reporting should annually evaluate the processes to ensure they are both efficient and effective. This is key to the day-to-day operations.

Engaging with personnel across the group ensures there is a shared understanding of the importance of data quality for decision-making. This is an area which, if not done to a sufficient level, may result in repeated control failures. Individuals in the data chain need to understand their roles and responsibilities for the data that is collected and how the decision that will ultimately flow from information that is provided at a local and group level.

TRAINING WORKSHOP

As noted above, effective internal controls rely heavily on a strong culture of data quality which prioritizes the need for effective control practices. Holding **training workshops** is an easy way for employees to understand the reporting processes and data flows.

Workshops are opportunities for personnel involved in the reporting process to describe the steps to clarify the ways of working and which controls most efficiently remediate the risks identified during the risk assessment.

It can be helpful to involve a range of team representatives in these workshops to get different points of views and different solutions to the same issues. Such exercises can also be useful in engaging teams to develop new solutions and taking ownership for their activities. Workshops can consider the quality of ESG data on an *as is* basis or think about *how it can be improved*. This would ask the group to define and describe current and future processes. Data moves across functions – identifying the need to work together to gain a mutual understanding of data needs and flows will support the journey towards improving the quality.

Combining workshops with risk assessments can be a means of identifying how the risk of reporting incorrect data can be mitigated – both in the first and second lines of defense (see Chapter 7).

CONTROL CATALOGUES AND STANDARD OPERATING PROCEDURES

A **control catalogue** helps provide an overview of the different control measures in place for specific indicators. Figure 8 shows what an example of this might look like. For each element in the control catalogue, the **standard operating procedure** (SOP) for each control is explained. It provides an overview of the activities performed, the intended output and evidence required. Documenting these measures serves as a control activity for improving the quality of ESG data. The control catalogue and standard operating procedures may be outlined and explained in the group ESG data manual.

Control catalogues and standard operating procedures may cover the following elements:

- Risk identification (what may go wrong – for example, incomplete documentation)
- Control objectives (what should the control do – for example, for each CO₂ source in scope, the full consumption documentation should be available)
- Evidence that the control has been carried out to a satisfactory level

One of the biggest challenges for companies is to identify what constitutes “valid” evidence and the extent to which this evidence is complete in terms of the subject matter it purports to represent, especially when there is a risk of data being incomplete. The tests for assessing completeness and validity are different.

For completeness, data is considered in aggregate in terms of whether it captures the material elements of the subject matter which may be verified from an external source – such as evaluating the subject matter information against a criterion.

To assess the validity of evidence, an individual data point is considered to assess whether the data is sufficient.

Another frequent problem, especially for standard operating procedures, is that most focus on process descriptions, but not necessarily on the control activities and the evidence of the control being performed. It can be helpful to use existing standard operating procedures but to include further information to support the integration of ESG data. This means the company may not necessarily have to change their processes.

⑥ Monitoring and on-going improvement

If the group has common activities and systems, the controls can be defined centrally, and then rolled out to all entities/ business units; but in many large companies, this is not the case. WBCSD's research with member companies has highlighted that a better solution may be to let local employees carry out their own risk assessment and establish

appropriate controls, as it ensures better ownership of the controls and a greater likelihood of the controls being performed. It demands that at the group level each local approach is approved to ensure consistency when consolidated. The group ESG data manual can be used to support local application of the common activities and processes.

Consistent documentation to evidence internal controls is fundamental for an effective system. Using templates across a group can be a useful means of driving a common approach to creating an effective internal control environment.

Figure 8:
Example of a control catalogue template to be completed by company

Internal control catalogue

Objectives and risk ID		Status tool		Activities and evidence	
Control objectives	Risk	Is this control objective relevant to your business unit?	If no, explain why.	Key control activities	Recommended evidence

Control overview

Process (e.g. reference to narratives flowcharts)	Names and/or references to evidence of documentation performed	Preventive/detective (P/D)	Automatic/manual (A/M)	Frequency of control	Control owner (title)	Responsibility for performing control (title)

⑥ Monitoring and on-going improvement

MONITORING

To ensure that the controls are working effectively, they should be monitored continuously. This provides an opportunity for challenges to be identified and addressed.

During the research for this guidance, WBCSD carried out a number of interviews with external assurance providers who consistently stressed that it is possible to reduce the time and cost of the external assurance process, especially for reasonable assurance where effective controls are in place, are tested and if the Internal Audit team is involved in assuring that the ESG data control environment is working effectively. This obviously demands a strong relationship between the internal and external assurance practitioner, to reinforce the three lines of defense.

For the Internal Audit team to be able to provide useful input to the external assurance process, they need to be able to assess the data quality during the year. Accordingly, it's helpful if the ESG data is reported at least twice throughout the year – but some companies advise that quarterly or monthly reporting may be better. This may serve as a practice opportunity for reporting entities. However, in many companies where the quality of data has been raised as an issue, improving data quality could also be included in the individual performance plans and bonus-scheme, so that the board can depend on reports during the year.

If the external assurance practitioner is to rely partly on the work performed by Internal Audit, then the monitoring carried out by the Internal Audit should include provision of a **positive statement** on the level of maturity across all control objectives identified in the risk assessment.

For Internal Audit to establish a positive statement, they may need to work within the boundaries of the proposed coverage - just like the financial audit. The company's Audit Committee should also state the level of coverage that is needed to sign-off the data. The role of Internal Audit is covered in more detail in Chapter 7.

Coverage may be calculated in the following two ways:

1. By indicator

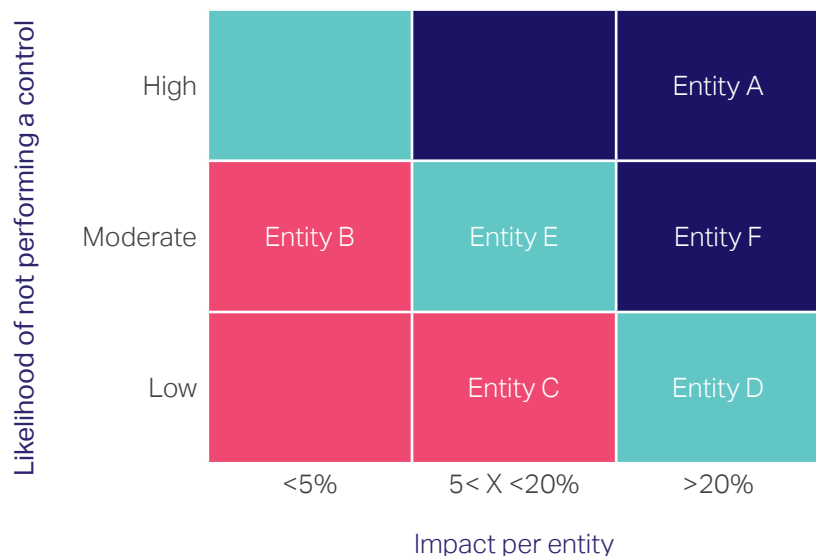
The organization selects a percentage threshold and the entities that meet that requirement are included in the monitoring scope, this may be 80% for example. This is especially helpful if the company has diversified activities, where only some entities or business units are in scope for some indicators/control objectives. This may result in monitoring more entities than are covered in the financial methods, but only for some indicators.

2. By financial impact

The inclusion of entities is determined by financial measures. For example, a combination of 80% of revenue, bottom-line and total assets are included in the scope. This is a simple calculation, but it only works well if the company has homogenous activities, risk profiles and worldwide systems. This method will typically result in choosing fewer entities to be monitored than the indicator method above.

In addition to this quantitative assessment, the entities that are not performing the controls to a satisfactory level should also be selected to be monitored. The assessment for this is based on the individual entity's history, skills, likelihood of fraud, activities and technical disadvantages. Each entity is then, based on this assessment, assigned a low, moderate or high likelihood of not conforming to the described controls, and the combined risk assessment could be documented in an **entity selection model**. Figure 9 illustrates such a model.

Figure 9:
Example of an entity selection model



⑥ Monitoring and on-going improvement

The combined entity assessment may follow these parameters:

- **Dark blue** = entity is to be tested at least every year
- **Light blue** = entity is to be tested at least every second year
- **Pink** = entity is to be tested at least every third year

Setting rules ensures that each entity within the group is monitored at least every third year for completeness. But it also means that those groups with subsidiary entities, and with equal likelihood of not performing the appropriate controls, are subjected to validation tests on a rotating basis. All entities to be monitored must be selected and a **monitoring plan** can be developed.

The plan needs to reflect agreements made between internal and external audit – and could, for instance:

- Outline the entities that are included the monitoring scope
- Determine the controls that will be tested at each entity
- Define the sample sizes and selection methods for each control at each entity
- Determine who will perform the monitoring and measurement?
- Identify when the testing will be performed and based on what reporting requirements?
- How will the monitoring be documented?
- How will the results be consolidated to business unit/ the group level?
- How will deviations be treated – in respect of increasing scope, corrective actions or a self-assessment and improvement plan from the entity?²²

The last point especially influences how the feedback process works and the impact it will have on the control environment going forward. The monitoring assessment could result in a report per entity, collated at business unit level and reported to the group.

7

Assurance

The quality of data collected is likely to depend on the effectiveness of data governance. Good governance is observed when responsibilities are cascaded throughout the organization to ensure that there is accountability across the whole organization.

⑦ Assurance

Where processes are not followed or are compromised, data governance provides the necessary checks and balances to address errors and omissions to avoid material misstatements in reported information. This provides the basis for accountability for the quality of the data so that decision-makers can rely on it with confidence.

MATURITY OF THE CONTROL ENVIRONMENT

Companies are likely to vary in the maturity of their controls over the production of ESG information. Even within a company, there may be varying degrees of control based on whether the information is subject to external assurance. Ideally, the same level of controls should be applied to all ESG information, but - for various reasons - that may not always be the case. Accordingly, an assessment needs to be made to establish the level of maturity to identify what actions need to be taken. Seeking assurance over the ESG information that your company reports may be a way of further enhancing the credibility of that information. This is also likely to enhance the trust and confidence that users have in this information.

INTERNAL ASSURANCE

Internal assurance aims to provide management and the board with confidence that there was a rigorous and controlled process for collecting, verifying, consolidating and reporting data. The role of Internal Audit can be extremely important in the external assurance process as well as managing internal control measures. Internal Audit should be responsible for overseeing information that is key for managing the business and used for decision-making, financial or non-financial. Internal Audit may also be able to play a role in helping to prepare the business for external assurance, supporting process changes and reinforcing the financial and operational benefits to management. By engaging with Internal Audit and strengthening the quality and processes of ESG data, it subjects this data to the same level of rigor as the financial data. This not only facilitates the process of external assurance but may also improve the confidence of management and other users of this information. For those companies who have chosen to align the boundaries of the financial and ESG data, the role Internal Audit will be critical.

EXTERNAL ASSURANCE

External assurance is a further step in improving the quality of information. It adds value by providing people who use ESG information with confidence in what the company has reported.

Third party independent assurance cannot provide additional confidence if the information is of low quality to begin with. Research suggests that the benefits of sustainability assurance efforts outweigh the costs of the assurance process, with significant capital market advantages including reduced cost of capital, increased analyst coverage, and lower analyst forecast errors and dispersion.²³

The research published in the Journal of Accountancy suggests that companies who obtain sustainability assurance from a large accounting firm can gain a 0.7% reduction in their cost of capital and a rise of 5.8% in analyst coverage over 12 months. The research stipulates that an improved information environment for capital providers may raise stock prices and lower borrowing rates.

7 Assurance

LIMITED AND REASONABLE ASSURANCE

The International Standard on Assurance Engagements ISAE 3000 (Revised) is the principal reference point for a standard on assurance in this guidance. It is the most widely used international standard for assurance over non-financial information issued by the International Auditing and Assurance Standards Board (IAASB). Assurance under ISAE 3000 (Revised) is provided at two levels 'reasonable' (in the form of a positive statement) and limited (in the form of a negative statement). The IAASB International Framework for Assurance Engagements sets out the difference between 'reasonable' and 'limited' assurance.

The objective of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement as the basis for a positive form of expression of the practitioner's conclusion. The objective of a limited assurance engagement is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner's conclusion. Paragraph 11

<http://www.ifac.org/system/files/downloads/b003-2010-iaasb-handbook-framework.pdf>

In February 2016, WBCSD launched, *Generating Value from External Assurance of Sustainability Reporting*, which sought to demonstrate the value that external assurance can add to sustainability reporting.²⁶ Using data collected from WBCSD's annual study, *Reporting matters*, the paper sets the status of assurance and illustrates that the process of internal control and external assurance is a journey.²⁷

To help reporters navigate through this journey we developed a three-stage assurance maturity model. The model focuses on external assurance at a limited or reasonable level.

The purpose of WBCSD's assurance maturity model is to help those who seek assurance services understand where they are, where they want to go and how they can generate value through continuous improvement. It helps reporters assess the current stage of their internal control environment and navigate their assurance journey through three stages.

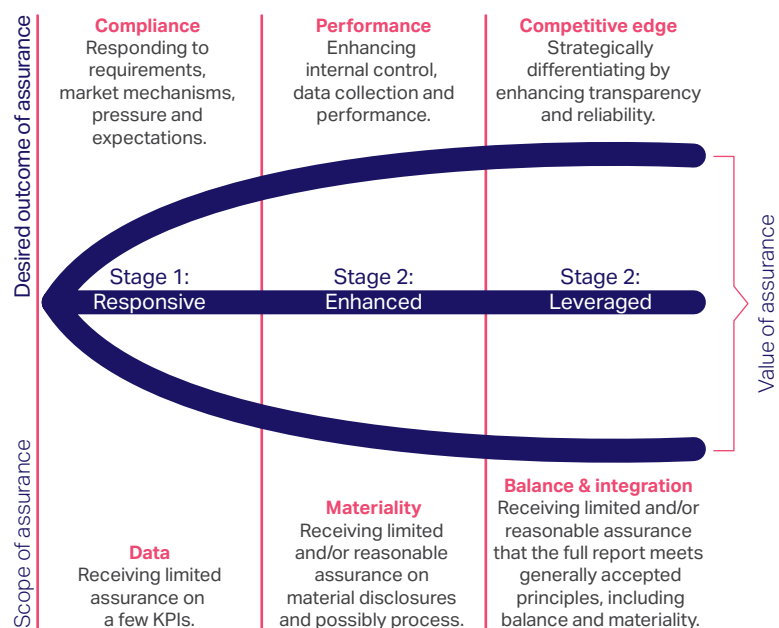
1. Responsive

At this stage, reporters are generally aware of external assurance requirements and are likely to seek limited assurance on a selection of data points or indicators. Many companies at this stage are just beginning their journey and are therefore unaware of how to fully utilize the benefits of external assurance. Reporters have an opportunity to enhance stakeholder trust and confidence.

2. Enhanced

Reporters at this level are seeking external assurance at a limited or reasonable level on material disclosures and potentially reporting processes. At this stage, companies are enhancing their own internal controls and data collection to improve the quality of data reported. The enhanced stage may help companies gain greater confidence in reported information to inform internal and external decisions.

Figure 10: WBCSD assurance maturity model



7 Assurance

3. Leveraged

Reporters at this stage are looking to gain a competitive advantage through transparency and reliability of data. External assurance is sought on the full report and meets generally accepted principles including balance and maturity. Reporters at this stage go beyond obtaining assurance on the accuracy of the information and seek a greater trust and transparency in the information. This assurance may be of limited or reasonable level. Higher levels of confidence can be achieved from this stage as the full report has gone through a rigorous assurance process.

To support the assurance process and yield the operational and financial benefits, you may choose to establish a **prepared-by-client (PBC) list**, this helps to facilitate external assurance, and may reduce the work needed to be carried out by the assurance practitioner.

Once the need for external assurance has been established, it is recommended that those responsible at the group level will agree in advance on the material to be covered by the external assurance engagement. To establish an alignment between the organization and the assurance provider, it can be helpful to produce a PBC list. This can be further supported by sharing the group ESG data manual with the assurance practitioner, to give them a better understanding of the definitions and scope of the data collected at entity level.

The PBC list may be adapted depending on the type of assurance that the organization is seeking and will be useful for assurance providers giving limited or reasonable assurance.

A simple PBC may include a(n):

- Draft sustainability report
- Inventory management plan
- Emission factors and conversion factors
- Documentation of internal reviews/data sign off
- Evidence and data used for internal reporting

A more complex list offering details of what companies could have ready in advance of the assurance engagement is illustrated in the following example. It outlines the material required for reporting on water access and use.

PBC lists can be useful at both the entity and group levels, if the assurance engagement is intended to look at the raw data from the individual entities, the PBC list will only enhance the assurance process. Having an agreed-on PBC list will allow for a more effective and efficient assurance process at the year-end.

Figure 11:
Illustrative example of a prepared-by-client list for water access and use

Water access and use		
W.1	Site level policy documents prepared by management for reporting of water use (including procedures, responsibilities, definitions, key assumptions and measurement methodology)	1-2 weeks prior to site visit
W.2	Listing of key water sources and water meters (Note: may be easily identified in sites water mass balance, if so no need to supply separately)	1-2 weeks prior to site visit
W.3	Listing of calibration of water meters and understanding of basis of the frequency of calibration	1-2 weeks prior to site visit
W.4	If meters are not in use/functioning, supply estimation methodology and accuracy statement.	1-2 weeks prior to site visit
W.5	Documentation of site boundaries including exclusions from reporting (if any)	1-2 weeks prior to site visit
W.6	Water mass balance including the process flow of water (e.g. showing water inputs, uses and water outputs)	1-2 weeks prior to site visit

8

Conclusion

The pressure on companies to disclose ESG information continues to increase exponentially as do the ranges of frameworks and guidelines that can be adopted to satisfy those disclosures.

For both investors and management to make informed decisions about the entity, high-quality, complete, reliable, accurate and understandable information is needed. If management can't support claims about the information being provided either internally or externally, then it's likely that the wrong decisions may be made.

This could have serious consequences operationally, reputationally and ultimately financially.

The evidence, based on numerous surveys of non-financial reporting, indicates that the quality of ESG information needs to substantially improved before companies can be rewarded for managing long-term value creation.²⁸

It's a process that takes time and commitment but one that is essential if companies are to properly identify the opportunities and challenges their business models need to address to remain resilient.

Appendix

1. COSO INTERNAL CONTROL FRAMEWORK

Better trust and understanding of the organization’s ability to identify, assess, manage and monitor risks is likely to enhance confidence among external stakeholders in the information reported.

Effective application of the framework enhances the likelihood of an entity achieving its objectives.

Objectives can be categorized as follows:

- Operations objectives pertain to effectiveness and efficiency of the entity’s operations, including operational and financial performance goal and safeguarding assets.
- Reporting objectives pertain to the internal and external financial and non-financial reporting which may include reliability, timeliness

and transparency set by regulators, standard setters or the entity’s policies.

- Compliance objectives pertain to adherence to the laws and regulations for which the entity is subjected to

The framework consists of five components;

1. The control environment
2. Risk assessment
3. Control activities
4. Information and communication
5. Monitoring activities

These five can be seen in the illustration of the “COSO cube” below. Many organizations create their enterprise risk management and internal control environment using the COSO frameworks. They provide a structure for the organization for both financial and non-financial information.

Control environment

The control environment sets the standards and processes of the organization, it includes the integrity, ethical values and the established parameters for which the board must carry out its duties of governance and oversight. These duties include attraction and retention of employees, performance measures, incentives and rewards, all of which contribute to the overall system of internal control. Within the parameters of the control environment, the board and senior management set the tone of the organization and expectations of process.

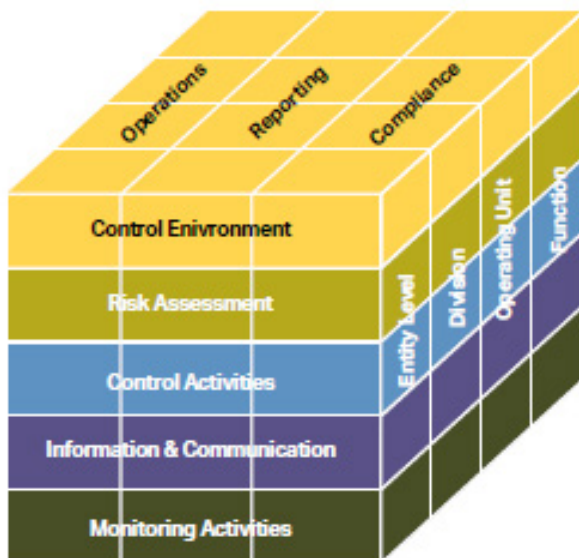
Risk assessment

The risk assessment process is a core component of designing, implementing and maintaining an effective internal control environment. It supports the process for controlling financial and non-financial performance data.

“Risk is defined as the possibility that an event will occur and adversely affect the achievement of objectives.”²⁹

Risk management and mitigation is an iterative process, and management will assign objectives to the relevant category. Operations, reporting, compliance and the management of risks should be addressed based on the impact of an internal or external factor that may restrict the organizations ability to achieve the objectives and result in an ineffective internal control process.

Figure 12: COSO Internal Control Cube



Appendix

Control activities

Control activities are the actions established through policies and procedures to help mitigate risks in pursuit of the objectives. These activities are performed throughout the organization at various levels and divisions but also throughout the business process. The controls may be preventative or detective and can be carried out through manual or automated processes. Tasks are often delegated to the appropriate division or unit for which the environment requires control.

Information and communication

Timely, relevant and reliable information is key to understanding changes in the internal and external business environment. The internal control process will support management in their internal decision-making. Communication within the organization is the on-going process of sharing and obtaining information which needs to flow vertically and horizontally through the entity, to effectively and accurately describe the current state of practice. External communication is necessary for interactions with external parties to engage and understand expectations.

2. COSO INTERNAL CONTROL FRAMEWORK PRINCIPLES

The five components of the COSO Internal Control Framework are supplemented by 17 principles, drawn from the components which provide additional support for an organization seeking to implement effective internal controls. The principles are below.³⁰

Control environment

1. The organization demonstrates a commitment to integrity and ethical values.
2. The board of directors demonstrates independence from management and exercises oversight of the development and performance internal control.
3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
5. The organization hold individuals accountable for their internal control responsibilities in the pursuit of objectives.

Risk assessment

6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
7. The organization identifies risks to the achievements of its objectives across the entity and analyses risks as a basis for determining how the risks should be managed.

8. The organization considers the potential for fraud in assessing risks to the achievement of objectives.
9. The organizations identify and assesses changes that could significantly impact the system of internal control.

Control activities

10. The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
11. The organization selects and develops general control activities over technology to support the achievement of objectives.
12. The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.

Information and communication

13. The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.
14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the function of internal control.
15. The organization communicates with external parties regarding matters affecting the functioning of internal controls.

Appendix

Monitoring activities

- 16. The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.
- 17. The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.

3. THREE LINES OF DEFENSE

The “three lines of defense” model is a commonly used method for providing effective governance of and organizational risk management.³¹ The model can be used to understand how processes are managed and controlled, which may allow internal audit to provide assurance to the audit committee and management. The model is intended to show a clear assignment of roles and responsibilities to ensure that material risks are not omitted, it provides a guide for how the responsibilities should be divided.³² Although the specifics of the model can vary between organizations and sectors, the functions are typically as shown in Figure 13.

The first line of defense

Responsibility and accountability at this level are under the remit of the operational management who must directly assess, control and mitigate risks.

The second line of defense

Controls at this level cover group functions (risk and compliance) and focus on the monitoring and implementation of effective risk management.

The third line of defense

At this line, the Internal Audit function give assurance to the board and Audit Committee on the effectiveness of the governance, internal controls and risk management in the first and second lines of defense.

External auditors, regulators and other external bodies

These actors reside outside the organization but are important for the control structures and processes within the organization, perhaps more so in finance and insurance sectors. They may provide an additional level of confidence

to external stakeholders. The way in which the three lines are coordinated may vary between organizations, but all lines should exist in some form. It is key to have an established and efficient three lines of defense. To prevent duplication of work it is also important to monitor each line and to coordinate closely between the second and third lines. This helps to define the minimum requirements and boundaries for the first line and allows the scope to be monitored at each level.

As an example, to monitor the controls around water consumption, at the first line of defense those responsible could compare the water consumption with a water bill from a utility provider. A reconciliation is performed, and the data is signed off. The second line of defense may ask for documentation as evidence that this reconciliation and sign off has been carried out. Internal Audit may periodically review and test the effectiveness of internal control procedures as the third line of defense. Finally, the board-level sustainability committee should then review the reported information to assess progress against targets.

Figure 13: Three lines of defense model



Glossary

Assurance engagement:

An engagement in which a practitioner aims to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the subject matter (that is, the outcome of the measurement or evaluation of an underlying subject matter against criteria).

Practitioner (as defined in the IAASB Handbook):

The individual(s) conducting the engagement (usually the engagement partner or other members of the engagement team, or as applicable, the firm). Where ISAE expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term “engagement partner” rather than “practitioner” is used.

COSO: Committee of Sponsoring Organizations of the Treadway Commission - is a committee of five sponsoring organizations whose representatives come together periodically to work on specific projects. COSO mission is to provide thought leadership through the development of comprehensive Frameworks and guidance on enterprise risk management, internal control and fraud deterrence designed to improve organizational performance and governance and to reduce the extent of fraud in organizations.

Control catalogue:

A comprehensive list of all the controls for each indicator. The Control Catalogue is usually found in the group ESG data manual

Control environment: Is the set of standards, processes, and structures that provide the foundation on which an effective system of internal controls is built. The board of directors and senior management establish the tone at the top regarding the importance of internal control including expected standards of conduct, such as the overall attitude, awareness and actions of directors and management regarding internal control system and its importance to the entity.³³

Data: Refers to the raw material inputs.

Data boundaries: Reported information should be complete in relation to the operational boundaries of the reporting organization, in other words, the range of entities for which the reporting organization gathers data. These boundaries should be selected with consideration of the economic, environmental, and social impacts of the organization. Such boundaries may be defined based on financial control, legal ownership, business relationships, and other considerations. The boundaries may vary according to the nature of the reported information. In some cases, the most appropriate boundaries for meeting the expectations outlined by other reporting principles may extend beyond traditional financial reporting boundaries.

Data governance: The oversight and overall management of the availability, usability, integrity and security of data used in an enterprise. The responsibilities for this data oversight are cascaded through the organization to ensure that there is accountability throughout the organization for improving the quality of data.

ESG information: [Information relating to] Environmental, Social and Governance factors [used] to evaluate companies and countries on how far advanced there are with sustainability. Once enough data has been acquired on these three metrics, they can be integrated into the investment process when deciding what equities or bonds to buy.³⁴

Evidence: refers to material that is needed to support management reporting and assurance.

External assurance: Assurance usually describes the methods and processes employed by an assurance provider to evaluate an organization’s public disclosures about its performance as well as underlying systems, data and processes against suitable criteria and standards in order to increase the credibility of public disclosure. External assurance is performed by a person from an organization independent of the company.

IFRS: International Financial Reporting Standards issued by the International Accounting Standards Board.

Glossary

Information: Refers to the processed, organized, structured or presented form of data, that is used as an output for decision-making.

Internal controls: Internal controls are the mechanisms, rules and procedures implemented by a company to ensure the integrity of financial and accounting information, promote accountability and ensure compliance with laws, regulations and contracts.

Limited assurance: Limited assurance engagement-An assurance engagement in which the practitioner reduces engagement risk to a level that is acceptable in the circumstances of the engagement but where that risk is greater than for a reasonable assurance engagement as the basis for expressing a conclusion in a form that conveys whether, based on the procedures performed and evidence obtained, a matter(s) has come to the practitioner's attention to cause the practitioner to believe the subject matter information is materially misstated. The nature, timing, and extent of procedures performed in a limited assurance engagement is limited compared with that necessary in a reasonable assurance engagement but is planned to obtain a level of assurance that is, in the practitioner's professional judgment, meaningful. To be meaningful, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the subject matter information to a degree that is clearly more than inconsequential.³⁵

Mainstream decision-making: Decision making processes is an integral part of modern management and is a continuous and indispensable component of managing any organization or business activities. Decisions are made to sustain the activities of all business activities and organizational functioning.

Maturity model: WBCSD's Assurance Maturity Model helps those who seek assurance services understand where they are, where they want to go and how they can generate value through continuous improvement. It helps reporters to assess the current stage of the internal control environment and navigate their assurance journey through three stages; responsive, enhanced and leveraged. The Model outlines potential value creation at each stage of the journey and includes recommendations for improving maturity.

Reasonable assurance: Reasonable assurance engagement-An assurance engagement in which the practitioner reduces engagement risk to an acceptably low level in the circumstances of the engagement as the basis for the practitioner's conclusion. The practitioner's conclusion is expressed in a form that conveys the practitioner's opinion on the outcome of the measurement or evaluation of the underlying subject matter against criteria.

Parent company: A company that has a controlling interest in another company, giving it control of its operations. Parent companies can be either hands-on or hands-off owners of its subsidiaries, depending on the amount of managerial control given to subsidiary managers.

Chart of accounts: This is a way of uniformly collecting and reporting data from all entities in the group. It sets minimum standards and boundaries for data collection.

Prepared-by-client List: Refers to schedules and other information that preparer provides prior to the commencement of the assurance process.

Three lines defense model: In the Three Lines of Defense Model, management control is the first line of defense in risk management, the various risk control and compliance oversight functions established by management are the second line of defense, and independent assurance is the third.

Service organization: A third-party organization (or segment of a third-party organization) that provides services to the user entities that are part of those entities' information systems relevant to financial reporting.

Standard operating procedure (SOP): Explains how and why each control should be performed and what the outcome/evidence of the control should be. SOPs will be found in the group ESG data manual.

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 - Subsidiaries are included 100%;
 - Joint operations (but not joint ventures) are included pro rata in proportion to ownership; and
 - Associates, joint ventures and other investments are not included.
 - In this way, it is secured the non-financial data is integrable with, for instance, the revenue, cost, assets and cash flow.
 - If the company wants to include data from operated entities, which are not to be included according to financial consolidation rules, this can happen in Scope 3 for GHG. This will also ensure the data boundaries are comparable across companies – see also CDSB (2014)
16. To follow IAS 17/IFRS 16 means (regardless of operator roles):
 - Consumption and emissions from owned and used assets must be included
 - Consumption and emissions from leased and used assets must be included
 - Consumption and emissions from owned assets leased out to others' use, must not be included
 - IFRS 16 also determines whether the lease truly is a lease – or it is sale of services. See also CDSB (2014)
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WBCSD is a global, CEO-led organization of over 200 leading businesses working together to accelerate the transition to a sustainable world. We help make our member companies more successful and sustainable by focusing on the maximum positive impact for shareholders, the environment and societies.

Our member companies come from all business sectors and all major economies, representing a combined revenue of more than USD \$8.5 trillion and 19 million employees. Our global network of almost 70 national business councils gives our members unparalleled reach across the globe. WBCSD is uniquely positioned to work with member companies along and across value chains to deliver impactful business solutions to the most challenging sustainability issues.

Together, we are the leading voice of business for sustainability: united by our vision of a world where more than 9 billion people are all living well and within the boundaries of our planet, by 2050.

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