How to Avoid Greenwashing in Corporate Sustainability Reporting

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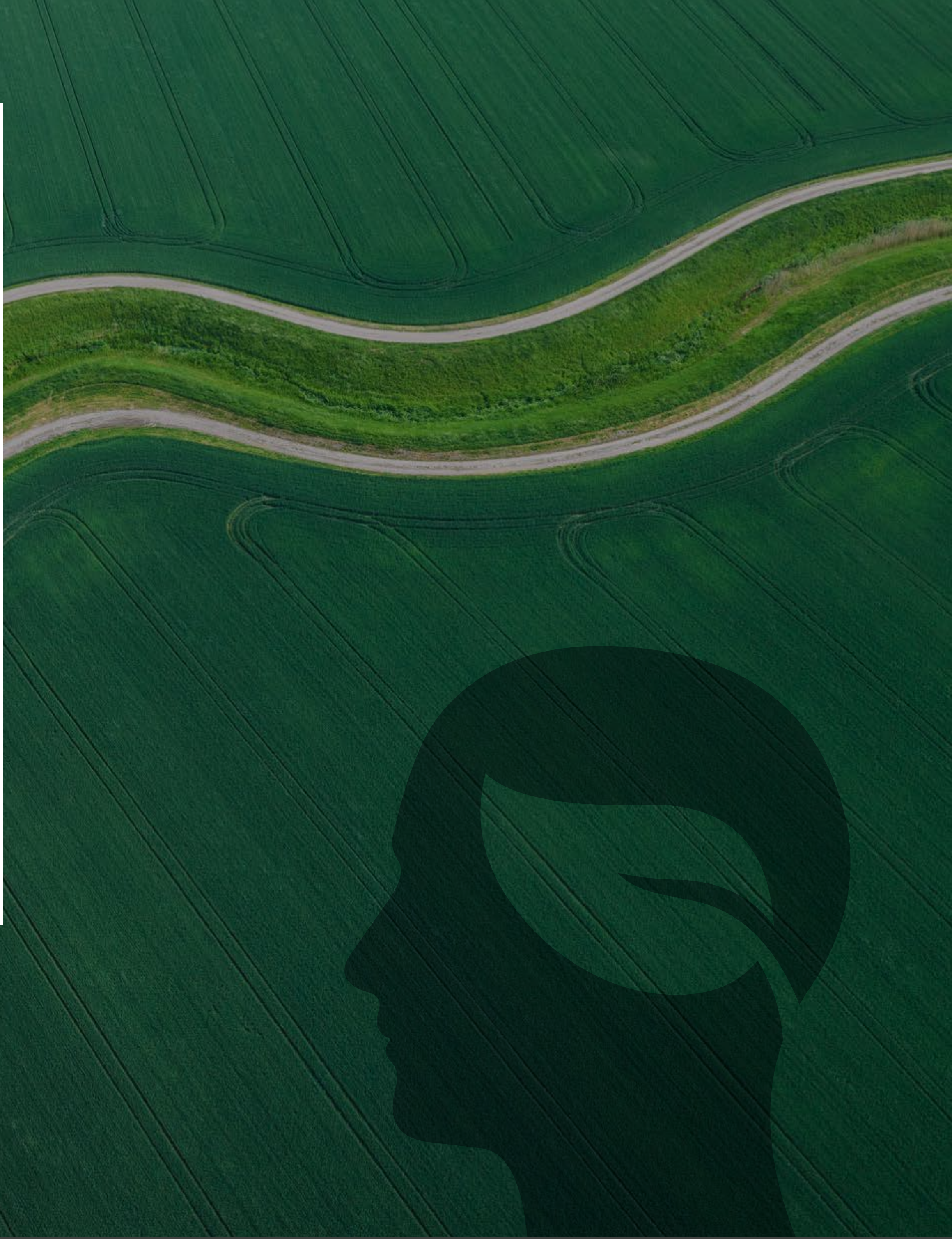
A nightmare scenario

A retail giant was in the news. Its brand reputation, revenues and potential for litigation were all at risk. Sustainability teams had invested time and resources into a new supply chain tracking system and were going to market with a "green" product line in their retail clothing stores. But soon after the rollout, they began hearing rumblings from environmental activists, then from the mainstream media.

The news headlines announced that the "green" clothes were no different from other clothes in the company's retail stores. They had the same carbon footprint, same use of water, same labor sourcing. Critics called it a clear case of greenwashing, accusing the company of breaking its brand promise. Soon even internal stakeholders started to agree.

The retailer cancelled their marketing campaign, unable to defend their green claims. Then they relabeled the entire clothing line. The fallout continues to unfold as the international retail brand contends with ongoing customer attrition, litigation and reputational damage.

These consequences could have – and should have – been easily prevented. Learn more below about how BDO suggests mitigating the risk of greenwashing.



What is greenwashing?

The Corporate Finance Institute says greenwashing is "when the management team within an organization makes false, unsubstantiated, or outright misleading statements or claims about the sustainability of a product or a service, or even about business operations more broadly."

GREENWASHING FALLS INTO FOUR GENERAL CATEGORIES:

Leaving out key information or context. For example, a company celebrates its diversity training while omitting data around DEI representation and efforts toward progress – demonstrating a lack of transparency around women and minorities in management and board roles.

Giving the wrong impression of status or progress. This might include pushing carbon-intensive operations down the supply chain to remove it from a company's direct responsibility. Not only is this misleading, it's going to come back around since companies are now expected to know their suppliers and report those emissions too.

Reporting data that isn't factual – even if it isn't intentional. In the early stages of an ESG strategy, estimations are necessary while tracking systems are being put into place. Internal teams may be tempted to take shortcuts to arrive at a metric, especially one that's favorable to the company.

When there's no standard to compare against. There are plenty of measurement frameworks, like the Global Reporting Initiative (GRI) or the Sustainable Accounting Standards Board (SASB). Using standard definitions and methodologies ensures consistency across companies and industries. It also gives an organization the ability to measure itself over time and against prior periods, avoiding the further pitfall of disclosing data that is favorable in one period and not disclosing it in another period when it is no longer favorable.

> *Companies need to be fair and balanced in their reporting, telling the whole story and sharing all materially relevant information based on external, accepted standards. Every company is on a journey and needs to inform stakeholders where they are. It's about progress, not perfection.*
>
> **CHRISTOPHER TOWER**
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How does greenwashing occur and what are the risks?

Some cases of greenwashing stem from inflated marketing claims. Certain terms such as natural, green, sustainable and eco-friendly aren't regulated, and products with environmental claims pepper the shelves of every supermarket, often **outselling mainstream products**.

Marketing claims can damage a company's social license to operate, but formal reporting and technical claims heighten the risk of greenwashing even more. Reporting on ESG and sustainability exposes companies to deeper scrutiny and criticism. Not every greenwashing accusation is credible and not every claim has a cascade of consequences. But when they do, companies struggle in three key areas:

- **Reputation:** Damaging the company's image and credibility. For many companies, their ability to generate revenue is tied to their brand equity – awareness, favorability and likeliness that customers will recommend the brand to others. That equity can take a big hit when a brand is associated with greenwashing. It damages the company's credibility and can erode its social license to operate.
- **Regulation:** The risk of actually breaking the law. Greenwashing can expose a company to government regulations at the state, national and international level. As ESG and sustainability become more important, the rules are evolving, and it can be hard to keep up with what's acceptable, both in the areas of ESG reporting and in the way banks and investment firms label ESG funds.
- **Regression:** A setback in a company's ESG momentum. Greenwashing claims can be a momentum-killer for proactive sustainability strategies within an organization. It's hard enough to obtain buy-in and alignment to share ESG goals, progress and stories. Greenwashing accusations can slow the progress of a company's sustainability strategy, sometimes setting teams back for months or years.

Organizations may be tempted to avoid any kind of proactive sharing. But there are too many **business benefits** to prioritizing ESG. And even if it's not a priority for you, it's likely to be a priority for your competitors.

Stakeholders are demanding corporate sustainability and responsibility too. Investors are using ESG factors in decision-making. Consumers want to know about the brands they buy. Employees want their employer to reflect their personal values. And regulators like the **U.S. SEC** and the **European Union** are actively codifying ESG reporting requirements into law.

How can greenwashing be prevented?

So how can companies maximize the benefits of ESG reporting for their stakeholders, while minimizing the perils of greenwashing claims?

Establishing internal controls for ESG data and reporting is essential. Every company should be doing so. Internal controls include systems, policies and processes that ensure the reliability of data and disclosures. They cover the full cycle of ESG data management, accumulation, evaluation and reporting. To do this right, you'll need to utilize cross-functional reviews, including the Office of the General Counsel, executive management, investor relations, the board or committee that oversees ESG, the Chief Financial Officer as well as the Disclosure Committee. Also, it's important to benchmark against the disclosures of competitors to see how you compare, as well as align with commonly used sustainability standards and disclosure requirements, including those that are industry-specific.

If you don't have the capabilities yourself, you might consider engaging external consultants. There are more and more service providers establishing their credentials in this area. If you do, be sure to understand their credentials and their ability to help you to:

- Establish an ESG strategy and program
- Improve ESG ratings
- Manage ESG risks and compliance
- Enhance their brand and drive new revenues
- Optimize costs to meet ESG targets
- Access sustainable financing and investing

Even with sound internal controls in place, third-party assurance – also known as attestation – is becoming a necessary safeguard to independently evaluate disclosures and thus mitigate greenwashing risk. Assurance is not new. It's been a necessary component of financial reporting for years. But now, there's a growing need for custom expertise around non-financial reporting too, applying the same rigor of assurance to ESG and sustainability reporting. Third-party assurance involves::

- Identifying the ESG factors that will be attested to – known as setting the scope.
- Assessing the design and effectiveness of the controls over the relevant data and disclosures.
- Performing procedures to assess the accuracy and completeness of these disclosures.
- Taking into consideration the disclosure requirements of the sustainability reporting frameworks the enterprise has elected to utilize.

Read more about **The Path to ESG Reporting and Attestation Readiness.**

Obtaining third-party assurance is not currently mandatory in the U.S. However, it may be very soon. In the U.S., SEC rules as currently proposed would require large accelerated filers to obtain third-party limited assurance in fiscal year 2024, with accelerated filers following in 2025. And in the EU, the European Corporate Sustainability Reporting Directive (CSRD) will require more than 50,000 European companies – and non-European companies with substantial activity in the European market – to obtain third-party limited assurance over sustainability metrics beginning in 2025. The BDO ESG Strategy and Services team will continue to monitor developments and share updates via our **ESG Center of Excellence site**.

> *More and more organizations are obtaining third-party attestation on their ESG reporting and disclosures. A verifiable third-party opinion gives both organizations and their stakeholders confidence around the integrity of their data and methodologies, and makes it easier to compare among peer groups.*
>
> **DAN HARRIS**
> ESG Assurance Strategy
> and Services Leader and Audit Partner

The journey toward transparent reporting

Consider a different scenario. Company X goes to market with a carbon-neutral product. They've used recycled materials. They have trimmed their carbon footprint and are purchasing offsets while they work towards zero emissions. They're using renewable energy and utilizing tax credits. It's a great story, a win for the entire organization and a point of pride for employees, investors, vendors and customers.

However, certain Company X leaders are hesitant to promote their sustainability actions, given the multiple variables and complex landscape. They know they aren't perfect, and some are afraid of backlash. So they engage assurance experts. Those experts inspect their ESG reporting for information that can be seen as an omission, misleading, inaccurate or non-comparable. They call out the fact that the company's tax contribution is lower because of the energy credits. They recommend disclosing the source of the offsets and data not only on their progress towards zero emissions, but on how far they have yet to go to reach their goals, and the key strategies that will get them there.

Ultimately, the company might be criticized for making slow progress. But they also get support from customers and employees who appreciate their transparency, and their commitment to the journey towards sustainability. They know which regulations to consider and build into their ESG framework. They know how to report progress in a fair and balanced manner. They have better key performance indicators, and a feedback loop on progress. And … most importantly … they have ESG disclosures they are proud of, and they can stand behind.

Do you have concerns about greenwashing and how to avoid it? Contact BDO's professionals in our ESG Center of Excellence to learn more.

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