IFS ESG Check

GUIDELINE

How to prepare the IFS ESG Check

ENGLISH

CONTENT

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INTRODUCTION

An organisation's performance is increasingly assessed not only to financial criteria but also based on its commitment to improve the sustainability circumstances linked to the products or services they provide. International guidelines and upcoming legislation set expectations for responsible business conduct and due diligence, ESG (economic, social and corporate governance) and non-financial reporting. At the same time, consumer awareness rises along with the tangible impact of climate change, the call for transparency and the result of initiatives like the United Nations Sustainable Development Goals and the targets set by the Paris Agreement.

Sustainability and human rights impacts are entering the domains of corporate risk management and compliance, tightening up sourcing requirements. On top of that, many companies are looking beyond compliance to create lasting positive impact for their stakeholders including society and to stand out from their competitors.

Looking at this from another perspective, there is also a risk of green-washing, when companies make themselves or their products appear more sustainable than they really are. For example, when companies communicate highly aspirational objectives that are not achievable. With sustainability gaining societal and business interest, it is becoming even more important to prevent these types of bad practices by building knowledge and the right competences within organisations.

MODULAR APPROACH

To support the increasing need for transparency and trust, and to support companies that want to flourish in their ESG journey, IFS has decided to develop a simple set of different modules – the IFS ESG Check – that organisations can use to become familiar with sustainability requirements. The IFS ESG Check is a voluntary tool based on verification of a self-assessment. The verification report reflects the ESG progress status of an organisation. The primary drivers of the IFS ESG Check are to create awareness and stimulate companies to grow in the field of ESG, thereby creating trust with their customers.

The requirements of the IFS ESG Check link to sustainability management system are geared to providing companies a consistent start in setting up a sustainability framework. For themselves, as well as for their customers and other stakeholders, this will give a solid insight into where they stand regarding implementation of sustainability, ESG and due diligence.

The IFS ESG Check is composed of several modules for different sustainability areas.

Within the context of sustainability management, the modules focus on how the company is dealing with measuring and mitigating the impact of their activities in the respective area.

The criteria of the IFS ESG Check can be assessed as an extra to annual IFS Certification audits and shall be performed onsite. Companies that are not IFS certified can also benefit from this new program.

The IFS ESG Check is expected to grow in the coming years with additional criteria and modules, such as food waste, water footprint, human rights, etc. For now, the only available modules are ESG Check and Carbon Footprint.

Finally, this guideline is intended to support companies that would like to voluntarily undergo the IFS ESG Check. They will find explanations about the structure of this check, the context and interpretation of the requirements, as well as practical examples of possible evidence.

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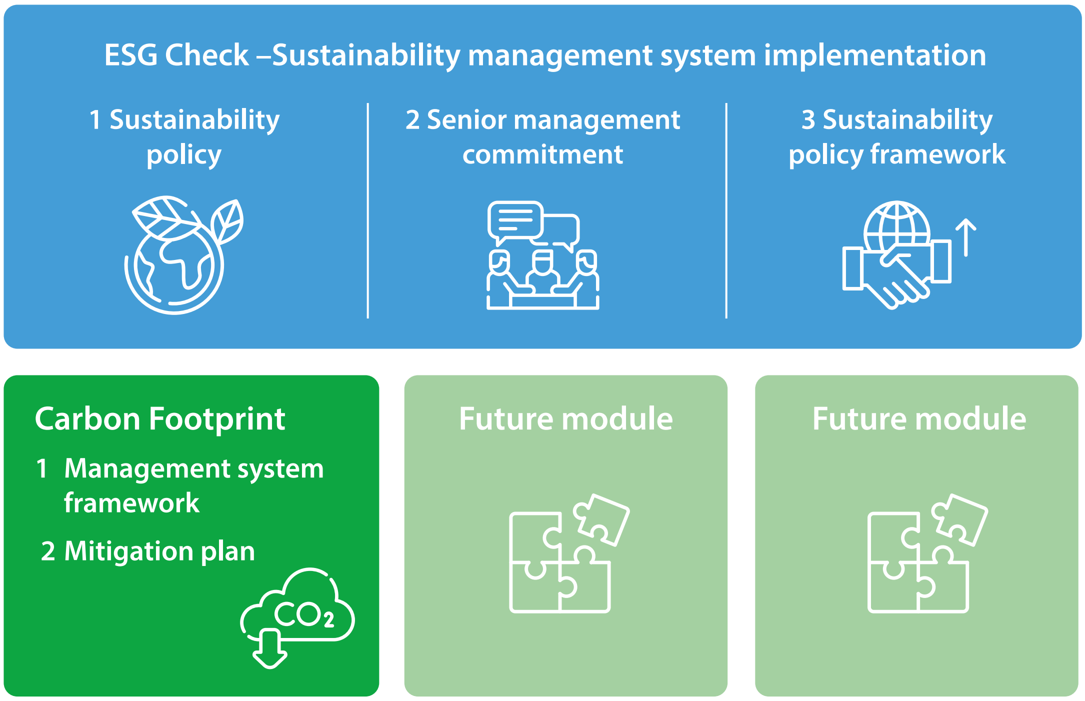
1 Requirements of the IFS ESG Check

The relationship between the IFS ESG Check and modules is visualized in the diagram below.



The basis of the IFS ESG Check is a set of general requirements that focus on the implementation of the sustainability management system in the organisation. The optional additional modules relate to specific sustainability impact areas that might be relevant for the organisation and its sustainability scope. The modules focus on setting scopes and goals and how mitigation strategies are implemented.

Presently, the Carbon Footprint module is available and can optionally be requested in combination with the IFS ESG Check. We expect to issue other modules, in areas such as food waste, water footprint, human rights, etc.

Requirements ESG Check

1. Sustainability policy

1.1 The company shall develop, implement and maintain a sustainability policy which shall include at a minimum the identification of the main relevant:

- Environmental, social and governance principles,
- Stakeholders (e.g. customers) concerns, if applicable.

1.2 The policy shall be reviewed annually or upon changes.

2. Senior management commitment

2.1 The senior management shall be fully committed to the achievement of a sustainability policy across the company and shall provide sufficient and relevant resources to make it possible.

2.2 The senior management shall set up goals, related measures and deadlines for implementation.

2.3 For any deviation detected to established measures, the senior management shall implement appropriate corrective actions.

2.4 The sustainability policy and framework shall be communicated to the employees and shall be broken down into specific goals and targets for the relevant departments.

2.5. The senior management shall ensure that a grievance mechanism is set up for the own business area and for the supply chain, that enables all stakeholders to report human rights and environment related risks and adverse impacts.

3. Sustainability policy framework

3.1 Responsible team/Sustainable team leader

3.1.1. There shall be a responsible team/sustainable team leader for the development and maintenance of the sustainability policy. Those responsible for the development and maintenance of the policy shall have received adequate training in the application of the ESG principles/sustainability topics. Where competent knowledge is not available, external expertise shall be obtained.

3.2. Identification and assessment of adverse impacts

3.2.1. The responsible team/sustainable team leader shall carry out a risk analysis to identify and prioritize adverse impacts that are most critical to the company. This analysis shall be reviewed annually or upon changes.

3.2.2. The responsible team/sustainable team leader shall make sure that measures to prevent and/or mitigate adverse impacts are planned and executed by the relevant departments.

3.3. Stakeholder communication

3.3.1. When required by the customer, the company shall update its customers about the progress made on identified goals.

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2 Implementation of a sustainability management system

The requirements of the ESG Check are built up in alignment with international guidelines and good practices with regard to sustainability management systems and due diligence processes. A number of relevant sources are included in Annex 2. Important references are the OECD Guidelines for Multinational Enterprises, the United Nations Guiding Principles on Business and Human rights, and the GRI Sustainability Reporting Standards.

The main recurring elements in international guidelines and legislation regarding corporate sustainability reporting and due diligence can be summarized in the diagram below.

These elements will be further explained and connected to the requirements in the ESG Check. Examples of evidence will be provided for each element to help support implementation of the system.

Sustainability policy (requirements 1.1 and 1.2)

WHAT DOES IT MEAN?

- The sustainability policy and/or policies on sub-areas encompass environmental, social/human rights and ethical issues related to the company's own business and supply chain. It is important that the policy includes all activities and stakeholders of the organisation.
- A policy is not only a written statement but has to be communicated in an effective way internally and externally to all relevant stakeholders, including employees and business partners.
- As part of policy implementation, it is important that long-term objectives and shorter-term goals and key performance indicators are set for the organisation and its units or departments.
- To remain valid as part of the management system and to improve the company's competitiveness, the policy should be regularly reviewed and updated. Reviews are to be informed by the outcomes of the annual materiality and risk assessments.

EVIDENCE

- Written policy statement(s), which should be easily and freely accessible via the internet.
- Records of communication of the policy statement to employees, e.g. as part of a newsletter, intranet, as part of the onboarding of new employees. The policy should be readily available for employees in multiple languages.
- Code of conduct for internal organisation, with records of communication to employees and available in multiple languages.
- Code of conduct for business partners/suppliers, with records of how the code is integrated into the agreements and tendering processes with suppliers (e.g. examples of supplier contracts or written commitments by suppliers to the code).
- Supplier requirements/sourcing conditions can also be reviewed as evidence of the communication of the policy to suppliers if no code of conduct has yet been set up.
- Updates/versions of the policy in the past years.
- Documents with information on the goals and KPI's set within the organisation related to the policy, e.g. strategy documents, performance updates/reports.

Governance and management (2.1 to 2.4, and 3.1.1)

WHAT DOES IT MEAN?

- For effective implementation of a sustainability management system and the sustainability policy, governance has to be in place. This relates to how the management of the impact on economy, environment and people is integrated into the organisation's strategy and operations. Good governance is the essential basis for an effective sustainability management system. It is also an important prerequisite for the prevention of bad practices like greenwashing. Greenwashing is the practice of making companies, brands and products appear more sustainable than they really are. This can vary from overly optimistic and insufficiently substantiated commitments, like unachievable carbon emissions reductions, to using no or unverified baseline data to measure improvement, or claiming a product is 'natural', 'healthy', or 'sustainable' without evidence or a benchmark.
- One of the main points for a strong governance is that the end responsibility to achieve the objectives and goals has to be allocated at senior management level. A lack of direct CEO involvement is widely regarded as an indicator that a company is not truly committed to sustainable development.
- Senior management sets out the goals and makes sure sufficient resources are allocated to the implementation of measures according to defined deadlines. Corrective actions are to be taken in case of deviations.
- Senior management has to be fully committed to the sustainability management system. The effectiveness of the sustainability policy can be substantially increased when non-financial metrics and targets relating to the sustainability policy are included in the compensation system of senior management. Thereby the company demonstrates the importance it adheres to responsible business conduct to its employees and external stakeholders.
- Roles and responsibilities within the organisation regarding the implementation of the sustainability policy must be clearly defined. This can either be done in the form of specific sustainability functions in the organisation or integrated in existing roles and organisational functions such as HR, operations, marketing/communication and procurement/sourcing. In smaller companies it is likely that the organisation starts either by appointing one lead person from an already existing role, for instance the quality manager, or to create a sustainability team, that combine the tasks with their existing functions.

- Employees have to be trained in the sustainability policy and what it means for their work, at a minimum those employees that are actively involved in the implementation of measures.
- There has to be a clear reporting relationship from the sustainability team/or lead to the senior management that has the end responsibility for the sustainability management system.

EVIDENCE

- Agendas and minutes of management reviews.
- Department/team goals and KPI's and records of review of progress, e.g. as part of team meetings or internal management reports.
- Job profiles and goals/targets of employees (including senior management) involved in the implementation of the sustainability policy, job appraisals.
- Attendance records of sustainability related training, training materials for different roles/departments.

Stakeholder involvement and reporting/ communication (3.3.1, 1.1, 3.2.1)

WHAT DOES IT MEAN?

- Stakeholders have a central role in sustainability management and due diligence processes. Not only customers and investors are important as stakeholders, the interpretation of 'stakeholder' is within the context of sustainability much broader and also includes: employees and their representative bodies, suppliers and their workers in the supply chain and their families, local communities (think of water use or water pollution by nearby industries, or land grabbing practices), the local environment of a company's operations and those of their suppliers and sub-suppliers (think of biodiversity loss by deforestation, soil degradation), and global environment (GHG emissions, climate change). The perspective and interests of all these potential stakeholders should be included throughout the sustainability and due diligence processes of an organisation: when defining the policy, when doing the risk analysis and defining the focus of the sustainability related efforts, when reporting on progress and results.
- Stakeholder communication is a very important element of a sustainability strategy, to demonstrate to stakeholders that what matters to them also matters to the organisation. This includes annual sustainability or due diligence reporting, but also informing stakeholders via public channels on a regular basis on objectives, goals and actions. Consumers can also be informed via the purchased products, for example via storytelling on the product packaging with information on where and how it was produced and how the brand contributes to improvement of the circumstances for both people and the planet.

EVIDENCE

- Records on stakeholder identification (internal and external) and regular review.
- Annual communication plan as part of the sustainability/due diligence processes.
- Easy-to-find information on the company website on sustainability policy and the actions that are taken to achieve the goals and targets. Regular updates on progress. Concrete examples of improvements and positive impact for stakeholders in the supply chain.
- Storytelling on products.
- Publication or internal records of stakeholder identification for the sustainability strategy and due diligence process.
- Formal annual sustainability/ESG, due diligence or non-financial report.

Identification and assessment of adverse impacts (3.2.1)

WHAT DOES IT MEAN?

- In the context of corporate ESG and non-financial reporting, the term 'materiality assessment' is commonly used to indicate the process of an organisation determining its main (i.e. material) impacts on economy, environment and people. Impacts are related to the nature of the company's activities and products, its supply chain and other business relationships. A materiality assessment is performed in consultation with representatives of the identified stakeholders. The result of the assessment is a short-list of topics that inform the company strategy and priorities. Knowledge about its main impacts should be the basis of the company's sustainability policy.
- In the context of due diligence, the assessment of impacts focuses on adverse impacts. This is often referred to as a risk analysis, risk being defined as a potential adverse impact on people, the environment, or animals. Part of potential adverse impacts of a company might be linked to their own operations and business area, for example bad living conditions for migrant workers that are employed in one of the distribution centers. However, especially for companies that produce or sell tangible goods, an important part of (potential) adverse impacts will be linked to the company's suppliers and their supply chains. For example, deforestation connected to the production of soy, coffee or other commodities, or pollution of local water sources by waste from a processing plant. Or severe health problems with workers that apply pesticides to the fields. Due diligence frameworks include a risk analysis process. The risk analysis helps to identify (potential) adverse impacts and to set priorities for the business strategy to prevent, mitigate and remediate those impacts.
- Prior or as part of the assessment of (potential) adverse impacts, it is necessary for the company to identify its stakeholders, and make sure they are involved in the process.
- Identification and assessment of (potential) adverse impacts has to be repeated regularly, in principle once a year or when aspects of the business change, such as adding a new product to the assortment or when considering other sourcing countries for an ingredient.
- The process and outcomes of identification and assessment of (potential) adverse impacts are disclosed and shared with stakeholders. Rationale has to be provided on why certain ESG issues or risks are either or not prioritized.

- For companies that have to set up a process for identification and assessment of (potential) adverse impacts, and who are looking for guidance and a starting point, there are several frameworks that offer information on material topics or risk areas that are likely to be relevant for certain sectors.[1]

EVIDENCE

- Information on the process of identification and assessment of (potential) adverse impacts by the company, the stakeholders involved and the outcomes. Examples: information on the corporate website, corporate newsletters or social media, information in the (annual) due diligence, sustainability or non-financial report.
- Internal records on the procedures and processes related to the identification and assessment of (potential) adverse impacts. How are stakeholders identified, are their interests taken into account during the assessment; what methodology is followed to assess the risks and impacts and to rank and prioritize these for measures and action; are all relevant sources of information taken into account such as the complaint system and supplier monitoring?
- A documented risk analysis that reflects the motivation of the prioritization of the risk profile. For example, why is a specific sourcing country identified as high risk on human rights? What is the source of this information? Are supply chain risks clearly mapped to where they can occur in the respective product or ingredient supply chain?
- An up-to-date overview of all direct suppliers and transparent supply chain data available from high-risk suppliers (see also next paragraph on tracking risk mitigation).
- Notes, minutes or recordings of internal and/or external stakeholder sessions organized as part of the process of identification and assessment of risks and impacts.

1 such as: GRI Material Topics (https://www.globalreporting.org/how-to-use-the-gri-standards/gri-standards-english-language) and Sector Standards (https://www.globalreporting.org/standards/sector-program), OECD (https://mneguidelines.oecd.org), MVO risk checker (https://www.mvorisicochecker.nl/en/start-check)

Mitigation strategy and continuous improvement (3.2.2, 2.2, 2.5)

WHAT DOES IT MEAN?

- Based on the identification and assessment of adverse impacts, a company will have to develop an effective mitigation strategy which targets the identified (potential) adverse impacts of the organisation. These impacts can be related to own operations as well as to the supply chain of the company. The measures and actions that are part of such a strategy can be of a preventive nature, or are more reactive and corrective, to minimize or remediate adverse impacts. Preventive actions are for instance the training of buyers, the inclusion of the company's code of conduct into supplier contracting procedures, and setting up control mechanisms for suppliers by using third party social compliance auditing standards.
- Examples of corrective (minimizing or remedial) actions are: start improvement programs with suppliers, reduce food waste or energy use within own operations, increase influence in specific sectors by joining up with other organisations in industry covenants, or offer remediation in cases such as instance harassment, child labor or pollution of water used by local communities. Calculating and reducing the carbon footprint of an organisation (and its supply chain) is also part of the mitigation plan.
- For many companies that produce or sell tangible goods, a major part of their due diligence and hence of their mitigation strategy will be focused on their supply chain. As a starting point for supply chain due diligence, a company has to know their direct suppliers and how these mitigate potential adverse impacts connected to the products that they supply to the company. If the risks identified are positioned deeper in the supply chain, for instance at the level of raw material production, it will be necessary to create, together with the direct supplier, further supply chain transparency to implement measures in indirect suppliers. The level of supply chain transparency required to map and mitigate the actual impacts related to specific products and their ingredients or components, has to be clearly explained as part of the assessment of adverse impacts and the mitigation strategy.
- The effectiveness of the mitigation strategy has to be monitored by tracking actions and their results with regard to the identified issues and risks. This will not only provide feedback for the recurring risk analysis; it will also enable senior management to measure progress against set goals, KPI's and metrics and to report this to stakeholders.
- Tracking progress and results also has to be implemented for strategies relating to suppliers and their supply chains. This means that the direct suppliers and – where needed

for monitoring identified risks – also indirect suppliers have to be known to the company, and relevant evidence on risk mitigation evidence is collected on a continuous basis.

- A sustainability or due diligence management system is in essence a cyclical process that works towards continuous improvement. In practice this means that actions that are taken to mitigate or prevent risks should result in an adjusted risk assessment for the next period. If mitigation actions are not implemented as planned or do not have the desired results, the (root) causes should be investigated and the organisation should carry out the necessary corrective actions to attain improvement.
- An important feedback mechanism especially for due diligence implementation are complaints. A grievance mechanism should be easily accessible to all stakeholders, including workers and communities in the supply chain of an organisation. It is part of the interaction with stakeholders and it provides information on possible violation of stakeholders' interests, so that the organisation can act on it. Complaints also provide useful input for the recurring risk assessment. For companies that are starting with implementing their sustainability management system it is recommended to first assess what complaint procedures are already in place.

EVIDENCE

- Records of action plans and specific measures that are implemented as a follow-up to risk analysis, including: what does the action entail and what (potential) adverse impact does it relate to, who is responsible, KPI's to monitor progress of implementation for the relevant teams and persons.
- Internal reports to senior management on progress and KPI's on the actions and measures.
- Records of systematic supplier/supply chain monitoring on client requirements related to the sustainability policy and risk assessment, to measure compliance and progress towards set goals and to be alerted to possible incidents and violations of stakeholders' rights. This can include mapping (part) of the supply chain per product or product group, collecting third-party audit reports and certificates, collecting quantitative data, e.g. on GHG emissions or water use, or living wage. Checks: are contents of audit reports analyzed to gather insights in the actual status of the ESG impacts? Do certificate standards sufficiently cover the identified risks for the specific product group?
- Complaint procedure(s) and whether these are publicly available. Checks: does the scope of the procedure include external stakeholders and supply chain, is confidentiality ensured, are reports of incidents fed back into the risk analysis.
- Records of complaints and concerns received via the complaint system.

3

ANNEXES

ANNEX 1
Terms and definitions

ESG
ESG stands for environmental, social and governance, which are the ESG principles for responsible investing. These principles refer to the practice of including non-financial impacts and sustainable development in the organisation's policies and strategies, and in the evaluation of the organisation by external stakeholders.

Impact
The effect an organisation has or could have on the economy, environment, and people, as a result of its activities or business relationships. These impacts indicate the organisation's contribution, negative or positive, to sustainable development (GRI 1: Foundation 2021).

Stakeholder
Individuals or groups that have interests that are affected or could be affected by an organisation's activities. Examples of stakeholders: employees, suppliers, non-governmental organisations, workers in the supply chain, local communities and local governments, shareholders. Also the environment and ecosystems can be seen as possible stakeholders.

Materiality assessment
An organisation, engaging its stakeholders, identifies and prioritises those topics that reflect its most significant (material) impacts on the economy, environment, and people. Examples of material topics are: consumer safety, water and effluents, greenhouse gas emissions, human rights in the supply chain. Material topics inform an organisation's sustainability policy and strategy, and corporate reporting.

Due diligence
The process through which enterprises can identify, prevent, mitigate and account for how they address their actual and potential adverse impacts as an integral part of business decision-making and risk management systems (OECD, 2011).

Risk analysis
Due diligence includes a recurring risk analysis to identify potential adverse impacts for stakeholders related to own business operations and the supply chain. Potential adverse impacts are prioritised to enable the organisation to address and act on the impacts, by a mitigation strategy.

ANNEX 2
References and sources

- **OECD Guidelines for Multinational Enterprises (2011)**
  https://www.oecd.org/daf/inv/mne/48004323.pdf

- **OECD Due Diligence Guidance for Responsible Business Conduct (2018)**
  https://www.oecd.org/investment/due-diligence-guidance-for-responsible-business-conduct.htm

- **UN Guiding Principles on Business and Human Rights (2011)**
  https://www.ohchr.org/sites/default/files/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

- **The Corporate Responsibility to Respect Human Rights. An Interpretative Guide (2012)**
  https://www.ohchr.org/sites/default/files/Documents/Publications/HR.PUB.12.2_En.pdf

- **UN Guiding Principles Reporting Framework (2015)**
  https://www.ungpreporting.org/wp-content/uploads/UNGPReportingFramework_2017.pdf

- **ISO 26000:2010 Guidance on social responsibility**
  https://www.iso.org/iso-26000-social-responsibility.html

- **GRI Sustainability Reporting Standards of the Global Sustainability Standards Board**
  https://www.globalreporting.org/standards/download-the-standards/

- **Lieferkettensorgfaltspflichtengesetz (2021)**
  German: https://www.bgbl.de/xaver/bgbl/start.xav?startbk=Bundesanzeiger_BGBl&jumpTo=bgbl121s2959.pdf#__bgbl__%2F%2F*%5B%40attr_id%3D%27bgbl121s2959.pdf%27%5D__1650913057433

  English: https://www.bmas.de/SharedDocs/Downloads/DE/Internationales/act-corporate-due-diligence-obligations-supply-chains.pdf%3bjsessionid=CD0566A73AB32BD8B75B2154D5F226AF.delivery1-replication?__blob=publicationFile&v=2

- **EU Commission's proposal for a Corporate Sustainability Reporting Directive (2021)**
  https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0189

- **EU Commission's proposal for a Corporate Sustainability Due Diligence Directive (2022)**
  https://ec.europa.eu/info/sites/default/files/1_1_183885_prop_dir_susta_en.pdf

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