

ESG IN THE INVESTMENT CYCLE: GUIDANCE



Types of Specialist E&S Assessments and Reports

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CDC GUIDANCE: TYPES OF SPECIALIST E&S ASSESSMENTS AND REPORTS

1. OVERVIEW

Fund managers may need to commission or review specialist assessments on environmental and social (E&S) matters to inform pre-investment appraisal, or during the ownership and monitoring phase to assess a company's ongoing management of specific risks, impacts or opportunities.

Main types of specialist E&S assessments and reports:

- Environmental and social due diligence (ESDD)/Environmental and social audit (E&S Audit).
- Full Environmental and Social Impact Assessment (ESIA).
- Limited or focused E&S assessments.

The following [table](#) summarises:

- What each type of study covers.
- Why it is useful.
- When it is usually commissioned.

A full explanation of each type is provided below.

See also [CDC Guidance: Working with Consultants](#).

CDC GUIDANCE: TYPES OF SPECIALIST E&S ASSESSMENTS AND REPORTS

TYPE OF SPECIALIST ESG INVESTIGATION	WHO COMMISSIONS IT?	WHO DOES IT?	WHEN IS IT TYPICALLY REQUIRED?	WHAT DOES IT COVER?	WHEN IS IT TYPICALLY COMMISSIONED?	WHY WOULD THE FUND MANAGER FIND IT USEFUL?
<p>ENVIRONMENTAL AND SOCIAL DUE DILIGENCE (ESDD) / ENVIRONMENTAL OR SOCIAL AUDITS (E&S AUDITS)</p>	<p>Fund manager (for ESDD or on specific issue); or company (certification or prior to merger or acquisition)</p>	<p>External expert, certification body or in-house E&S specialists.</p>	<p>To inform an investment decision. To check progress or change in status since previous audit, or against action plans. To obtain independent certification standards such as ISO, OHSAS, SA 8000 and RSPO.</p>	<p>ESDD identifies and prioritises gaps to investor standards specified in DD scope as well as identifies E&S opportunities for improvement. ESDD can look at management systems and approaches or processes. Audits include: energy efficiency audits, legal compliance audits, labour audits, cleaner production audits, or audits to specific standards which result in certification e.g. ISO 14001 or Forest Stewardship Council (FSC).</p>	<p>Pre-acquisition. Ownership and monitoring. A prerequisite for certification/accreditation.</p>	<p>Important as a means to assess risks and compliance of management systems or specific activities with applicable requirements. Also to investigate methods for promoting improved efficiency and production. Resulting Environmental and Social Action plans (ESAP) for addressing gaps can allow an investor to structure conditions precedent (CPs) to investment for significant compliance breaches as well as conditions subsequent to improve E&S performance over time.</p>
<p>ESIA: ENVIRONMENTAL AND SOCIAL IMPACT ASSESSMENT</p>	<p>Company</p>	<p>Typically a team of independent E&S experts/ consultants. Occasionally, some companies (e.g. mining or oil & gas) will have an in-house ESIA team.</p>	<p>All 'High' risk (or Category A) and, as appropriate, 'Medium' risk (Category B) Projects (e.g. greenfield Projects and large-scale expansions). Usually a requirement under host country environmental regulations for new developments before planning permission, operating permit or equivalent is given.</p>	<p>An in-depth study to establish a baseline and assess the potential E&S risks and impacts (positive and negative) of a new Project or expansion.</p>	<p>Should be conducted prior to construction or expansion.</p>	<p>Provides important information on key risks and impacts and measures to address them (forms basis of environmental and social management plan for the Project). When investing in a Project, fund managers need to determine whether an ESIA is adequate (i.e. has it been completed to the applicable requirements of the fund e.g. IFC Performance Standards), or whether supplementary work is needed (e.g. a gap analysis against fund requirements) to meet E&S requirements.</p>

CDC GUIDANCE: TYPES OF SPECIALIST E&S ASSESSMENTS AND REPORTS

TYPE OF SPECIALIST ESG INVESTIGATION

WHO COMMISSIONS IT?

WHO DOES IT?

WHEN IS IT TYPICALLY REQUIRED?

WHAT DOES IT COVER?

WHEN IS IT TYPICALLY COMMISSIONED?

WHY WOULD THE FUND MANAGER FIND IT USEFUL?

LIMITED OR FOCUSED ENVIRONMENTAL AND SOCIAL ASSESSMENTS

Company

Typically a team of independent E&S experts/consultants.
Occasionally, some companies (e.g. mining or oil & gas) will have an in-house ESIA team.

As necessary but typically 'Medium' risk (Category B) Projects (e.g. brownfield developments and medium or small expansions).

A focused study to assess specific potential E&S risks and impacts (positive and negative) of a new Project or expansion
The scope of the assessment is determined by the nature, location and magnitude of the risk or impact.
Examples of limited or focused assessments include air pollutant emissions and air quality impact studies, noise and vibration studies, water resources impact studies, contamination investigations and assessments, traffic studies along transport corridors, community needs assessment and/or development plans.

Typically, prior to construction or expansion.

Provides important information on specific risks and impacts and measures to address them.
Potentially fills gaps in information not covered by other studies or procedures.
Gives comfort to fund manager on scale, scope and management of key risks and impacts.
May result in revisions to environmental and social management plan (or result in an ESAP with additional requirements for the company).

2. ENVIRONMENTAL AND SOCIAL DUE DILIGENCE/ENVIRONMENTAL AND SOCIAL AUDITS

2.1 What is it?

Environmental and social due diligence (ESDD) and E&S Audits are evaluations undertaken to assess compliance with a specific set of requirements/standards ('standards') as determined by the scope of the ESDD/E&S Audit. These are the assessments typically conducted/commissioned by fund managers.

ESDD is carried out to ensure that a proposed investment does not carry E&S risks which could present a potential liability (including reputational risk) to the investor. ESDD, in the case of private equity funds, typically assesses:

- Key E&S risks and impacts in existing operations (particularly audit) or, in some cases, risks linked to greenfield Projects. Audits are typically conducted to assess risks & impacts in existing operations.
- Areas of non-conformity/gaps with the IFC Performance Standards and actions to address these gaps.
- Whether certain industry-specific environmental, social and/or occupational, health and safety standards are being achieved (legal or voluntary).

Examples of E&S Audits include those to confirm:

- Whether certification can be awarded or retained (e.g. for Fairtrade, sustainable forestry, ISO 14001).
- The root cause of an accident or incident, and what can be done to prevent recurrence.
- The effectiveness of the existing management system as part of a post-investment monitoring review.

In particular, ESDD/E&S Audits can be useful in establishing a starting point for the implementation of corrective actions and identifying how a company's E&S management system (ESMS) might need to be strengthened going forward. In the case of private equity funds, ESDDs/E&S Audits are more frequently conducted to review the status of an existing operation and compare it against good international industry practice or against new or additional standards.

E&S Audits differ from focused E&S assessments in that the latter principally investigate E&S risks and impacts arising from a greenfield Project or from one specific aspect of the existing business (e.g. air emissions or effluent), whereas the former assess overall compliance with certain standards. An E&S Audit will review the practices and performance of an operation at a particular point in time.

The main difference between an ESDD and an ESIA or a limited E&S assessment is that with an ESDD (even when conducted for a greenfield Project (less frequent in the case of fund managers)), the main purpose is to inform investors about the risks and impacts which could affect their investment, whereas an ESIA or a limited E&S assessment focuses on assessing E&S risks and impacts without taking into account risks for investors.

2.2 When is an audit typically commissioned and who commissions it?

ESDD/E&S Audits are generally commissioned in response to an investment-specific ESG concern or opportunity (as noted above).

ESDD/E&S Audits are commissioned by the fund manager when:

- It wishes to assess or independently verify an existing company's performance and/or management system against its own ESG requirements prior to investment (ESDD).
- It wishes to verify that certain industry-specific environmental and/or social or health and safety standards are being met.
- It requires independent evaluation of an accident or incident at a company, and recommendations for improvement of systems and practices are required to prevent the incident from occurring again.

ESDD/E&S Audits are commissioned by the company when:

- It plans to acquire a new company or asset and wishes to assess how closely aligned the target is with its own practices and performance (i.e. to check for suspected or possible environmental or social liabilities or impairments, or to assess how far or closely aligned the target is from the acquiring company in terms of ESG management and performance).
- It wishes to assess or independently verify current ESMS performance as compared to previous performance.
- It is working towards, or intending to obtain, certification by an independent body.

2.3 What does it cover?

The terms of reference (ToRs) of E&S Audits can be flexible according to the type and aim of the audit (e.g. pre-investment or certification).

All E&S Audits/ESDD should include:

- **Scope:** Describe the scope of the ESDD/E&S Audit.
- **Limitations:** Where the ESDD/E&S Audit has limitations, these should be incorporated.
- **Process:** Summary of the process which was followed (e.g. documentation review and site visits).
- **Identify risks:** Describe E&S risks which could present a potential liability (including reputational risk) to the investor or materially impact the valuation.
- **Describe key findings/issues/gaps against applicable standards:** Especially explain the main environmental and social issues associated with the asset (e.g. air emissions, wastewater effluents, hazardous waste generated, historical pollution and contaminated sites, land acquisition issues, occupational health and safety, public/community safety, labour management and standards, impacts on cultural resources, internal and external grievances, disputes).
- **Materiality of the findings:** Provide information on the materiality of each of the findings (i.e. how can each of the findings affect the company and/or the fund manager's investment).
- **Remediation measures:** Describe the remediation actions to be implemented to address the gaps.
- **Opportunities:** Consider and identify improvement opportunities, e.g. energy efficiency, cleaner technologies, water use reduction, emission reduction, safer working conditions,

community development programs.

2.4 What to look for in an ESDD/E&S Audit

- **Scope and limitations:** Does the ESDD/E&S Audit cover the facilities, activities and aspects that should be assessed/audited? Are there any material limitations which could significantly reduce the relevance/adequacy of the ESDD/E&S Audit?
- **Expertise:** Was it completed by a sufficiently qualified team? (Check for qualifications and any accreditation, experience, international and local expertise. Look specifically for experience in the issue or activity being evaluated and expertise in the applicable standards. Where **certification** is being sought, the auditor should be registered with a reputable international body).
- **Requirements/reference framework:** Does the ESDD/E&S Audit clearly state its scope and aim (i.e. to assess alignment of a potential target with the acquiring company's expectations, or with those of the fund manager)? The audit should include a clear and concise description of the requirements of the applicable standards.
- **Analysis/assessment against applicable standards:** Does the audit adequately investigate current practices and performance compared to the required standards (e.g. IFC Performance Standards, past practice or industry standard)? Does the audit gather the necessary data in areas where there are specific risks in a particular company (for example - accident statistics, effluent data, wages paid, hours worked)?
- **Findings/next steps/ESAP:** Are gaps against applicable standards clearly identified (along with magnitude/scale/potential and actual impact)? Does the audit assess management and mitigation measures and identify additional corrective actions required to ensure compliance?

3. ENVIRONMENTAL AND SOCIAL IMPACT ASSESSMENT

3.1 What is it?

An Environmental and Social Impact Assessment (ESIA) is an **in-depth study by technical specialists** to establish the E&S baseline prior to development, and assess the potential negative and positive impacts of a new Project or expansion on the baseline, including (where necessary) measures to avoid, minimise, mitigate or offset negative impacts.

3.2 When is it typically required?

- **Legal requirement:** ESIA's are usually a requirement under host country environmental legislation before planning permission or operating permits are approved. Most emerging market countries' environmental legislation includes a schedule of the types of Projects or activities for which ESIA's would be required and the typical information to be included in such studies.
- **Financial institutions:** Development Finance Institutions (DFIs) and Equator Principles Finance Institutions (EPFIs) require an IFC Performance Standard compliant ESIA for all Category A ('High' risks/impacts), and, as appropriate, Category B ('Medium' risks/impacts) Projects.

3.3 When is it typically commissioned, and who commissions them?

An ESIA is usually completed prior to financial close for a Project. An ESIA is commissioned by the Project sponsor.

3.4 What is the fund manager's role?

ESIA's are the responsibility of the company/Project sponsor. The fund manager's role is to:

- Ensure the ESIA's are completed by competent experts and to the appropriate methodology and standards. The ESIA must conform to the requirements of the host country's environmental assessment laws and regulations, including the relevant disclosure of information and public consultation requirements, and should be developed following principles of good international industry practice (e.g. IFC Performance Standards) and the requirements of the fund's ESMS. In certain cases the fund manager might commission an external expert to review the ESIA, check that it meets the applicable standards, and, where necessary, conduct a supplemental investigation to cover any areas not adequately addressed by the original study.
- Review the results and analyse what they mean for the fund's proposed investment. For example, the cost of mitigation measures and the ability to add value. Again, the fund manager might commission an external expert to review the ESIA and assist in determining headline issues or conditions precedent.

3.5 What does it cover?

The breadth, depth and type of analysis should be proportionate to the nature and scale of the proposed operations' potential impacts as identified during the course of the assessment process.

An ESIA should be undertaken by an experienced team of professionals and should include extensive site work. Key elements are:

- **Scope:** Initial scoping of the E&S risks and impacts associated with the Project.
- **Limitations:** Where the ESDD/E&S Audit has limitations, these should be incorporated.
- **Analysis of alternatives:** Examination of alternatives to the proposed Project site, technology, design, and operation in terms of their potential E&S impacts and the feasibility of mitigating these impacts. This should include the 'do nothing' option.
- **Affected Communities/area of influence:** Identification of stakeholders (focusing on those directly affected) and existing receptors and sources of impact. Describe the E&S conditions in the Projects' area of influence, which will serve as the baseline for impact assessment.
- **Impact assessment:** Assess both positive and negative environmental impacts in terms of magnitude, significance, reversibility, extent and duration. The possibility for cumulative impacts should also be considered. (For further information refer [to IFC Good Practice Handbook - Cumulative Impact Assessment and Management: Guidance for Private Sector in Emerging Markets](#)). Quantitative data should be employed to the extent possible, and opportunities for E&S enhancement should be identified. E&S impacts should be assessed for relevant phases of the Project such as: construction, operation and maintenance, and decommissioning.
- **Mitigation/management measures:** Identify technically and financially feasible measures to prevent or minimise E&S impacts to acceptable levels. Also outline measures to enhance positive E&S aspects within the Project's area of influence.
- **Assessment of residual impacts:** Assess the nature and significance of any residual E&S impacts (after mitigation). Proposed contingency planning measures (i.e. emergency planning) should be described and their adequacy evaluated.
- **Documented assessment process:** Documentation of the assessment process (i.e. the ESIA report) and an environmental and social management plan (ESMP) should be established with clearly stated outcomes or targets, timeframes, responsibilities and resources required.

3.6 What to look for in an ESIA

In reviewing the ESIA the fund manager should consider the following:

- **Scope and limitations:** Does it adequately consider the scope of the operations in terms of phase of development, timescale, physical footprint, associated facilities and up/downstream activities? Are both environmental and social impacts assessed? Are there any significant limitations which could affect the relevance of the assessment?
- **Area of influence/Affected Communities:** Were the areas of influence and the Affected Communities properly identified?
- **Expertise:** Was it completed by a sufficiently qualified team? (Check for qualifications and any accreditation, experience, international and local expertise).
- **Assessment process:** Was the assessment process properly designed and followed?
- **Standards:** To what standards has the ESIA been completed (national standards, IFC Performance Standards and applicable WBG EHS Guidelines. Are these sufficient for the fund manager's requirements?)
- **Management plan:** Does it include a mitigation and management plan that details specific actions, timelines, actual resources required? For example, 'improve emissions quality' is not specific enough.

3.7 Plans generated through an ESIA

Where a Project involves significant environmental and/or social risks a standalone assessment may be required, as well as a detailed management or action plan for managing such complex processes:

Resettlement Action Plan (RAP):

- Prepared by an external independent expert as part of the ESIA, or, where full ESIA's are not required, prepared as a limited E&S assessment for expansion activities.
- Commissioned by the investee company to address the implications of physical or economic displacement of host communities.
- Includes an assessment of baseline conditions, community mapping, and the extent of physical or economic displacement, resulting in a plan to avoid, minimise or compensate any displacement according to requirements of [IFC Performance Standard 5](#).

Biodiversity Management Plan (BMP):

- Prepared by an independent expert as part of the ESIA, or as a limited E&S assessment for expansion activities where full ESIA's are not required.
- Addresses the implications of the company's activity in relation to biodiversity considerations and residual impacts that cannot be mitigated.
- Includes an assessment of baseline conditions, biodiversity mapping and the extent of potential biodiversity loss, resulting in a plan to avoid, reduce/minimise or offset any biodiversity loss according to requirements of [IFC Performance Standard 6](#).

Stakeholder engagement plan:

- All credible ESIA's should include a stakeholder engagement plan or public consultation and disclosure plan.
- Outlines the process for engaging with Affected Communities and other interested parties around new developments, activities or expansions of a business and offers opportunities to collect their input and document any concerns. For further information refer to [Doing Better Business Through Effective Public Consultation and Disclosure: A Good Practice Manual as a guide](#).
- Specific attention and a management plan may be required if the Project has or is likely to have impacts in relation to Indigenous Peoples (IPs). See [IFC Performance Standard 7](#).

4. ENVIRONMENTAL AND SOCIAL IMPACT ASSESSMENT

4.1 What is it?

A limited or focused assessment has a narrower scope and/or higher level of assessment when compared to a full ESIA. A limited or focused assessment is required in situations where companies or activities to be financed consist of specific activities with potentially limited adverse environmental and social risks and/or impacts, and therefore the development of a full-scale ESIA is not required by the host country's environmental assessment laws and regulations or by applicable international standards.

4.2 When is it typically required?

The circumstances in which these studies are required may include:

- Modernisation and upgrade of existing production facilities that do not involve major expansions or transformations.
- Real estate Projects in urban areas and/or developed areas where the associated infrastructure is already in place (e.g. power, water, sewage).
- Development of social infrastructure such as health and education facilities with specific potential environmental and social (including labour, health, safety and security) risks and/or impacts identified during screening and scoping.

4.3 When is it typically commissioned, and who commissions it?

Focused E&S assessments are usually completed prior to financial close for a Project, where there is maximum chance to influence Project design. Focused E&S assessments are commissioned by the Project sponsor.

4.4 What might the scope be?

Examples of focused assessments include:

- Air pollutant emissions and air quality impact studies.
- Noise and vibration studies.
- Water resources impact studies.
- Contamination investigations and assessments (useful for greenfield Projects on newly acquired land, or businesses targeted for potential acquisition in a company's growth plan).
- Traffic studies along transport corridors.
- Social baselines.
- Resettlement evaluations.

4.5 What does it cover?

The approach and focus of the study will be determined by the issue(s) being investigated, which should be clearly specified. The study should be proportionate to the nature and scale of the E&S impacts associated with the Project. The assessment(s) should be undertaken by experts in the particular issue.

4.6 What to look for in a limited/focused assessment

In reviewing the ESIA, the fund manager should consider the following:

- **Scope and limitations:** Does it adequately consider the scope of the operations in terms of the issue or activity being investigated, the status of existing operations or practices, timescale, physical footprint and up/down-stream activities? Are there any significant limitations which could affect the relevance of the assessment?
- **Expertise:** Was it completed by a sufficiently qualified team? (Check for qualifications and any accreditation, experience, international and local expertise. Look specifically for experience in the issue or activity being evaluated).
- **Standards:** To what standards has the limited or focused assessment been completed (e.g. national standards, IFC Performance Standards and applicable World Bank Group EHS Guidelines, best practice standards for the sector)? Are these sufficient for the fund manager's requirements?
- **Assessment process/data points:** Was the assessment process properly designed and followed? Does the assessment include data points that are relevant to the specific issues being investigated (accident statistics, effluent data, lowest wage paid, longest hours worked) which can verify the current status and be used as benchmarks for improvements where action is required? If not, is that because the company does not record the data, or because the consultant did not gather it?
- **Management plan(s):** Does it include a mitigation and management plan that details specific actions, timelines, actual resources required? For example, 'implement ongoing monitoring' is not specific enough.
- **Project phase:** Does it adequately consider and compare risks and impacts before and after the activity or issue being investigated?