

Part 30 of 32

## ESG in Private Capital: Reporting Requirements, LP Expectations, and Financial Integration

LP reporting expectations, the major ESG frameworks, financial integration of ESG metrics into management reporting and governance, ESG in M&A due diligence, and the CFO's ESG financial infrastructure

## WHAT YOU WILL LEARN AND WHY IT MATTERS

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Environmental, Social, and Governance (ESG) considerations have moved from the periphery of private capital financial management to its center over the past decade. Institutional limited partners — the pension funds, endowments, and sovereign wealth funds that provide the capital for PE and venture funds — have adopted ESG policies that require their managers to assess, report on, and increasingly manage the ESG dimensions of their portfolio companies. PE funds have responded by incorporating ESG assessments into their investment processes and by requiring portfolio companies to measure and report on ESG metrics alongside their financial performance.

For the CFO of a private capital-backed company, the ESG requirements create new financial governance obligations: the measurement and reporting of ESG metrics, the integration of ESG considerations into the financial decision-making process, the ESG due diligence support in M&A transactions, and the financial modeling of ESG-related risks and opportunities. Understanding these obligations and building the ESG financial infrastructure in advance of the LP's reporting deadline is the preparation discipline that distinguishes the proactively managed from the reactively compliant.

## LP ESG REPORTING EXPECTATIONS

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Limited partners' ESG reporting requirements vary significantly by LP type, geography, and fund vintage. The most demanding LP reporting requirements come from European institutional investors — particularly Scandinavian pension funds and Dutch institutional investors — who have adopted the EU Sustainable Finance Disclosure Regulation (SFDR) and who require their fund managers to provide detailed ESG data on every portfolio company. Less demanding but still significant requirements come from US institutional investors, particularly university endowments and public pension funds, who typically require the fund manager to complete an annual ESG questionnaire and to report on portfolio-level ESG metrics.

**THE ILPA ESG REPORTING TEMPLATE:** The Institutional Limited Partners Association (ILPA) has published an ESG data convergence initiative framework — a standardized set of ESG metrics designed to create consistency in the ESG data reported by PE portfolio companies to their fund managers and ultimately to LPs. The ILPA framework covers six primary ESG metrics: Scope 1 and Scope 2 greenhouse gas emissions, total energy consumption, total water consumption, total waste generated, the diversity of the company's workforce (gender and racial/ethnic diversity at the leadership and total workforce level), and the number of work-related injuries. For PE-backed companies whose fund managers are signatories to the ILPA ESG Data Convergence Initiative, the CFO must establish the measurement processes and the data collection infrastructure required to report on these metrics annually.

**THE REPORTING TIMELINE:** Most LP ESG reporting requirements follow an annual cycle aligned with the fund's annual reporting calendar — the ESG data is typically due within sixty to ninety days of the fiscal year-end, alongside the annual audited financial statements. The CFO must ensure that the ESG data collection process is integrated into the annual close calendar so that the ESG metrics are available on the same timeline as the financial metrics.

## ESG FRAMEWORKS: SASB, GRI, AND TCFD

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Three frameworks dominate the ESG reporting landscape for private capital-backed companies: the Sustainability Accounting Standards Board (SASB) standards, the Global Reporting Initiative (GRI) standards, and the Task Force on Climate-related Financial Disclosures (TCFD) recommendations. Each framework has a different focus, a different level of industry specificity, and a different reporting format, and the CFO must understand the differences to design the ESG reporting framework that most efficiently satisfies the company's LP obligations.

**SASB STANDARDS:** The SASB standards provide industry-specific ESG disclosure guidance — a different set of metrics for each of seventy-seven industries, designed to identify the ESG topics that are most financially material for that specific industry. A technology company's SASB metrics focus on data security and privacy, employee diversity, and energy consumption in data centers; a manufacturing company's SASB metrics focus on greenhouse gas emissions, occupational health and safety, and supply chain management. The industry-specific focus of SASB makes it the framework most aligned with the financial materiality principle — the idea that companies should report on the ESG topics that are most likely to affect financial performance.

**TCFD RECOMMENDATIONS:** The TCFD framework focuses specifically on climate-related financial risks and opportunities, requiring companies to disclose how climate-related risks (physical risks from climate change and transition risks from the move to a low-carbon economy) affect their business strategy, financial planning, and risk management. The TCFD recommendations have been adopted as mandatory disclosure requirements in the UK and are moving toward mandatory adoption in the US, EU, and other major economies. For PE-backed companies in carbon-intensive industries, the TCFD analysis may reveal material financial risks that affect the company's valuation and that must be addressed in the value creation plan.

**THE INTEGRATED REPORTING APPROACH:** Rather than choosing a single ESG framework, most sophisticated private capital-backed companies use an integrated approach: the SASB standards to identify the financially material ESG topics for their industry, the GRI standards to report on the full range of ESG impacts, and the TCFD recommendations to disclose climate-related financial risks and opportunities. The CFO should design the ESG reporting infrastructure to produce the data required for all three frameworks simultaneously, rather than running separate reporting processes for each framework.

## ESG FINANCIAL INTEGRATION

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Beyond the external ESG reporting obligations to LPs and other stakeholders, the most sophisticated PE sponsors are integrating ESG metrics into the financial management and governance of their portfolio companies — treating ESG performance as a financial management variable rather than a compliance obligation. This integration creates specific financial governance responsibilities for the CFO.

**THE ESG KPI INTEGRATION:** The ESG KPIs — greenhouse gas emissions per dollar of revenue, water consumption per unit of production, employee injury rate, gender diversity at the leadership level — should be integrated into the company's monthly operational dashboard alongside the financial KPIs. This integration ensures that the management team tracks ESG performance with the same frequency and visibility as financial performance, and it provides the data required for the annual LP ESG report without requiring a separate data collection effort at year-end.

**THE CARBON COST MODELING:** As carbon pricing mechanisms — carbon taxes, cap-and-trade systems, and implicit carbon prices in procurement and financing decisions — become more prevalent, the CFO must integrate carbon cost modeling into the financial planning process. The carbon cost model estimates the financial impact of different carbon pricing scenarios on the company's cost structure, identifying the products, processes, and facilities that are most exposed to carbon pricing risk and providing the financial analysis required to evaluate the investments in emissions reduction that might mitigate that risk.

**ESG IN M&A; DUE DILIGENCE:** ESG due diligence has become a standard element of PE acquisition due diligence. The ESG assessment in M&A identifies the environmental liabilities (contaminated sites, regulatory compliance issues, hazardous materials exposure), the social risks (labor practices, human rights in the supply chain, employee health and safety performance), and the governance risks (board composition, executive compensation, anti-corruption compliance) that could affect the company's value or create post-acquisition liabilities. The CFO must ensure that the company's own ESG record is clean enough to withstand this scrutiny in any future sale process and must prepare the ESG data room materials required for the ESG due diligence.

## **ACTIONS TO TAKE BEFORE PART THIRTY-ONE**

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**Commission the ESG baseline assessment:** measure the company's current performance on the ILPA Data Convergence Initiative metrics (Scope 1 and 2 emissions, energy, water, waste, diversity, and injury rate), the SASB financially material metrics for the company's industry, and the TCFD climate risk categories. Present the baseline assessment to the board as the starting point for the ESG improvement plan and as the foundation for the annual LP ESG report.

**Design the ESG data collection infrastructure:** identify the data sources for each ESG metric (the utility bills for energy and water consumption, the waste management records for waste generation, the HR system for diversity and injury data, and the GHG inventory methodology for emissions), establish the data collection process, and integrate the ESG data collection into the monthly operational reporting process so that ESG metrics are available quarterly rather than only annually.

## CLOSING PERSPECTIVE

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*ESG in private capital has evolved from a peripheral governance topic to a central financial management discipline — one whose financial materiality is increasingly recognized by the PE sponsors, the LPs, and the exit buyers who ultimately determine the financial outcome for the private capital-backed company. The CFO who builds the ESG financial infrastructure proactively — who integrates ESG metrics into the management reporting, who models the financial implications of ESG risks, and who prepares the ESG data room materials required for the exit due diligence — is building the financial governance capability that distinguishes the most sophisticated and most resilient private capital-backed companies.*

## COMING NEXT IN THE SERIES

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### **Part 31 — CFO Transitions in Private Capital Companies: Joining, Leading, and Exiting**

Part Thirty-One covers the personal and professional dimensions of CFO transitions in private capital-backed companies — what to assess before joining, the first ninety days framework, how to establish financial governance authority quickly, the signals that indicate a CFO should consider leaving, and the financial considerations of CFO departures including equity, severance, and transition obligations.