Welkom bij De RO Masterclass

SCARCITY

23 & 24 NOVEMBER 2023

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Sustainability reporting

ESG Governance, ‘in control’ and the role of Internal Audit

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With you today

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ESG enthusiast, challenger, pragmatic trouble shooter

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Short refresh: What is ESG?

Environmental

- Climate change
- Greenhouse gas (GHG) emissions
- Natural resource depletion
- Waste and pollution
- Deforestation
- Hazardous materials
- Biodiversity

Social

- Working conditions
- Impact on local communities
- Conflict regions
- Health and safety
- Employee diversity, equity, and inclusion
- Product mis-selling
- Data protection

Governance

- Executive pay
- Bribery and corruption
- Political lobbying and donations
- Board diversity and structure
- Tax strategy
- Data breaches

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Internal Audit's role in ESG

- Internal controls over ESG reporting
- Internal assurance
- ESG operational audits
- ESG sub-sections of operational audits

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Why is Governance over ESG important?

*"Investors and rating agencies around the world are **increasingly seeking and relying on sustainability performance data**. So, there is a need among all stakeholder groups for **effective controls and oversight** so that this information is **high-quality and fit for purpose**: decision-making in this changing world"*

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COSO – Internal controls over sustainability reporting (ICSR)

*"Internal controls have value **beyond compliance and external financial reporting**. … The 2013 Framework has been enhanced by expanding the financial reporting category of objectives to include other important forms of reporting, such as nonfinancial and internal reporting. We believe that this **expansion is inclusive of sustainable business information**"*

COSO ICS

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COSO ICSR

How Internal Audit functions can apply the framework to assess Governance over ESG

For effective internal control:

- Each of the 5 components and 17 relevant principles must be present and functioning
- Point of focus are characteristics supporting achievement of control objectives
- The 5 components must operate together in an integrated manner

Control environment	• Demonstrate commitment to integrity and ethical values • Exercises oversight responsibility • Establishes structure, authority, and responsibility • Demonstrate commitment to competence • Enforces accountability
Risk assessment	• Specifies suitable objectives • Identifies and analyzes risk • Assesses fraud risk • Identifies and analyzes significant change
Control activities	• Selects and develops control activities • Selects and develops general controls over technology • Deploys through policies and procedures
Information & communication	• Uses relevant information • Communicates internally • Communicates externally
Monitoring activities	• Conducts ongoing and/or separate evaluations • Evaluates and communicates deficiencies

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Key considerations for each component

Control environment

- Evaluate the organizational structure and identify the areas most likely impacted by current and pending regulation
- Hire, train, and retain the right people with the right skills
- Establish and communicate the structure, roles and responsibilities to all involved in ESG reporting
- **Define realistic and attainable metrics that do not create undue pressure that could lead to fraudulent reporting**

Monitoring activities

- Consider expanding the role of Internal Audit Functions to include assurance of ICSR. **Internal Audit can assess the design, implementation, and effectiveness of ESG data controls prior to any external assurance**
- Encourage the chief audit executive to collaborate with leadership to build an efficient, effective, risk based ICSR portfolio

Risk assessment

- Define sustainability reporting objectives in sufficient detail to form the basis for a thorough risk assessment
- **Identify and analyze material risks to the achievement of sustainable reporting objectives**
- Consider the potential risk of fraud in sustainability reporting during the risk assessment
- Continuously monitor for changes that could impact sustainability reporting objectives

Control activities

- Design the ICSR program and controls to be scalable to achieve the desired level of assurance. Remember to **design controls that address future commitments and not just current metrics**. Using the ICSR program can be beneficial in supporting potential internal or external assurance needs
- **Get control performers prepared with expectations prior to assurance requirements**
- Develop and regularly update policies, procedures, and training to create tools to achieve ESG reporting objectives

Information and communication

- Consider how to integrate sustainability data capture and controls into any future system discussions to scale the technology environment appropriately
- Gauge the consistency, veracity, and completeness of the data for ICSR
- Design and implement controls to mitigate the risk of inaccurate or missing ESG data

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ESG Governance

"G" factors

- Structure and oversight
- Code and values
- Transparency and reporting
- Risk Management

Key Governance Principles

- Structure & Oversight
- Code and Values
- Transparancy and Reporting
- Risk Management

Governance Fundamentals

- Board role
- Managerial structure & responsibilities
- Policies, Procedures & Internal Controls
- Internal Audit
- Ethical Climate
- Employee engagement and incentivization
- Organizational Culture
- Transformation Integrity
- "Trusted" reporting
- Risk Management
- Regulatory Compliance
- Technology

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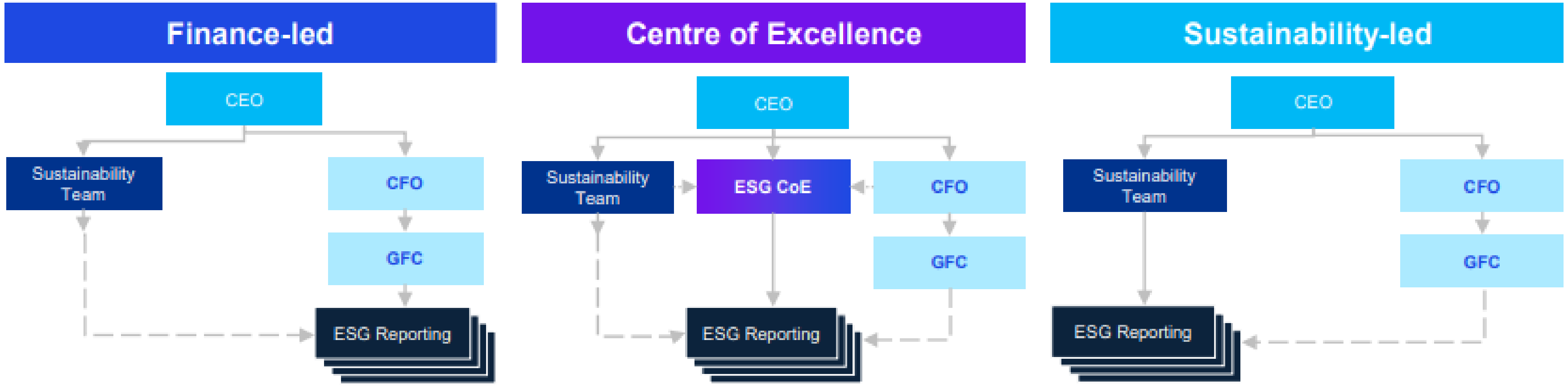
ESG reporting operating model

Not a 'one size fits all' structure



KPMG insights:

- Finance's inherent role in external reporting positions them to lead non-financial reporting, however existing operating models are not equipped and need to be adapted to address the broader ESG scope.
- Market leading organizations have ESG 'Center of Excellence' to support the Finance function.

Poll question:

Does internal audit currently play a role in monitoring ESG risks at your organization?

- ❑ Not yet
- ❑ Acting in a consultative capacity
- ❑ Validation over ESG reporting
- ❑ ESG risks are embedded within our operational audits
- ❑ Testing of internal controls over sustainability reporting

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Poll question:

How do you see the role of internal audit in monitoring ESG risks at your organization changing in the next 2-3 years?

- ❑ Not yet required
- ❑ Reducing
- ❑ Staying consistent
- ❑ Involvement will grow significantly

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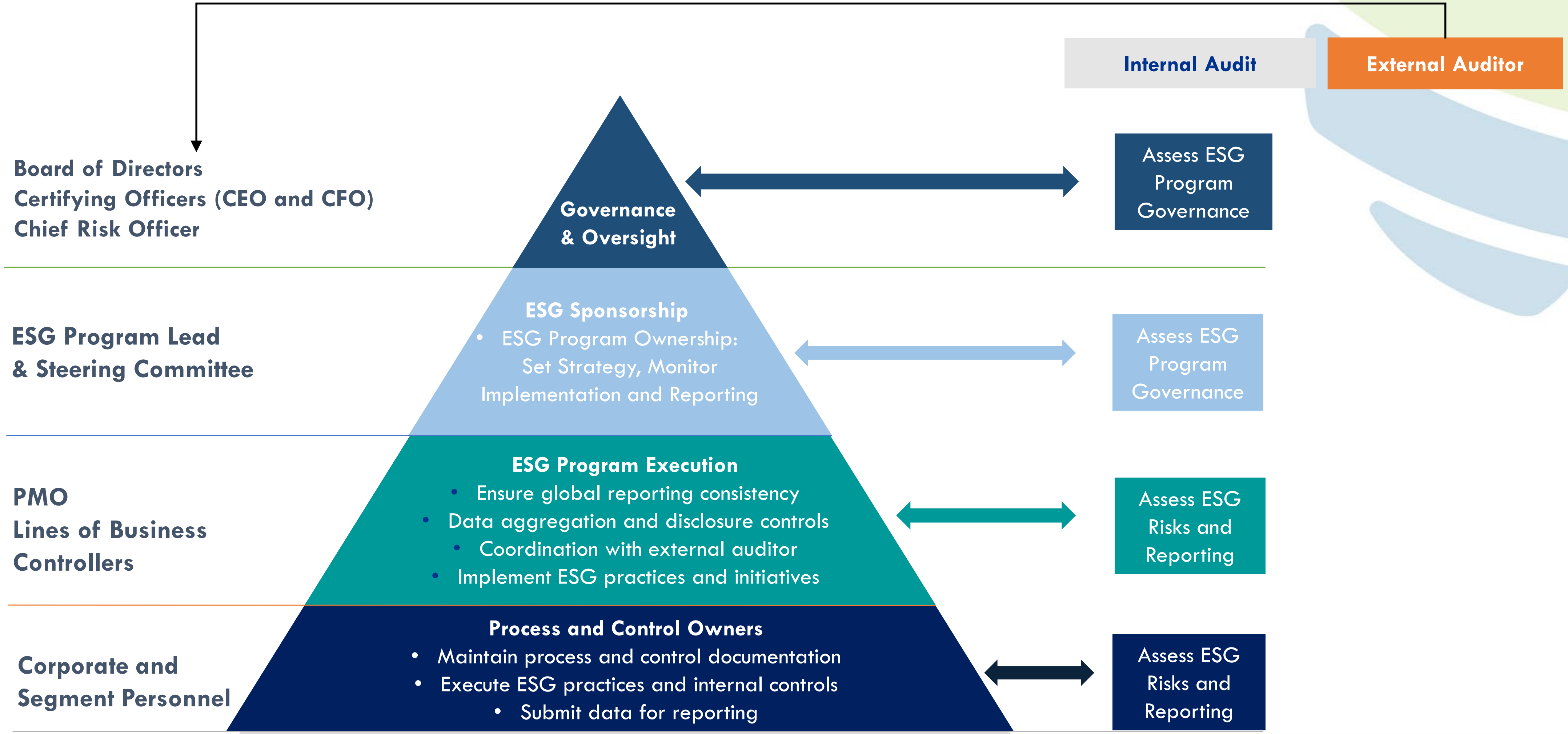
Role of Internal Audit



Internal assurance over ESG reporting

Governance and Strategy	Scope and Level of assurance	Risks (what could go wrong?)	Process and controls	Tech and data	Monitoring	Oversight
Determining overall **strategy for the ESG internal assurance program** sets the direction and level of effort to be applied.	Scoping ESG by material items, entities, assurance needed and value chain will ensure that a **complete picture of ESG impact** of company is identified.	Not all ESG risks are equal. Risk assess to drive **prioritization of resources** for both assurance and control build out.	Once risks are considered, **processes will need to be mapped** and controls identified commensurate with the risk and level of assurance needed. **Ongoing execution of key controls** is key to achieving investor-grade disclosures	**Data lineage, security, integrity and governance** needs to be considered for technology enabling the collation, calculation and reporting processes	Monitoring of successful execution of key controls is an important step to monitor the level of risk and control within the ESG reporting processes. Develop a **testing strategy based on risk and level of desired assurance**	**Robust reporting** of any control deficiencies identified within the ESG environment is key to **maturing the control environment** and providing Board and Executive management with the information needed to provide sufficient oversight.

Performed at an enterprise level → **Performed at a material ESG area level** → **Performed at an enterprise level**

Guiding principles

- Simple to understand and execute
- Agile enough for different material ESG areas
- Adaptable to regulatory changes
- Assurance for where you are in your ESG journey
- Align with COSO-13
- Evidence to support disclosures
- Increased leadership confidence in ESG

New challenges for IA Functions

Changing expectations

Strategic, regulator and customer expectations are extremely fluid in this topic. Inability to adapt to these will challenge the impact of assurance.

Risk Inter-connectivity

ESG risks are not independent of each other. All are interrelated and cause complexity in operation and context.

Technical experience

Lack of experience in reviewing ESG areas and lack of technical expertise/investment in ESG operations.

Bandwidth and resources

Given multiple requirements, does IA have the bandwidth to develop internal assurance and the ability to execute it?

Data and technology

Inability to trust internal and external data sources, obtain complete and accurate data, and inability to rely on tech systems that support ESG.

Modeling and goals

Complexity and challenges of being able to review ESG models, supporting sources, and goals toward progress.

Over-complicating ESG

If not scoped correctly, ESG could overwhelm an Internal Audit function. Consider agile approaches and continuous monitoring.

Ownership

Bringing multiple cross-functional teams together to buy into a disciplined assurance approach will be a challenge.

Poll question:

How are you addressing upskilling your internal audit team for the ESG skill set?

- ❑ Training
- ❑ Hiring and/or (co-)sourcing specific competencies / new roles
- ❑ Engaging with third parties on specific audits
- ❑ No specific actions yet

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Food for thought

Are sustainability experts becoming internal auditors, or should internal auditors become sustainability experts?

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The road ahead

Educate your organization and be prepared for the finalization of ESG reporting regulatory frameworks (e.g., CSRD/ESRS, ISSB, etc.)

Enhance enterprise risk assessments to identify ESG-related risks that are considered material in the context of the respective ESG regulatory framework

Develop a **governance structure** around ESG-related risks and opportunities to support the **ongoing identification and monitoring** of commitments and targets

Assess how ESG impacts valuations, broader financial results and the types of data, systems, processes, internal controls and mythologies that would have to be developed to **facilitate timely and accurate ESG reporting**

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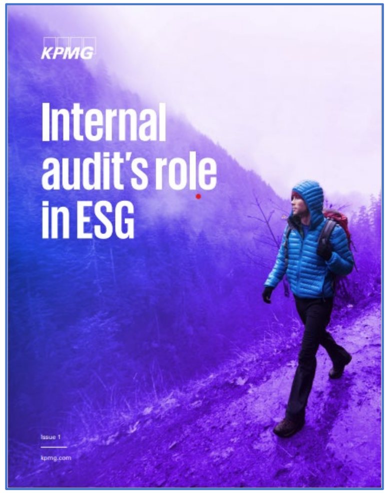

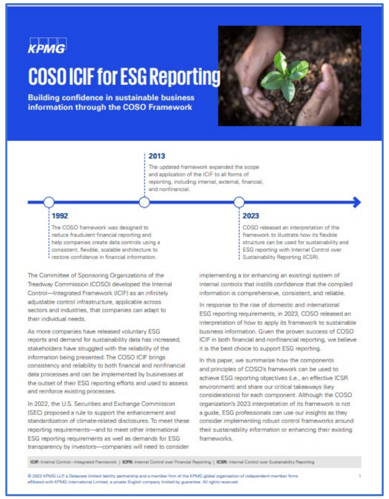

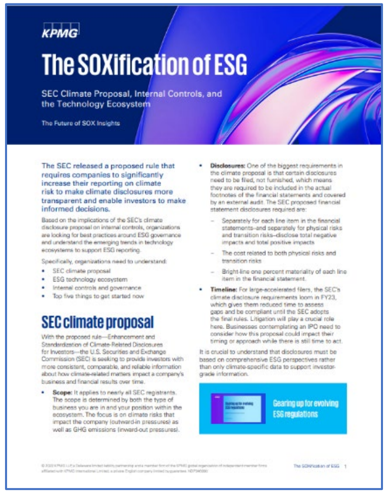

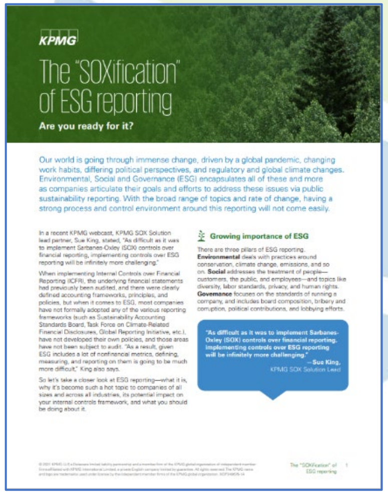

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