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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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- Business Development Manager – ESG Governance solutions

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	<ul style="list-style-type: none"> • Demonstrate commitment to integrity and ethical values • Exercises oversight responsibility • Establishes structure, authority, and responsibility • Demonstrate commitment to competence • Enforces accountability
Risk assessment	<ul style="list-style-type: none"> • Specifies suitable objectives • Identifies and analyzes risk • Assesses fraud risk • Identifies and analyzes significant change
Control activities	<ul style="list-style-type: none"> • Selects and develops control activities • Selects and develops general controls over technology • Deploys through policies and procedures
Information & communication	<ul style="list-style-type: none"> • Uses relevant information • Communicates internally • Communicates externally
Monitoring activities	<ul style="list-style-type: none"> • Conducts ongoing and/or separate evaluations • Evaluates and communicates deficiencies



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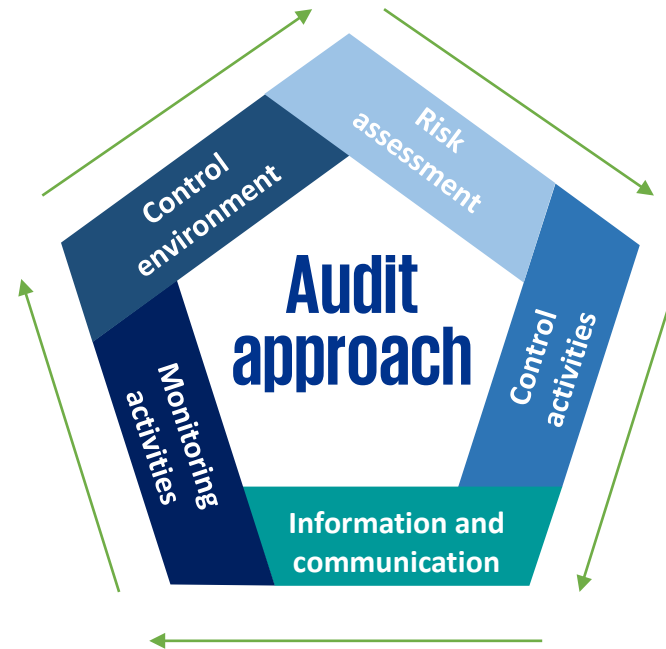
Key considerations for each component

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

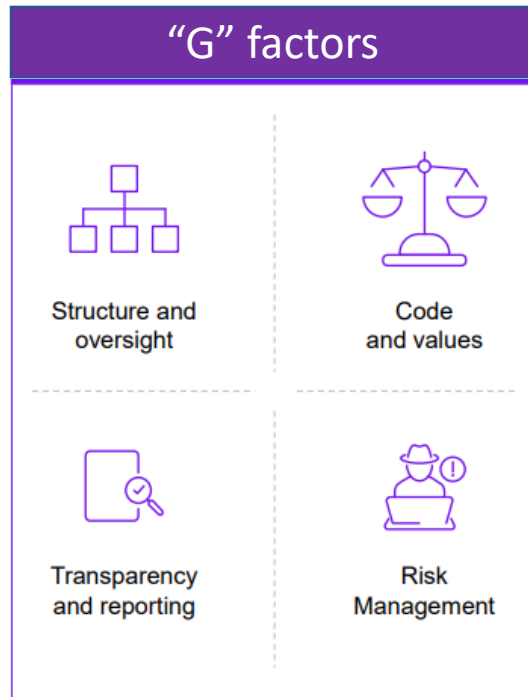
Information and communication

- 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

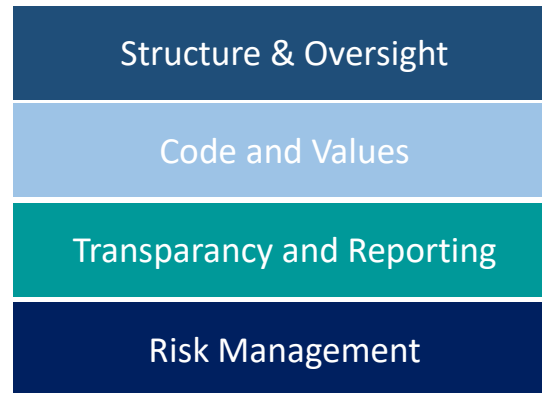


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ESG Governance



Key Governance Principles



Governance Fundamentals



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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.



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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



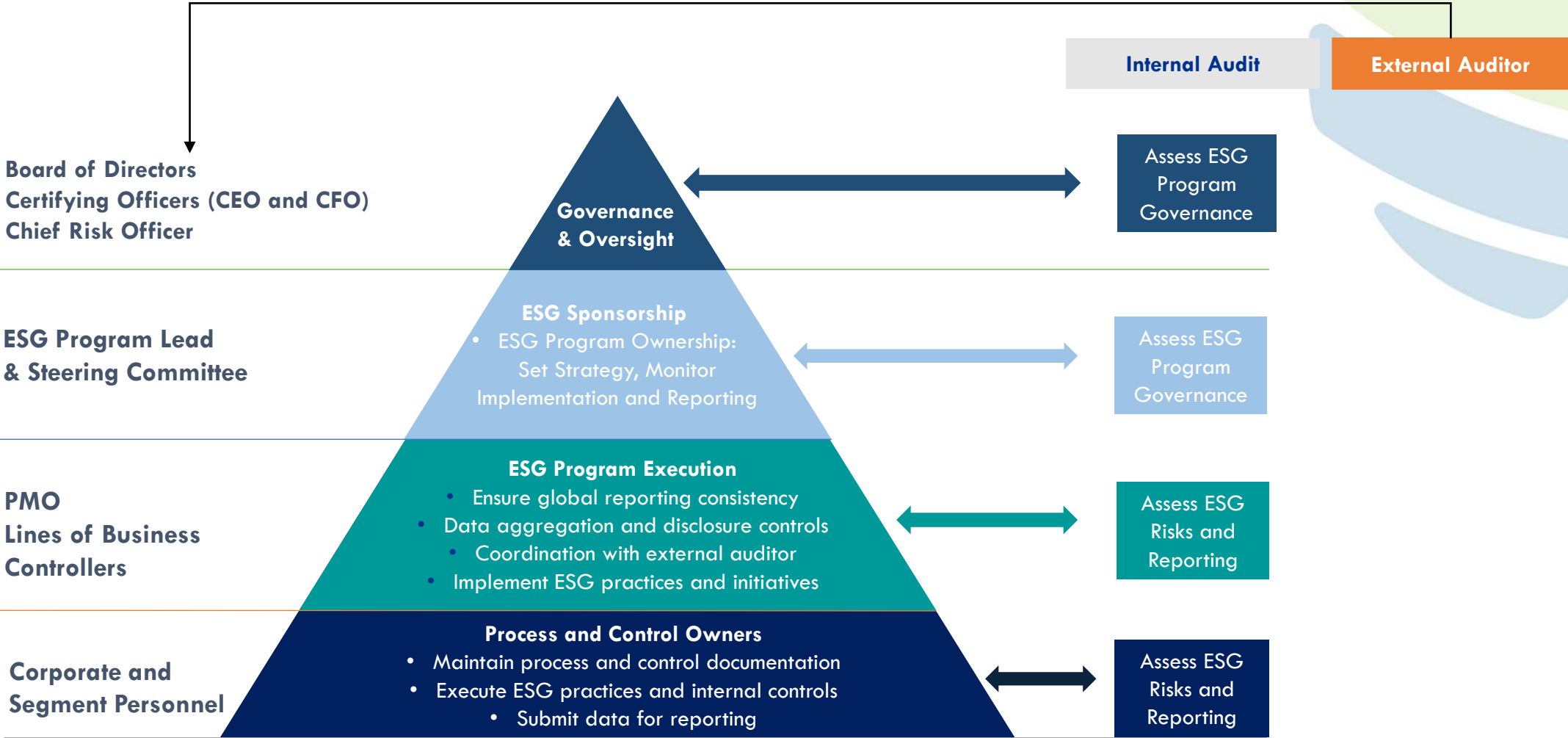
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Role of Internal Audit



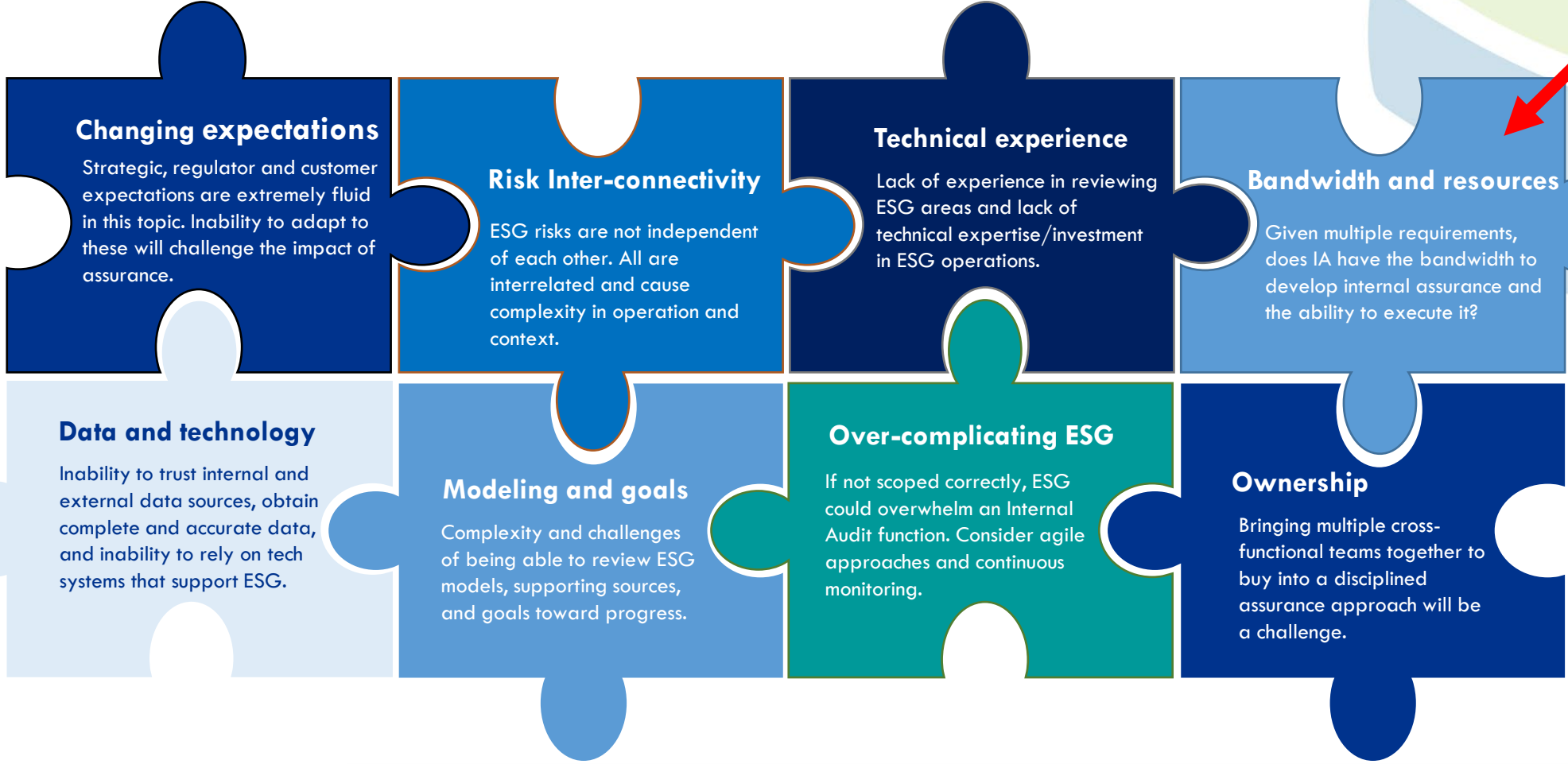
Internal assurance over ESG reporting

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

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



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

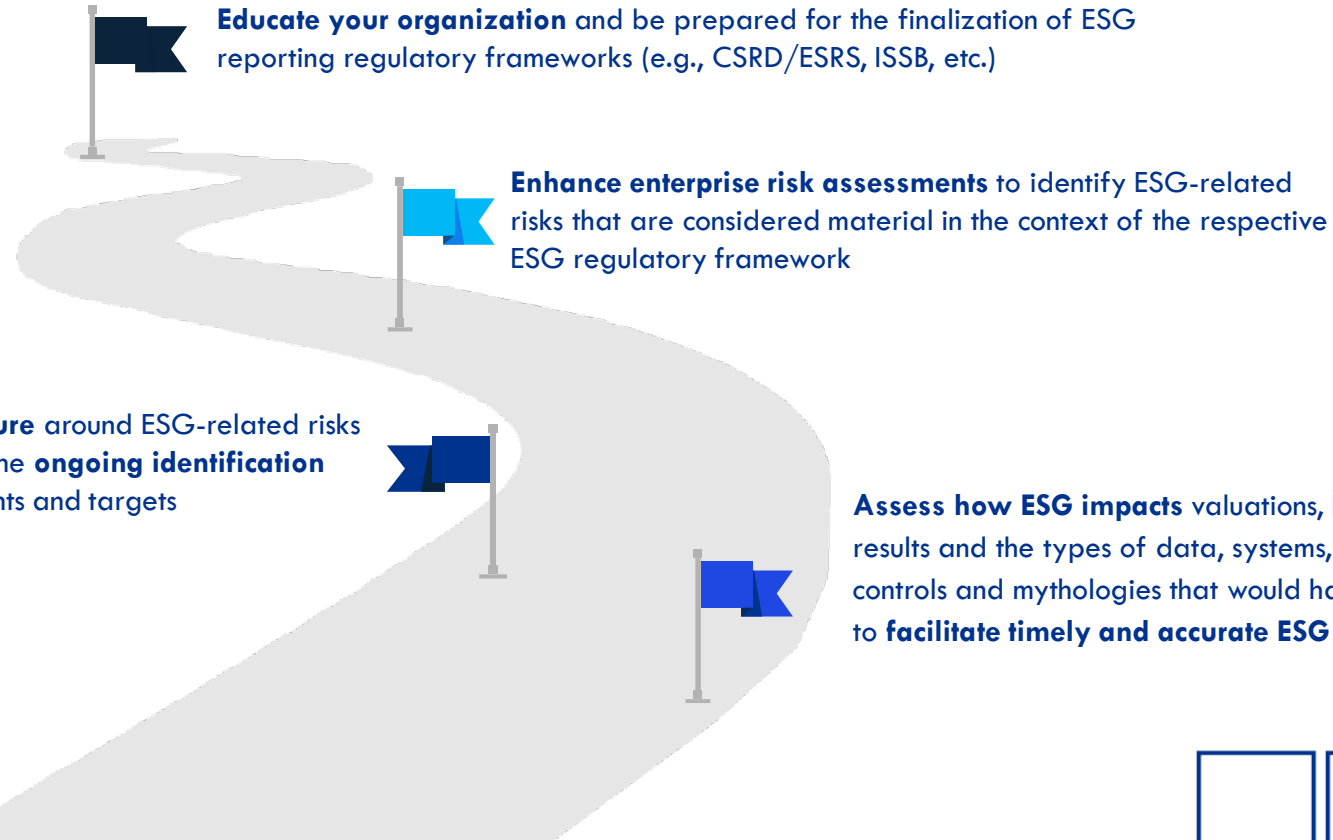
Are sustainability experts becoming internal auditors, or should internal auditors become sustainability experts?



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The road ahead



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KPMG Thought leadership

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Internal audit's role in ESG

The powerful combination of Workiva's cloud-based platform for ESG, financial reporting, and GRC, with the ESG, financial, technology reporting, and control experience of KPMG professionals, helps companies fully leverage technology to address key reporting and governance outcomes: trusted ESG reports.

Substantial demand for ESG reporting and increased transparency is driving

- 58% of U.S. chief financial officers believe ESG disclosures will be more transparent and "easier to grasp" in 2023, based on company, accuracy, and compliance data. Companies can achieve ESG reporting efficiency, quality, and control through the effective use of integrated technology solutions along with the guidance from trusted professionals with deep expertise in ESG strategy, reporting, and control processes.

Reliable ESG reporting is now a corporate requirement, demanded by many stakeholders: from investors and consumers to employees. Executives and board directors recognize the demonstrated value derived from ESG strategies, compelling more companies to establish or upgrade existing programs.

Regulators, including the U.S. Securities and Exchange Commission, European Commission, and European Parliament, also have recently introduced ESG disclosure rules that require additional reporting requirements, even organizations that have been producing ESG reports for some time. Notwithstanding reporting mandates, and their reporting 2023, the gap marks the sign of their financial disclosures. The time and level of effort continue to grow with existing regulatory requirements.

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The trusted path to ESG reporting

The powerful combination of Workiva's cloud-based platform for ESG, financial reporting, and GRC, with the ESG, financial, technology reporting, and control experience of KPMG professionals, helps companies fully leverage technology to address key reporting and governance outcomes: trusted ESG reports.

As a result, companies are reviewing their ESG reporting capabilities and looking to technology to enable a more robust ESG program—one that can help us increase stakeholder scrutiny, emerging regulatory reporting, and regulatory requirements.

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The trusted path to ESG reporting | 1

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COSO ICIF for ESG Reporting

Building confidence in sustainable business information through the COSO Framework

2013

The global framework expanded the scope and application of the COSO framework of reporting, including internal, external, financial, and nonfinancial.

2021

COSO released an interpretation of the framework to illustrate how its flexible structure can be used for sustainability and ESG reporting with Internal Control over Sustainable Reporting (ICSR).

2023

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The Committee of Sponsoring Organizations of the Treadway Commission (COSO) developed the Internal Control—Integrated Framework (ICIF) as an infinitely adjustable control observation, applicable across sectors and industries, that companies can adapt to their individual needs.

As more companies have released voluntary ESG reports and demand for sustainability data has increased, organizations have struggled with the quality of the information being reported. The COSO ICIF brings consistency and reliability to both financial and nonfinancial data processes and can be implemented by businesses at the scope of their ESG reporting efforts and used to assess and reinforce existing programs.

In 2023, the U.S. Securities and Exchange Commission (SEC) proposed a rule to support the enhancement and standardization of climate-related disclosures. To meet these reporting requirements—and to meet other international ESG reporting requirements as well as demands for ESG transparency by investors—companies will need to consider implementing an enhancing or enhancing their existing frameworks.

ICIF: Internal Control—Integrated Framework | ICSR: Internal Control over Sustainable Reporting | ICN: Internal Control—Sustainability Reporting

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The SOXification of ESG

SEC Climate Proposal, Internal Controls, and the Technology Ecosystem

The Future of SOX Insights

The SEC released a proposed rule that requires companies to significantly increase their reporting on climate risk to make climate disclosures more transparent and enable investors to make informed decisions.

Based on the implications of the SEC's climate disclosure proposal on internal controls, organizations are looking for best practices around ESG governance and understand the emerging trends in technology ecosystems to support ESG reporting.

Identifying organizations need to understand:

- SEC climate proposal
- ESG technology ecosystem
- Internal controls and governance
- Top five things to get started now

SEC climate proposal

Under the proposed law, Enforcement and Discipline of Climate-Related Disclosures for Issuers (the U.S. Securities and Exchange Commission (SEC) is seeking to provide investors with more consistent, comparable, and reliable information about climate-related matters invest a company's business and financial results over time.

Scope: It applies to nearly all SEC registrants. The scope is extended to both the type of business you are in and your position within the government. The focus is on climate data that impact the company (forward-looking processes).

Deadline: One of the biggest requirements in the climate proposal is the carbon disclosure. This is not to be confused with the carbon data that is required to be included in the annual disclosure of the financial statements and covered by an external audit. The SEC proposed financial statement disclosures required are:

- Separately for each item in the financial statements and separately for physical risks and transition risks (disclosure that require impacts and their positive impacts)
- The cost related to both physical risks and transition risks
- Significant climate-related materiality of each item in the financial statements

Timeline: For large companies, the SEC's climate disclosure requirements begin in FY23, which gives them about two years to prepare and be compliant with the SEC actions. The final rules, litigation will start a couple of years. Businesses contemplating an IPO need to consider how this proposal could impact their timing or approach while there is still time to act.

It is crucial to understand that disclosures must be based on comprehensive ESG perspectives rather than only climate-specific data to support investor-grade information.

Getting clear on why ESG reporting | 1

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The 'SOXification' of ESG reporting

Are you ready for it?

Our world is going through immense change, driven by a global pandemic, changing work habits, differing political perspectives, and regulatory and global climate changes. Environmental, Social and Governance (ESG) encompasses all of these and more as companies navigate their goals and efforts to address these issues via public sustainability reporting. With the broad range of topics and rate of change, having a strong process and control environment around this reporting will not come easily.

In a recent KPMG webcast, KPMG SOX Solution Lead, Steve, CFA, noted, "The critical is not to implement Sarbanes-Oxley (SOX) controls over financial reporting, implementing controls over ESG reporting will be infinitely more challenging."

Given understanding Internal Control over Financial Reporting (ICFR), the underlying financial statements had previously been audited, and there were clearly defined accounting frameworks, practices, and policies, but when it comes to ESG, most companies have not formally adopted any of the various reporting frameworks such as Sustainability Accounting Standards Board, Task Force on Climate-Related Financial Disclosures, Global Reporting Initiative, etc., have not developed their own standards, and those that have not been subject to audit. As a result, given the lack of an established standard, defining, measuring, and reporting on them is going to be much more difficult," King added.

So let's take a closer look at ESG reporting—what it is, why it's becoming a hot topic to companies of all sizes and across all industries, to better understand the internal and external drivers, and what you should be doing about it.

Growing importance of ESG

There are three pillars of ESG reporting: Environmental, Social, and Governance. Each pillar is critical to the success of a company, and so on. **Environmental** focuses on practices around conservation, climate change, emissions, and so on. **Social** addresses the treatment of people—customers, the public, and employees—and topics like diversity, labor standards, unions, and human rights. **Governance** focuses on the standards of running a company, and includes board composition, salary and compensation, political contributions, and lobbying efforts.

As difficult as it may be to implement Sarbanes-Oxley (SOX) controls over financial reporting, implementing controls over ESG reporting will be infinitely more challenging. — Steve King, KPMG SOX Solution Lead

The 'SOXification' of ESG reporting | 1

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