

Internal Audit's role in ESG

The same but different: providing objective insights, assurance and advice - on ESG matters

There has been an uptick in ESG reporting worldwide, with a recent KPMG study demonstrating that 80% of companies now report on ESG topics.¹ Internal audit can play a critical role in providing objective assurance and advice on ESG reporting and sustainability matters more broadly.

Defining E-S-G

Environmental considers how an organisation performs as a steward of nature. This can include issues related to carbon emissions, waste management, water management, raw material sourcing, and climate change vulnerability.

Social examines how organisations manage relationships with employees, customers, and the wider community. Risks that fall under this category can include corporate social responsibility, labour management, data privacy, general security, health and safety and wellbeing.

Governance refers to variables such as business ethics, board and leadership, executive pay, audits, internal controls, intellectual property protection, and shareholder rights.



Why the drive for sustainable change now?

Over the years we have seen a shift in the capital markets from a focus on maximising shareholder return to maximising shareholder value. Organisations are responding by reporting publicly on their ESG strategies, commitments, actions and results. As highlighted in the Institute of Internal Auditor's (IIA) recent white paper - 'Internal Audit's role in ESG reporting',² several key factors have emerged that are making this shift more rapid:



Investor and public interest

Investors and the public are expecting corporates to manage the ESG risks in their businesses and also factor in the environmental, social and community impact of their initiatives. Failure to do so many involve reputational risks, financial impact, potential lawsuits and other legal risks. We are consequently seeing a shift in the capital markets as products and services transition towards more sustainable approaches.



Regulation

As of 1 July 2020, a new ESG reporting framework was issued by the HKEX for listed companies which includes environmental and social KPIs to be disclosed. With a Cross-Agency Steering Group on Green and Sustainable Finance launched in 2020, more policy and regulatory initiatives with enhanced requirements on financial institutions and corporations regarding ESG are expected, especially with respect to climate. To this end, by 2025 TCFD disclosures will be mandated in the finance sector in Hong Kong.



Frameworks

Although no single environmental standard exists, there are several recognised standards that provide market guidance on how to monitor, evaluate and report on environmental-related disclosures. Many organisations reference the frameworks in their ESG reporting. Whilst these frameworks are useful, there is a need for better and more accurate data as this information is used by policymakers, financial regulators and investors to make business decisions.

As with financial reporting, the independent and objective assurance only internal audit can provide must be an integral part of an organisation's ESG response.



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Management teams across organisations are recognising the opportunities and risks ESG presents. This includes the due-diligence required to integrate ESG measures across any organisation. To make informed decisions, directors must have reliable assurance on the effectiveness of ESG management, including ESG governance, risk assessment, KPI monitoring and reporting. That assurance should come from internal audit.



Assurance

According to the IIA², at a minimum the internal audit function should provide the following assurance over ESG reporting;

- **Review reporting metrics for relevancy, accuracy, timeliness and consistency:** It is critical that all public ESG reports provide information that accurately depicts an organisation's ESG efforts. This is particularly important as regulatory oversight and public scrutiny increases.
- **Review reporting for consistency with formal financial disclosure filings:** While ESG reporting provides non-financial data, any information that conflicts with formal financial disclosures will raise a red flag with investors and regulators.
- **Conduct materiality or risk assessments on ESG reporting:** Organisations must have a clear understanding on how ongoing ESG efforts or public commitments to reaching ESG goals can rise to the level of materiality.
- **Incorporate ESG into regular audit plans.**



Advisory

- **Build an ESG control environment:** Internal audit can advise on developing specific internal controls for ESG reporting.
- **Recommend reporting metrics:** Internal audit can provide insights into the kind of data that accurately reflects relevant ESG efforts within the organisation.
- **Advise on ESG Governance:** Internal audit can provide guidance on ESG governance because of its holistic understanding of risk across the organisation.

More broadly, internal audit can support management in answering relevant questions such as:

- Do we have a clear view on all ESG risks, including compliance risk related to existing and forthcoming national and international legislation, and are those regularly re-assessed?
- Do we have a proper ESG culture that goes hand in hand with our ESG initiatives?
- Do we measure our ESG activities, based on KPIs linked to the ESG strategy and do we report in a controlled and reliable way?



Sustainability Reporting Frameworks to leverage

01

Global Reporting Initiative (GRI) is

designed for disclosure on a wide range of ESG issues and topics relevant to stakeholders.

02

Sustainability Accounting Standards Board (SASB) is more

narrowly focused on a selected few disclosures relevant to a company's overall sector and is geared more toward an investor audience.

03

Task Force on Climate-related Financial Disclosures (TCFD) is a

more recently introduced reporting framework and is fixed solely on climate-related financial risk.

04

International Integrated Reporting Council (IIRC) supports development of

integrated reports on an organisation's strategy, governance, performance and prospects in the context of its external environment.



Internal Audit's role in ESG

Any internal audit activity should go beyond simply identifying risks to include identifying root causes, potential risk management strategies and preventive controls. It should also ensure that governance, risk management and internal controls are operating effectively throughout the organisation.

KPMG has developed an internal audit work program combining different elements of well-known standards, which serve as a basis for good practices, supplemented by our internal expertise in the areas of internal audit and ESG.

In their assessment, internal auditors should examine aspects that define the company's ESG policy like high-level oversight, risk assessment, due diligence procedures and awareness and implementation actions.

Key ESG categories	Governance	Human rights	Labor practices	Environment
	Operating practices	Customer issues	Community	

ESG risks

- Risk (& opportunity) assessment
- Regulatory requirements
- New product review
- Third party due diligence

Policies and procedures

- Entity-wide policies & procedures on human rights, health & safety, etc.
- Existence of relevant processes (e.g. supply chain, production, sales)
- Consistency between policy framework
- Policy management

High level oversight

- Definition of ESG
- Mission, vision, values & strategy
- Periodic review by top management
- Context & stakeholder analysis
- Time, resource & budget

Reporting

- Periodic reporting to management & the board
- Mandatory regulatory reporting
- External reporting to stakeholders
- Record keeping

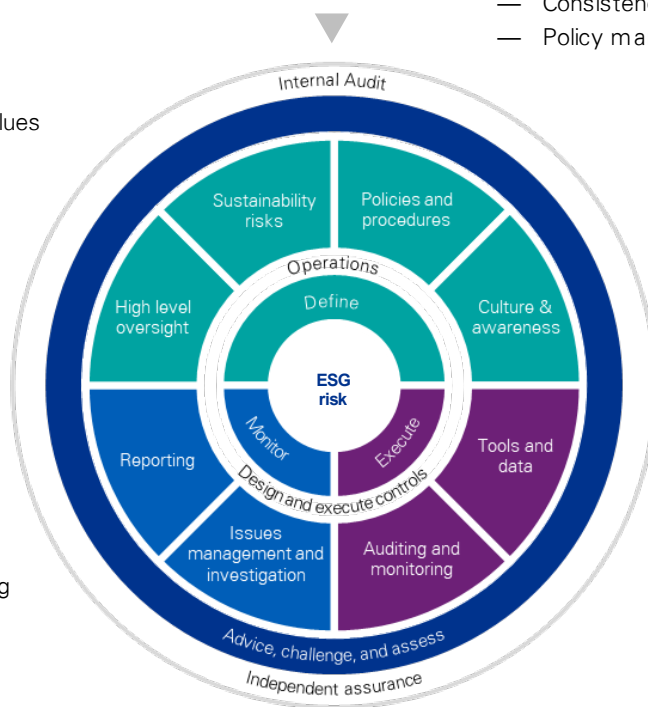
Issues management and investigation

- Issues/complaints management & remediation
- Responding to government investigations/exams/inspections
- Response plan & process for investigating alleged non-compliance
- Continuous improvement

Auditing and monitoring

- Monitoring & tracking of regulatory change
- Transactional, process & control testing
- Third party and employee compliance due diligence & management (licensing)
- Periodic ESG Risk program evaluation
- Involvement of 2nd & 3rd line

KPMG internal audit methodologies



Culture & awareness

- Engage & create dialogue with all the stakeholders
- Culture/tone of ESG/ sustainability & behavioral change
- Regular and frequent training & communication

Tools and data

- Technology to support ESG program (testing, training records, etc.)
- Predictive measures: key risk indicators and key performance indicators
- Root cause analysis & trending



Internal Audit's role in ESG

How can KPMG help?

KPMG has profound experience and a tested methodology to deliver solutions across the spectrum of internal audit as well as ESG advisory services.

We differentiate ourselves by our ▶



Expertise



Our team of subject matter professionals, with expertise in internal audit as well as ESG has the skills and knowledge to provide innovative internal audit services that meet varied needs across a wide range of industries.

Flexible methodology



KPMG's internal audit methodology is flexible and can be tailored to each company's specific needs. This can range from examining aspects that define the company's ESG policy like high-level oversight, risk assessment, due diligence procedures and awareness to the ESG policy's implementation and quality, consistency and reporting aspects.

Multi-disciplinary approach.



We have access to a wide range of competencies within KPMG. Our experienced and highly qualified core team can always appeal to appropriate Subject Matter Professionals within the KPMG network as needed. In addition, KPMG can serve as a one-stop-shop and support organisations with the implementation of possible points of improvement brought forward by the internal audit.

Contact us



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Source 1: "The Time Has Come: The KPMG Survey of Sustainability Reporting 2020," Executive Summary, KPMG, December 2020, <https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/12/the-time-has-come-executive-summary.pdf>.

Source 2: "Internal audit's role in ESG reporting" The Institute of Internal Auditors, Lake, Mary FL, 2021. <https://global.theiia.org/about/about-internal-auditing/Public%20Documents/White-Paper-Internal-Audits-Role-in-ESG-Reporting.pdf>



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