INTERNAL AUDIT TIPS FOR SUSTAINABILITY REPORTING

INCREASING MANAGEMENT’S COMFORT OVER SUSTAINABILITY REPORTS AND METRICS

Investors increasingly value companies by analyzing intangible factors such as reputation, intellectual property, and how a company deals with its community of stakeholders. Gone are the days when companies were valued simply on their physical assets: their plants, facilities, products, and equipment. Tangible assets comprised 83 percent of a company’s value in the ’70s, according to a study by Ocean Tomo.1 Today that figure is down to 16 percent.

But surveys also show investors are dissatisfied with the information they find when they dive in to learn about a company’s sustainability and discern how it is innovating. In a study conducted by PwC in 2014, approximately 80 percent of investors said they consider sustainability information in their decision-making process,2 but only approximately 30 percent were confident in the quality of the environmental, social, and governance (ESG) information they were receiving from companies.3

This presents a challenge for management. In the United States, there is no mandatory standard for what sustainability reporting is. And while sustainability is often referred to as nonfinancial reporting, other related terms include corporate social responsibility (CSR) reporting, integrated reporting, holistic reporting, enhanced reporting, ESG reporting, service efforts and accomplishments reporting — and that’s not even an exhaustive list.4 So how do companies reveal the right information in the best format to position their companies as valuable investments?

Two PwC experts offered some guidance for unraveling this conundrum to attendees of The IIA’s 2016 Environmental, Health & Safety Exchange in Washington, D.C. How internal audit can play a role in increasing management’s comfort over sustainability reports and metrics was discussed by Marie-France Hache, CIA, director, and Leah Picker, manager, of PwC’s Sustainability Services group and risk assurance practice.

SUMMARY

When making decisions about supporting a company, stakeholders increasingly expect a more comprehensive report — one that goes beyond financial health. The lack of reporting standards in this area and the complexity of information available presents a challenge for management to accurately and consistently tell their organization’s sustainability story. This also presents a real opportunity for internal audit to help verify data, ensure consistency over reporting, and build trust with stakeholders, investors, board members and employees.

References:

1 http://www.oceantomo.com/blog/2015/03-05-ocean-tomo-2015-intangible-asset-market-value/

www.theiia.org/EHSAC
Today’s complicated and evolving business structures create relationships and generate interactions that can potentially damage trust and destroy value, especially when local problems become global events. So before investing in a company, more and more investors want clear, relevant, and reliable information they can trust, Hache said. This has resulted in a growing trend — a movement she called it — for companies to report on their corporate social responsibility.

Investors and other stakeholders want to know if the organization is operating sustainably, if it monitors its impacts on the environment, if it is mindful of social issues such as diversity and equal opportunity. When making decisions about supporting a company, stakeholders increasingly expect a more comprehensive report — one that goes beyond financial health.

In 2011, an estimated 20 percent of S&P 500 companies made sustainability, corporate citizenship, or environmental reports available to users, according to the Governance & Accountability Institute. In just five years, that number jumped to 81 percent.\(^5\)

Comparing the various sources of information out there — sustainability reports, websites, annual reports, 10-Ks — isn’t easy when data is presented using different parameters, even for things that may seem similar such as greenhouse gas emissions. Companies themselves often define what and how they report.

There is an effort underway to get at least the same industries to report sustainability metrics according to voluntary standards, Picker said, and to adopt and report metrics in their 10-Ks, so investors can more easily compare companies.

The Global Reporting Initiative, for example, provides a list of metrics, while other organizations are trying to facilitate the collection and comparison of sustainability related information, among them: CDP (formerly the Carbon Disclosure Project) and Bloomberg Terminal. Information is self-reported and voluntary, at least in the United States, but countries around the world are starting to ask companies to report on sustainability metrics, Hache said.

There is also an effort to standardize the reporting of specific risks, such as climate change impacts. New recommendations by a task force that reports to the Financial Stability Board (FSB), an international body that monitors and makes recommendations about the global financial system, are designed to help organizations report climate-related risks and opportunities.\(^6\)

“The absence of a standardized framework for disclosing climate-related financial risks makes it difficult for organizations to determine what information should be included in their filings and how it should be presented,” the FSB report reads. “Even when reporting similar climate-related information, disclosures are often difficult to compare due to variances in legal and voluntary frameworks.”

Tackling this confusion is where internal audit can be very helpful. “Management can engage their internal audit function to get comfort over the data,” Hache said. “The benefits are that it is low-cost, the results of internal audit procedures can be assessed internally and remediated as needed before the related metrics are made public, and it leverages resources already familiar with company data and financial systems.”

Assurance provided by internal audit over the reliability of sustainability information benefits management, Picker said. Internal audit:

- Helps ensure consistency over reporting.

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\(^{5}\) Governance & Accountability Institute, http://www.ga-institute.com/research-reports/research-reports-list.html

www.theiia.org/EHSAC

\(^{6}\) Task Force on Climate-Related Financial Disclosures, https://www.fsb-tcfd.org/
Verifies data input into questionnaires used to create scores.

Can contribute to the earning of more points across various reporting channels and questionnaires, and a higher score for the company.

Can enhance company decisions made based on the data.

Can build trust with stakeholders, investors, board members, and employees.

Can allow for better management of business risks and opportunities.

If internal audit is not an option, or does not have the necessary expertise, management should consider engaging an outside vendor, at least for a readiness assessment, Hache advised. “This is different from an actual assurance opinion, just sheer readiness,” she said. “It identifies opportunities for improvement and allows time to fix any gaps.”

The experts outlined the main steps to performing a sustainability assurance engagement:

- Determine the scope and plan for the engagement.
- Identify key risks.
- Determine the appropriate test approach.
- Complete the engagement and document findings.

Hache and Picker offered attendees an exercise to show how easy it is to get data wrong. Say management is reporting its U.S. workforce by gender in its sustainability report. Employees filled out a voluntary form, HR entered the answers into its system, and the sustainability manager ran a report from that system at the end of the period. What are the risks that come along with that metric?

Exchange attendees discussed the scenario for a few minutes and came up with a long list of possible problems with the data, including contract and temporary workers not being included, the time of year the report is run, categories missed, lack of controls over data entry, and errors in inputting the information.

Many organizations want stakeholders to have improved insight into activities they perform that benefit the greater public good or serve a public interest. Nonfinancial reporting fills the void by reporting quantitative and qualitative information that falls outside the scope of mainstream financial statements.

Yet, from a consistency perspective, it is not unusual for CEOs and other executives to have an incomplete view of all the sustainability communications from their company, Hache said, as different departments within the company often work in silos. To help executives get comfortable with what is being reported, in addition to providing assurance over the data, internal audit should get an understanding of the various components of the sustainability-related communications throughout their company.

“Most importantly, identify what your organization is already reporting,” Picker said. Companies tell Hache and Picker they receive hundreds of questionnaires a year, from suppliers, customers, and regulatory agencies. With a solid inventory of what is being reported, internal audit can assess the risks of inconsistency. Internal audit should then engage with the various internal stakeholders involved, to gather their views and perceptions on those risks.

“Develop an action plan to address the risks. Be sure to think how this plan aligns against the company strategy. Prepare your process,” Hache said. “Do you have controls, implemented the right way, to provide comfort over the accuracy of the data? Would you be ready for external assurance?”

Hache and Picker also recommend companies engage with external stakeholders to understand what is important to them.

“Clearly internal audit can help, assessing processes and data, leveraging existing frameworks out there,” Hache said. “Internal audit can bridge the gap between sustainability reporting and financial reporting and determine how they can better align. Internal audit can bring that value.”
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