

Subject: ESRS Consultation

We thank you for the opportunity to share our view on the European Sustainability Reporting Standards (ESRS).

ECIIA is the European Confederation of Institutes of Internal Auditors and represent 55,000 members (via 34 members). ECIIA's primary goal is to be the consolidated voice for the profession of internal auditing in Europe, and to promote the role of Internal Audit and good corporate governance, by dealing with the European Union, its Parliament and Commission and any other European Regulators and Associations representing key stakeholders»).

This initiative on ESRS is crucial for Internal Audit, as we observe that non-financial information is now (at least) as important as financial information and we need common definitions.

We thank the EFRAG SRB and the EFRAG SR TEG for the extensive work performed and the very detailed and prescriptive Standards. They will provide clarity, comparability and a level playing field for the execution. They will however also lead to an intensive and long process for companies, to be ready.

The ESRS clearly demonstrate that a strong and clear governance model is required and that **Internal Audit has a pivotal role to play** as it provides assurance and insight on most of the topics identified in the ESRS.

1. The Governing model

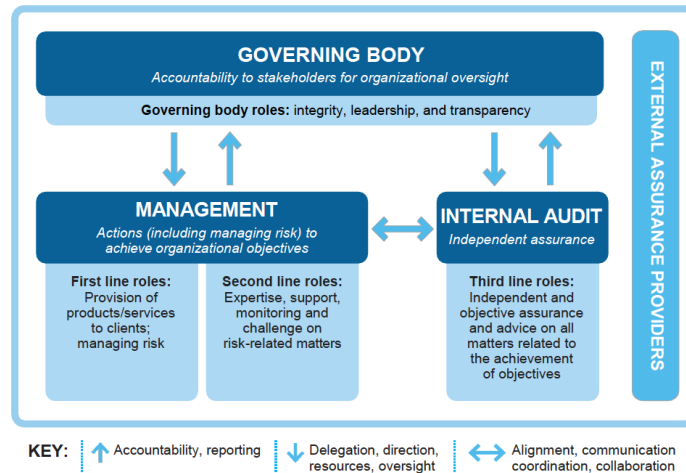
We recommend the [Three Lines Model](#)ⁱ as a key tool to understand the organisation's governance, risk management, audit and assurance functions.

The model articulates the core components of effective governance and includes principles on:

- The governing body being accountable to stakeholders for organisational oversight;
- Management to take actions, including risk management, to achieve the objectives of the organisation, through a risk-based approach; and
- Assurance and advice by an independent Internal Audit function, to provide clarity and confidence, and to promote and facilitate continuous improvement.

These principlesⁱⁱ are important for the effectiveness and efficiency of internal control and risk management systems.

The IIA's Three Lines Model



The reporting process involves actors from each Line and organisations must define the accountability of each actor involved to ensure the reliability, coherence and transparency of the information published.

Under this Three Lines Model, Internal Audit is shown as the Third Line internal assurance provider, with a primary reporting line to the Governing Body/Audit Committee. The external/statutory auditor is considered as an external assurance provider, located outside the business.

2. The role of Internal Audit in a nutshell

In the context of the sustainability journey, Internal Audit may at first assist organisations in an advisory role (regulations, best practices...), if needed and based on the organisation's ESG maturity level. As the ESG implementation and embedding will be a long journey for all organisations, Internal Audit should be involved from the beginning, and give "insight" to the Governing Body and to Management, based on its business and organisation knowledge.

When ESG maturity is growing, Internal Audit may play different roles:

- providing reviews of draft policies, procedures, process enhancements, and any management requests for reviews of areas considered mutually critical for ESG;

- providing reasonable assurance on the effectiveness of the governance, risk management and internal control across the business, including ESG targets, policies & procedures, processes, monitoring and reporting KRI/metrics, and the like;
- providing insight to the board/governing body on a broad range of financial and non-financial risks areas and performance metrics; and
- providing assurance on the ESG management reporting.

As ESG reporting will be included in the annual report, the role of the external auditor will be to provide (external) assurance. Given the expected level of details and process-related content of the draft reporting standards, the external auditor will need to rely on Internal Audit's work; we advise to already address that in the standards.

3. The role of internal auditors in the context of ESRS: journey

Internal Audit is ideally placed to advise businesses evaluate ESG opportunities, assess necessary changes to operations and reporting, to integrate ESG, and to meet regulations. Internal audit provides independent assurance on the ESG journey and is a catalyst for improvement.

ESRS 1: General Principles

Principle 1: reporting under ESRS

- Strategy

Strategic objectives will be adjusted to include ESG. It will lead to adapted control cycles and risk controls. Internal Audit will assess the goals and target settings related to ESG and report major risks to the Governing Body. They will also issue recommendations, discussed with Management, to initiate continuous improvement.

- Risks assessment

The organization assesses its sustainability-related material impacts, risks and opportunities in consideration of the disclosure requirements mandated by ESRS. Internal Audit makes (at least) an annual risk assessment of all the processes (based on the audit universe) to set up the audit plan. It will include ESG and be discussed with the 2d Line (Risk management, Compliance,...), but also with the external auditor.

- Entity specific disclosure

Internal Audit applies a "risk -based" approach and, based on the knowledge of the business, can advise for the entity specific disclosure to develop.

Principle 2: applying CSRD concepts (double materiality-value chain)

- Internal controls and processes must be adequate to guarantee "faithful representation"

Internal Audit generally assesses the design and effectiveness of the internal controls. They audit the implementation, the embedding of ESG, the compliance with the regulation. That includes important elements such as the culture and behavior towards ESG objectives.

It is important to involve Internal Audit from the beginning (including for the framework selection), in order to integrate its insight in the design of the new processes.

- Sustainability reporting process

Internal Audit will audit the entire cycle of target setting, execution, monitoring and reporting. An important element is the data collection.

This will imply interviews with key stakeholders, to obtain knowledge about the "technical" data and review of the process (efficiency and effectiveness) to provide assurance re the transparency, adequacy, comparability, accuracy and completeness of the information.

- Double materiality

Internal Audit will generally also audit non-measurable elements such as culture and behavior, that are important for ESG and impact the ESG data reported. It will not always be possible to provide reasonable assurance for softer information, but insight may be equally valuable.

Internal Audit will also audit the threshold for the impact materiality and advise.

- Value chain

Internal Audit's mandate generally includes outsourced activities as well as its vendor management. Important - in that respect - may be auditing the upwards and downwards value chain assessment's approach and results, to make sure ESG is integrated. It generally already is included in the audit universe (in the financial sector, the concept of the "right to audit" has been established).

- Forward looking information

There is a risk of inaccurate information. Internal Audit will review the reliability of the (hardness of) assumptions, and the calculations, to provide assurance and recommendations.

ESRS 2: General, strategy, governance and materiality assessment disclosure requirements

Principle 1: General characteristics of the sustainability reporting

In Section 1.1, point 5, it is explicitly mentioned that "the undertaking should disclose the audit firm or the independent assurance provider that has audited the sustainability information".

If the undertaking has an Internal Audit function, it should be compulsory to describe the role of Internal Audit in reviewing the company's ESG governance, policies/internal controls, risk management and reporting.

Principle 2: Strategy and business model: see above

Principle 3: Governance

- Roles and responsibilities of the governance bodies and management levels with regard to sustainability matters

Internal Audit provides independent, reasonable assurance on the internal governance and corporate governance, including risk management and the internal control processes.

- Integration of sustainability strategies and performance in the incentive schemes

Internal Audit audits the remuneration policies and the way they are executed very frequently (it is included in the EBA guidelines).

Principle 4: impacts, risks and opportunities

Together with Risk management, Internal Audit is specialized in risk identification, risk assessment and risk management. In all engagements, Internal Audit assesses the risks involved and reports accordingly. Internal Audit can play a key role here and provide assurance and input on ESG risks and opportunities, both internally and for the various stakeholders, cooperating with the external auditor.

ESRS G1: Governance, Risk Management and Internal Control

Principle 1: Disclosure requirements

Internal Audit is independent (see Three Lines Model above), is professional ([certifications...](#)) and is required to comply [with the International Professional Practices Framework of the IIA, and with the IIA Code of Ethics](#), which is a statement of principles and expectations governing behaviour of individuals and organisations in the conduct of internal auditing. These principles and behaviours include integrity, objectivity, confidentiality, and competency.

Internal Audit reports directly to the Governing Body (Audit Committee).

To support statutory auditors in auditing the wider corporate information, we believe there should be an important and enhanced role for the work of Internal Audit.

To support statutory auditors having a better understanding of the company's broader financial and non-financial risk landscape, the Chief Internal Auditor and the partner responsible for the external audit, should ensure appropriate and regular communication and sharing of information.

In order to maintain both assurance functions' independence and objectivity, whilst external/statutory audit cannot receive direct assistance and cannot rely wholly on the work of Internal Audit, and vice versa (in accordance with our respective professional standards), statutory auditors should make appropriate use of Internal Audit reports, to place maximum reliance of the work performed and the related findings, also to get a better sense of a company's approach to key risk areas (e.g. ESG corporate culture, ..), whilst maintaining professional scepticism.

As some areas might be "non auditable" because of the lack of standards, lack of data (mainly the soft(er) aspects of the information), it would be useful to define the level of assurance required. Maybe internal auditors are best placed to report on these elements (e.g.: diversity and equality, behavioural board culture,...) in their "insight" role.

The collaboration should be validated by the Governing Body and be explicitly published in the governance disclosure.

4. Conclusions

The role of Internal Audit is to provide assurance and insight on the design and effectiveness of governance, risk management and internal control across the business, also providing insight to the board on a broad range of financial and non-

financial risks areas. As the ESG Reporting is the (ultimate) result of internal processes, managed and controlled through the internal governance, risk management and control activities, Internal Audit's work is an important element of good governance.

We, therefore, strongly recommend to explicitly refer to the role of Internal Audit in the ESRS 2 and ESRS G1 when describing the monitoring and governance model related to the ESG information. The obligation to set up an Internal Audit function in organisations of a certain size, should be part of future regulations.

Internal Audit has a unique position as the Third Line in the business, having an independent 'helicopter view' of the entire audit, risk and assurance landscape, in partnership with the other assurance functions (internally and externally). They play an important coordination role and assist the Governing Body in its oversight role.

We also recommend to clearly define the role of Internal Audit in the assurance process of ESG disclosures, and to emphasize the cooperation with the statutory auditors, to avoid duplication of work and safeguard completeness, transparency and quality.

Finally, we acknowledge that the implementation of ESRS will be a long journey, also for the Internal Audit profession. Not all Internal Audit functions already have the same maturity level, and their roles will depend on the organisation's ESG maturity. Besides, new skills might be needed (for some specific ESG areas). Nevertheless, we advocate that Internal Audit should be involved from the beginning, to assist the Governing Body and the organization in embarking the ESG journey in a successful manner.

Congratulations for the great job in drafting these Standards and looking forward to more detailed discussions about the role of Internal Audit in ESRS implementation.

Kind regards,

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About ECIIA

The European Confederation of Institutes of Internal Auditing (ECIIA) is the professional representative body of 34 national institutes of internal audit in the wider geographic area of Europe and the Mediterranean basin. We represent 55.000 internal auditors.

The mission of ECIIA is to be the consolidated voice for the profession of internal auditing in Europe by dealing with the European Union, its Parliament and Commission and any other appropriate institutions of influence. The primary objective is to further the development of corporate governance and internal audit through knowledge sharing, key relationships and regulatory environment oversight.

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ⁱ Already used as a reference by the Financial Regulator (eg: the EBA guidance about internal governance : EBA-GL 17/11 reviewed in April 2021

ⁱⁱ It is worth mentioning that the role of internal auditors is widely described in the COSO framework as well and the framework is very popular in organisations as Enterprise Risk Management framework.