

THE ESG DAY

BRUSSELS | 1 DECEMBER 2023 | HYBRID EVENT



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INTRODUCTION

ECIIA believes that CSRD is not about reporting anymore but about acting and internal auditors must become an important actor in the sustainable journey that companies are driving.

More than ever, a collaboration between all stakeholders is important and the program of the day articulates the best practices to apply to save together the planet.



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WHY IS ESG IMPORTANT & COMPLEX

The climate urgency is not an assumption anymore, there is no time left to act! We have 7 years to cut CO2 emissions by 50% and the current plans are aligned with this target but the implementation is too slow, and the speed is not the one promised.

There are already social consequences such as insurance premium raises, real estate market prices... Only 24% of businesses have adapted their model in Europe because they are afraid of slowing down their operations.

Top management must support the initiative of transitioning towards a sustainable business, not doing so is considered "business malpractice".



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HOW TO MEASURE ESG

Sustainability reporting itself is not the objective, it is broader: to deeply change the supply chain.

ISSB, EFRAG and GRI are the 3 main standard setters with a specific perspective on reporting. On some matters, they can be interoperable but a global standard would ease the reporting for business.

ISSB was created to provide relevant financial data for investors. financial reporting. **EFRAG** was created to ease the report by combining financial and non-financial impact. **GRI** was created for material reporting, to help organisations increase their transparency and communicate their sustainability contributions and impacts.

Investing in mitigating the risk should be a priority for board members, knowing that shareholders and stakeholders will look at it. Internal Auditors can check if the sustainability policy of the company applies inside the organization.



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Europe is the first continent that has adopted European Sustainability Standards. Currently, only the sectorial agnostic standards have been issued: 2 cross-cutting ones, and 11 topical ones. Important new concepts are developed: double materiality, future-looking impact, and value chain.

The EFRAG's top priorities for 2024 are implementation assistance for the first set of ESRS, the development of the standards for SMEs, and the digital tagging of ESG information. Standards for branches and subsidiaries of non-EU companies are also on the list.

For businesses, those regulatory standards are costly and demanding and not all companies are at the same stage in the journey. The delimitation of the value chain is still vague.

ESG ratings are not tackled yet in any regulation and this is an extra complexity for the business. It is important to reach alignment amongst all the regulations (eg SFRD and ESRS) and efforts have been made (eg financial impact harmonized between ESRS and ISSB) but it is a difficult exercise.



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THE ESG REPORTING

The quality of the data is important (we will need proxy and estimates...) and it is key to remember that everything is about trust for stakeholders in the ESG reporting.

Internal auditors must have a sounding board role, as an advisor, as a critical challenger (eg for the materiality assessment). They must learn and work with departments they are not used to collaborating with (including technical ones).

It is a learning process for everyone, it will not be perfect from the start but each step is good to stimulate the company to change their strategy and business. There will be costs in the short term while benefits will come in the longer term.

In a nutshell, mindsets, strategies, business, culture, and behaviour must change.

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THE EUROPEAN REGULATORY CONTEXT

The starting point was the Paris Agreement on climate change with concrete commitments in the EU and specific measures: the European Green Deal, an action plan on sustainability finance. The goals are clear but need huge investments from the private and public sectors.

Everyone in the financial markets must be on the journey. After CSRD was developed, together with the taxonomy it is a great step forward. The European Commission is helping the countries with the translation and a Q&A platform will be opened in Q1 2024.

For the assurance of the reporting, the European standards will adopt a delegated act and look closely at the work of IASB.

Internal auditors must play an important role, as we move from voluntary to mandatory reporting, and will include substantial information about internal processes.



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WHAT IS THE IMPACT OF ESG REGULATION ON THE BOARDS & AUDIT COMMITTEES

The Boards have big challenges ahead: ESG is one of them, but also resilience, digitalisation.

The Boards are mixed with a desire to explore the opportunity that exists in ESG (ex: profitability, integration in the economic strategy) and a fear of being too open in a competitive economy (comparison, steal of idea).

Implementing ESG in the operations is a challenge, it is a new management system and you need to analyse all processes and adjust them.

In their ESG journey, companies need to make a choice early in the process (setting the ESG strategic objectives). They must also consider what is material or sensible information in the reporting process. Moreover, in listed companies that have complex value and supply chains, it's challenging to be confronted with suppliers not complying with due diligence issues.



WHAT IS THE IMPACT OF ESG REGULATION ON THE BOARDS & AUDIT COMMITTEES

Regarding the assurance process, in some countries (eg France: H3C), the oversight bodies have issued guidelines about the assurance of ESG reporting and a discussion is taking place between the CEAOB and the EC to develop common guidance about the assurance of the ESG reporting before the deadline announced by EC (Oct 2026).

Today, assurance providers and internal auditors are lacking skills regarding ESG regulation. This gap must be overcome quickly and new profiles must be hired (more technical). It is also time to strengthen the IA function as they are the only ones used to check the complexity of the company, they know the specificities of the company and they are used to speak to everyone in the company. The collaboration with the second line is also key to giving coherent information to the Board (risks, internal controls, compliance..).

For the Audit Committee, the top priorities are to review the Audit Committee Charter, define new risks oversight and resilience, define a new assurance chain, and get assurance on new topics. Here the main problem is the accumulation of data, coming from various places.



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WHAT DOES ESG REGULATION MEAN FOR INTERNAL AUDIT

ESG is a journey and there is no one-size-fits-all solution regarding the role of IA...but collaboration is key.

Firstly internal auditors must create awareness with boards to emphasise change. They start with insights, and advice and can finally give assurance, depending on the mandate received from the Board. IA is part of the assurance chain: strategy, governance, roadmap, KPIs, culture processes, risk management, internal control... The role of IA is similar to the one they have for all new regulations.

There are new concepts and thoughts: double materiality, complex reports with intangible data, forward-looking information, need to report risks, opportunities, and impacts. The question remains how external auditors will go from limited to reasonable assurance? In the audit plan, ESG is impacting every line.

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ENHANCING INTERNAL AUDIT VALUE THROUGH ESG

Based on a recent survey from Wolters Kluwers, 47% of internal audit shops do not include ESG in their audit plan for 2024.

To start, ESG must be integrated with the risk assessment, consider starting with broad coverage –strategy, programs, reporting, and talk to the audit committee, sustainability committee, executive management, and risk management.

While mapping the work to plan, be careful because ESG components are often already included in the audit plan but not categorized as such!



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THE ASSURANCE BY THE EXTERNAL AUDITORS: THE CHALLENGES, AND THE COLLABORATION WITH THE INTERNAL AUDITORS

Sustainability assurance holds various challenges, regarding double materiality, greenwashing, connecting financial information with non-financial one, and the availability of data. To overcome those challenges, external auditors must have a close look at the compliance with the CSRD directive.

The need for an international sustainability assurance standard, framework is highlighted and IASB launched a consultation on this topic (ISSA 5000). A mandatory discussion between management and external auditors is key. External auditors must give limited assurance on the ESG reporting: it must be in line with ESRS, in line with the entity materiality process, and in conformity with the green and digital taxonomy. There will be qualified conclusions from the external audit reports and this is new.

Professionals agree that the cooperation of IA and EA makes more sense than ever, IA will share information about the entity specificities and the risk assessment and EA will share the control deficiencies, and material misstatements. EA will rely on IA work and we need to agree on the conditions. The independence of the auditors should be protected to ensure a system of quality control. Finally, what applies to EA should also apply to other assurance providers.



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THE COLLABORATION BETWEEN THE DIFFERENT ACTORS IN THE ESG CONTEXT

A recurring piece of advice concerning ESG matters is to start at the top of the company, at the board level, to have an impact. After this step, sustainability is still complex, and knowing how to mitigate risks remains a challenge. Therefore, hiring specialized people (ex: engineers, jurists) and educating mainstream auditors is a good solution. As a reminder, auditors must be able to audit 60 % of ESRS, even KPIs. Next, comes the definition of materiality inside the value chain. While double materiality is important, we can't forget the risk approach and how something with a low probability can have a huge impact.

Here are some best practices to remember :

- Trying to converge in a one-and-only form of reporting
- Working together constructively
- Making a judgment about which KPIs disclosure is the most risky
- Keeping a risk-based approach
- Staying aware of the complexity of the value chain



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CONCLUSIONS

Pressure is on everyone to embed ESG in the organisations. It seems easy from a regulatory standpoint but implementation is not easy, there will be trials and errors. We need to develop guidelines for the assurance of the ESG report. Collaboration between the different stakeholders in the organisation is key.

IA must be part of the journey, a trusted advisor of the Board. It is time to act! Full sustainability might be a dream but it is vital for developing future and current generations!



THANK YOU!

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