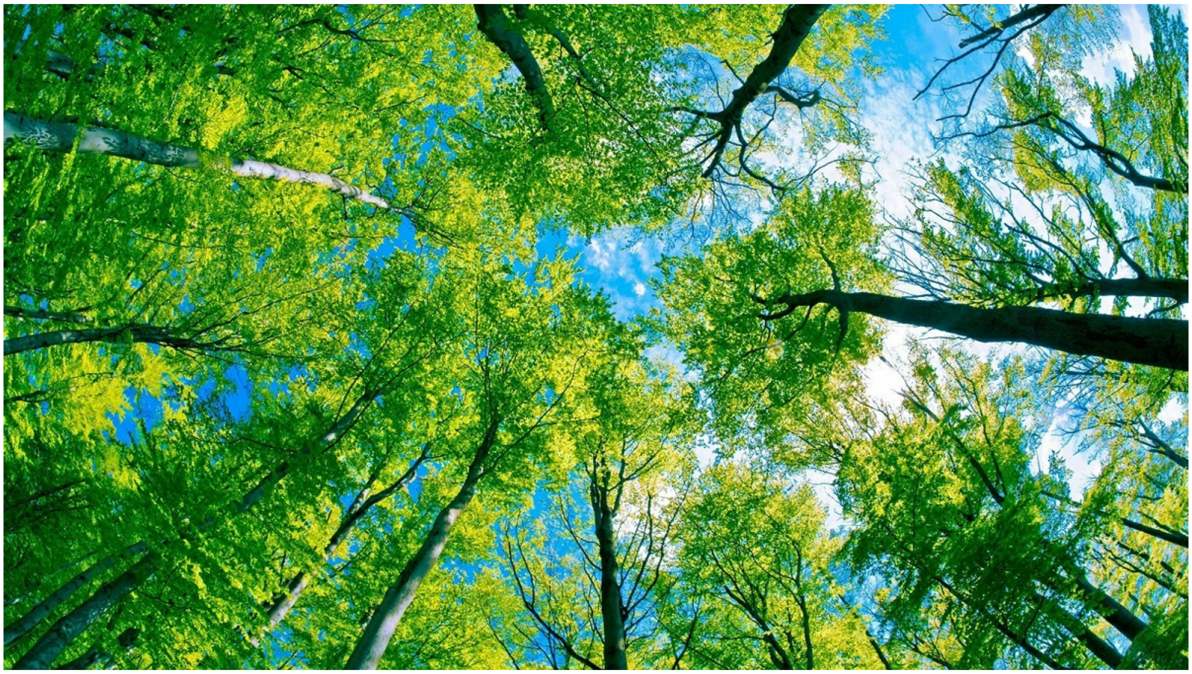
Sustainability assurance



The climate emergency and BEIS White Paper on restoring trust in audit and corporate governance are creating a landscape where sustainability is rapidly becoming as mainstream as financial controls for assurance providers.

Mandatory sustainability reporting is gaining pace such as TCFD reporting within financial services and the wide-reaching BEIS governance reform proposals.

As transparency demands increase, so does the risk of reporting inaccurate or incomplete data. Independent assurance is critical. Now is the time for CAEs to have clarity and purpose regarding the role of internal audit in providing assurance across a wide range of non-financial data including sustainability reporting.

Join us as we recap on the topic of sustainability assurance and invite you to look afresh at what you are doing today and whether it is enough.

Is sustainability the same as CSR?

In a word - no - it is important to understand the difference as they are often interchanged.

In the 90s early advocates proposed the triple bottom line, broadening the focus of financial reporting to include social responsibility and environmental impact in addition to economic value. The challenges of measuring these constructs financially led to organisations adopting CSR (corporate social responsibility) reporting; a narrative style with occasional targets and financial information.

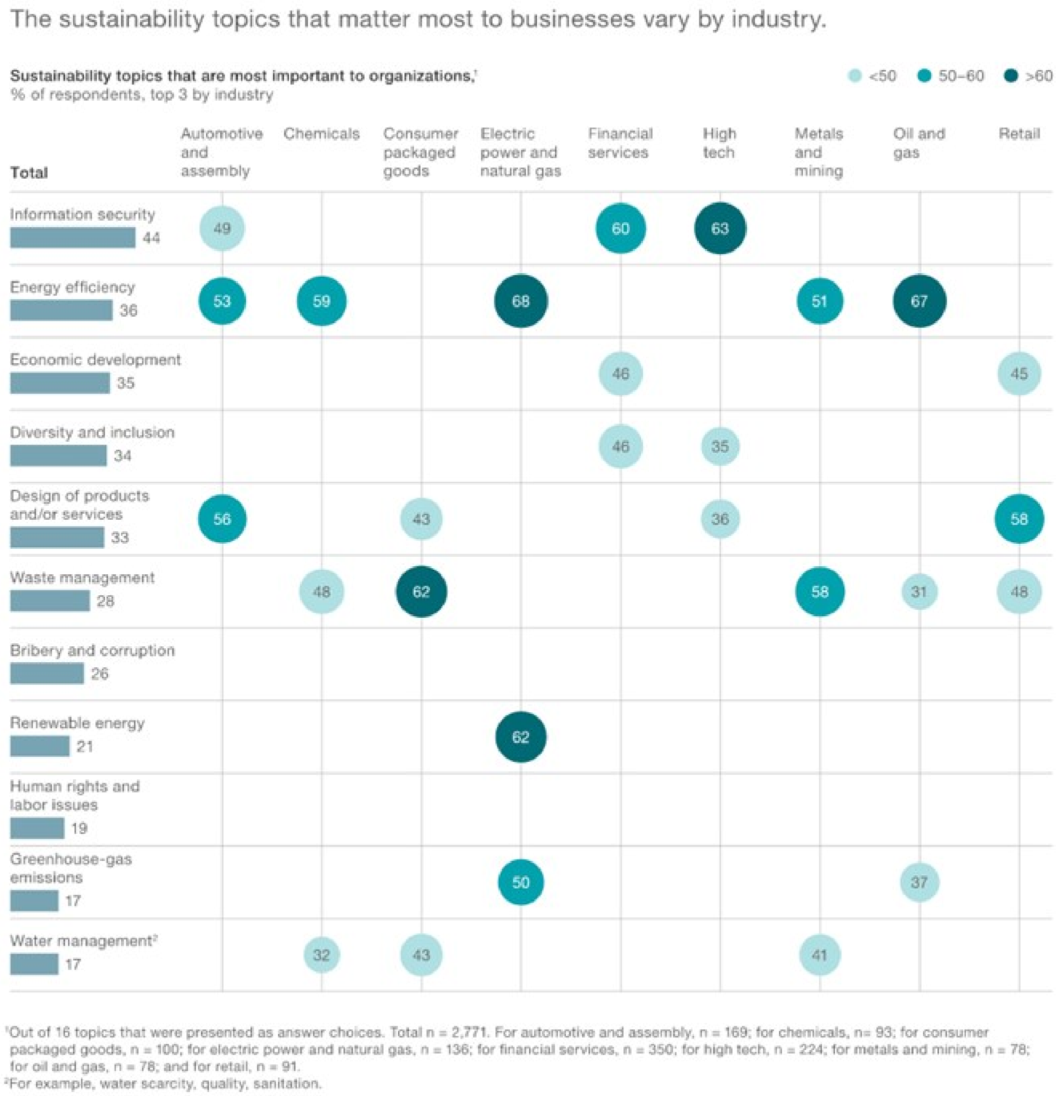
Sustainability is more specific, it is about operating to ‘meet the needs of the present without compromising the ability of future generations to meet their own needs’, the concept of environmental fair play, producing goods and services in a way that avoids depleting natural resources that cannot be replaced. Natural resources are not renewable yet they are an essential component of many industries; heating in healthcare, sand in construction, oil in logistics.

CSR reports traditionally look at performance over the last year against often self-declared targets and whilst covering the same issues, the context, environment and community, they can fall short of the requirements of sustainability reporting which necessitates a longer-term position, looking strategically at the operations to ensure not only the success of the business for the immediate future but environmental security for future generations.

With the ever-increasing focus on how organisations operate there is a natural convergence of CSR, sustainability and corporate governance; how are these issues reported by your organisation and has it changed in recent years? Who has board responsibility for sustainability?

A McKinsey survey on the subject found that the formality of sustainability programmes and their governance is increasing as organisations seek transparent alignment of their values with their operational practices.

The following diagram shows the global sustainability priorities by industry, interestingly water management only just makes it into the list despite water crises being on the World Economic Forum's list of the top global risks. Diversity and inclusion is a key priority compared to projections from a few years ago when it was thought that renewable energy and waste management would become top priorities; social pressure and legislation around gender equality may have skewed the results. The topics show the complexity of sustainability reporting and that despite its definition in relation to natural resources it has become almost all encompassing. It is interesting how high tech and automotive industries prioritise information security despite their dependency on natural resources for component parts. Auditors are familiar with Maslow’s hierarchy of needs, perhaps considering the needs of the organisation would be a useful exercise.



Source: McKinsey

What are the requirements?

In 2015, the United Nations agreed the 2030 Agenda for Sustainable Development, including 17 goals and 169 targets. These goals, together with the aims of the Paris Climate Agreement (goal 13), are addressed in various legislation covering topics such as gender pay, diversity, anti-bribery and corporate governance. In December 2020, the UK pledged to reduce emissions by 68% by 2030, compared to 1990 levels. A target that will form part of the UK's Nationally Determined Contribution (NDC) to the Paris Agreement.

Listed companies are required to report non-financial data within their strategic report. The BEIS consultation proposes to further strengthen non-financial reporting to improve transparency for stakeholders, particularly investors. The Task Force on Climate Disclosure (TCFD) reporting requirements also support transparency for investors and are now mandatory in some sectors as part of the UK Government's roadmap which is scheduled to include listed companies in 2022.

HM Treasury produce guidance for public sector sustainability reporting in England, members in Northern Ireland, Scotland and Wales are advised to source regionalised versions.

The Charity Commission has no mandatory requirements for non-financial data and the sector has largely been overlooked for CSR reporting as it has been considered inherent in their activity. Should any organisation be exempt from reporting on sustainability? Is it an unnecessary administrative overhead for charities or a governance weakness?

What does good reporting look like?

The diverse nature of organisations means that there is no standard format for reporting. It is incumbent on organisations to consider their operations, strategic intent, stakeholders and values to decide what and how to report externally. Generically organisations are required to consider the impact of their activities on the environment with the robustness of reporting largely dependent on the quality of critical thinking, risk awareness and corporate culture.

TCFD reporting uses a defined framework which organisations may find useful. Interestingly, the London Stock Exchange guidance on sustainability report has been aligned to this since 2017. The GRI provides a global standard for sustainable reporting; it is aligned to the requirements of the EU directive and supports the UNs goals. According to GRI, 74% of the world's largest organisations use their standards for reporting sustainability.

Organisations can incorporate this within their existing strategic, CSR, sustainability reporting, as achieved by Rio Tinto. The standards are flexible with an emphasis on materiality to enable organisations to ascertain what is important.

Mondi, a global packaging and paper group, won a PwC award in 2017 for their sustainability report. Their 2020 report continues to inspire in its approach to their goals for 2030, each with strong ties to sustainability and explicit linkage to the UN's Sustainable Development Goals. Whilst it is a detailed report, given its global reach and sector (paper and packaging), their approach of relating everything to the UN's goals is something all organisations can achieve.

Why is assurance important?

Trust is paramount to organisations across all sectors. The BEIS consultation, a culmination of various independent reviews is all about rebuilding trust.

According to Edelman's annual 2021 trust barometer, 59% of the UK expect CEOs to step up and fix societal problems when governments fail to do so. Furthermore, 63% expect CEOs to be publicly accountable not just to their own shareholders.

Transparent and accurate reporting is a major step towards building and maintaining trust - having assurance across the reporting is the foundation of surety for the board in taking the step.

If sustainability is not on your audit plan why not? Rectify it today.

Assurance options

Depending on the maturity of existing reporting, not all of these suggestions will be appropriate, however for organisations that have not undertaken a comprehensive risk assessment or provide limited information, they may be useful.

Where reporting is mature there will be formal processes and reports to review. Aside from compliance assurance, consideration could be given to evaluating the principal risks from a sustainable perspective or facilitating a workshop to assess if sustainability initiatives could drive improvements to service or cost savings. In new or evolving situations, internal audit may need to take a more advisory role to begin with. Considerations should also be given to 1st and 2nd line assurance activity; a sustainability assurance map may become a necessity to support the development of the Audit and Assurance Policy proposed in the BEIS consultation. Why wait? Get ahead of the curve.

Fitness for purpose

An objective, strategic opinion on the appropriateness of the information being reported.

This could be step one of a broader audit or a standalone piece before getting into the detail of the data;

- Consider the organisation using the GRI standards and UN sustainable development goals
- Consider TCFD reporting framework
- Create a high level diagram of the organisation – where are the touchpoints for the different index categories/goals? How important are they? How many are relevant?
- Have there been any past incidents or near misses related to any of these areas?
- What policies are already in place relevant to these areas?
- Does reporting link to strategy?
- Conduct a critical review of the information currently being reported. What does it tell a stakeholder? Is it comprehensive? Is it retrospective or future focused?
- Corporate values. What is the tone from the top? Is reporting to tick a box or to do what's right?
- Stakeholder interest. Who asks questions? Has the topic impacted decisions including investment?
- A useful tool for exploring potential stakeholder interest is a GRI report that details 52 different sectors
- Remember what Peter Drucker famously said, "What gets measured gets managed".

Data assurance

A review of the robustness of the data being used in reporting; accuracy, reliability, validity, completeness, timeliness and relevance. It is important that stakeholders, particularly investors and regulators, trust the reliability and relevance of non-financial data and value its quality.

- Where is data sourced from? Is it a reliable source? Are there other means of capture?
- How deep is the reach? Components of products not just end product, for instance the cobalt in lithium batteries is principally mined in the Democratic Republic of the Congo with its poor human rights record.
- Diamonds and many minerals can be traced through their supply chain from mine to product, likewise meat and milk from farm to plate.
- This may seem daunting but it is possible, organisations such as Geotraceability collect data globally to support traceability across industries including coffee, cocoa, minerals, livestock and healthcare.

- Is the data complete? Thinking back to the diagram of the organisation, are there other processes that should be considered?

An interesting thought paper on leveraging the COSO framework to improve the confidence in sustainability data may be of interest to CAEs in large organisations or those with complex supply chains.

Compliance

These could be risk rated and audited on a schedule over a period of years depending on materiality to the organisation. Ring-fencing even a small amount of resource to provide assurance or advice over sustainability risks demonstrates the integrity of internal audit.

Audits of policy compliance such as anti-bribery and corruption, health and safety, diversity and inclusion, procurement, product sourcing, political donations or waste management.

Process

Rather than focusing solely on internal controls, using an appropriately worded terms of reference, reviewing an entire process enables internal audit to evaluate the extent to which sustainability is embedded.

- Are practices regularly reviewed and challenged or accepted for what they are?
- How innovative are management?
- Does the culture support learning from trying new things?
- The centre for sustainable healthcare demonstrates how an industry can focus on improvements, internal audit can research and offer advice to their organisations of relevant groups if links have not already been made

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Closing thoughts

The Blue Planet series, presented by Sir David Attenborough, highlighted the issues of poor waste management related to plastic. People are now very aware of what their daily water bottle and takeaway coffee cup mean for the planet and, with increased awareness, the beginning of meaningful change. For organisations the challenge is much greater than a few less coffee cups, using eco lightbulbs or recycling rubbish.

As you can see from reading this, CAEs have an opportunity to position internal audit at the heart of restoring trust by providing assurance across the whole suite of issues at the forefront of corporate governance reform, including sustainability reporting.

> *"Cherish the natural world, because you're a part of it and you depend on it"*

- Sir David Attenborough