



Climate risk and internal audit



When properly resourced, positioned and targeted, professional internal audit provides the kind of insight that boards need to make effective decisions.

Over the past decade or so, internal audit has been moving out of the back office in many organisations to play a leading role in helping businesses get to grips with today's dynamic risk landscape. With that, audit leaders have become trusted advisors to boards on an increasingly complex range of risks including identification and management of climate risk.

Climate change, as we know, is a key issue in today's risk landscape and brings with it both challenges and opportunities for audit leaders. According to Mark Tucker, Group Chairman for HSBC: "Climate Change is not only one of the biggest challenges facing UK businesses today, it is also a huge opportunity. Meeting the challenge and making the most of this opportunity depends on corporate boards being well briefed and committed to focussed action."

If it all seems too big, too inaccessible and too remote then this article is for you. As is our podcast by Jonathan Porritt, [business and prevention of environmental collapse](#). To help navigate your understanding of climate risk and why it's important, we give you three priorities, five conversations and 10 top tips.

Three climate risk priorities for audit leaders

Climate risks are those arising from the effect of global warming. Yet despite the world being in the midst of a climate crisis, [Risk in Focus 2020](#) – our annual report for internal auditors - found only 14% of organisations have environment and climate change as a top five risk.

Scientists talk about the need to reduce greenhouse gases and move to a low-carbon economy to limit these effects, a goal endorsed by Mark Carney the UN special envoy for climate action and finance and former governor of the Bank of England.

Of the many climate focused priorities on the radar for governments and business leaders, we focus here on just three: stewardship, risk management and assurance.

Stewardship

Business leadership is often focused more on short-term risk than long range climate risk is beyond the viability horizon of most organisations and internal auditors. Taking personal ownership of climate risk is the precursor to boards taking meaningful action. With access to key decision-makers, such as the board, non-executives, trustees and accounting officers, audit leaders across all sectors must ensure there is adequate **stewardship** of the environment.

According to CAE, a Swedish professional services firm quoted in Risk in Focus 2020: “Companies are working in three-year cycles, they are too short term.”

Clear accountability is essential. Decision-makers must have carbon literacy, a personal understanding of the risks facing the organisation, the sector and their impact on the planet.

Sustainability and corporate social responsibility are familiar wrappers for such initiatives; however, slogans and meeting legislative targets are no longer sufficient mitigations for climate risk.

Like wildfires that sweep across Australia and California, the velocity of understanding in respect to climate risk is fast and non-linear...so too is the speed at which social media can promote protests, boycotts and impact reputations.

Is climate risk management embedded into the decision-making of your organisation?

Risk Management

Climate and the wider environmental risk landscape is highly volatile. The only certainty for organisations is that scientists agree that a significant change in carbon factors must happen quickly; the 2010s was the warmest decade since record keeping began.

Accordingly to our Risk in Focus 2020 report, Natural disasters and extreme weather caused around \$160 billion worth of damage in 2018. Only \$80bn of which was insured against.

Climate risk can be separated into two distinct strands; physical and transitional risk. Physical risk relates to the impact of a climate induced event on the business model, supply chain and processes. Transitional risk relates to the disruption of business strategy/model, either through proactive adaption or external enforcement.

Is your organisation carbon intensive? What natural resources does it depend on?

Assurance

Audit leaders must include climate **assurance** in their audit plan.

This should be appropriate to the maturity of the conversations within your organisation; climate risk is a top risk for all organisations regardless of whether it features on the risk register. If the board is asleep at the

wheel, internal audit must wake them up to avert disaster.

Ideas to think about include:

- Climate strategy assurance
- Energy audit: reducing carbon
- Supply chain: resource dependencies
- Plastic audit: removing single use
- Waste audit: reduce, reuse, recycle
- Viability statement: stress testing
- Climate data: reporting accuracy
- Business resilience: extreme weather

How are you addressing climate assurance this year?

5 conversations for audit leaders to kick-start

The priorities for audit leaders lend themselves to the unique attributes of the profession; a careful balance of hindsight, insight and foresight combining together to enhance and protect the organisation.

Using these skills, audit leaders can perform their own work and encourage discussion to evaluate climate risk to identify and evidence what has happened, what is critical to success (hindsight) to define cause and effect relationships (insight) and analyse causal events and horizon risks(foresight).

Key conversations to inform and then share outputs include.

Audit committee chair

Non-executives have an important role in climate oversight. They may need to be the drivers of change where board executives defer difficult decisions in favour of maintaining existing business models to achieve targets and associated incentives.

Audit leaders are the trusted advisors of the board, the eyes and ears of the audit (and risk) committee; building a constructive partnership with the chair and other non-execs is critical to meaningful discussions on climate risk and the sustainability of the organisation. Perhaps encourage them to expand their learning through organisations such as [Chapter Zero](#) (free membership).

Finance Director

Financial climate risk is an ongoing conversation. What is your organisations finance strategy in relation to the low carbon economy? Audit leaders need to understand how the value of [assets](#) might change to ensure assurance is future focused. What could the impact be on the pension fund? The [financial markets](#), including lenders and insurers, are clear about the disclosures companies need to make around their management of climate risk.

215 of the world's largest companies have valued climate risks to their businesses at almost \$1trn; these same companies calculated that climate business opportunities are worth some \$2.1trn.

Property/Energy/Facilities Director

Removing reliance on fossil fuels is a key step in reducing harmful greenhouse gases. There are two aspects to this that organisations need to be actively addressing; **energy** efficiency and energy choices. Audit leaders can promote these issues through discussion and highlighting opportunities for adaption through maintenance/renewal programmes and relevant projects.

Procurement/Supply Chain Director

All organisations procure products and services, whether for own use, manufacturing or resale. There are many **topics** of conversations that can either raise awareness or inform the audit plan depending on the maturity of climate risk management. For example, is single use plastic being removed from the supply chain? Are all consumables recyclable? Do green credentials carry higher weightings in selection of products/partners? Where is the organisation vulnerable to extreme weather events – factories, suppliers, raw materials, customers?

Audit team

In addition to stakeholders within the organisation, it is also important to maintain dialogue within the audit team itself. As an audit leader do you empower your team to look for opportunities to engage with auditees regarding climate risk regardless of what they are auditing? Do you have any internal auditors that are climate sceptics? What ideas do the team have about providing climate assurance? The tone from the top is important in any culture, including the tone that audit leaders set about the importance of climate risk management.

10 top tips for internal audit teams

- Build personal knowledge of climate facts relevant to your organisation
- Understand the basics of climate science
- Map the climate risk 'threats' in your organisation to the audit plan
- Map the climate risk 'opportunities' in your organisation to the audit plan
- Network with other internal auditors – share ideas on climate assurance
- Look for opportunities to raise issues concerning climate risk in all audit engagements
- Link data analytics with climate data where appropriate
- Run lunchtime/breakfast climate risk workshops to generate discussion
- Personalise findings by making direct links between climate facts and the organisation
- Promote rationale, business arguments not emotional rhetoric

Climate risk data

There is a plethora of information on climate risk which internal auditors can utilise as evidence in audit findings. It is important to use reputable sources and whilst this list is not intended to be comprehensive it is a good start point.

World Economic Forum	Effective Climate Governance on Corporate Boards	A paper designed to equip boards with the right tools to steer climate risks and opportunities and make decisions for the long-term resilience of their organisation.
Task Force on Climate-related Financial Disclosures	TCFD Knowledge Hub	The TCFD help companies understand the disclosures that financial markets need. Full details of recommendations and how to deliver them can be found here .
Intergovernmental Panel on Climate Change	Reports	Variety of reports including a 2018 publication on the impacts of global warming of 1.5°C.
UN Climate Action Summit	The United in Science report, convened by the Science Advisory Group of the UN Climate Action Summit 2019	Summary report of state of climate and projections for future, key message that current policies and actions are insufficient to avert dangerous global temperature increase with potentially irreversible impacts.
Published in BioScience	Full paper Summary in The Guardian	11,000 scientists join to warn of climate emergency, includes graphics, details and projections.
Met Office	Climate Science	Webpage with lots of research/data.
Met Office	UK Climate Projections 2018	Overview of research including types and extremes of weather in UK regions.
Grantham Institute – Climate Change and the Environment	Website	Communicating academic knowledge to businesses, industry and policymakers to help shape their decisions.

Why your role is important

Audit leaders are a powerful instrument in the governance of organisations. This includes the tone from the top on the importance of climate risk and how it is being identified and managed. How are you using the power of your influence?

In 2019, the UK joined with other countries and local governments to declare a [Climate Emergency](#). It was also a time when the protests of Extinction Rebellion and schoolchildren across the globe took centre stage – demanding action not words.

Do you want to act but don't know where to start, what to read or who to believe?

As this infographic by Iberdrola indicates, the social and economic impact of climate change is wide-ranging. But, as an audit leader, there is plenty you can do to help.

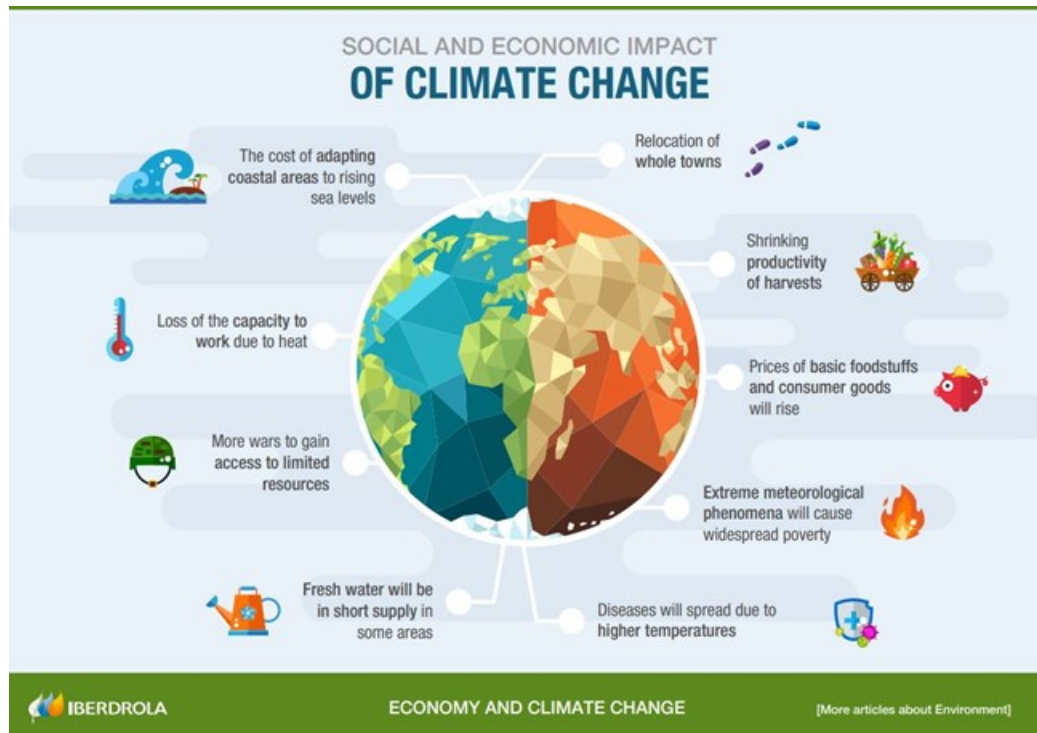


Image credit: Iberdrola

Every little helps

Internal audit has visibility and the ability to influence across the entire organisation. There are basic things that all organisations can do to protect the environment. Can you effect positive change in your organisation through assurance, advice and consultancy?

Does your organisation:

- Have a motto to recycle or to reduce, reuse, recycle?
- Provide easy to use recycling points for all materials?
- Use water filter cartridges on taps to encourage people to use tap water rather than bottled water?
- Operate a paperless office or have unnecessary print outs at meetings, for reference etc?
- Use energy efficient lightbulbs?
- Encourage staff to work from home rather than commute wherever possible?
- Power down electrical equipment overnight – printers, monitors etc?
- Utilise videoconferencing to reduce the need for business travel?
- Facilitate a car-share scheme for staff to reduce car usage?
- Mandate cleaning contractors to use environmentally safe products?
- Incentivise 'green-thinking'?
- Give higher weighting to potential suppliers/partners with good green credentials?

Closing Thoughts

In his [speech](#) at the Chartered IIA's 2019 Internal Audit Conference, Jonathan Porritt, environmentalist and co-founder of Forum for the Future, reminded delegates that it's not all doom and gloom, there are solutions and progress is being made. However in order to avert the crisis more needs to be done throughout this decade that will require "an unprecedented set of interventions by government, investors, businesses and citizens."

What are your organisations priorities? What are your priorities?

"Climate change is, simply, the greatest collective challenge we face as a human family."

Ban Ki-Moon, former UN Secretary-General

Further reading

Guidance - [Climate change and environmental impact](#)

Technical Blog - [Climate change brings evolving and challenging risks for all organisations](#)

Technical Blog – [Climate crisis, time to act](#)

Technical Blog – [Is plastic on your audit plan](#)