Providing senior management, boards of directors, and audit committees with concise information on governance-related topics.

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## A Watershed Moment in Sustainability Reporting

Organizations around the world routinely struggle to capture important sustainability information and consistently report on their sustainability efforts. Contending with a wide range of possible frameworks or guidelines for environmental, social, and governance (ESG) disclosure only heightens the confusion and uncertainty. Indeed, global professional services firm EY has estimated that there are more than 600 ESG reporting provisions globally.

The absence of uniform, global reporting standards has vexed organizations and meant inconsistencies and frequent gaps in

reporting and measurement of nonfinancial information related to ESG and sustainability. However, sustainability proponents and regulators are working to better define and clarify requirements for sustainability reporting. One significant example is the release of the first round of standards from the International Sustainability Standards Board (ISSB), an important step forward in sustainability reporting. This issue of *Tone at the Top* will discuss the new standards and how internal auditors can help boards make sense of them.

## **New ISSB Standards**

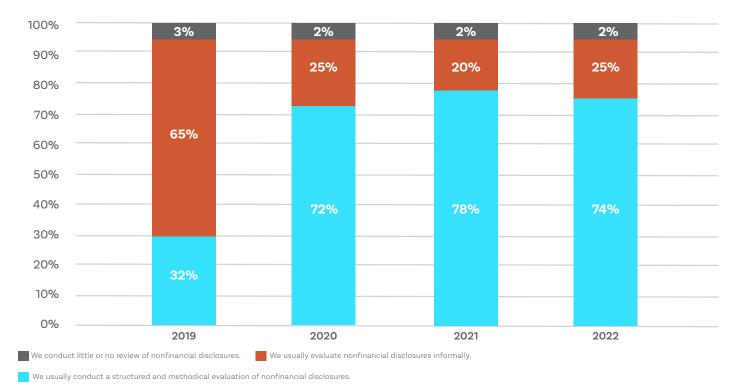
The International Financial Reporting Standards (IFRS)
Foundation created the ISSB in 2021 in part to provide a
"high-quality, comprehensive global baseline of sustainability
disclosures focused on the needs of investors and the financial
markets." The launch of the ISSB, which consolidated several
existing sustainability framework organizations, came at a
time when investors and other stakeholders were calling for
sustainability information that was more reliable, comparable,
and generally useful in decision making. The launch of the ISSB
brings financial and nonfinancial reporting under the auspices of
one organization — IFRS — and is intended to promote greater
trust and confidence in company sustainability disclosures.

Countries that are set to consider using the standards include Australia, Canada, Japan, Hong Kong, Malaysia, New Zealand, Nigeria, Singapore, and the U.K., and others are expected to adopt them.

In recent years, the bulk of investors have moved to a structured and methodical evaluation of nonfinancial data (see Figure 1). EY asked nearly 1,400 senior finance leaders and investors to describe how they and their investment team evaluate nonfinancial disclosures relating to environmental and social aspects of a company's performance.



Figure 1-Investors' Approach to Evaluating Nonfinancial Disclosures



Source: "How Can Corporate Reporting Bridge the ESG Trust Gap?", EY Global Corporate Reporting and Institutional Investor Survey.

Note: Some numbers don't add up to 100% due to rounding.

# **A Promising Alternative**

The comprehensive new ISSB standards give organizations worldwide a common language they can use to report on sustainability-related risks and opportunities. The standards are:

- IFRS S1, General Requirements for Disclosure of Sustainability-related Financial Information, sets forth entities' required disclosures of sustainability-related risks and opportunities. It is meant to allow companies to communicate with stakeholders about sustainability-related risks and opportunities in the short, medium, and long term. It prescribes how an entity prepares and reports its sustainability-related financial disclosures, sets out general rules for what should be included in disclosures, and prescribes how they should be presented to ensure their usefulness to financial statement users.
- IFRS S2, Climate-related Disclosures, which is designed to be used with IFRS S1, details specific required climate-related

information. It integrates the recommendations of the Task Force on Climate-related Financial Disclosures and requires disclosures on both cross-industry and industry-specific climate-related risks and opportunities.

A widely accepted and reliable set of standards can provide directors with the specific, concrete metrics they need to oversee a company's sustainability efforts. According to Luis de la Fuente, CIA, head of internal audit for sustainability, talent, and culture at global financial services group BBVA, the new standards provide a systematic approach that will offer boards consistency of information over time and comparability with past company efforts and with the results of other organizations.

## **Working With Internal Audit to Enhance the Process**

As companies consider adopting new guidance and taking a more directed approach to reporting and disclosing nonfinancial information, internal audit can be called upon to make important contributions. Internal audit "can play a critical role in providing objective assurance and advice on ESG reporting and sustainability matters more broadly," according to KPMG. Examples of internal audit's role include:

Offering insights on building new internal controls. To establish the validity and thoroughness of the data used in complying with the standards, the company's internal control system for nonfinancial information should be as robust as the internal control system for financial information, de la Fuente noted. The system should be able to collect, aggregate, and validate sustainability-related information across the company and its value chain. That's a task best undertaken sooner rather than later, since current internal control systems



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Visit theiia.org/Tone to sign up for your complimentary subscription. have taken decades to build, so companies should not expect that a comparable system for nonfinancial information can be built overnight, he cautioned. Even if an organization has established ESG internal controls and processes, it may need to enhance or revise them to comply with the new guidance. Internal audit can offer advice on necessary steps in developing an internal control system for nonfinancial information and provide assurance over the information that system provides. Because an external review can only take place after adequate controls are in place, internal auditors are uniquely positioned to provide a timely and accurate assessment of the current control environment for nonfinancial information.

**Assessing data quality**. Part of building a reliable reporting system is ensuring the quality of the data being used to develop metrics, de la Fuente said. While financial information is prepared by the finance team, nonfinancial data is gathered from across the company, including areas not accustomed to generating reliable, traceable, and publicly available information. Once again, internal audit can offer advice on which areas should be involved in the information gathering process and on the best way to build an effective, reliable process.

Facilitating compliance. With its expertise in compliance concerns, internal audit can advise on the best ways to implement new ESG standards. Currently, standards are not mandatory, but boards may want to urge their organizations to adopt the ISSB or other relevant, comprehensive standards. Given stakeholder interest in this area, providing accurate data on the company's ESG and sustainability efforts can make a difference in gaining financing or investments and even in recruiting top talent. In addition, reporting solid information backed by appropriate data can protect companies from accusations of inappropriately enhancing their data through "greenwashing." The ISSB standards provide comparable metrics that allow companies to be very clear on their ESG-related efforts and results and to demonstrate their commitment to sustainability, de la Fuente said.

**Putting the information in perspective.** Internal audit already provides assurance on financial information and offers context and recommendations on its meaning, and it can offer the same insights for nonfinancial information.

**Positioning the organization for continuing evolution.** The ISSB standards should be seen as an initial foundation for an evolving set of guidelines that be added to and revised going forward, according to de la Fuente. "We are still learning," he said. He cited decisions on the offsetting of greenhouse gas emissions through carbon credits as one area where concerns about greenwashing may still need to be resolved. Internal audit can advise the board on new developments and what they mean to the organization.

## Capture the Moment

Before the ISSB standards were issued in final form, the National Association of Corporate Directors said, "as global standards for carbon disclosure and climate risk evolve and more general sustainability disclosures begin to converge and become regulated, it's clear that corporate directors must be aware of the upcoming ISSB standards to ensure future compliance."

The release of the standards is a defining moment in ESG and sustainability reporting. Boards that capture the moment can be prepared for new regulations and ensure their organizations gain the most value from accurately gathering and reporting nonfinancial information. Internal audit can be an important partner in this effort.

## **QUESTIONS FOR BOARD MEMBERS**

- » What is the organization's ESG governance structure? How well is it functioning?
- » How is nonfinancial information currently used in decision making and adding value?
- » What ESG or sustainability frameworks or guidelines does the organization follow? Would the ISSB standards add value to current efforts?
- » Is the company prepared to implement the new reporting standards? If not, what changes in processes or policies would be necessary to do so?



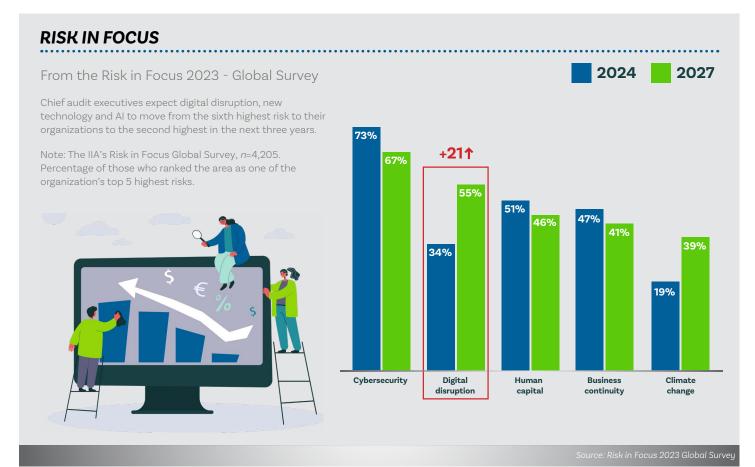




### What is the status of your organization's ESG or sustainability reporting effort?

- We have a strong internal control system for nonfinancial information.
- We have made a start, but we don't yet have a thorough or consistent system of collecting, assessing, or managing nonfinancial information.
- We don't collect this information at all.
- Don't know.





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The Future of Sustainability Reporting Standards, EY, 2021

"About the International Sustainability Standards Board," IFRS.

"Pro Take: Forget the SEC, International Climate Reporting Standards Could Become the Global Baseline," Rochelle Toplensky, WSJ Sustainable Business, June 26, 2023.

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