

# ESG – Role of Internal Audit



The Institute of  
**Internal Auditors**

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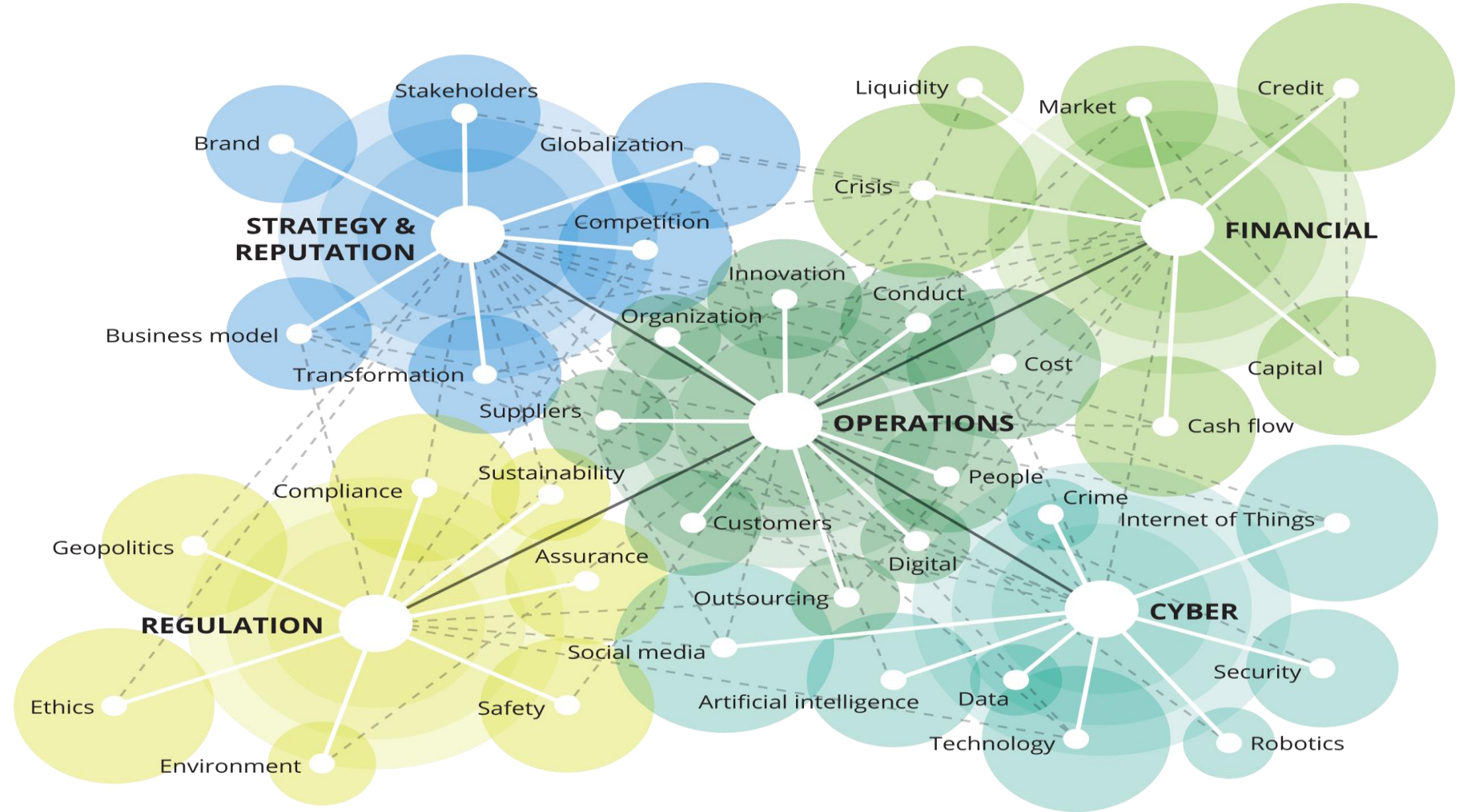
IIA Annual Seminar



# ESG Landscape



# The landscape of uncertainty

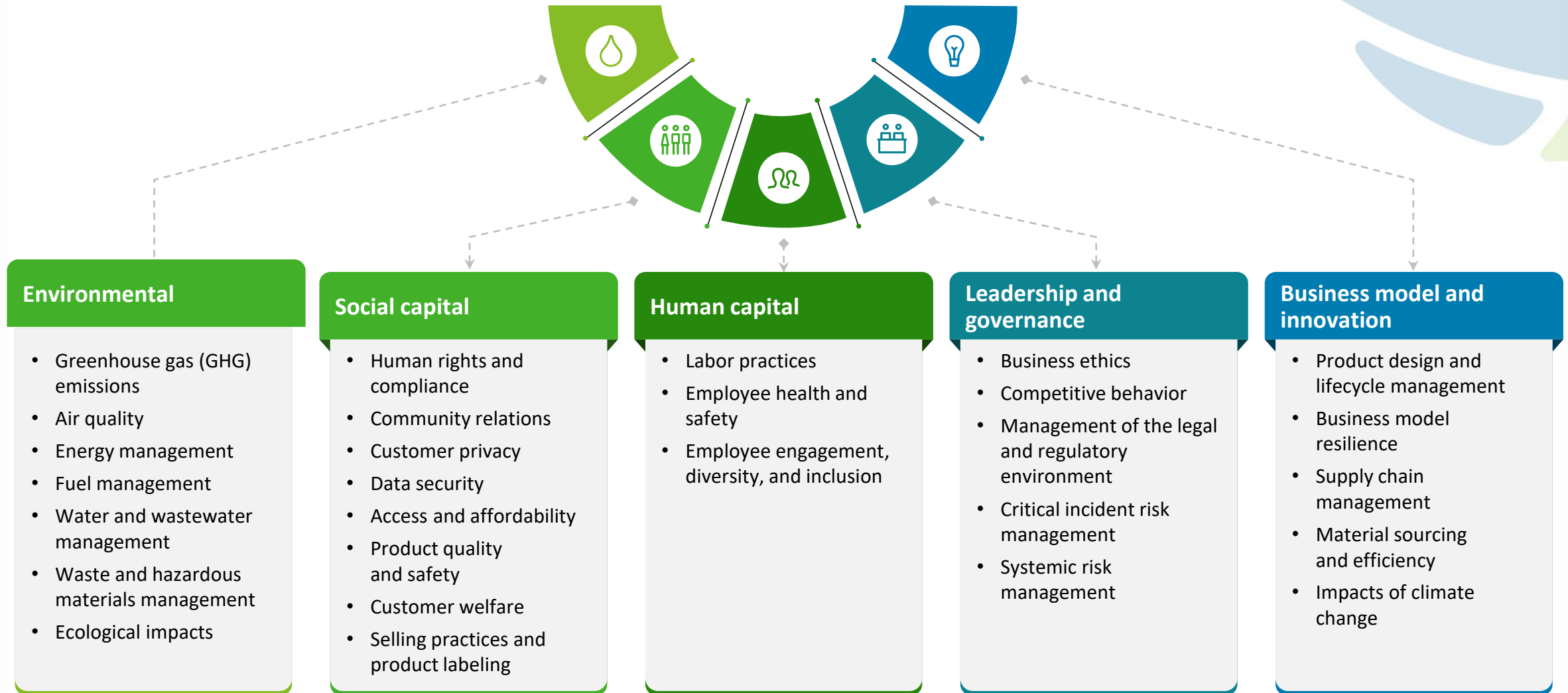


The risk ecosystem is generally getting more significant and interconnected. ESG risks are included in the landscape.



# ESG Landscape

What is ESG? The universe of topics that reflect areas of performance management around impacts and dependencies of the business on society and the environment.



# ESG Trends

1

## Climate Change: Net Zero

Climate Action Tracker (CAT) warns the world is on track for 2.4 degrees Celsius of warming above pre-industrial levels.

Global countries and businesses renewed commitments to climate pledges at the COP26:

- East Africa countries joined over 100 countries in committing to halting and reversing deforestation and land degradation by 2030.

3

## Diversity, Equity & Inclusion

Diversity – focus in achieving gender balance in boardrooms and workplaces.

Equity – bridging the gap between the rich and poor, pay disparities.

Inclusion – creating an environment in which all individuals feel valued and connected.

2

## ESG Disclosures

IFRS Foundation announced formation of the International Sustainability Standards Board (ISSB) which will see the consolidation of the Climate Disclosure Standards Board (CDSB—an initiative of CDP) and the Value Reporting Foundation (VRF)

ISSB will develop a global baseline of sustainability disclosure standards.

4

## Stakeholder Activism

Stakeholders demanding more accountability and transparency from businesses.

Young people advocating for urgent solutions to address the climate change.

Consumers turning away from goods and services they deem unsustainable.



# Transformation towards sustainable organizations

Rapid pace of change – from voluntary to regulated ESG disclosures

Regulators are shifting from light-touch expectations on disclosures to expecting comprehensive climate risk stress testing and fully embedding ESG risks into prudential supervision. In Kenya NSE and CBK have issued guidelines on sustainability & climate risk reporting

Investors are increasingly concerned about the valuation of 'stranded assets and reputational risk. Fossil fuel divestment campaigns continue to gather pace



The green agenda opens up numerous lending and investment opportunities; organizations will be actively looking to combine profits with environmental and social.

Public interest in sustainability agenda has grown at all levels in operational activities

# Reporting frameworks

There are numerous sustainability frameworks. Some cover broader sustainability disclosures and others focus on a single topic

- Global Reporting Initiative (GRI)
- United Nations Global Compact (UNGC)
- UN Sustainable Development Goals (SDGs)
- World Economic Forum (WEF) - International Business Council (IBC) Stakeholder Capitalism Metrics
- Integrated Reporting (IR) + Sustainability Accounting Standards Board (SASB) = Value Reporting Foundation (VRF)



United Nations  
Global Compact



## Climate

- CDP (formerly Carbon Disclosure Project) - Climate
- Taskforce for Climate-Related Financial Disclosures (TCFD)
- Climate Disclosure Standards Board (CDSB)



## Biodiversity

- CDP – Forests
- Taskforce on Nature-related Financial Disclosures\* (TNFD)
- Convention on Biological Diversity - Post-2020 Global Biodiversity Framework\*
- Natural Capital Protocol (NCP)



Taskforce on Nature-related  
Financial Disclosures



## Other

- CDP – Water
- CDP – Cities





# Polling question #1

Where would you place your organisation on the ESG/sustainability agenda?



- a) Initial – Organisation is just starting to think of ESG.
- b) Defined – Organisation has a clear strategy, roles and responsibilities are well outlined with regards to ESG initiatives.
- c) Mature: Governance structures exist, forms part of the business agenda, resources are allocated, reports on required disclosures and everyone is held accountable.



# Polling question #2



## Poll 2

As an Internal Auditor I must be an expert in the previously covered facts in order to have a conversation related to IAs role in ESG?

- a) True
- b) False



# Internal audit's organizational position and role

# ESG within an Organisation



# Internal audit's role in assessing ESG

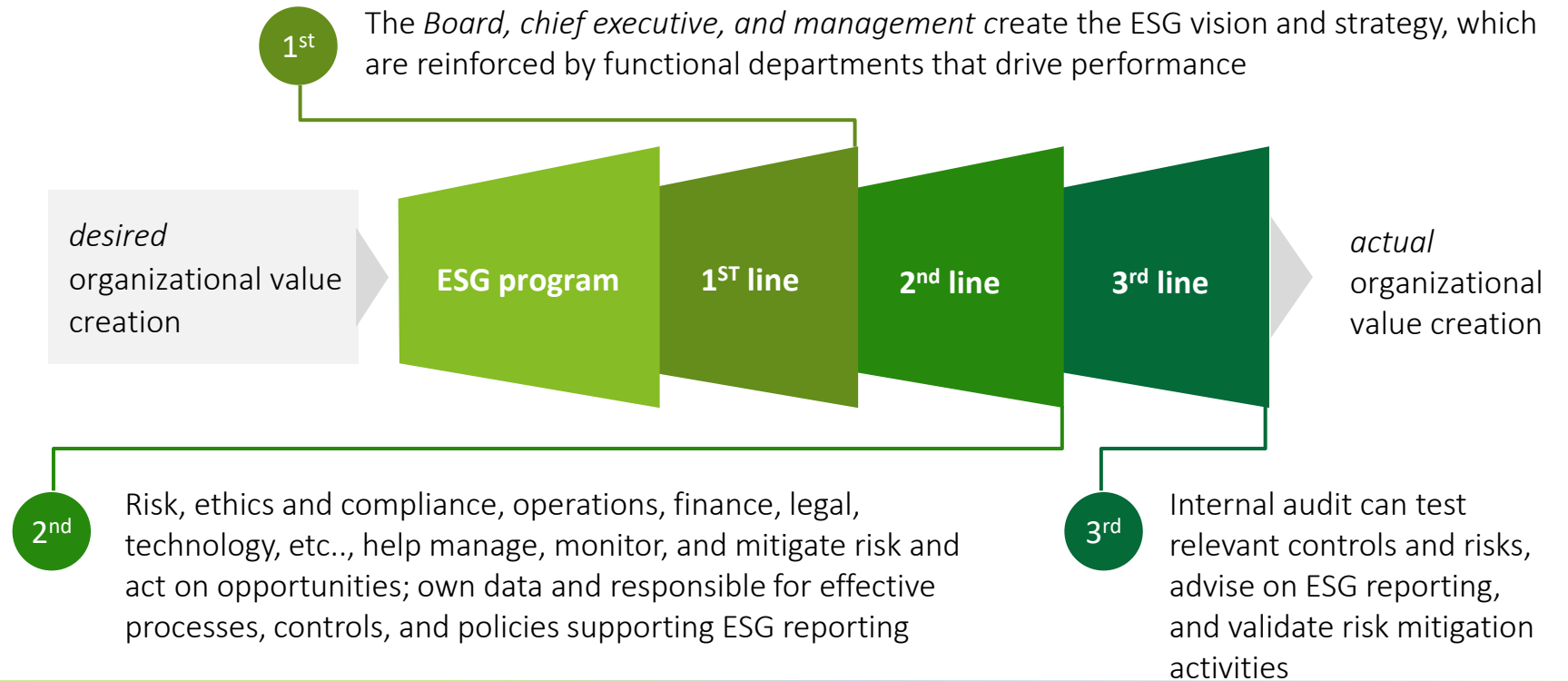
An adapted three lines of defense model applied to ESG reporting

## Example areas to take action:

- Drive accountability and visibility while monitoring risks to the entity raised by environmental and social issues alongside ERM
- Enhance governance processes, controls, and policies
- Leadership reporting to proactively identify risks, inform action plans, and promote ESG integration
- Training and guidance to operational teams and business units
- Escalation criteria and response capabilities actively mitigate threats

## Three lines model

Roles across the organization have a responsibility to manage ESG risk and drive organizational alignment.



# Polling question #3



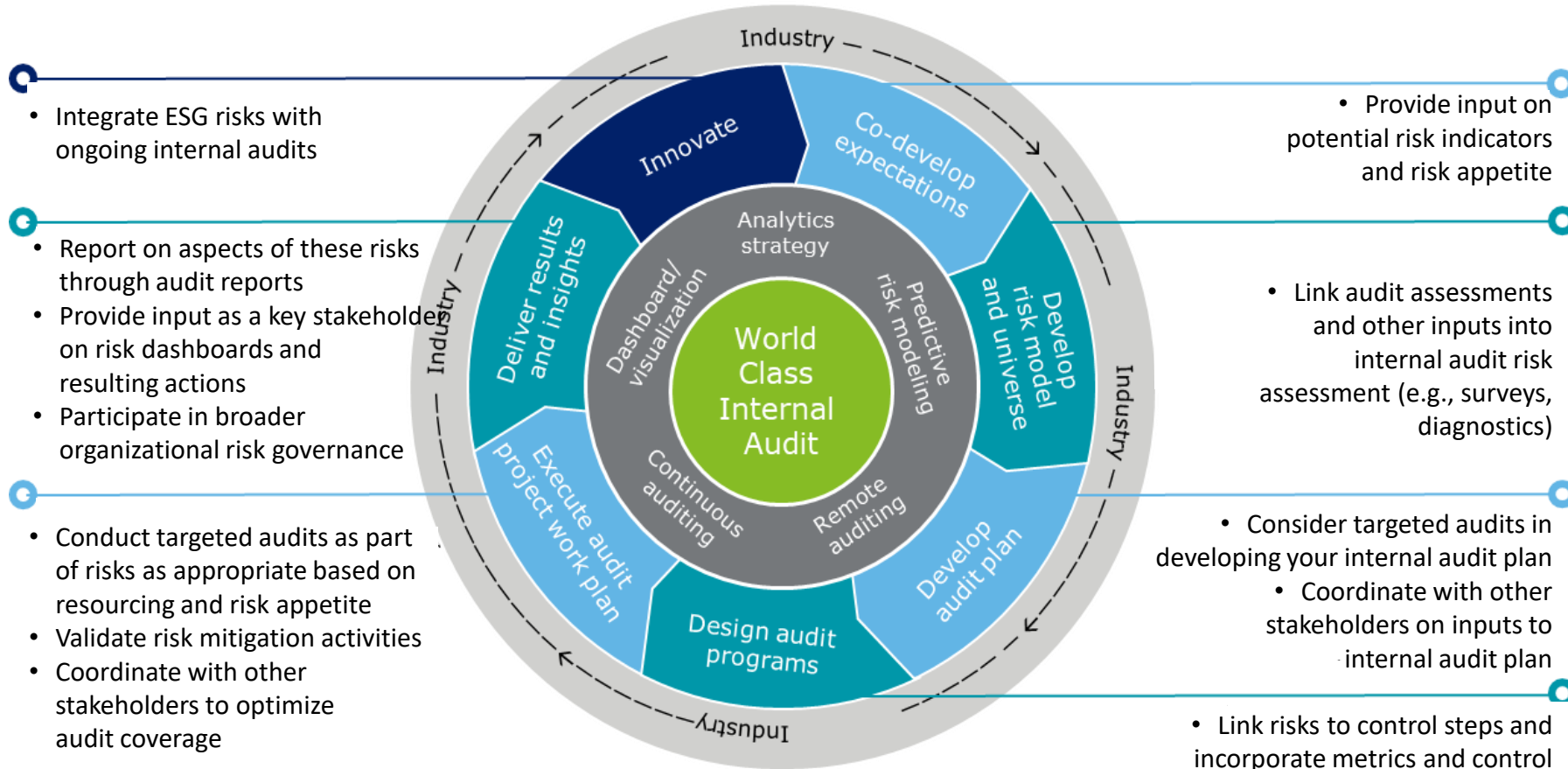
**Poll 3** My clients are currently considering ESG in their Internal Audit plans and scope:

- a) Yes – to a high degree
- b) Yes – to a moderate degree
- c) They don't currently include ESG in the plan and scope
- d) Unsure /has not come up.

# Inherent value underpinning internal audit's role

## – internal assurance, advising, anticipating

As the third line, internal audit plays a vital role in assuring fundamental financial, operational, and compliance internal controls are operating effectively and validating the effectiveness of ESG activities



- Integrate ESG risks with ongoing internal audits
- Report on aspects of these risks through audit reports
- Provide input as a key stakeholder on risk dashboards and resulting actions
- Participate in broader organizational risk governance
- Conduct targeted audits as part of risks as appropriate based on resourcing and risk appetite
- Validate risk mitigation activities
- Coordinate with other stakeholders to optimize audit coverage

- Provide input on potential risk indicators and risk appetite
- Link audit assessments and other inputs into internal audit risk assessment (e.g., surveys, diagnostics)
- Consider targeted audits in developing your internal audit plan
  - Coordinate with other stakeholders on inputs to internal audit plan
- Link risks to control steps and incorporate metrics and control aspects into audit programs



**Assure.**  
Internal audit provides risk-based internal assurance on the fundamental financial, operation and compliance internal controls and risks of the organization.



**Advise.**  
Internal audit advises the organization on the ability to effectively manage risk broadly. Internal audit is proactive and transparent, relevant and valued by the organization. Relevant subject matter specialists assist in delivering value added insights.



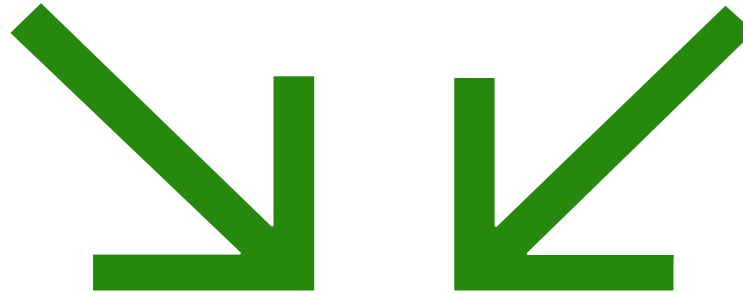
**Anticipate.**  
Internal audit anticipates and aligns efforts to emerging risks, strategies and operational objectives of the organization. Analytics and new technologies enable the organization to deliver insightful, proactive, and future-focused insights.

# Typical approach of incorporating ESG into an internal audit plan

Boards and executive leadership are asking more of the third line to assess and audit intangible risks either through individually focused audits, audits on areas of known risk, or through incorporating elements of these risks throughout each audit in the plan.

## Standalone Reviews

- Standalone assessments can help understand appropriate policy, control landscape, and responsibilities around ESG as of a point in time.



Internal Audit  
Framework

## Integrated audit approach

- Embedded approach should be used as pulse check on the business as part of any audit performed to ensure ESG related activities are being appropriately identified, considered, and documented.

## Focused reviews

- Deep dive focus can provide valuable assurance on key ESG areas, where stakeholders have concern, or where risk appetite is low.

## Competency

Investment in resources with the right capability and skillset to understand, recognize, and assess ESG risks. Level 3 bullet



# Polling question #4



## Poll 4

What is your primary concern with integrating ESG into the internal audit plan ?

- a) Knowledge gap
- b) Staffing constraints
- c) Uncertainty in timing
- d) No concerns
- e) Other



**ESG reporting internal audits – key differences and execution**

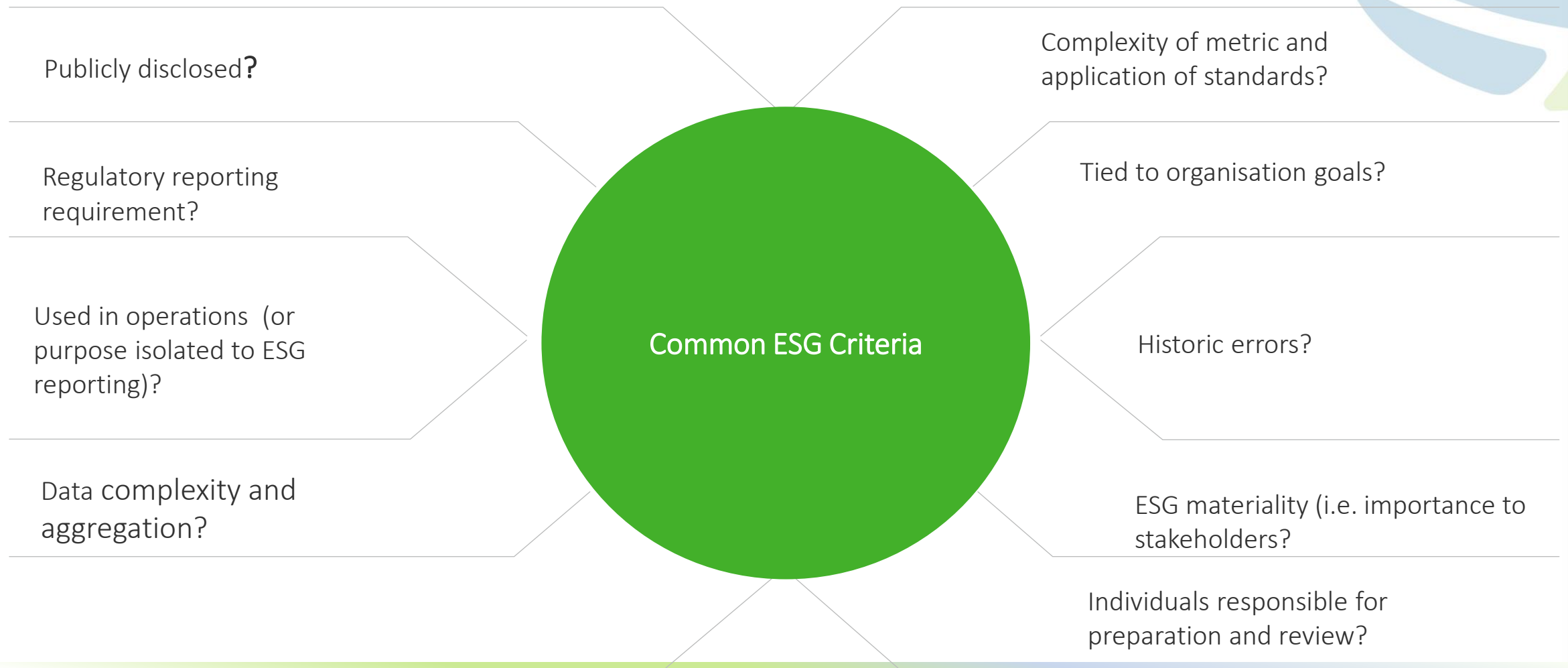
# ESG reporting internal audits – key considerations for a risk based approach

The below can provide a starting point for internal audit functions to assess the risks across enterprises.

Key questions to ask	
Governance & Policy	<ul style="list-style-type: none"> <li>• Has the enterprise created a governance structure and culture that supports effective ESG risk management?</li> <li>• Has the organization defined a strategy to strengthen internal awareness and commitment, emanating from top management (setting the “tone at the top”)?</li> <li>• Is information on ESG risk being reported to the board?</li> </ul>
Risk strategy and appetite	<ul style="list-style-type: none"> <li>• Is ESG strategy and risk appetite consistently cascaded through the organization, including limits and metrics?</li> <li>• Are ESG related risks being considered in new products and services?</li> <li>• How has ESG change and the changing external business environment affected the resilience of the business model and hence the risk strategy?</li> </ul>
Risk assessment, measurement and analytics	<ul style="list-style-type: none"> <li>• Has the organization defined a consistent and comprehensive methodology for ESG quantification?</li> <li>• Has stress testing been adapted to reflect the long term horizon of ESG risk?</li> </ul>
Monitoring & reporting	<ul style="list-style-type: none"> <li>• What ESG related disclosures around governance, strategy, risk management, and Key Performance Indicators (KPI’s) and Key Risk Indicators (KRIs) are being published?</li> <li>• How is ESG risk monitoring and reporting being aggregated into existing risk practices?</li> </ul>
Risk , data and systems	<ul style="list-style-type: none"> <li>• Is there readily available, consistent, credible, and sufficiently meaningful data?</li> <li>• What are the ‘new’ data elements that will be required for the organization, as well as it’s suppliers, borrowers, and other third parties?</li> </ul>
Risk operating model, people and culture	<ul style="list-style-type: none"> <li>• Has ownership and accountability for ESG risks been determined and is it linked with other risk types?</li> <li>• How are we monitoring and understanding the complex and evolving regulatory landscape?</li> <li>• Are we attracting and retaining resources with ESG skillsets?</li> </ul>

# ESG reporting internal audits – key considerations for a risk based approach

The below are examples of criteria that can be applied alongside the risk –based criteria



# ESG reporting internal audits – illustrative internal audit plan and approach

A strong control environment as a part of an effective governance structure is imperative as ESG considerations rise to the top of the agenda for many stakeholders. With the increased attention on ESG comes an increased focus on data quality. Internal Audit plays a key role in bringing structure, rigor and internal controls to expanding risk areas like ESG risk.



### Disclosures

- What disclosures exists?
- Who is responsible?
- Who is involved?
- What are the significant risk areas?

### Frameworks & Standards

- Are frameworks & standards used in current disclosures? If so which..
- How can frameworks and standards enable IA reviews?

### Processes & controls

- Are processes and controls formal or informal?
- Are processes and controls documented?
- How can lessons from other areas of internal controls be applied to ESG?



# Polling question #5



## Poll 5

Do you feel you have what you need to have a conversation about IAs role in ESG?

- a) Ready
- b) Still learning but have enough to get started.
- c) Not there yet
- d) Other





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