

Internal Audit Engagement with ESG Issues – July 2021

ESG Defined – Environmental, social and governance – the three central factors in measuring sustainability and impact on society of an investment in a company to help determine future financial performance.

- > The environmental criteria look at how an organisation performs as a steward of the natural environment eg greenhouse gas emissions, water usage, and waste and pollution, including both outputs and inputs.
- > The social criteria examine how an organisation manages relationships with its employees, suppliers, customers, and the communities in which it operates eg employee relations, diversity, health and safety, and community support.
- > Governance relates to an organisation’s internal processes and leadership including executive remuneration, audit and internal controls, and shareholder rights including board diversity, ethical decision-making, and deterring corruption and bribery.

More than 80% of mainstream investors now consider ESG information when making investment decisions. There are currently \$22.89 trillion of assets being professionally managed under responsible investment strategies, exceeding the gross domestic product of the entire USA economy. This responsible investment has increased by 25% since 2014.

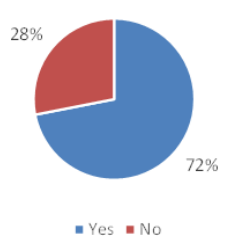
While experience suggests that the three lines model has been broadly adopted for the management of financial reporting risk it does not seem to be so widely adopted in assurance over ESG. The question that this prompts is the availability of individuals who are competent to assess ESG performance. Only 44% of organisations have ESG auditing arrangements in place.

In July 2021, IIA-Australia surveyed Australian Chief Audit Executives to assess corporate and internal audit engagement with ESG issues. There were 57 responses.

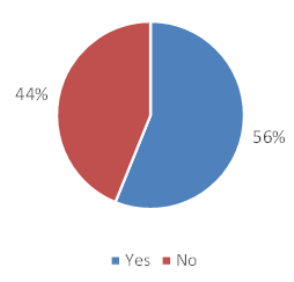
Corporate Awareness

While the majority of respondent organisations considered ESG as part of their strategic risk profile, just over half have processes to monitor compliance with good practice ESG Principles. Even fewer have established structured assurance processes based on the three lines model.

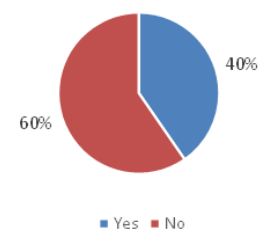
Does your organisation consider ESG issues to be a real risk, with ESG contained in the strategic risk register and actively monitored?



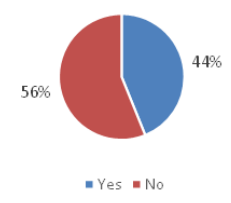
Does your organisation monitor its compliance with good practice ESG principles?



Does your organisation have an integrated 3 lines of assurance approach to assurance activities over ESG?



Does your organisation have ESG auditing arrangements in place by either a specialist service provider or as part of the internal audit plan?



The Internal Audit Response

Responses suggest that internal audit has recognised the risks associated with ESG issues even when their organisations have not. A number of internal audit functions have ESG issues on their audit plan even when their organisations have not placed the issues on their strategic risk profile (9 or 16% of Respondents); strangely there are 7 respondent organisations (12%) where the internal audit program does not address ESG issues even when the

organisation as a whole has recognised them.

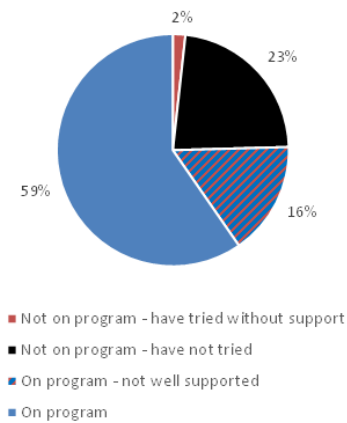
18% of respondents have indicated that they have tried to incorporate ESG audits in their program but have not gained traction. Nevertheless, many of these internal audit functions have included such reviews on their program.

A large proportion (56%) of internal audit functions have completed an internal audit on ESG issues in the last 12 months.

Recognition of ESG Issues in Organisation Risk and Internal Audit Planning



Support for ESG Reviews



Competent Resources

ESG audits require a particular skill set. Most Chief Audit Executives believe that their internal audit function has the necessary skills. Only a small number of organisations have instituted targeted training to develop these skills. A small number of CAEs report that, in spite of training, their functions do not have the necessary skills to conduct ESG audits.

About half of those organisations that have assessed themselves not competent to perform ESG audits have such an engagement on their plan.

IA has the skills to perform ESG Audits

