

## The **Chief Audit Executive** and ESG Reporting:

### Getting Better Answers for the Board

Protiviti recently published “10 ESG Reporting Questions Directors Should Consider.”<sup>1</sup> It’s a good list. Chief Audit Executives (CAEs) could use more background on the underlying ESG risks and opportunities to help Directors steer companies towards optimal success, and to demonstrate their own value. As an ESG specialist/ Sustainability specialist, Douglas Hileman Consulting LLC (DHC) offers five tips to get more out of these conversations. [See blog posts for Board members and EHS Audit Program Leaders.]



1. **Begin with what you’ve got.** Protiviti suggests Board members ask about “what we are telling the street”, ESG risks, and incentive programs (a possible factor in ESG fraud/ environmental fraud). Review any internal audits for ESG (including non-financial reporting) in the last three years, and follow-up actions. Review the current risk register(s) for ESG topics. Compile an honest baseline.
2. **Wherever non-financial reporting frameworks mention “assurance”, establish a role for Internal Audit.** Several prominent reporting standards and frameworks for ESG information target investors’ needs. All are working to increase the rigor of ESG reporting/ non-financial reporting, and to achieve more consistency among the frameworks. Just during 2020, WEF, SASB, IFRS, IIRC and GRI<sup>2</sup> published some type of proposed revision or consultation draft and invited comments. The EU is preparing the next wave of activity on the Non-Financial Reporting Directive. All emphasize the importance of reliable data and information - and encourage “assurance”. Internal Audit plays a key role preparing for assurance of internal controls over financial reporting. Internal Audit should focus on internal controls over non-financial reporting, to prepare for whatever assurance efforts their company must undergo. Since assurance of sustainability is still evolving, giving room for Internal Audit to add real value.
3. **Know who should have more information.** Topics in Protiviti’s questions include incentive compensation plans, risk assessments, external reporting, COVID-19/ health and safety, and climate change. Responsibilities for these areas are typically dispersed – in HR, Operations, Environmental, Supply Chain Management, Quality, Health & Safety and other areas. Studies of whistleblower hot



<sup>1</sup> “10 ESG Reporting Questions Directors Should Consider”, published October 2020; accessed several times through January 18, 2021; available at [10 ESG Reporting Questions Directors Should Consider | Protiviti - United States](#).

<sup>2</sup> World Economic Forum, Sustainability Accounting Standards Board, International Financial Reporting Standards, International Integrated Reporting Council; GRI was formerly known as Global Reporting Initiative.



lines show that over 5% of all tips relate to environmental, health and safety (EHS). If you are only getting information from the CFO or Marketing, dig deeper.

4. **Revisit 2LOD Audit role and capabilities in mitigating ESG risks.** “Second line” audit functions<sup>3</sup> – environmental audit, health & safety audit, and others – have existed in many companies for decades.

Their objectives and activities may still focus only on regulatory compliance, whereas the risks have expanded and changed dramatically. CAEs should check the extent of risk mitigation coverage current EHS audit programs provide for the full range of ESG compliance and ESG risk. The risks posed by ESG certainly warrant a second line audit function – or perhaps a “Sustainability audit” cluster. Very environmental, health and safety auditing programs (EHS audits) few have undergone an independent Quality Assurance Review, as provided in the IIA’s International Professional Practices Framework. A QAR could be an excellent mechanism to begin revisions to these programs to align with business objectives.



5. **Have a plan to meet the challenges.**

ESG covers a lot of ground – and it is changing fast. Just in 2020, there have been dramatic changes involving: non-financial reporting frameworks and commitments; expectations on diversity, inclusion, and racial justice; climate change; and new requirements via regulatory, contractual, commercial, and social mechanisms. Many of these changes in external drivers will require the company to make substantive changes to maintain financial

performance, to create financial value, and to improve the environment and human capital. Internal Audit is an ideal group to monitor how the company plans to meet these challenges, how they will identify when mid-course corrections are required, and if they make consistent progress on issues that align with business objectives. In conversations with the Board, the CAE has an excellent opportunity to get buy-in, and to demonstrate that Internal Audit is providing value

<sup>3</sup> The Institute of Internal Auditors updated its seminal “Three Lines of Defense” position paper in 2020, now calling it the “Three Lines Model” for governance.



### **About Douglas Hileman Consulting LLC**

Douglas Hileman Consulting LLC (DHC) supports Clients in environmental, social and governance (ESG, or “Sustainability”), audits/ risk/ compliance, and non-financial reporting (aka “Sustainability reporting”). Mr. Hileman has been in the forefront of emerging issues for over forty years. He has worked in operations and corporate compliance; environmental, health and safety compliance and auditing; Internal Audit; and external assurance for financial audits and conflict minerals submittals to the SEC. He was the senior technical specialist in environmental management and environmental auditing on the Volkswagen Monitor team, created for the company to fulfill obligations to the US Department of Justice. Mr. Hileman has reviewed frameworks for non-financial reporting (SASB, GRI, etc.), submitting comments on many proposed revisions. He helps members of the Institute of Internal Auditors stay abreast of changing risks and opportunities. As an ESG specialist/ Sustainability specialist, he has supported Client audits, conducted audits, and redesigned Client EHS/ ESG audit programs (often after an EHS audit program Quality Assurance Review (QAR)).

Prior to launching his firm in 2008, Mr. Hileman worked at a Big 4 accounting firm for six years, supporting financial audits, enterprise risk management, internal audit and the Sustainable Business Solutions practice. Mr. Hileman holds the credential in Fundamentals in Sustainability Accounting (administered by the Sustainability Accounting Standards Board). He is also a Certified Risk Management Assurance (CRMA) professional, and a Certified Professional EHS Auditor (both granted by The Institute of Internal Auditors).

See also [www.douglashileman.com](http://www.douglashileman.com).