

## Internal Controls over Sustainability Reporting (ICSR)

### Internal Audit's Role

#### IIA Los Angeles 2022 Fall Conference Session: Takeaways



I presented “Internal Controls over Sustainability Reporting” (ICSR) at the Institute of Internal Auditors – Los Angeles Chapter – 2022 Fall Conference in October 2022. This long-running, marquee event attracts hundreds of attendees from across the Southland. My latest installment was another successful session on hot topics related to Sustainability/ ESG. Reporting, disclosures, and even expectations of assurance are on the rise. Here are key takeaways from the session, where Internal Auditors learned how to add value to their organizations.

- 1) **Sustainability reporting:** Sustainability/ ESG reporting is done to meet the needs of many stakeholders. Investors – and analysts supporting them – have been leading the charge, demanding accurate, reliable, decision-useful reporting and disclosure on sustainability topics.



- 2) **Climate Change:** Climate change affects everybody and every organization. Reporting of climate change-related risks and performance are in class by themselves. Every organization – publicly-traded, privately held, or public entity – is expected (at a minimum) to calculate and report greenhouse gas (GHG) emissions, to establish goals and targets, describe how they will achieve them, and to report on progress in future reporting periods.



- 3) **Like Financial Reporting – and Not:**

Sustainability/ ESG reporting differs from traditional financial reporting in three key aspects. First, it includes areas of control and influence. It includes more narrative than commonly included in financial reporting. And it involves more forward-looking content.



- 4) **ESG Assurance Expectations Growing:** There is a growing chorus asking for assurance over sustainability reporting. The SEC's proposed rule for disclosure of climate-related risks would require attestation of GHG emissions inventories. Some applicable line items in financial statements are already subject to assurance; expectations for more detailed procedures at lower levels of materiality is possible. Demands for other assurance are likely to grow, notably



for reporting and disclosures in financial filings, such as the Form 10-K (Management Discussion & Analysis).

- 5) **Different Reporting Channels for Capital Providers:** Sustainability-related data and information is provided to capital markets via channels other than SEC filings for publicly-traded entities. These include additional information requests from impact investors, and other providers of capital (banks, etc.). As capital markets tie interest rates and other terms to ESG data and information, there are greater risks associated with inaccurate or misstated information. With companies already suffering from “questionnaire fatigue”, it is a stretch to obtain assurance over the supplemental data and information provided in these questionnaires. Nonetheless, this data and information should be supported by rigorous internal controls, as can be outlined in the COSO Internal Control Framework.

- 6) **COSO Internal Controls Framework:** The COSO Internal Control Framework is topic-neutral. The 2013 version removed “financial” from the Reporting category of controls. Examples of content in principles for each of the ICF components are provided below.



- Control Environment, Principle 3: *Management establishes, with board oversight, structures, reporting lines and appropriate authorities and responsibilities.*
- Risk Assessment, Principle 7: *The organization identifies risks ... and analyzes risks as a basis for determining how the risks should be managed.*
- Control Activities, Principle 12: *The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.*
- Information and Communication, Principle 15: *The organization communicates with external parties regarding matters affecting the functioning of internal control.*
- Monitoring, Principle 16: *The organization selects, develops and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.*



## ROLES FOR INTERNAL AUDIT

- 1) Prepare for "Soxification" of Sustainability reporting:
  - Dig into ICFR: Learn where sustainability issues (especially climate-related risks) map to income statements and balance sheets. Revisit whether SOX controls and procedures are sufficient, and adjust as appropriate.
  - Prepare for SOX-like (in early years!) involvement in sustainability reporting. Begin with content in Form 10-K, and what is expected for your sector and industry. Begin with relevant SASB/ ISSB standards.
  - Walk first. Do a pilot assurance engagement over ESG disclosures.
- 2) Use all the tools in your toolkit: assurance engagements; advisory/ consulting engagements; meetings and discussions.
- 3) Build and augment competence and capacity. Use subject matter experts for sustainability reporting in general, or for specific topics.
- 4) Watch for the COSO report linking Internal Controls Framework to Sustainability (January 2023). And more content at [www.douglashileman.com](http://www.douglashileman.com)



**Internal Controls** over  
**Sustainability** [content in]  
**Reporting** [to capital markets]



### **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 co-developed and presented a half-day workshop on ESG Reporting for Internal Auditors at a key conference in 2022. Recent focus areas include GHG emissions reporting, sustainability reporting and disclosures, human rights (Uyghur Forced Labor Prevention Act), internal controls over sustainability reporting (ICFR), and ESG support to complex transactions and integration.

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. 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)). Primary Client contacts are in Legal, Compliance, Investigations, Sustainability, Executive (CEO, CFO), Risk and Internal Audit.

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 (granted by The Institute of Internal Auditors), and a Certified Professional EHS Auditor.

White papers, videos, and more resources at [www.douglashileman.com](http://www.douglashileman.com).