The Institute of
Internal Auditors
Elevating Impact

29 July 2022

Subject: [Draft] IFRS S2 Climate-related Disclosures

Dear ISSB Chair Emmanuel Faber and Vice-chair Sue Lloyd:

The Institute of Internal Auditors (IIA) appreciates the opportunity to comment on the International Sustainability Standards Board's (ISSB) exposure draft of climate-related disclosures. The IIA is fully invested in this effort as the internal audit profession's leader in standards, certification, education, research, and technical guidance throughout the world. Our 215,000 global members are actively contributing to this imperative global effort to accurately embed sustainability in organizations and report relevant and comparable climate-change mitigation efforts.

The new ISSB will provide much-needed global standards for disclosures around sustainable business that will give investors and other stakeholders comparable, reliable decision-useful information about an organization's performance related to environmental, social and governance (ESG) matters. To achieve that, an organization's internal audit function can provide assurance that the organization employs rigorous internal controls around its climate change and ESG data, and that it communicates reliable sustainability disclosures to internal and external users of that information.

The IIA's 112 affiliates across the world have been supporting and advocating for international and universally understood standards, frameworks, and reporting mechanisms for organizations, to avoid fragmented and inconsistent approaches to climate change risks and climate-related reporting. The IIA continues to play a leadership role in championing the vital role that internal audit can play in supporting organizations in identifying, managing, and mitigating climate-related risks.

The IIA has released numerous white papers recently on the role of internal audit in relation to sustainability- and climate-related risk, recognizing the need for boards and management to ensure efficient and effective risk management and internal oversight over sustainability issues, including by utilizing The IIA's Three Lines Model. Links can be found to recent publications in the addendum to this submission along with responses to pertinent exposure draft questions.

A governing body that is truly accountable for the actions it has asked management to perform must have assurance from an objective independent source that what has been asked has been accomplished. Without that assurance, there is no governance. We ask the ISSB to keep this fundamental need for effective governance in mind as it finalizes its disclosure requirements.

The IIA thanks the ISSB for the opportunity to provide our input and expertise on this important issue and welcomes further discussion. Please don't hesitate to contact me or Mat Young, VP of Global Advocacy, Policy, and Government Affairs, at mat.young@theiia.org, if The IIA can be of further assistance. Thank you for your consideration.

Sincerely,

Anthony J. Pugliese, CIA, CPA, CGMA, CITP
President and Chief Executive Officer
The Institute of Internal Auditors, Global Headquarters

Addendum

Overall Approach

Broadly speaking, we agree with and support the ISSB approach in both of its exposure drafts, Draft S1 on sustainability-related disclosures and Draft S2 on climate-related disclosures. They take a comprehensive approach to sustainability and climate-related disclosures. Financial markets in particular need clear, holistic, and high-quality information on the impacts of climate change and will likely welcome steps to reach this goal.

We particularly welcome the fact that the ISSB is bringing together the recommendations of the Task Force on Climate-related Financial Disclosures, the Climate Disclosure Standards Board, the Sustainability Accounting Standards Board Standards, and the Integrated Reporting Framework and consolidating these four key initiatives under one umbrella. We believe this will lead to comparable reporting on climate and sustainability-related matters around the globe.

We know it is difficult for organizations to implement multiple reporting standards and we look forward to the ISSB, EFRAG and the U.S. Securities and Exchange Commission working together as much as possible to eventually simplify disclosure requirements globally.

While we recognize the deep scrutiny surrounding the decision to create two sets of disclosure standards, we would support the eventual simplification to one set of disclosures to avoid duplication and encourage implementation. For example, the S1 Governance language in paragraphs 12-13 and S2 paragraphs 4-5 are the same. Meanwhile S2 paragraphs 6 and 18 advise against unnecessary duplication. The drafters could well reduce unnecessary duplication between documents when content overlaps, however this may require a significant restructure into a single over-arching standard defining the structure of reporting and subordinate subject-matter enhancements. Two sets of standards may be confusing to the market and set up the possible dynamic that somehow the E is more important than the S and G instead of being taken collectively.

There is no question that a robust assurance process is needed for effective sustainability and climate-change disclosures to serve their intended purpose, a continuous chain of assurance that begins inside the organization and extends out to the external auditors. In Europe, we support reasonable assurance as the clear objective versus the current focus on limited assurance.

Question 1 – Objective of the Exposure Draft

We applaud the intent of expanding the financial reporting regime to include the effects of these significant classes of risk.

We would encourage for the long term that all risks eventually will be assessed together, just as we will have reporting that doesn't identify as integrated ESG or sustainability reporting – it will simply be reporting that is accepted as the way a company reports and automatically includes ESG within that reporting.

Additionally, we suggest that the ISSB in the future take a broader view of entities to include the public sector, rather than focusing solely on information that is material to the decisions of investors and other participants in the world's capital markets. Governments everywhere are trying to deliver greater service and achieve public policy goals while dealing with climate crises and other growing risks and regulations regarding ESG. The current emphasis on ensuring reporting that satisfies investors downplays social and environmental imperatives for responsible stewardship. Furthermore, mindful of criticisms often levied at international standard-setting mechanisms, much care should be taken to ensure that whatever structure is implemented encourages economy, agility, and responsiveness, and avoids bureaucracy in favor of utility.

Please note that regarding overall terminology, we suggest a clarification of "climate-related" risk in the draft, as it can mean the effect of an entity on the climate as much as the effect of the climate on the entity. A "sustainability" definition should be clearer, too, as it could relate to the on-going existence of the entity or could relate to the effect the entity has on its environment.

Question 2 – Governance

We agree with the statement that it is of the utmost importance that users of "general purpose financial reporting understand the governance processes, controls and procedures used to monitor and manage climate-related" threats and opportunities. However, it is important to make it clear that this is best accomplished with a properly resourced and positioned internal audit function reporting to the board.

We believe internal audit's helicopter view of the organization, coupled with its direct link with the board and senior leadership, puts it in an ideal place to ensure that an appreciation of climate change risk is embedded within an organization's strategy.

Organizations can utilize the Three Lines Model (see graphic below) as a roadmap to effective ESG governance and risk management. ESG-related threats and opportunities embedded into the roles and responsibilities outlined in the Three Lines Model can ensure effective risk management, internal oversight, and integrated sustainability across the organization. The Three Lines Model focuses on the accountability of the governing body, the actions of management, and the assurance of internal audit as essential to effective governance. Each organization can decide how to apply the model according to its needs, strategy goals, culture, resources, and business context.

We also recommend to clearly define the role of internal audit in the assurance process of ESG and sustainability disclosures, and to emphasize the cooperation with the external and statutory auditors to avoid duplication of work and safeguard completeness and quality.

Paragraph 5: This paragraph defines what is meant by "governance body or bodies (which can include a board, committee or equivalent body charged with governance)." Therefore, using elsewhere "the body and its committees" seems to make unnecessary intrusions into organizational structure.

Paragraph 5: We suggest the ISSB recommend the role of internal audit specifically to achieve what is outlined in Paragraph 4. If the purpose is to enable users of financial reporting to feel confident in an organization's actions related to "sustainability-related risks and opportunities," it is important to reflect that objective, independent assurance has been required and fulfilled. We recommend adding to the list "entity shall disclose" an entry as letter (h) requiring a description of internal audit's role in assessing the effectiveness of controls and providing assurance as to the accuracy of the financial reporting regarding climate-related risks.

Question 3 – Identification of climate-related risks and opportunities

Paragraph 9: Here (and elsewhere) the draft refers to "risks and opportunities." While in the context of the COSO documents this has some meaning, we believe that it is not the correct way to refer to risks in the context of ISO 31000. The ISO Standard has been almost universally adopted as a national standard outside of the United States and therefore the terminology as presented is likely to find itself inconsistent with the more widely used meaning. In ISO 31000, opportunities are counterposed with threats: both opportunity and threat may represent a risk. In the ISO 31000 context, a risk is neither good nor bad: it is a measure of uncertain consequences. The IIA defines risk as the possibility of an event occurring that will have an impact on the achievement of objectives. Risk is measured in terms of impact and likelihood.

Question 4 – Concentration of climate-related risks and opportunities in entity's value chain

Question (a): It is unreasonable to require an organization to disclose information about significant opportunities and about significant processes for managing risk (competitive advantage) in a competitive environment. These are issues that make a significant difference to the long-term performance of an organization.

Question 6 – Current and anticipated effects

We recommend explicitly mentioning the role of internal audit in auditing climate-related targets, commitments, and action plans, particularly in relation to steps toward carbon neutrality and/or net zero goals. Specifically, the role of internal audit can provide assurance over the completeness and accuracy of data on these targets and actions, and over the processes and controls used to source, compile, and report information.

Question 7 – Climate resilience

Climate risk stress testing is an area where internal audit can play a valuable role in supporting. In the UK and the EU, for example, the financial services sectors are amongst the most highly regulated and in which there are strong examples of internal audit teams carrying out essential work to prepare for future climate-related economic shocks. Stress testing is also something that regulators are increasingly expecting to see. Internal audit is able to support stress testing across many sectors.

Question 8 – Risk management

We know climate change is a dynamic risk that is quickly moving up the agenda. A survey of CAEs by the Chartered IIA UK and Ireland showed almost half (47%) indicated that they have discussed climate change with their audit committee, 35% with their risk committee, and 22% have done so with their board. It is with executive management that CAEs seem to have had the most engagement on this topic (64%). A large majority, 83% of those surveyed, believe there should be a universally agreed framework to report climate-related information.

Paragraph 21 (b): The draft seems to assume that all transition risk is damaging. An organization may obtain substantial benefits from transition. These need not be the same as climate-related opportunities.

Question 17 – Other comments

The IIA is playing a leadership role in championing and advocating the vital role that internal audit can play in supporting organizations to identify, manage and mitigate sustainability- and climate-related risks, including through internal audit's independent and objective assurance on these risks. Recent thought leadership and white papers include:

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Embedding ESG and sustainability considerations into the Three Lines Model: A joint paper from The IIA and the World Business Council for Sustainable Development released July 14.
Internal Audit's Role in Integrated Reporting Assurance: A joint paper from The IIA, IFAC, and the Value Reporting Foundation.
OnRisk 2022: A Guide to Understanding, Aligning and Optimizing Risk: Examination of the top 12 risks for 2022, along with six key observations from the boardroom, C-suite, and internal audit.
Harnessing internal audit against climate change risk: A guide for audit committees and directors: A guide to motivate senior leaders to fully harness their internal audit teams.*:*
Organisations' preparedness for climate change: an internal audit perspective. An overview of the role of internal audit in relation to climate-related risks.
Risk in Focus 2022: The latest edition of this annual report found that climate change and environmental sustainability is seen as a top five risk by as many as 31% of CAEs, representing an increase of more than 40% on last year's survey.
Practical guidance on climate change and environmental sustainability*:* a joint effort of IIA affiliates in Europe.
The Three Lines Model: An update to the Three Lines of Defense

The IIA's Three Lines Model