



Internal Audit Round Table

Auditing sustainability

Webinar

—
June 18th 2021



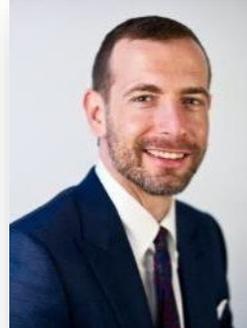
Speakers & Host



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Who joined us at our "round table"?



We have participants today from:

Belchim Crop Protection
Port of Antwerp
Beaulieu International Group
SDWorx
Union des Mutualités Libres
Alcopa
AZ Damiaan

Samsonite Europe
KU Leuven
Proximus
Matexi
Thomas More
Fluvius
ZOL AV

Emmaüs
Tessenderlo Group
Jan De Nul
Kinopolis Group
Valley National Bank
Ter Beke
Bpost

Willemen Finance
UCB
Proximus
capac
Domo Chemicals
Ontex
UZ Brussel

VDAB
UZ Brussel
Fluxys Belgium
Proaxia
VIVES
Materialise

'Virtual' round table: some guidelines

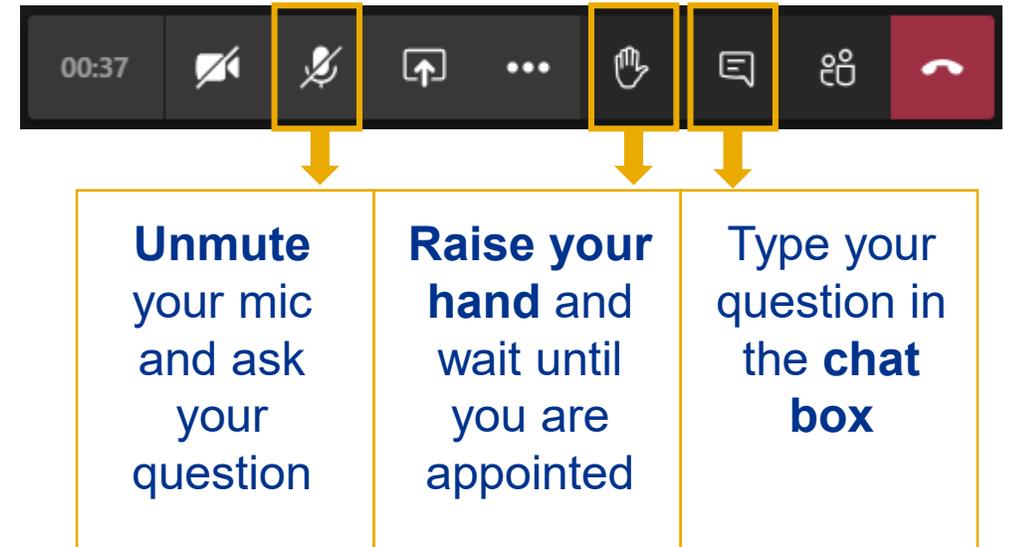


We do want to make it interactive, but also want to ensure good sound quality for everybody.

- Please mute your microphone during the presentation
- We have foreseen specific Q&A sessions throughout the webinar,
- You can ask questions through the chat function or raise your hand if you want to share some insights or ask a question orally,

In case you have issues with the sound or can't see the presentation, let us know through the chat function.

We will share the slides with you afterwards.

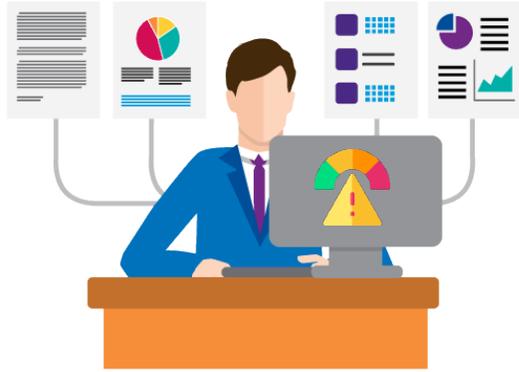


Today's agenda



An introduction to the concepts: Sustainability & ESG

Sustainability. What is it about?



*The
responsibility
of companies
for the **impact**
they have on
society*

Reducing negative impact

About detecting, preventing and reducing potential negative impact of business operations

Examples

- Corrupt practices and unethical behaviour
- Human rights breaches in the supply chain

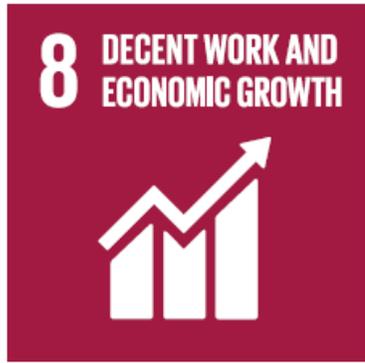
Stimulating positive impact

About contributing meaningfully to solving global challenges

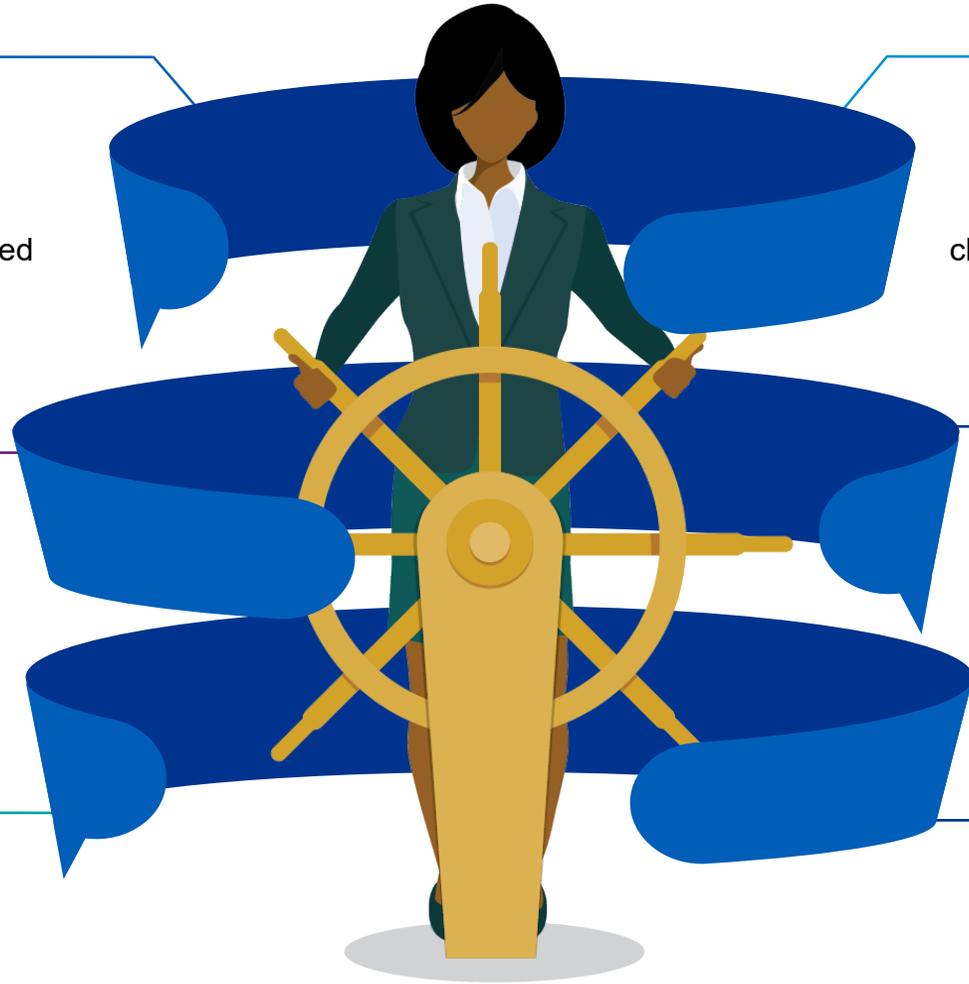
Examples

- Affordable health insurance for people suffering from chronic diseases





Why act now? We are in the perfect storm!



Consumers

Sustainability increasingly features in purchase decisions.

Example – Half of the growth in consumer packaged goods are due to “sustainable-marketed goods”.

Financial community

Investment appetite is shifting to ESG / sustainability.

Example – Sustainability-linked financial instruments are becoming mainstream.

Authorities

Regulatory complexity regarding sustainability increases.

Example – EU Taxonomy and Sustainable Finance Disclosure Regulation, NFRD and CSRD.

Business partners

Greater demand to improve sustainability of value chains.

Example – Companies with complex supply chains face more demand for supply chain-related information about e.g. ingredients, food fraud, animal welfare and child labor.

Employees

Sustainability has become a vital flank in ‘the war for talent’.

Example – Young graduates prefer to work for a company that has a positive impact on the world.

Civil society

Stakeholder capitalism is in vogue.

Example – Civil society is calling companies to account on important topics, such as diversity & inclusion.

There has been an evolution in the way companies engage sustainability

RISK MITIGATION



Avoiding downsides due to cost increases, market share loss or fines driven by regulation or market consensus.

Example

Risk of non-renewal of operating license in case of non compliance to environmental concerns.

COST REDUCTION



Improving cost position through operational efficiency with company's internal scope (e.g. energy, waste, water, ...).

Example

Using IoT devices and software to monitor real-time data about buildings for cost-efficient resource management.

NEW MARKETS



Creating value from product / service innovations, new markets, and commercial validation of sustainability efforts (e.g. charge premium, preferred partner position).

Example

Carefully tailored new product offerings for segments at risk (low income, chronic diseases, elderly, ...).

REPUTATION & OTHER BENEFITS



Capturing extended reputation benefits from sustainability (e.g. employee engagement, brand enhancement, ...).

Example

"Sustainability is an increasingly important factor in attracting and managing talents. With top talent in short supply, more companies take sustainability seriously, yielding better business results" – Harvard Business Review.

Tackling sustainability in business through engagement of ESG-factors or ESG incorporation/integration

ESG is short for Environmental, Social, and Governance

ESG includes a constellation of **sustainability-related themes** and corresponding **non-financial performance indicators** to assess:

- The viability of a business
- The impact of the company's products, services and business practices on the planet and society

ESG factors are recognized as representing significant **financial risks and opportunities**

There is a push towards **ESG integration / incorporation**



A snapshot of ESG factors



Environmental

- Emission to air, land, and water
- Energy consumption: Direct with Fuels/Indirect with Electricity
- Energy efficiency strategy and carbon management
- Use of water, especially in water scarce regions
- Use of raw materials
- Use of scarce resources
- Sourcing practices such as the use of responsibly sourced materials
- Management of waste and recycling
- Impacts on ecosystems and biodiversity (e.g. deforestation and the use of pesticides)
- Exposure to extreme weather
- Readiness to respond to changing regulations on environmental performance



Social

- Worker safety
- Employee demographics
- Employee attraction/retention records
- Approach to diversity and equal opportunities
- Level of customer satisfaction
- Protection of customers' data and compliance with privacy laws
- Approach to human rights risks, such as labor standards, child labor and modern slavery
- Strength of relationships with workers and communities
- Supply chain risks, such as standards of working conditions in the supply chain
- Appropriate and lawful use of marketing communications
- Product safety records



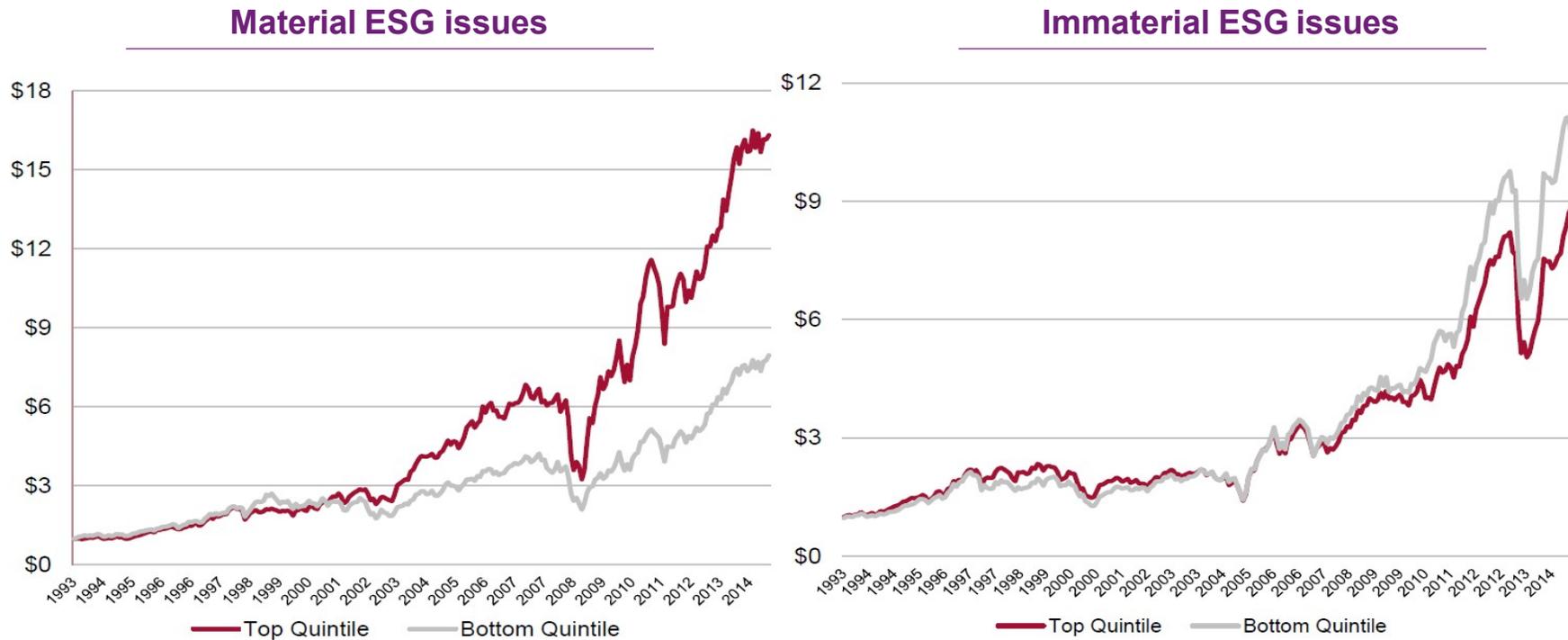
Governance

- Executive remuneration and demographics
- Board remuneration and demographics
- Compliance with accounting standards
- Examples of anti-competitive behavior
- Audit Committee and Board structure
- Bribery, corruption, and responsible tax record
- Succession planning
- Lobbying record and political contributions
- Robustness of ESG risk management processes
- Presence of appropriate whistleblower and grievance mechanism

ESG is a very dynamic space that continues to evolve

ESG incorporation contributes to superior financial performance

Companies with good performance on *material ESG* issues significantly outperform firms with poor performance on these issues. Further, firms with good performance on ESG issues not classified as material do not underperform firms with poor performance on these same issues



Source: Mo Khan, George Serafeim and Aaron Yoon (2015), Corporate Sustainability: First Evidence on Materiality. The Accounting Review



Reporting requirements: NFRD & CSRD



1. Non-Financial Reporting Directive (NFRD)



WHEN APPLICABLE

- EU Directive 2014/95/EU, transposed into member states' law in 2016 (BE: 3/9/2017)
- Requirements applicable as of FY 2017



SCOPE OF COMPANIES

Large **public interest entities** (PIE's) with:

- Average number of employees > 500
- Either: Balance sheet total > 17 M €, OR a net turnover > 34 M €



- EU: ± 11.600
- BE: ± 100



SCOPE OF REPORTING REQUIREMENTS

Companies are to report on:

- Diversity
- Environmental matters
- Social and employee matters
- Respect for human rights
- Anti-corruption and –bribery matters



1. A description of the policies and due diligence
2. The results of those policies
3. The principal risks
4. Non-financial key performance indicators



ASSURANCE

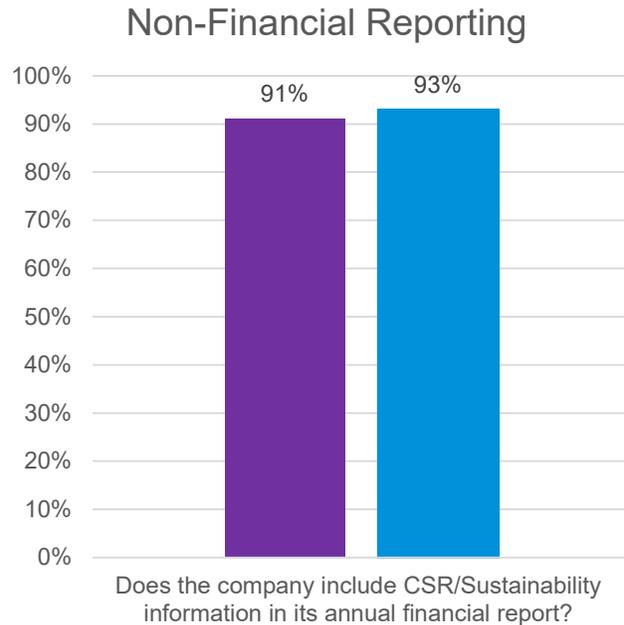
- **Non-mandatory** (for most countries)
- The statutory auditor only performs completeness and consistency checks – No assurance provided herewith.



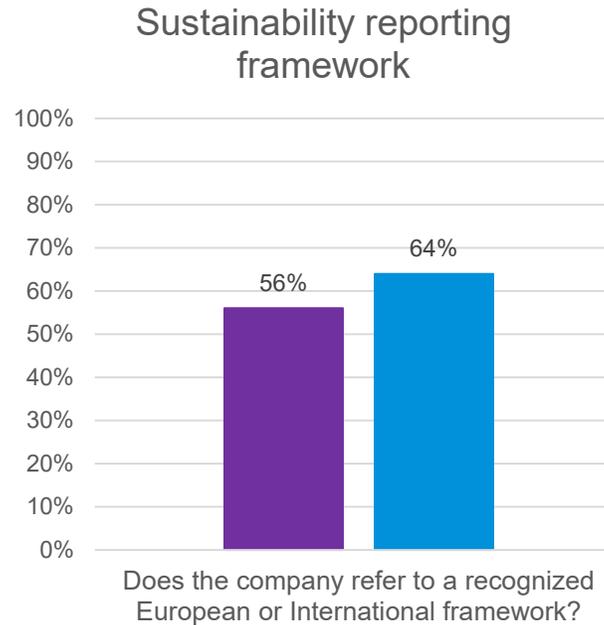
REPORT

- Included in the Annual Report OR in annex to the Annual Report (e.g. in a separate Sustainability Report)
- Online or PDF version

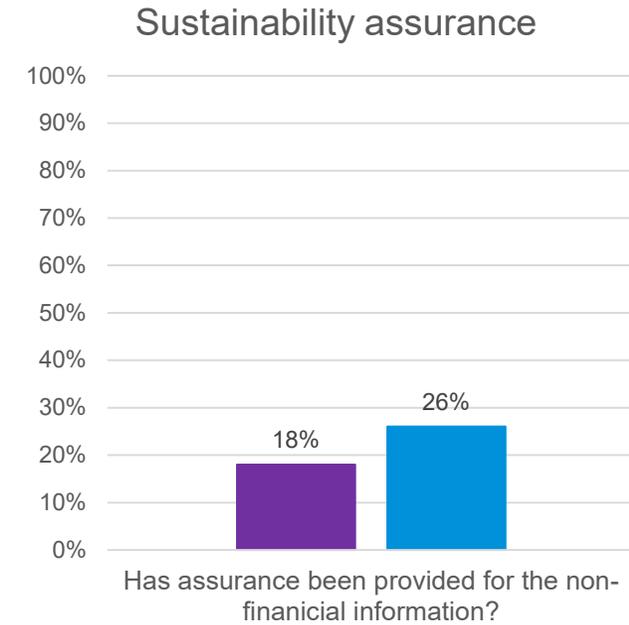
2. KPMG's Non-Financial Reporting Survey 2020



Still not all companies in scope of the 2014 NFRD are reporting on non-financial information as required.



Just 64% of companies referred to a European or international sustainability framework.



Only 1 in 4 companies obtain assurance on sustainability information (2017: 1/5).

Source: [The KPMG Survey on Non-Financial Reporting 2020](#)

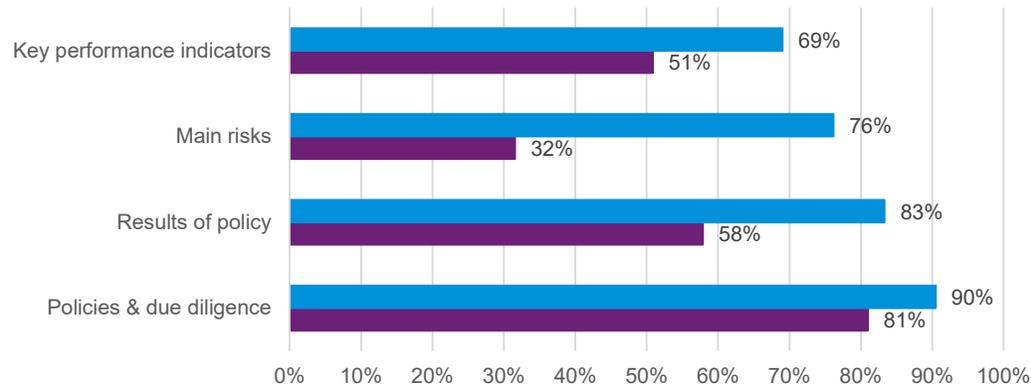


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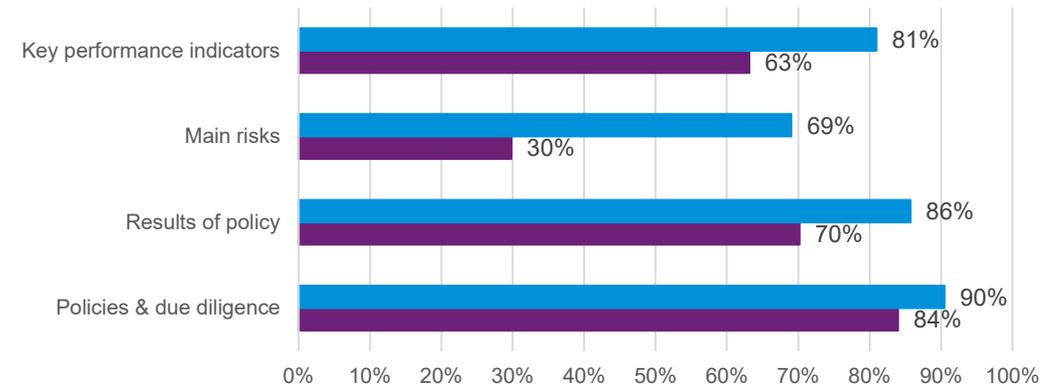
2. KPMG's Non-Financial Reporting Survey 2020



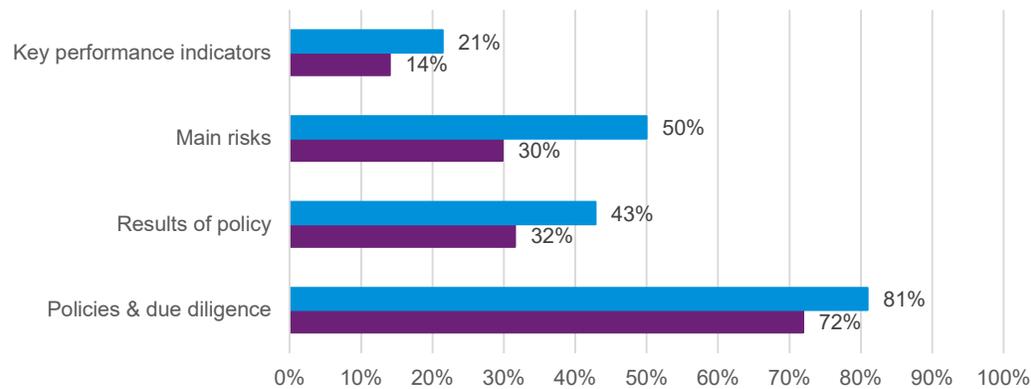
Social and personnel matters



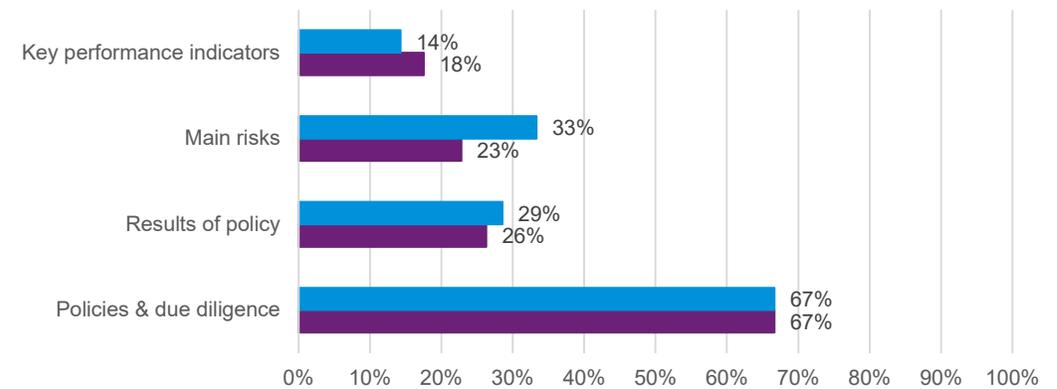
Environmental matters



Anti-corruption & -bribery matters



Human rights matters



Source: [The KPMG Survey on Non-Financial Reporting 2020](#)



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3. Corporate Sustainability Reporting Directive (CSRD)



WHEN APPLICABLE

- Proposal adopted in April **2021**; expected to be transposed into member states' law in Dec 2022
- Requirements expected to be applicable as of FY **2023**



SCOPE OF COMPANIES

- **All large companies** (meeting min. 2/3 criteria):
 - Average number of employees > 250
 - Net turnover > €40M
 - Balance sheet total > €20M
 - **All listed companies** (exception: micro-entities)
 - *Note: SME's get an extra 3 years to comply*
- EU: x 5 → ± 49.000
➤ BE: x 10 → ± 1.200



SCOPE OF REPORTING REQUIREMENTS

Specifying and amending the sustainability reporting requirements on:

- **Double materiality**
- Strategy, targets, role of the board/management, principal adverse impacts, intangibles,...
- Qualitative & quantitative information, forward-looking & retrospective information, ...
- Reporting in accordance with **mandatory European sustainability reporting standards**.
- Reporting in line with Sustainable Finance Disclosure Regulation (**SFDR**) and the EU **Taxonomy** Regulation



ASSURANCE

- **Mandatory** – limited level of assurance on company's sustainability reporting



REPORT

- Inclusion in the Annual Report
- **Digital** tags and to be submitted in **electronic format**

Challenges





Why auditing Sustainability and ESG



Sustainability as risk in focus

Internal audit focus should be aligned with risk priorities. Climate risk and sustainability is highlighted as one of the “hot topics” for which the importance will increase in the coming 3 years.

22% of Chief Audit Executives cited climate change and sustainability as one of their top 5 risks.

Furthermore, **41%** believe it will be a top five risk in 3 years time.

There is no other risk area expected to gain more priority over the coming years.*

** Risk in focus 2021, IIA*

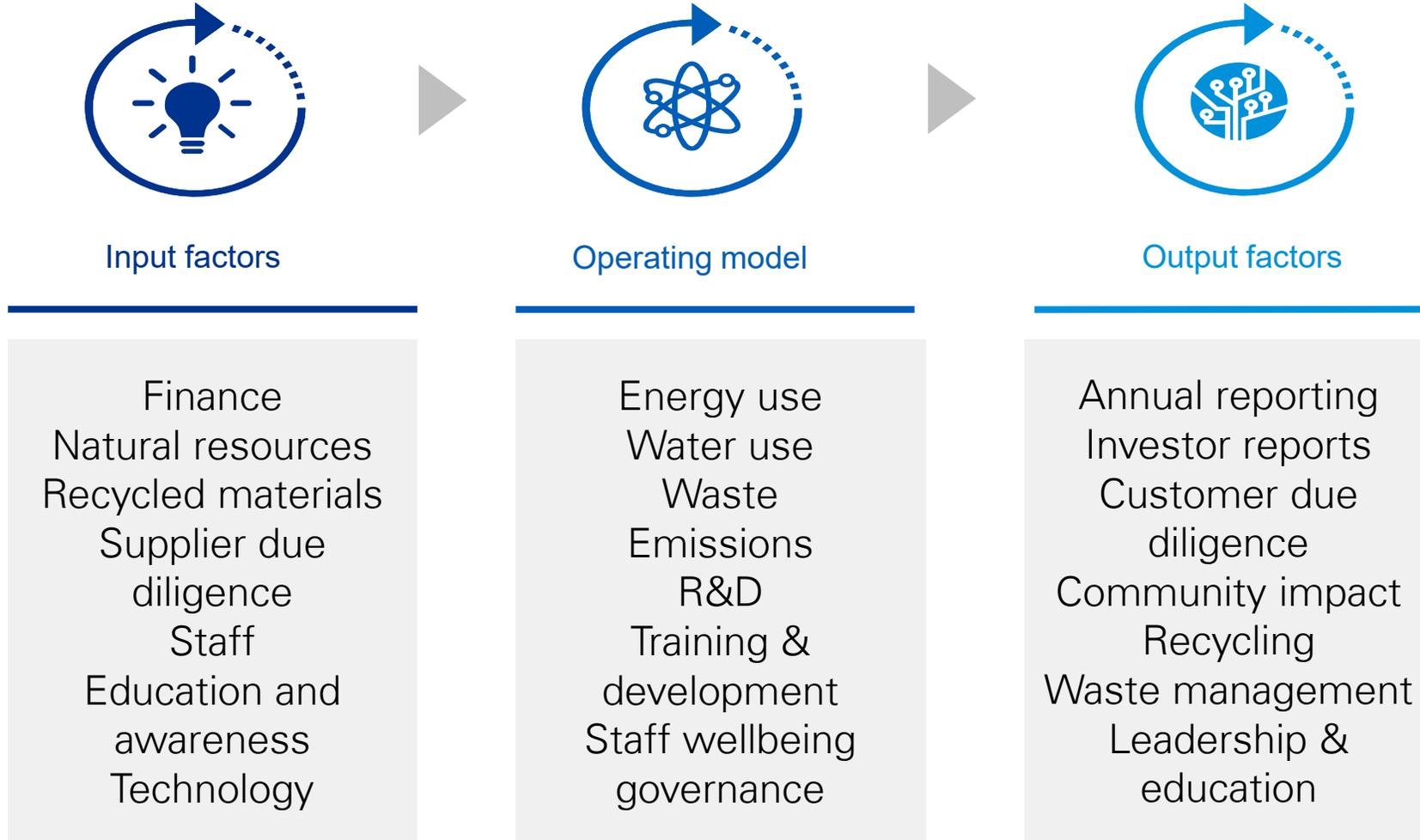


However sustainability is more than Climate risk

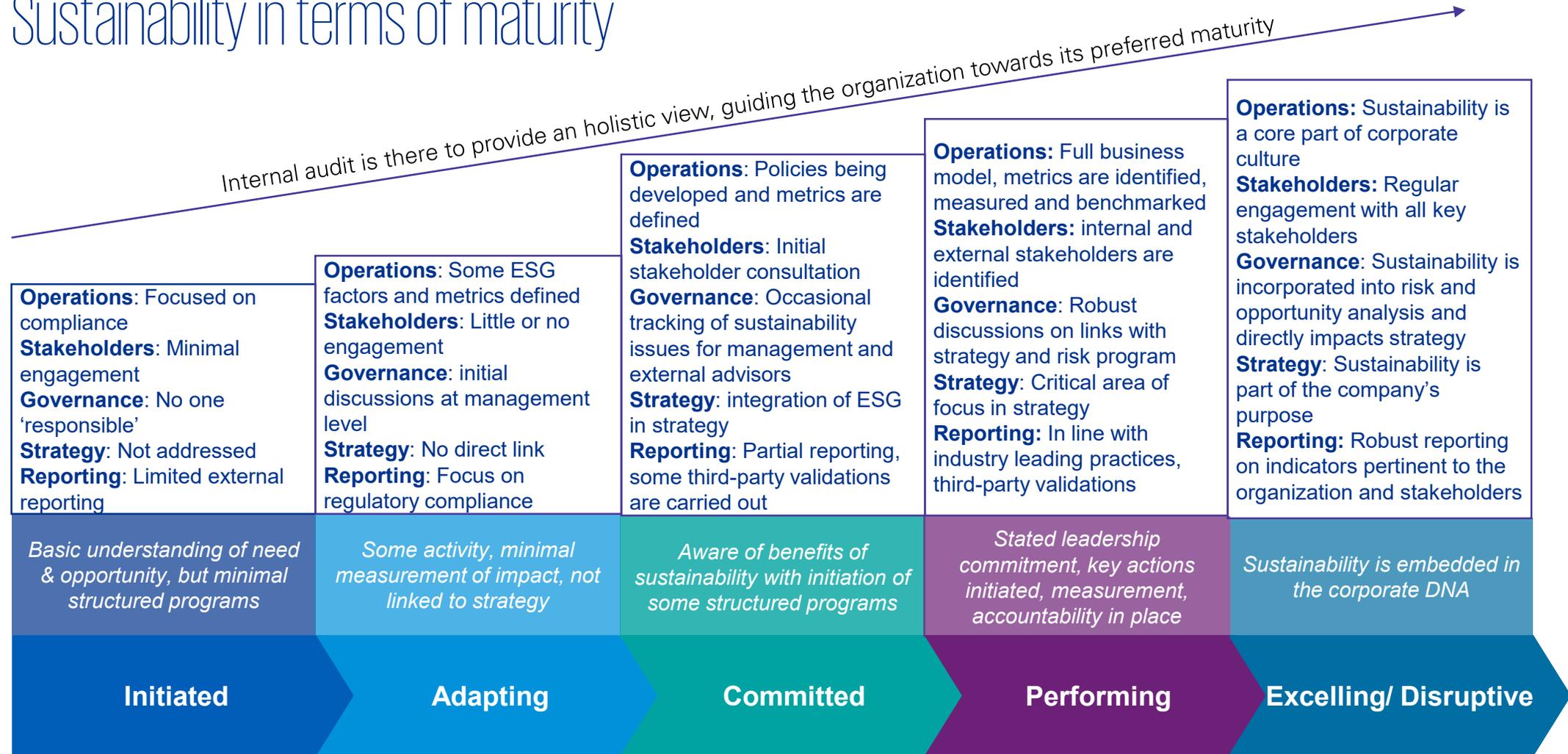


Sustainability as an element of the entire business cycle

A sustainability process flows throughout the whole organization, from its strategic goals down to its operational practices. It is present in an organization's input and output aspects as well as the operating model. Internal audit is the well placed to **facilitate an holistic approach**.



Sustainability in terms of maturity



There are five stages of maturity that organizations go through on their sustainability journey, however, **ESG is not a destination**, but an ongoing process throughout the business lifecycle. Realizing advantages requires a commitment to continuously investing in, managing, monitoring, and improving ESG efforts.

Role of the internal audit function

Internal audit is there to provide an holistic view, guiding the organization towards its preferred maturity

Initiated

Adapting

Committed

Performing

Excelling

*For organisations limited maturity, internal audit's role is to challenge executives' **risk awareness** and support the **risk identification and assessment** in order to address potential reporting errors, comply with ESG related legislation or regulation, prevent damage to local biodiversity or community, etc.*

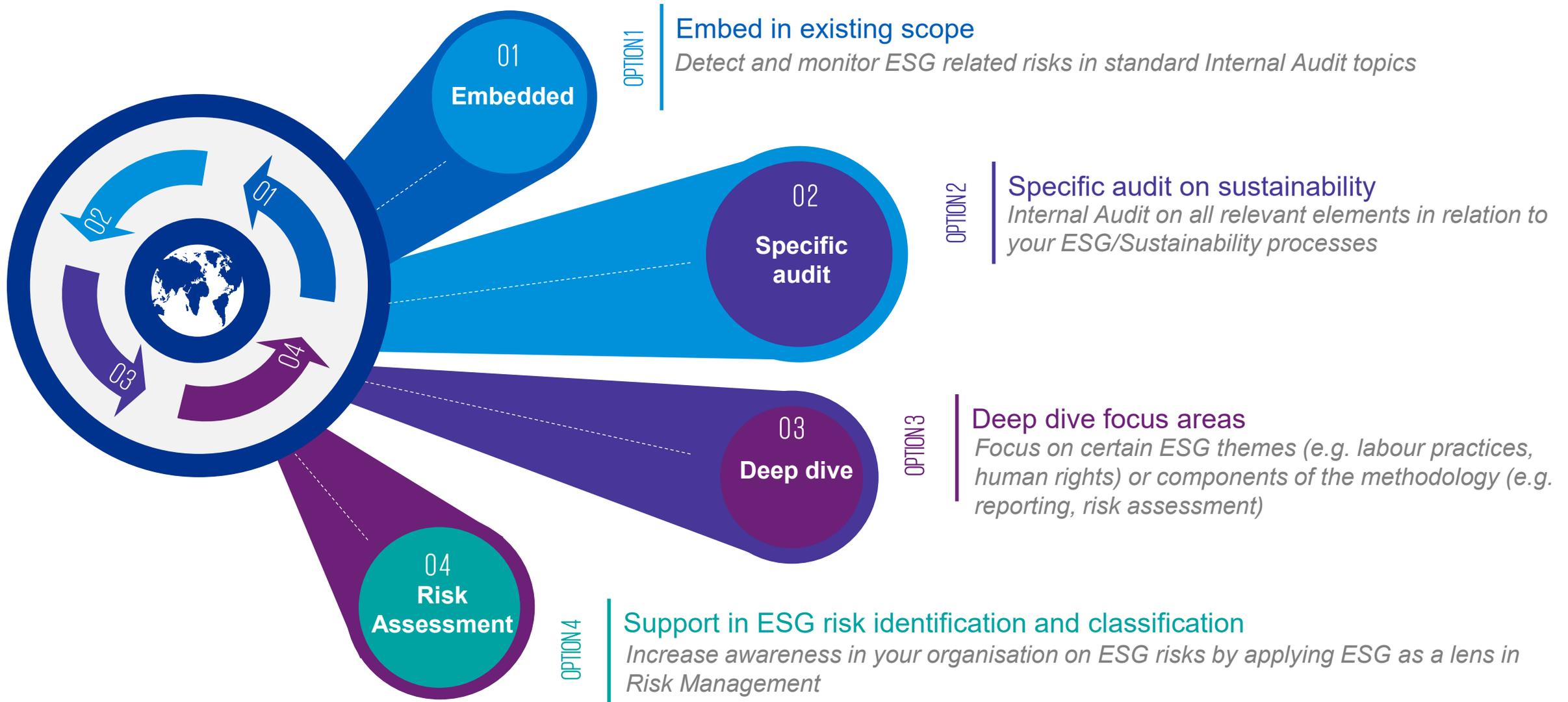
*For organisations with specific actions or overall management systems in place, the objective of internal audit is to provide **assurance and create business value** by enhancing confidence in information reported (internally & externally), consistent integration of ESG elements throughout processes find efficiency gains, etc.*



An integrated and practical approach



4 ways to integrate sustainability in Internal Audit



Option 1: Embed in existing scope

Example: auditing your organisation's procurement process

Standard Scope Control Objectives:

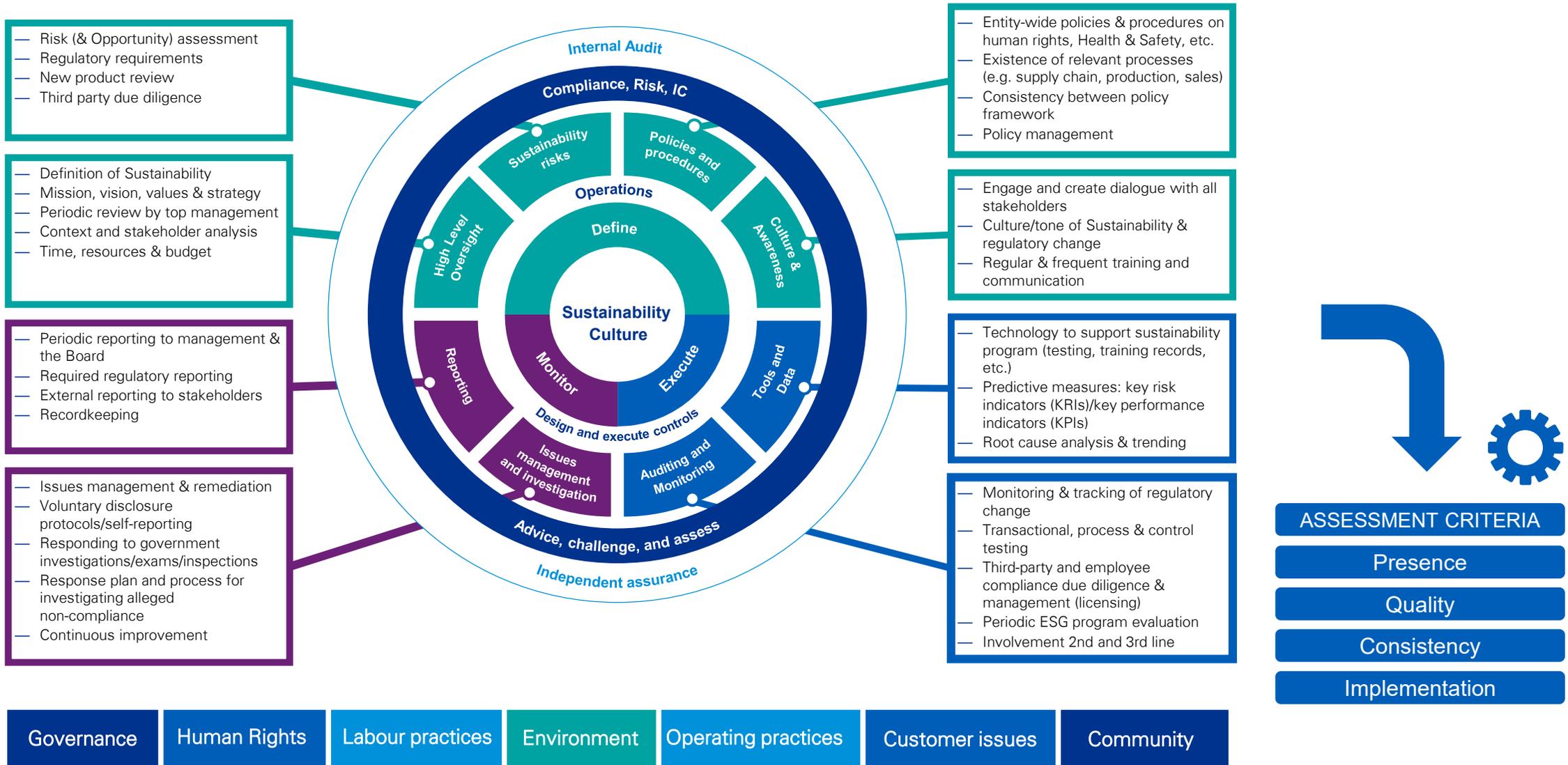
1. All suppliers are pre-approved in accordance with company policy
2. Key contracts > 10k per annum are tendered by min of 3 suppliers
3. A procurement committee approves all long term contracts (> 6 months)
4. All goods are receipted prior to payment
5. Supplier performance is monitored with KPI's / SLA's



Extend scope to assess ESG control objectives:

1. Supplier terms and conditions are agreed to ensure compliance with human rights regulation and internal policies
2. Procurement policy is aligned with ethical sourcing, sustainable product specifications, recycling, etc.
3. Process on supplier screening is aligned with ESG requirements
4. Supplier terms incorporate KPI's to enable the business to measure, minimise and report

Option 2: KPMG Sustainability Audit Methodology



Option 2: Internal audit on sustainability / ESG

Example: KPMG's Sustainability Audit Methodology

Control objectives :

1. Sustainability / ESG is part of the mission, vision and values of the organization and is clearly documented in the mission/ vision statement
2. Continuous risk management system / monitoring is in place taking into account new sustainability risks
3. Appropriate training and awareness programs are developed and implemented (in scope: new joiners, permanent employees, service provider employees, etc.)
4. Due diligence is conducted for onboarding of suppliers taking into account ESG related criteria (human rights, ethical practices, working conditions, etc.)

KPMG Audit program						
Social Responsibility audits						
Client						
Auditor(s)						
anges in processes or control steps compared to prior year (if applicable):						
write IA grading						
SR concepts: Organizational governance, human rights, labour practices, environment, fair operating practices, customer issues, community involvement and development						
Audit steps necessary to test controls						
Control id	Subtopic	Risk	Best practice / Expected control	Control in place (organization description)	Design Effectiveness Testing	Test procedure
1. Define						
1.1 High-Level Oversight / tone at the top						
1.1.1	Definition of SR	No clear definition of what the organization considers to be SR, leading to inconsistent actions and behaviours	The scope of SR is clearly defined, documented and communicated throughout the organization and is subject to periodic review		Absent	<ul style="list-style-type: none"> Check through inquiry what SR means according to the organization and verify whether this is present in the entire value chain: product design, supply chain, facilities and operations, distribution and logistics, disposal Desktop review: obtain and review the SR management policy and verify whether SR is clearly defined and includes aspects of the entire value chain. Desktop review: verify whether key stakeholders in the process have a similar understanding of SR
1.1.2	Mission statement & Vision & Values & Strategy	<ul style="list-style-type: none"> Unclear stance on mission, vision, values, culture in relation to SR towards employees leading to inconsistent actions or behaviours. SR is not embedded in the activities, goals and action plans SR is used as a marketing strategy and is not aligned with the organizational strategy leading to 	<ul style="list-style-type: none"> SR is part of the mission, vision and values of the organization and is clearly documented in the mission/vision statement SR is a key part of the company's business goals. The SR strategy is aligned with the organizational strategy. Goals and action plans are defined on SR SR is a key part of the marketing strategy. The SR marketing 		Basic	<ul style="list-style-type: none"> Check through inquiry that top management sees and acknowledges the importance of SR within the companies vision/mission and culture Check through inquiries that the role of SR is incorporated in product development / business goals/ corporate strategy/ marketing strategy Desktop review: verify whether SR is formally included in mission/vision/values/strategy/marketing Desktop review: verify whether goals and action plans are defined on SR
1.1.3	Periodic review by top management	<ul style="list-style-type: none"> SR policies are not / no longer in line with the organizational strategy Perception that top management does not support / is not involved in SR related matters 	<ul style="list-style-type: none"> Strategic review: SR policies and statements are kept up to date / aligned with organizational strategy Discussions are held between SR resp. and management to ensure SR policies remain relevant Clear reporting lines are in place regarding SR 		Mature	<ul style="list-style-type: none"> Verify per inquiry that top management periodically reviews relevance and applicability of the SR policy to ensure this is in line with regulations and the organizations context Verify per inquiry that clear reporting lines are defined of functions occupied with SR topics towards top management Desktop review: obtain meeting minutes to ensure that the SR policy is subject to periodic review by top management
1.1.4	Time, resources and budget	SR goals are not achieved or cannot be executed due to lack of resources, time, budget, etc.	SR responsibilities, timelines and budgets are determined and regularly reviewed		Advanced	<ul style="list-style-type: none"> Verify per inquiry that the organization has attributed clear roles and responsibilities to SR related topics, and sufficient resources and budget is made available. Desktop review: review the organization description / role description (e.g. working group, department, FTE, etc.) for relevant functions to ensure sufficient responsibility is allocated Desktop review: screen the annual budget for adequacy

Important to highlight is that this methodology should be tailored to the organization's context and material risks / strategic priorities and current future maturity

Option 3: Deep dive focus area

Example: Internal Audit on ESG Reporting Framework / data validity

Control Objectives:

1. ESG Reporting Framework was **approved by the board**
2. Framework and objectives were communicated to all staff
3. Framework has been developed to meet the requirements of **all stakeholders**
4. Framework includes **metrics** which are aligned with corporate strategic objectives to manage ESG
5. Framework includes clear metrics to measure and report performance against p.e. **net zero waste**
6. Framework includes clear metrics to monitor and report compliance with p.e. **health and safety** standards
7. Metrics are **reported** on a regular basis to senior management
8. **Remedial action** has been taken when adverse metrics are identified
9. Data collected to measure the metrics is complete and accurate

Option 4: ESG Risk identification and assessment

Example: Risk identification and assessment



ESG Strategic Risk

The Strategy does not support sustainable business performance or growth; market opportunity or value creation.



Environmental Risk

Risks related to inadequate environmental considerations resulting in financial exposure or adverse impacts on business operations or company reputation



Social Risk

Risks related to working and safety condition, respect for human rights, and management of social and political trends.



Governance Risk

Risks related to lack of understanding of the link between ESG factors and corporate purpose, corporate performance and leadership.



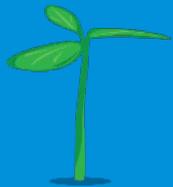
Key take-aways and Q&A



Wrap-up

- Companies are no longer only evaluated from an economic perspective, but also from a societal and environmental one
- The rising importance of ESG is illustrated by the amount of standard-setting initiatives that have been developed over the years
- A sustainability process flows throughout all the whole organizations, from its strategic goals down to its operational practices
- Internal audit plays an important role in guiding the organization through ESG initiatives

4 reasons to conduct a sustainability audit

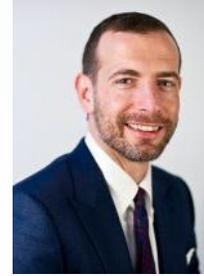


- **Get insights in stakeholders expectations regarding the organization's ESG responsibility**
- **Create a clear view on all ESG risks**
- **Align ESG culture with ESG initiatives**
- **Measure ESG activities, based on KPI's linked to the ESG strategy**



Thank You!

Let's keep in touch



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