



Integrating sustainability and operational audits

How internal audit can help keep
sustainability transformation on course



A person with a backpack is hiking on a dirt path through a forest. The path leads towards a rocky cliff face. The trees are lush green, with some showing early autumn colors. The overall scene is a natural, outdoor setting.

Introduction

As companies ramp up environmental, social, and governance (ESG) initiatives, the internal audit function has an important role to play within the G in ESG—governance. Internal audit provides an independent, objective source of risk management, strategy, and oversight. However, it can be a challenge for internal audit to determine the best use of its resources to bring value to an organization’s sustainability priorities.

The risks around sustainability reporting and regulatory compliance are well-deserving candidates for consideration in an internal audit plan. However, it is important to also recognize strategic and operational risks, including the risk of not achieving publicly communicated targets and goals. These are often overlooked or given less priority compared to the more conspicuous reporting and compliance risks. Internal audit can play a role in helping to provide oversight and insights into the effectiveness of organizational transformation efforts.



Internal audit’s role on the sustainability steering committee

Companies engaging in cross-functional initiatives such as sustainability often establish a steering committee with one or more executive leaders. Committee responsibilities typically include overseeing sustainability-related transformation and sustainability reporting while monitoring associated risks. When the chief audit executive, or delegate, has a seat at the table, they can offer a valuable horizontal perspective, pose challenging questions to help assess and manage the risk to the achievement of sustainability objectives, and determine necessary controls.

When an organization sets sustainability targets and goals, the internal audit representative can encourage a structured approval and monitoring process enabling informed decision-making, strategic alignment, and transformation integrity.

“ As the business prepares to become compliant with sustainability reporting requirements, internal audit can help determine their reporting readiness. ”

Sample questions internal audit should ask

- Are we confident in the accuracy of reports related to metrics, goals, and other disclosures?
- How are we engaging with our stakeholders and addressing their concerns and feedback? Is our communication frequent enough?
- Are we incorporating sustainability considerations throughout our decision-making processes?
- Do our people understand our sustainability strategy and their role in how we plan to achieve it?
- Do we have a clear action plan to achieve our sustainability goals and objectives?
- Do our teams have the necessary resources and skills to ensure process integrity?
- How are we creating a culture of awareness and accountability that aligns with our sustainability objectives across the organization? How are we staying updated on and preparing for the emerging regulations?
- Do we aim to follow leading practices or only meet the minimum reporting requirements?
- Have we allocated budgets to initiatives that will enable us to meet our goals?
- Is adequate reporting in place so the board can effectively carry out its oversight responsibilities?



Integrating sustainability risks into the internal audit risk assessment

Developing a comprehensive internal audit risk assessment requires proper input and consideration of the organization’s sustainability goals, objectives, and strategic initiatives. By incorporating sustainability risks into the auditable universe, internal audit can ensure broader oversight of the sustainability risk landscape.

Internal audit should include vital sustainability stakeholders in risk assessment discussions, such as the chief sustainability officer and sustainability reporting lead. Internal audit also needs detailed knowledge of the company’s sustainability strategic objectives, externally reported targets, initiatives related to set goals, and the status of regulatory reporting readiness.

A company’s auditable universe should reflect updates that mirror the growing significance of sustainability initiatives and reporting. Sustainability risks can reach across multiple functions or processes in an organization. After taking a holistic view of existing processes, businesses should determine where to incorporate sustainability subprocesses or create new processes (auditable entities).



“ Procurement processes likely exist within an auditable universe but may not reflect their importance in a company’s ethical supply chain goals. For example, if a business claims it only works with vendors that comply with an hourly workweek limit, audit subprocesses related to supplier due diligence and risk management may increase in priority. ”



Selecting areas of focus for the internal audit plan

Internal audit can operate as third-line assurance or provide consultative support in new and developing areas. In many companies, internal audit is playing an important role in Areas 1–3 highlighted in the diagram below due to their role as control specialists.

However, as sustainability-related risks grow in prominence, internal audit can take a more transformational role. By

incorporating sustainability risks into the internal audit plan and identifying the impacted process and subprocesses, internal audit can thoughtfully design their role in assessing the effectiveness of the required process transformation to support achievement of sustainability objectives through operational audits.

01 Internal controls over sustainability reporting

Internal audit can act as a consultant for process and control documentation and development, control design, and as a review point before control implementation.

Internal audit can also include sustainability controls within their internal control testing program.

02 Validation of sustainability reporting

As sustainability reporting processes and controls are typically undergoing significant change and maturation, it may not yet be possible to rely on effective internal controls over reporting. Internal audit can help conduct validation testing before releasing external reports.

03 Regulatory readiness

Internal audit can help to determine regulatory readiness by evaluating the governance structure, project roadmap, and resources. Internal audit can also assess assurance readiness of supporting critical documentation in their regulatory roadmap as the project team completes key milestones.

04 Operational audits

Internal audit can incorporate sustainability elements into existing operational audits, or add in new targeted sustainability audits. For example, a procurement audit may include assessing whether sustainability considerations are consistently embedded within procurement decisions.



Building the ideal internal audit team

To successfully execute on sustainability-related internal audits and consultative projects, the internal audit function needs the necessary skills and expertise to identify, scope, and execute them.

The process starts by assessing the current level of sustainability experience and knowledge within the internal audit function, and identifying where gaps exist. Next, strategically determine whether the internal audit team should develop sustainability expertise internally, hire new professionals for their team with the required skill set, or rely on external third parties to complement their existing knowledge and recommend best practices. There may be an option to team with other internal groups who can

provide sustainability expertise. For example, a corporation may have a robust environmental second-line function that could provide insight on an audit in this area.

When relevant, it is essential to learn from the organization itself and leverage expertise from other roles, particularly second-line monitoring functions. For instance, a corporation may need a robust environmental or quality monitoring function to help internal audit define success for a particular metric. If the organization lacks the necessary skills, internal audit can consider options such as training existing team members, hiring professionals with sustainability experience/credentials, or involving outside subject matter experts who can recommend best practices.

Internal audit typically uses three sourcing models for sustainability-related projects:



1 Delegating sustainability risk ownership and audits to in-house staff. Those individuals will manage tasks such as understanding the organization's sustainability risks, advising on which projects the internal audit plan includes, and execution. This model requires expertise and knowledge within the in-house internal audit team.



2 Involving third-party sustainability specialists to supplement the internal audit team, in an outsource manner for end-to-end project delivery. This model provides leading practice recommendations and insight while alleviating pressure on a team's limited capacity.



3 Adopting a hybrid of the first two models, where third-party sustainability specialists provide up-to-date advice and execution support to in-house staff while helping upskill them. This co-source model provides flexibility in allocation of team resources by filling gaps in capacity, skill set, or subject matter understanding.



Building a sustainability risk reporting dashboard

Traditional audit reporting includes a single report at the end of the review, feedback to the process and control owners, and communication of gaps and issues to leadership. In the case of sustainability, the fast-paced development of potential risks necessitates a more cohesive approach since the risk and operational process owners may be different people. For example, an organization may want to eliminate exploitative labor practices in its supply chain. If supply chain processes are decentralized among different business units or geographies, internal audit may review controls associated with this risk, at multiple different audits throughout an

audit cycle. A risk dashboard provides a mechanism to consolidate just those audit results that are relevant to the supply chain labor risk owner, and if this is a priority target or goal, may be a relevant summary and monitoring tool for the sustainability steering committee.

For these reasons, a thoughtfully designed risk dashboard can serve as a feedback loop for management and helps internal audit manage sustainability risks proactively. Real-time insights allow risk owners to course correct on a timely basis and may mean the difference between achieving a stated target, and not.

Conclusion

The fundamental goal of sustainability initiatives should never be overlooked: to bring about significant organizational transformations—be it in reducing climate impact, improving social equity, or strengthening governance practices. The successful achievement of sustainability goals may rely upon the effective transformation of multiple functions and processes throughout an organization.

Internal audit has the power to go beyond the typical reporting focus and expand its reach in sustainability risk oversight. This includes assessing the effectiveness of critical transformation of operational processes, pinpointing areas where necessary changes are not consistently implemented, and thereby jeopardizing the attainment of objectives and targets. To do this successfully, internal audit teams must assess their own sustainability skill set and determine how to enhance their resources. This is where KPMG comes in. We can provide sustainability expertise to supplement or upskill internal audit teams, from embedding sustainability risks into the internal audit plan, to execution of internal audits. Let's work together to make a positive impact.



How KPMG can help

KPMG helps clients address risks at any point along their sustainability journey. Our wide-ranging service offerings can support organizations' internal audit functions, expand their sustainability capabilities, and improve the integration of sustainability considerations into strategy and risk management. Below are examples of how KPMG can help in this process.

Our professionals can help you through:

Internal audit risk assessment

KPMG has extensive experience conducting risk assessments to help organizations prioritize risks and audits by assigning overall risk ratings on various factors.

Subject matter support

Organizations can bring in KPMG as subject matter professionals for specific audits or to provide supplemental, external knowledge and experience as needed.

Sustainability process and controls maturity survey

KPMG can survey an organization and use responses to evaluate the maturity of sustainability processes and controls and identify potential weaknesses and areas for improvement in the reporting process.

Internal assurance framework

KPMG can provide advice on how to establish an internal assurance model, as well as assistance in control design, documentation, and testing for sustainability-related risks.

Internal controls

KPMG can support the design and formalization of your internal control framework for key metrics.

Sustainability governance framework assessment

KPMG can provide valuable insights into an organization's governance framework to identify potential weaknesses and areas for improvement.

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