The Institute of
Internal Auditors
Elevating Impact

29 July 2022

RE: IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information

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 sustainability-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, comparable climate-change mitigation efforts organizations.

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 disclosures to 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 utilizing The IIA's Three Lines Model. Links to recent publications can be found 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

Question 1 – 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.

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.

Question 2- Objective (paragraphs 1-7)

Paragraph 1: The draft requires disclosure of (any) information about significant sustainability risks even though it is directed at financial information.

Paragraph 2: 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. (Similarly, the requirement at 6 b seems to impair competition.)

Paragraph 5: There is an underlying assumption that enterprise value is related entirely to cash flow. There is also scope for this to be manipulated, as "uncertainty" about cash flows is always a judgment – any modelling can only be interpreted if the assumptions are fully disclosed. Also, the definition here is at variance with the definition in Appendix A.

Question 2 (a): The definition of "sustainability-related financial information" is not clear, as understanding of the word "sustainability" is not established. Sustainability could relate to the on-going existence of the entity or could relate to the effect the entity has on its environment. This goes for "climate-related" risk in the drafts as well, which can mean the effect of an entity on the climate as much as the effect of the climate on the entity.

In addition, the definition refers to "risks and opportunities" and this reference is found throughout the draft as well. 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 meanings.

The Institute of Internal Auditors
Elevating Impact

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 3 – Scope (paragraphs 8-10)

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

Paragraph 9: We recommend clarifying what is meant by "primary users" vs. "users" and clarifying the term "reasonably be expected to." For example, does this mean reasonably expected by the casual reader of financial information, by an expert in the field, by a financial journalist with the advantage of hindsight? It is too important to be left unclear.

Question 4 – Core content (paragraphs 11-35)

Paragraph 13: We suggest the ISSB recommend the role internal audit specifically to achieve what is outlined in Paragraph 12, which calls for the users of "financial reporting to understand the governance processes, controls and procedures used to monitor and manage sustainability-related risks and opportunities." 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) that requires 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 sustainability-related risks. Organizational resilience is strongly linked to sustainability-related threats and opportunities, and internal audit can connect the future sustainability of an organization to how resilience is managed.

Paragraph 13: 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.

In addition, we recommend that 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 Model can ensure effective risk management, internal oversight, and integrated sustainability across the organization. The Three Lines Model focuses on the accountability of the board, 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 13 (g): While this is trying to promote the integration of controls applied to sustainability-related risks with other controls, there is some weakness in the use of "whether" in this context. It might be better to use "The description shall include information about how any specialised controls and procedures are applied to management of sustainability-related risks and are integrated with other internal functions." This brings to mind the requirements of the UK stewardship code.

Paragraph 17: There is certainly value in building consideration of supply chain risks into this standard, but it is also going to build significant complexity into the reporting process. Data is often difficult to consolidate for reporting and the quality is inconsistent and unreliable. We believe that internal audit can be of great assistance in validating the sources and quality of data.

Paragraph 18: The draft says use time horizons "typically used" in the entity's industry. This abdicates the problem and suggests that an organization must determine what is "typical." (See also paragraph 29.)

Paragraph 19: There is a need to define "short, medium or long term." This paragraph seems to suggest that reporting entities should make up their own definitions for these terms. In a sustainability or environmental context, long term could be 5 years, 50 years, or 500 years.

Paragraph 23: This statement needs clarification – "understand its capacity to adjust to the uncertainties arising from significant sustainability-related risks." – particularly given the understanding of risk within ISO 31000 as previously mentioned.

Paragraph 26 (b)(i): As written it encourages incorrect assessment of level of risk (which is likelihood of experiencing a consequence). It would be better to simply say "how it assesses the level of risk, the impact and probability, as well as the consequences if the risk occurs"

Paragraph 26 (b)(ii): There is no need to mention risk-assessment tools.

Paragraphs 26(e): Risk management processes are integrated to management processes – sustainability risks are no different. If the risk management process is not integrated, then the risks are not managed.

Paragraph 27: Consider expressing these provisions better by comparing to the provisions expressed in paragraph 18.

Question 7 – Fair presentation (paragraphs 45-55)

Paragraph 54: This is another invitation for reporting entities to make up their own mind about what to report.

Question 8 – Materiality (paragraphs 56-62)

Paragraph 59: Unless these statements are to be audited against some objective criteria, this paragraph is a provision that will allow the dishonest to manipulate the reported result.

Question 11 – Comparative information, sources of estimation and outcome uncertainty, and errors (paragraphs 63-65, 79-83, and 84-90)

Paragraph 63: An entity could change its metrics every period and select only those that show an improvement at a given time. Given the emphasis on "sustainability," multiple prior periods might be asked for. Certainly, comparative information should always include what was actually reported in the prior period.

Paragraph 81: This language should be clarified with specifics: How far into the future and what level of uncertainty should an organization report?

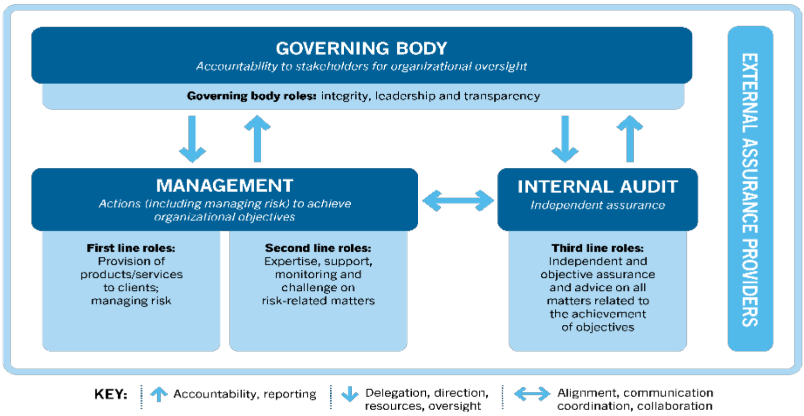
Question 17- Other Comments

The IIA is championing and advocating the vital role that internal audit can play helping boards and management to identify, manage, and mitigate sustainability- and climate-related risks by including independent and objective assurance from internal audit functions.
Recent thought leadership and white papers include:

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 Institute of
Internal Auditors
Elevating Impact

The IIA's Three Lines Model



Copyright © 2020 by The Institute of Internal Auditors, Inc. All rights reserved.

GLOBAL HEADQUARTERS | 1035 Greenwood Blvd., Suite 149 | Lake Mary, FL 32746 USA | Phone: +1-407-937-1111 | Fax: +1-407-937-1101