

ESG: Implementation, Reporting, and Internal Audit's Role

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This paper explores the implementation, reporting, and role of internal audit in Environmental, Social, and Governance (ESG) practices within organizations. It examines the growing importance of ESG factors in corporate decision-making, the challenges associated with their implementation, and the role of internal audit in ensuring effective ESG reporting. A survey comprising nine questions was conducted, focusing on the Consumer Electronics, Metals and Mining, Automobile, and Chemical industries. The transition of ESG factors from conceptual and investor preferences to regulatory requirements presents challenges for all stakeholders, particularly in integrating sustainability risk factors into existing Risk Management Frameworks.

Keywords: internal audit, ESG practices, corporate decision-making, sustainability risk, risk management framework, consumer electronics, metals and mining, automobile industry, chemical industry.

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1. Introduction

Environmental, Social, and Governance (ESG) factors have emerged as crucial elements in assessing and guiding corporate performance and sustainability. Unlike traditional financial metrics, ESG criteria provide a comprehensive evaluation of a company's impact on the physical environments where it operates, its social responsibilities, and governance practices. This holistic approach not only reflects a company's operational integrity and ethical standards but also its long-term viability and ability to adapt to evolving market expectations and regulatory demands.

The Environmental component of ESG scrutinizes a company's ecological footprint, focusing on metrics such as carbon emissions, energy usage, water and waste management.. Social factors assess a company's impact on society, examining aspects like labour practices, employee well-being, diversity and inclusion, human rights, and community engagement. Governance, the third pillar, evaluates the robustness of a company's internal frameworks and processes, including board composition, executive compensation, minority shareholder rights, transparency, and adherence to ethical standards and legal compliance.

The growing importance of ESG considerations is driven by an increasing recognition among investors, stakeholders, and society of the need for sustainable and responsible business practices. Companies that excel in managing ESG factors are seen as better positioned to create long-term value, mitigate risks, attract investment, retain talent, and foster positive relationships with customers and communities.

ESG reporting and disclosure have gained prominence, supported by frameworks such as the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), the Task Force on Climate-related Financial Disclosures (TCFD). These frameworks provide structured guidelines for companies to report their ESG performance, ensuring transparency and enabling comparability across different entities.

In India, the introduction of the Business Responsibility and Sustainability Report (BRSR) underscores the importance of ESG reporting.

The BRSR aims to facilitate meaningful stakeholder engagement by encouraging companies to report beyond mere financial compliance and disclose their social and environmental impacts. Initially voluntary for the financial year 2021-22, BRSR reporting became mandatory for the top 1000 listed entities by market capitalization from the financial year 2022-23 onwards. Subsequently, the BRSR formats have evolved into Core and Lite with the top 150 listed entities having to report in the Core format with 3rd party assurance from FY 2023-24. SEBI has introduced a glide path for compliance by other listed entities stretching up to FY 2027-28, by which time top 1000 entities are expected to report their ESG compliance in the BRSR Core format. In addition, from FY 2024-25, top 250 listed entities are also expected to report on their supply chain ESG footprints as well. Third party assurance from FY 2024-25 will be on comply-or-explain basis.

SEBI also encourages non-obligated entities that do not have prior experience in sustainability reporting to adopt BRSR Lite, which is a pared-down version of the BRSR Core.

This paper delves into the implementation, reporting, and role of internal audit in ESG practices within organizations. It highlights the challenges associated with integrating ESG factors into existing Risk Management Frameworks and underscores the role of internal audit in ensuring the accuracy and reliability of ESG reporting. By surveying industries such as Consumer Electronics, Metals and Mining, Automobile, and Chemical, this study provides insights into how various sectors are navigating the transition of ESG factors from conceptual ideas and investor preferences to regulatory requirements.

2. Literature Review

Integration of Environmental, Social, and Governance (ESG) factors into corporate decision-making and reporting has become increasingly significant in recent years. The growing importance of ESG is driven by the recognition that sustainable and responsible business practices are essential for long-term value creation and risk management.

ESG Frameworks and Reporting Standards

Several frameworks and standards have been developed to guide companies in measuring and reporting their ESG performance.

The Global Reporting Initiative (GRI) provides comprehensive guidelines for sustainability reporting, emphasizing transparency and comparability. The Sustainability Accounting Standards Board (SASB) focuses on industry-specific standards to help companies disclose financially material sustainability information. The Task Force on Climate-related Financial Disclosures (TCFD) offers recommendations for climate-related financial disclosures, aiming to improve and increase reporting of climate-related financial information.

Importance of ESG in Corporate Strategy

Research has shown that companies that effectively manage ESG factors tend to perform better financially and are more resilient to risks. Eccles, Ioannou, and Serafeim (2014) found that companies with high sustainability performance outperform their peers in terms of stock market and accounting performance. This is supported by Friede, Busch, and Bassen (2015), who conducted a meta-analysis of over 2,000 studies and concluded that there is a positive relationship between ESG criteria and corporate financial performance.

Role of Internal Audit in ESG

Internal audit plays a crucial role in ensuring the accuracy and reliability of ESG reporting. According to the Institute of Internal Auditors (IIA), internal auditors can provide independent assurance on the effectiveness of ESG-related controls and processes. They can also help identify and mitigate ESG risks, ensuring that companies meet regulatory requirements and stakeholder expectations.

Challenges in ESG Implementation and Reporting

Despite the benefits of ESG integration, companies face several challenges in implementing and reporting ESG practices. These include the lack of standardized metrics, difficulties in data collection and management, and the need for specialized expertise. A study by PwC (2020) highlighted that many companies struggle with inconsistent ESG data and reporting frameworks, which can hinder comparability and transparency.

ESG Practices in Different Industries

The adoption of ESG practices varies across industries. For instance, the Consumer Electronics industry faces significant environmental challenges related to e-waste and energy consumption,

while the Metals and Mining sector must address issues such as resource depletion and community impacts. The Automobile industry focuses on reducing emissions and improving fuel efficiency, and the Chemical industry deals with hazardous materials and pollution. Each industry has unique ESG challenges and opportunities, which require tailored strategies and solutions.

ESG in India

In India, ESG reporting has gained momentum with the introduction of the Business Responsibility and Sustainability Report (BRSR). The BRSR aims to encourage companies to disclose their social and environmental impacts, going beyond financial compliance. According to a report by KPMG (2021), the mandatory adoption of BRSR for the top 1000 listed entities by market capitalisation from FY 2022-23 is expected to enhance the quality and consistency of ESG disclosures in India.

The literature highlights the growing importance of ESG factors in corporate strategy and reporting. Effective ESG integration can lead to better financial performance, risk management, and stakeholder relations. However, companies face challenges in implementing and reporting ESG practices, which vary across industries. The role of internal audit is crucial in ensuring the reliability of ESG disclosures and mitigating associated risks. The introduction of the BRSR in India represents a significant step towards improving ESG reporting and encouraging sustainable business practices.

3. Research Objective

The research aims to address the following objectives:

1. To analyse the existing practices and trends in ESG implementation within organizations. This includes understanding how different industries integrate ESG factors into their operations and decision-making processes.
2. To identify the challenges organizations face in implementing ESG practices and reporting. This involves investigating barriers to effective ESG integration, such as regulatory compliance, data collection, and stakeholder engagement.
3. To assess the level of collaboration between internal audit and other functions, such as sustainability, risk management, and compliance, in ensuring effective ESG reporting.

This objective seeks to understand how internal audit contributes to the accuracy, reliability, and transparency of ESG disclosures.

4. To evaluate ESG implementation, adoption, and reporting in the automobile, consumer goods, energy, mining and metals, and chemicals industries in India. This involves assessing how these industries are integrating ESG factors into their risk management frameworks and operational strategies.

5. To determine the level of awareness, integration, and quality of ESG practices in the targeted industries. This objective aims to gauge how well companies understand and apply ESG principles and the effectiveness of their ESG initiatives.

6. To formulate conclusions and recommendations based on the research findings to enhance ESG practices and reporting in India's corporate sector. This includes providing actionable insights and strategies for improving ESG integration, addressing challenges, and enhancing overall ESG performance and reporting standards.

By addressing these objectives, the research seeks to provide a comprehensive understanding of ESG practices in India and offer guidance on enhancing the implementation and reporting of ESG factors across various industries.

4. Research Methodology

Data Collection

- Gather data from ESG consultants/advisors who have experience advising clients on ESG implementation in the selected industries.

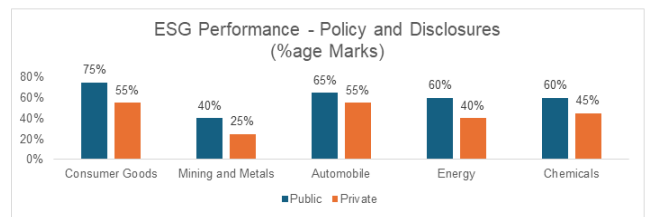
Data Analysis

- Analyze the collected data to identify trends and best practices in ESG implementation and reporting.
- Compare data across industries to understand variations in ESG practices.

5. Sample Size

Industry	Number of Companies
Consumer Electronics	5
Metals and Mining	5
Automobile	5
Chemicals	5

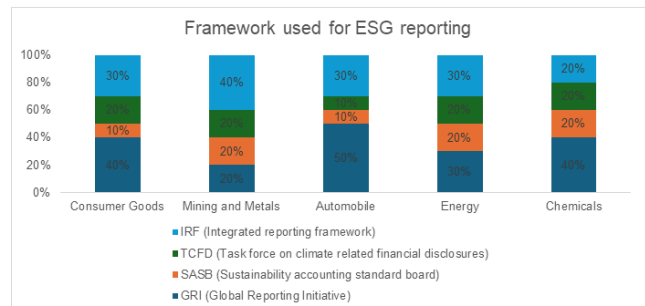
5.1 Summary of Key Findings



Highlights/ Conclusion from Figure 5.1.1:

- As can be seen, disclosure is high in Consumer goods and automobiles, however it is lower in energy, Mining metals and chemicals.
- In private companies, disclosure is low as it is not yet mandatory.

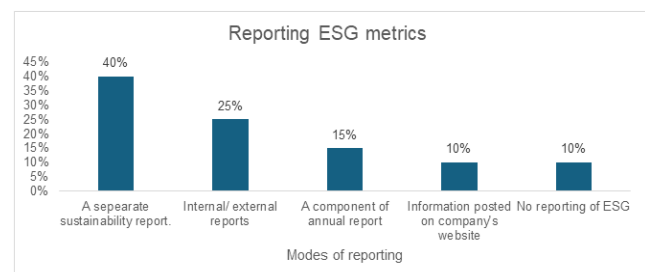
5.1.2 Framework Used for ESG Reporting



Highlights/ Conclusion from Figure 5.1.2:

- Indian Companies that publish a sustainability report follow the GRI guidelines and framework.
- Publication of annual sustainability reports and integrated annual reports, based on the GRI Standards and the Integrated Reporting Framework, respectively, is the most commonly used means of reporting among Indian companies.

5.1.3 Reporting of ESG Metrics

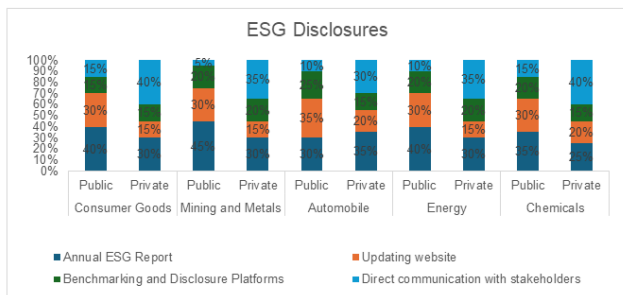


Highlights/ Conclusion from Figure 5.1.3:

- A variety of modes are utilized by companies to report on Environmental, Social, and Governance (ESG) information. Approximately 40% of companies opt to publish a separate sustainability report to comprehensively cover their ESG performance.

- Another 25% of companies rely on internal or external reports dedicated specifically to ESG reporting. Approximately 15% of companies choose to incorporate their ESG information as a component within their annual report, providing a comprehensive overview of their sustainability efforts. Additionally, 10% of companies make their ESG information available to stakeholders by posting it on their official website. However, there is also a segment comprising 10% of companies that do not engage in any reporting of ESG information. These diverse approaches reflect the varying practices employed by companies to communicate their sustainability and ESG initiatives.

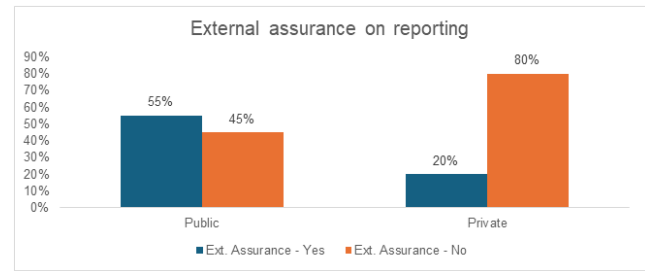
5.1.4 Communication with Stakeholders



Highlights/ Conclusion from Figure 5.1.4:

- In ESG reporting, consumer goods companies (public and private) emphasize annual reports (40% and 30% respectively) and website updates (30% and 15% respectively). Public mining and metals companies prioritize annual reports (45%) and website updates (30%), while private companies focus on website updates (15%) and direct communication with stakeholders (35%). For the automobile industry, public companies highlight website updates (35%) and private companies emphasize annual reports (35%) and direct communication (30%). Energy companies (public and private) prioritize annual reports (40% and 30% respectively) and website updates (30% and 15% respectively). Chemical companies (public and private) emphasize annual reports (35% and 25% respectively) and direct communication (15% and 40% respectively).

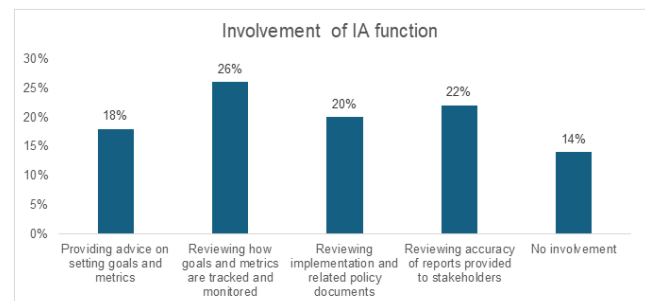
5.1.5 External assurance on ESG:



Highlights/ Conclusion from Figure 5.1.5:

- External assurance practices for industries can be summarized as follows:
1. Public companies:
 - 55% of public companies obtain external assurance for their reports.
 - 45% of public companies do not seek external assurance for their reports.
 2. Private companies:
 - 20% of private companies opt for external assurance for their reports.
 - 80% of private companies do not obtain external assurance for their reports.

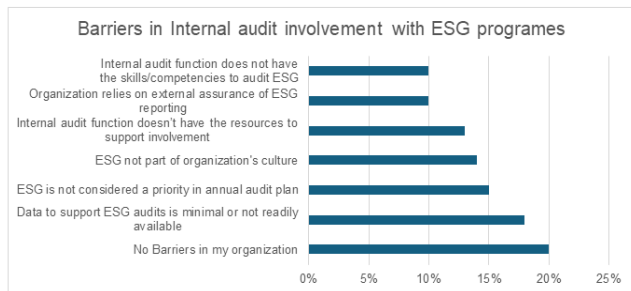
5.1.6 How does the Internal Audit Function Involved in a Company's ESG Programme



Highlights/ Conclusion from Figure 5.1.6:

- 18% of entities offer guidance on establishing goals and metrics for ESG reporting.
- 26% participate in assessing the tracking and monitoring of goals and metrics.
- 20% concentrate on examining the implementation and associated policy documents.
- 22% are involved in verifying the accuracy of reports shared with stakeholders.
- 14% of entities do not engage in any ESG reporting involvement.

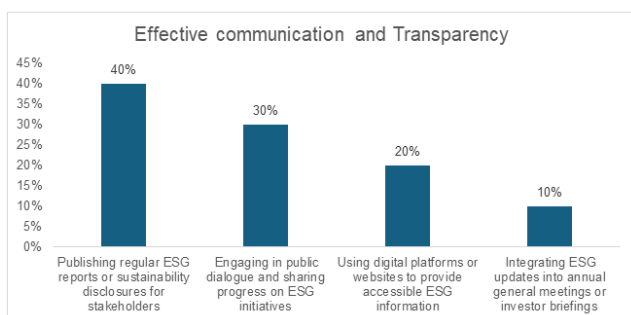
5.1.7 However, There are Few Barriers to Internal Audit's Involvement with ESG Programmes



Highlights/ Conclusion from Figure 5.1.7:

- In conclusion, organizations face various barriers when it comes to ESG reporting. While some organizations have no barriers, others encounter challenges such as limited data availability, low priority given to ESG in audit plans, lack of ESG-focused organizational culture, resource constraints within the internal audit function, reliance on external assurance, and a deficiency in skills and competencies for auditing ESG. Overcoming these barriers requires addressing data gaps, prioritizing ESG within the organization, providing necessary resources and training, and integrating ESG considerations into the overall audit framework. By doing so, organizations can enhance their ESG reporting practices and align with evolving stakeholder expectations.

5.1.8 Corporate uses Various Modes of Effective Communication to Ensure Transparency in its ESG Implementation Efforts

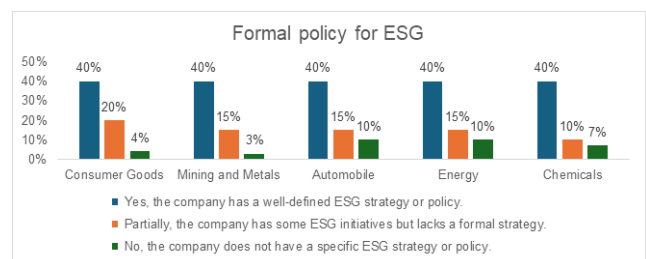


Highlights/ Conclusion from Figure 5.1.8:

- In conclusion, effective communication and transparency play vital roles in ESG reporting, enabling organizations to build trust and engage with stakeholders. Approximately 40% of organizations prioritize publishing regular ESG reports or sustainability disclosures to provide

transparent information on their ESG performance. Additionally, 30% of organizations actively engage in public dialogue and share updates on their ESG initiatives, enhancing transparency and demonstrating their commitment. Around 20% of organizations utilize digital platforms or websites to ensure easy accessibility of ESG information for stakeholders. Lastly, 10% of organizations integrate ESG updates into annual general meetings or investor briefings, providing direct communication channels. By implementing these practices, organizations can strengthen their ESG communication, foster trust, and meet the evolving expectations of stakeholders

5.1.9 Has the Company Established a Formal ESG Strategy or Policy that Outlines its Commitment to Sustainability and Responsible Business Practices?



Highlights/ Conclusion from Figure 5.1.9:

- In conclusion, the presence of a well-defined ESG strategy or policy varies across industries. Consumer goods and mining and metals sectors show a relatively higher percentage (40%) of companies with a well-defined ESG strategy or policy. However, some companies in these industries (20% in consumer goods and 15% in mining and metals) have initiated ESG efforts without a formal strategy. A smaller percentage of companies (4% in consumer goods and 3% in mining and metals) do not have a specific ESG strategy or policy in place

6. Conclusion

The integration of Environmental, Social, and Governance (ESG) factors into corporate strategies and reporting has become increasingly critical for organizations seeking to achieve long-term sustainability and responsible business practices. This study has explored the implementation, reporting, and role of internal audit in ESG practices

across various industries, highlighting the challenges and opportunities that companies face in this evolving landscape. Our findings underscore the importance of ESG factors in corporate decision-making and the need for robust frameworks and standards to guide ESG reporting. The Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), and Task Force on Climate-related Financial Disclosures (TCFD) provide valuable guidelines that help ensure transparency, comparability, and accountability in ESG reporting. However, the adoption and effectiveness of these frameworks can vary significantly across industries, influenced by sector-specific challenges and regulatory environments.

The role of internal audit is pivotal in ensuring the accuracy and reliability of ESG disclosures. Internal auditors provide independent assurance on ESG-related controls and processes, identify and mitigate ESG risks, and help organizations meet regulatory requirements and stakeholder expectations. Despite these contributions, internal auditors face barriers such as limited data availability, low prioritization of ESG in audit plans, and resource constraints.

The introduction of the Business Responsibility and Sustainability Report (BRSR) in India marks a significant step toward enhancing ESG reporting and fostering sustainable business practices. The mandatory adoption of BRSR for the top 1000 listed entities by market capitalization from FY 2022-23 is expected to improve the quality and consistency of ESG disclosures in India.

To further promote ESG adoption in India, there is a need for increased awareness among companies, investors, and regulators about the importance of ESG factors for sustainable and responsible investing. Companies should strive for more comprehensive and standardized disclosures, while the regulatory environment should be strengthened to promote greater ESG compliance.

In conclusion, effective ESG integration can lead to better financial performance, improved risk management, and enhanced stakeholder relations. By addressing the challenges and leveraging the opportunities identified in this study, organizations can enhance their ESG practices and reporting, ultimately contributing to a more sustainable and responsible corporate sector.

Way Forward:

1. To promote ESG adoption in India, there needs to be increased awareness among companies, investors, and regulators about the importance of ESG factors for sustainable and responsible investing.
2. Companies in India should provide more comprehensive and standardized disclosures on ESG factors to enable investors to evaluate their ESG performance more effectively.
3. The regulatory environment in India should be strengthened to promote greater ESG compliance by companies. This could involve introducing more robust reporting requirements, establishing clearer ESG standards, and enforcing regulations more rigorously.

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