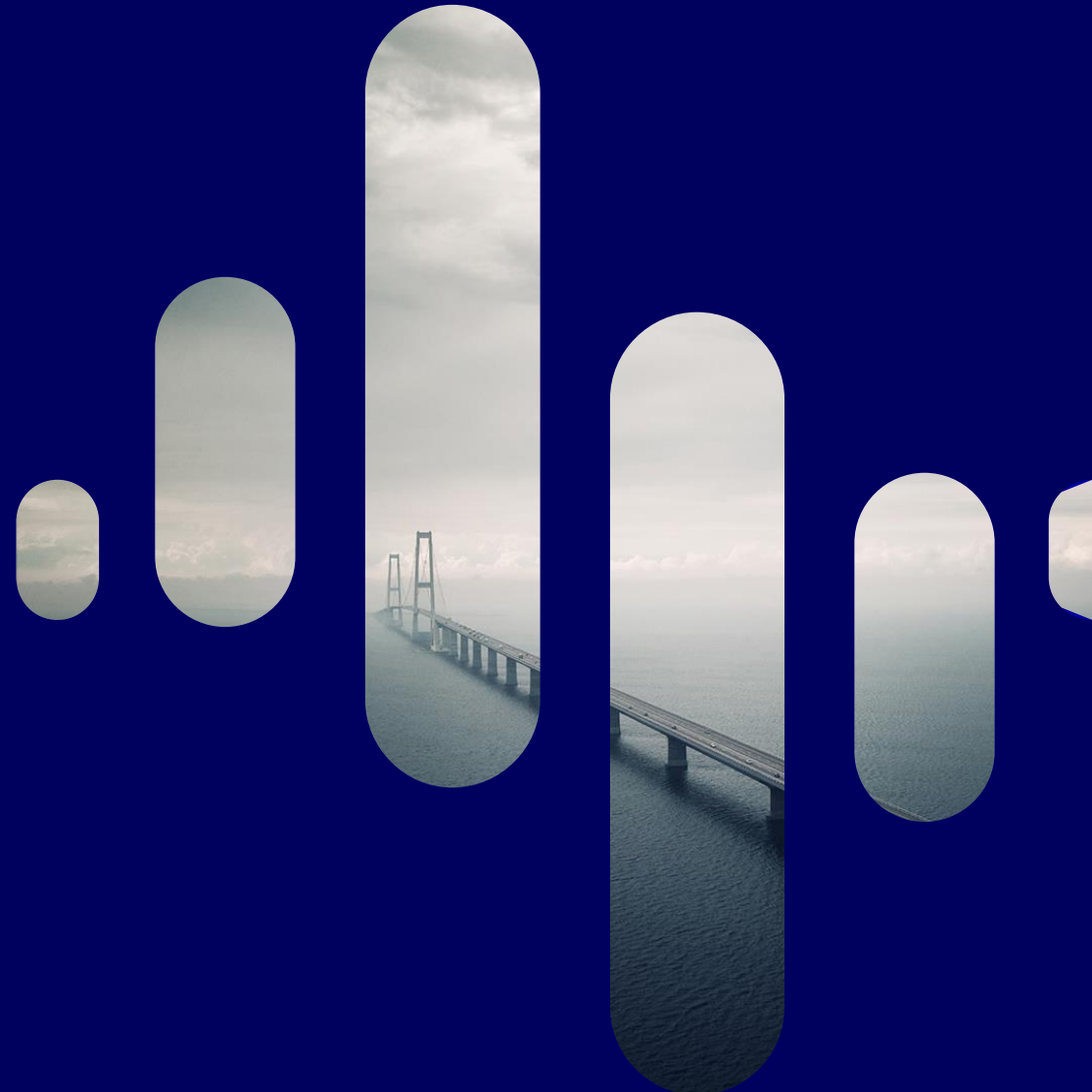


Internal Audit's Role in ESG and ESG Reporting – Sharing Experiences from the Financial Industry

GLC Audit Masters

Virpi Vuorinen, Chief Audit Executive, Nordea
24 May 2024



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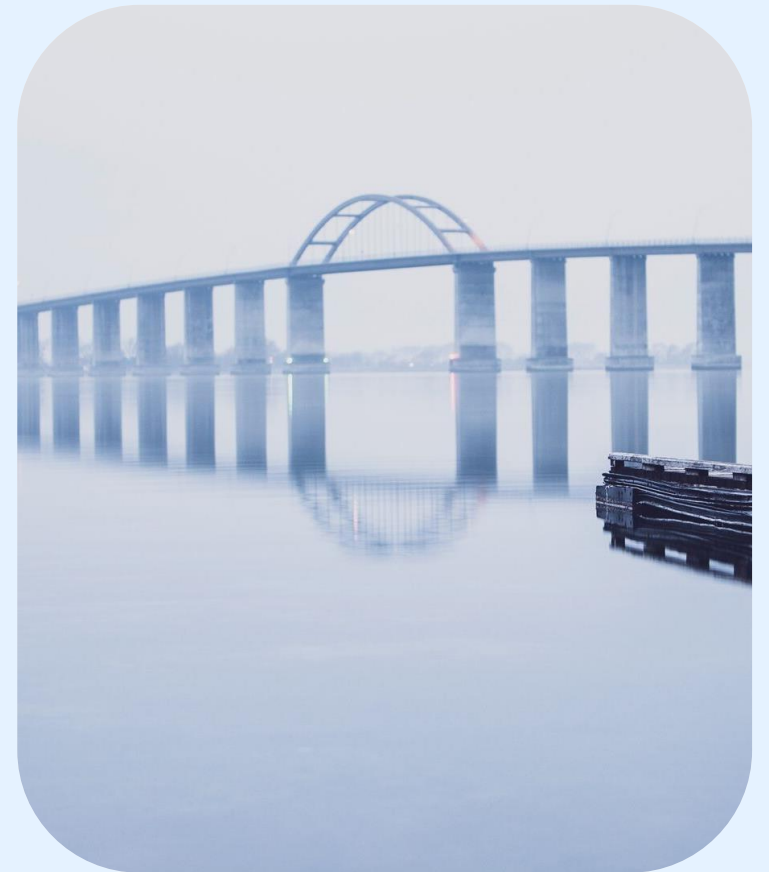
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Background & Introduction

About Me

25 years in the banking sector, of which ~20 years in different roles in internal audit

Chief Audit Executive at Nordea Group

Member of the Banking Committee in the European Confederation of Institutes of internal Auditing (ECIIA)

Certified Internal Auditor (CIA), Certification in Control Self-Assessment (CCSA), Certification in Sustainability in the Financial Industry



This is GIA



Group Internal Audit (GIA) is an **independent** and **objective** assurance activity, designed to add value and improve the operations of Nordea.



The **Chief Audit Executive (CAE)** has overall responsibility for GIA in the Nordea Group and reports **functionally** to the Board and its Audit Committee, and **administratively** to the Group CEO. Nordea's CAE and Head of GIA is Virpi Vuorinen.



Benchmark studies against peers show that Nordea GIA is an **efficient and effective audit function**, having **strong governance** and **audit methodology**, as well as **competences**.

GIA's Purpose Statement

Group Internal Audit is a **collaborative and inclusive** department, which, by providing objective **assurance** and **advice**, supports the Group Board and Group Leadership Team in protecting the **assets, reputation and sustainability** of the Group

Trusted Partner



As the audit function, GIA is the **Third Line of Defence**. Our primary role is to help the Group Board and Group Leadership Team (GLT) to protect the **assets, reputation** and **sustainability** of Nordea.



One of our strategic goals is to be a **trusted partner** for the Board, the business, and our stakeholders. We seek to **add value** to the organisation through **insights** based on our assurance activities across the bank.



We are **passionate about our work**, and we seek to make a difference at Nordea. Collaboration is a key value for us, and we **seek and encourage talent and diversity** in GIA.

Group Internal Audit in brief



No. of employees
~220
Nationalities > 20



Locations
Copenhagen, Helsinki, Gdynia,
Luxemburg, Łódź, New York, Oslo,
Stockholm, Tallin and Warsaw



Chief Audit Executive
Virpi Vuorinen

Nordea is a leading financial services group in the Nordic region and one of the biggest banks in Europe

Nordea

Our home is in the Nordics



*Our headquarters is in Helsinki, Finland.

The **Nordic countries** in which we operate – Denmark, Finland, Norway and Sweden – are based on politically stable democracies with high levels of trust and compliance.

The region also benefits from having a reliable and profitable banking sector, with financial institutions notable for their high degrees of digitalisation.

Nordea itself is one of the strongest and most profitable banks in Europe, with a pan-Nordic business model and a very well-diversified lending portfolio – **giving us a great capacity to support our customers.**

Our sustainability targets

2025

Short-term
targets

2030

Reduce carbon
emissions by
40-50%

2050

Become a
net zero bank

Nordea has reported on environmental and sustainability performance on an annual basis since 2002. In 2021, the sustainability reporting was integrated into the Annual Report. Reporting is performed in relation to Principles for Responsible Banking, the Task Force on Climate-Related Financial Disclosures, and the GRI standards.

Ambitious and specific targets - such as these

Climate action

- Facilitate more than EUR 200bn in sustainable financing by the end of 2025.
- Ensure that 90% of our exposure to large corporate customers in climate-vulnerable sectors is covered by transition plans by the end of 2025.
- By 2025, ensure that 80% of the top 200 financed emissions contributors in Nordea Asset Management's portfolios are either aligned with the Paris Agreement or subject to active engagement to become aligned.
- Double the share of net-zero-committed AuM by 2025.
- Grow gross inflows from the [sustainable selection](#) universe to account for 33% of total fund gross inflows by the end of 2025.
- Reduce the carbon footprint from Nordea Life & Pension's listed equity, corporate bond and real estate portfolios by at least 25% by the end of 2024.
- All asset managers* managing assets on behalf of Nordea Life & Pension must commit, no later than 2024, to transitioning their assets under management to net-zero by 2050.
- Total carbon reduction from internal operations of 30% compared with 2019 by the end of 2023.
- Suppliers covering 80% of spend are either aligned with the Paris Agreement or subject to active engagement to become aligned by 2025.

*All managers in liquid asset classes and selected managers in illiquid asset classes.

Social responsibility

- Each gender has at least 40% representation at the top three leadership levels* combined by the end of 2025.
- With a minimum average index score of 92, respondents** feel they have been treated fairly regardless of gender, gender identity, age, ethnicity, sexual orientation, religious affiliation, (dis)ability, etc. by the end of 2023.
- All direct investments in companies made by funds managed directly by Nordea Asset Management are assessed against the minimum safeguards in the area of human rights (in line with the EU taxonomy) by the end of 2023.
- Human rights impact assessment of the supply chain in place by the end of 2023.

*Group Leadership Team (GLT), GLT-1 and GLT-2

**To Nordea's employee engagement survey.

Expectations on companies are increasing ...

ECB threatens to fine banks over climate risk shortcomings

November 23, 2023 | Written by Moriah Costa | European Central Bank

The European Central Bank (ECB) has warned 20 banks that they will be fined if they don't address their climate risk shortcomings, [Bloomberg has reported](#).

Letters were sent out over the last few months to the banks giving them individual deadlines, as the central bank's patience has worn out.

The news comes just a week after ECB board member [Frank Elderson said](#) the central bank had started to issue enforcements around climate risk, as some banks have failed to deliver on an interim deadline of March this year.

Lenders that don't remedy their deficiencies around climate risk "will have to pay a penalty for every day the shortcoming remains unresolved," he said during a speech in Brussels.

The ECB has taken a strong stance on addressing climate risks and has long told financial institutions in the EU they are not doing enough. The central bank released a guide for banks to identify and manage climate and environmental risks as part of their governance but a [2022 report](#) found that none of the 109 banks under its supervision met its disclosure expectations.



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Companies walk ESG tightrope, under fire from all sides over disclosures

By Richa Naidu and Simon Jessop

February 29, 2024 4:58 AM GMT+2 · Updated a month ago



ESG-related legal risk is on the rise, says Conor Chell, KPMG's national leader for ESG

By Aidan Macnab

11 Apr 2024 / Share   

In a recent survey of 300 Canadian businesses, KPMG found that nearly 90 percent of respondents said they faced "intense scrutiny" to demonstrate progress on ESG targets and were concerned that these pressures increase the risk of ESG-related fraud in their organization.

According to the survey, 81 percent of respondents experienced ESG-related legal risk in the past 12 months, and 81 percent said stakeholder records, and 81 percent said they had inadvertently committed ESG-related legal violations.

Historically, ESG has been a focus for investors and regulators, but it is now becoming a focus for governments and other stakeholders. Bill S-211, the Labour in Supply Chain Act, is a new piece of legislation that will require businesses and other organizations to disclose their ESG risks and conditions in their supply chains.

Sustainability chiefs overwhelmed by plethora of ESG disclosures and platforms

By Pirkko Juntunen | 29 September 2023

The onslaught of ESG disclosures sent to companies is overburdening chief sustainability officers (CSOs), risking greenwashing, according to a recent global survey of CSOs by EthicsGrade, a company that aims to increase efficiency and transparency in ESG reporting and disclosure.

CSOs are responsible for consolidating data from different departments to generate accurate ESG responses. "Despite publicly available reports, many ESG disclosure requests are still received and valuable resources are spent on sourcing, analysing, and consolidating information for each request. We must find a way to support CSOs in streamlining ESG reporting and alleviating the burden of ESG disclosure to decrease the risk of greenwashing," according to Tess Buckley, AI ethics senior analyst at EthicsAnswer, a Software as a Service (SaaS) platform created by EthicsGrade, using GenAI (generative AI) to simplify responding to disclosure requests.

We saw invest what

Most pop



What does all this mean for internal audit?

“As with any risk area, internal audit should be well-positioned to support the governing body and management with objective assurance, insights, and **advice** on ESG matters”

IIA White Paper on Internal Audit's role in the ESG reporting



What has this meant to our annual audit plan at Nordea?



~10% of the audits in the annual audit plan for 2024 have ESG in key focus, covering all key areas of the bank

In addition, ESG is included in the scope of several other audits



Audit themes include:

- **reporting** (ESG quantitative disclosures (incl. real time, limited assurance), social disclosures, sector targets),
- **climate risk assessments and relevant risk management frameworks**,
- **ESG related data solutions and IT applications**
- **sustainable products offering and product approvals** (several audits)

During our journey, we have learned about the expectations of the senior management, we have enhanced our audit product offering to meet these needs and we have built up our competences

How to meet the expectations from the senior management and board – and why are the expectations on Internal Audit’s role evolving?



External Auditors are continuously developing their coverage of ESG related reporting, but often provide limited assurance, and do not provide assurance on all related disclosures –or the wider control environment

This, combined with increasing expectations on the Board’s role in the ESG, and ESG related reporting, result in the Board members turning to internal audit for additional assurance

The CEO and senior management appreciate early involvement from internal audit – instead of coming in late to challenge the design and execution of the programme

Requires audit functions to adapt quickly to increased expectations – agile audit plan and a potentially new role for internal audit in advisory capacity may be needed

Video - Nordea's CEO on Internal Audit's role in ESG



Nordea Brand Hub

Ensure your independence is maintained

A group of business professionals in a meeting, smiling and looking at documents. The background is a blurred office setting with a desk, a laptop, and a pen.

When providing advice, extended assurance or consulting, it is important to discuss the approach with the Board of Directors / Board Audit Committee or other governing body that is overseeing the Internal Audit Function

This is necessary to identify and manage any potential threats to the independence of the function

SLIDO #5467522

Do you have concerns or hesitation when it comes to stepping into an audit advisory role?

Yes, I see this as a significant challenge to my independence

Yes, I have some concerns, but I believe these can be managed

No, I am used to providing advice or extended assurance

<https://admin.sli.do/event/6pxPUaKcwprZ1eXCCoCzJD/polls>



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Coordination and alignment on the roles of various stakeholders is crucial when auditing fast evolving areas such as ESG



Examples of alternative audit approaches for a fast moving and evolving area such as ESG

Preparedness audits – in advisory capacity

Limited, real time, assurance on disclosures – with timely reporting to the senior management and Board (before they sign off the disclosures).

Continuous coverage through **validation of deliveries from the programme** – to avoid late surprises

While focus is very much on the **E** of the ESG, do not forget **S** and **G** – early involvement is needed here too



Preparedness audits

Intention is to go in early to help the organisation to “get it right from the start”

Due to the programme potentially being at an early stage, **creating an un-rated audit advisory product** may help to get management’s trust and strong support for the audit work

Covering the governance and scope of the ESG related project or programme could be an example of a **preparedness audit**. In such audit potential areas to cover include:

- ESG **strategy** including targets and commitments
- Clarity of **roles and responsibilities**, incl. decision-making process
- Process for **reporting and monitoring** the progress
- Process for capturing **regulatory requirements** / reporting requirements
- Management of **dependencies** with the other risk frameworks and relevant units
- **Risk identification** and management processes
- Sufficiency of **funding and headcount**

Preparedness, or status, audit of the CSRD implementation could include all the above, but in addition;

- Processes related to **data** gathering and data quality
- **Applications** used, including potential end-user application design
- Process to assess Double Materiality – if possible, incl. **benchmark** perspective



Real time assurance of ESG disclosures

Intention is to add value to the senior management and the board by providing assurance that no erroneous data is disclosed to the public related to ESG

What to consider:

- **Complex process with several stakeholders** involved at the same time, with limited time available – coordination of the efforts between the parties is a must
- **Multi-skilled audit team of experts** in financial reporting frameworks, data analysts, ESG experts and depending on the industry also other risk experts most likely needed
- **The identified gaps must be communicated immediately**, to allow management to remediate those within a tight timeline, before publishing the disclosures
- Audit **conclusion must be ready** for discussion in the same Board meeting where the disclosures are signed off.

The scope of the audit work and the audit product;

- Key focus on whether the information (quantitative and qualitative) being reported is accurate, relevant, complete, and timely
- Focus on data – internal and external sources and their reliability. Use of data analytics is critical.
- The audit product can be, for example:
 - Formal Limited Assurance Statement
 - Standard Audit Memo / Report
 - Formal Limited Assurance Statement, and Audit Memo / Report with issues raised related to the Control Environment



SLIDO #5467522

Is there a clear distribution of the responsibilities between your audit department and the external audit when it comes to providing assurance on the ESG disclosures?

Yes, external audit covers everything related to ESG disclosures

Yes, we have agreed which disclosures external audit covers and which are covered by the internal audit

No, we have not agreed the division of our work yet

<https://admin.sli.do/event/6pxPUaKcwprZ1eXCCoCzJD/polls>



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Continuous validation of the key deliveries from the programme / project

Intention is to add value to the senior management and the board by providing **timely assurance** on the key deliveries from the project or programme, immediately after those have been flagged as delivered

The benefit of this approach is that the audit function can provide a fast response, and does not come in too late, when the entire programme has been finalised

Internal audit can also choose to **assess the design** of the delivery in a first step, and **later**, perform **operational effectiveness testing**. This allows audit to provide timely view on any potential design flaws and in the end of the implementation perform traditional audit assurance.



Remember also the **S** and the **G** of the ESG

These include topics around company's role in the society and community such as:

- *health and safety of the employees and customers,*
- *inclusiveness of the workplace,*
- *customer engagement,*
- *governance, including transparency in reporting,*
- *living up to the core values of the company / organisation*



How to ensure sufficient competences to audit the area?



Competence ramp-up is needed urgently – if not already there

ESG specialists are in high demand, ESG + Internal Audit specialist even in higher demand

Training is needed for the entire audit department and in-depth targeted training for those who are more involved in auditing the topic

Examples of potential skills needed to perform the requested work on ESG disclosures; Data experts, IT experts, Financial reporting experts, ESG risk specialists

Consultants may be needed to fill in the gaps initially – ensure knowledge transfer to internal audit



What have we done?

Mandatory certification for all leaders in our audit department – and for other targeted staff

Bigger share of department training budget directed to ESG related training

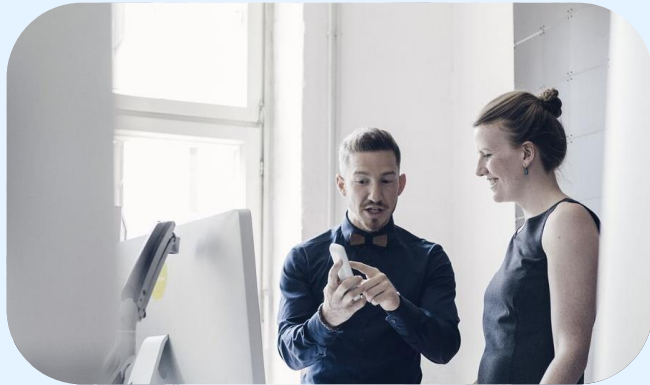
Inbound and outbound **job rotations** between audit and ESG functions

Established internal audit banking industry round-table for audit functions of Nordic banks to share best practice and to learn from each other

Auditors specialised in different risks get together and learn from each other – GIA ESG Risk Forum

Key takeaways

The expectations on internal audit are increasing



Internal audit needs to consider possibilities for “**extended assurance**” role, which may include advisory, or consulting.

Careful **balancing of efforts between traditional and extended assurance** and managing **independence** and objectivity is needed.

Traditional audit products may not be a best fit for auditing ESG and ESG reporting



Preparedness audits of the **design, real time assurance** of the disclosures, and **continuous validation** of key deliveries from the ESG programs/projects should be options in the audit toolbox **to ensure fast audit response** that adds most value to Senior Management and the Board.

Competence building is needed most likely across the entire audit department



Department wide training activities and **mandatory training** and/or certifications needed for targeted teams / individuals.

Board, or CEO, may expect the audit department to have some of the core ESG competences in the company