How better quality information and robust internal controls relate to sustainability

Reliable information is crucial for good business. With the challenges faced by companies today, more rigor and stronger internal controls should be applied to environmental, social and governance (ESG) information to strengthen both investor and company decision-making.

By Rodney Irwin

The business landscape is shifting: politics are becoming more unpredictable; technology changes everything we do; environmental pressures are now reaching alarming or irreversable levels and societal tensions are rising in many parts of the world.

As companies, investors and analysts start to understand the importance of navigating this new global landscape, companies face increasing pressure, through both regulation and voluntary mechanisms, to disclose environmental, social and governance (ESG) information to investors and other key stakeholders.

Over the past decade, companies have been pushed to disclose more with a 10-fold increase in regulation and an explosion in voluntary solutions.

While the overall trend towards transparency on ESG information is positive, the diversity of approaches and abundance of non-material and irrelevant information has become probematic.

Information isn't collected uniformly across sectors – or even within companies themselves.

For both management teams as well as investors to make informed decisions about a company, they need high-quality, complete, reliable, comparable and accurate information – both financial and ESG information.

Reliable data on a timely basis

For many businesses, establishing an appropriate and robust internal control environment for collecting, consolidating and reporting ESG information delivers more reliable data on a timely basis. This can influence decision-making and can also result in influential, high-quality information flowing to the capital markets.

Accurate, timely and reliable information on ESG-related risks, opportunities and performance should result in capital flowing to businesses who more clearly demonstrate resilience against global changes, and their commitment to long-term value creation.

In other words, reliable information is essential for good business.

Evidence shows, though, that there's still a long way to go before companies provide ESG information that's solid enough to inform capital allocation decisions.

Even in countries across Europe, where there has been strong support for ESG reporting, reporting practices are still not at a level where they compare with financial reporting practices – and so the value to investors and analysts is limited.

«But there's a solution: stronger internal controls for ESG and non-financial information.»

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Internal controls are defined as "the mechanisms, rules and procedures implemented by a company to ensure the integrity of financial and accounting information, promote accountability and prevent fraud". The World Business Council for Sustainable Development (WBCSD) and FSR – Danish Auditors published a first-of-its-kind guidance on how companies can improve the quality of, and confidence in, their ESG information by considering the basic building blocks of internal controls.

The guidance offers a roadmap of continuous improvement through internal control measures and assurance provisions to provide reliable ESG information, and ultimately achieve ESG investment grade data.

It's a process that takes time and commitment, but one that is essential if companies are to properly identify the opportunities and challenges their business models need to address in order to remain resilient.

Material financial information is subject to compliance requirements and scrutiny from regulators – which means there's little debate about the need for robust data, accurate information and strong internal controls.

If ESG information can materially impact a business, then why wouldn't the same level of robustness, accuracy and rigor be applied?

To be resilient, successful and sustainable, companies must understand the impacts and dependencies of their business models. They must manage risks and take advantage of opportunities in their operating environment. This demands comprehensive information – which starts with reliable data flowing through the business to support internal decision-making.

The new guidance is an important first step to help companies get that information in a clear, concise and uniform way.

ADDITIONAL INFORMATION

- **Definition of Internal Controls: bit.ly/2KtCyto**
- **CFA Institute – The evolving future of fiduciary duty in an ESG world: cfa.is/2MYFQ9L (2018) and cfa.is/31CpkjY (2017)**
- **FSR – Danish Auditors: bit.ly/2H3lhFA**