Leveraging the COSO *Internal Control—Integrated Framework* to Improve Confidence in Sustainability Performance Data

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Statement of Purpose

“Effective internal controls are good for business.” This is perhaps an interesting way to introduce the purpose of this thought paper, but, as its authors, our collective knowledge is very straightforward in this regard. Internal controls have value beyond compliance and external financial reporting. Effective internal controls can help organizations grow on a sustained basis, with confidence and integrity in all types of information.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control—Integrated Framework (the Framework; originally issued in 1992, refreshed in 2013) was developed as guidance to help improve confidence in all types of data and information. From the Framework’s foreword, dated May 2013 (emphasis added):

• “The Framework will enable organizations to effectively and efficiently develop and maintain systems of internal control that can enhance the likelihood of achieving the entity’s objectives and adapt to changes in the business and operating environments.”

• “The Framework continues to emphasize the importance of management judgment in designing, implementing, and conducting internal control, and in assessing the effectiveness of a system of internal control.”

• “The Framework has been enhanced by expanding the financial reporting category of objectives to include other important forms of reporting, such as non-financial and internal reporting.”

We believe that this expansion is inclusive of sustainability performance measures. Sustainability performance data—often referred to as “nonfinancial,” “balanced scorecard,” “performance dashboard,” “environmental, social, and governance (ESG),” and/or “integrated reporting” data—is rising in importance as organizations seek to improve their enterprise performance management (EPM) systems and processes. They are doing so in order to generate sustained value—ethically and responsibly—over the longer term given the increasing complexities and challenges of doing business in the world today. Companies are improving their performance management systems to have reliable data for decision making. Meanwhile, investors and ratings agencies around the world are increasingly seeking and relying on sustainability performance data. So there is a need among all stakeholder groups for effective controls.

In fact, asked what lies ahead on the road toward integrated reporting (of which sustainability performance information is part), John White, former director of the U.S. Security & Exchange Commission’s Division of Corporation Finance, responded simply: “Controls, controls, controls.”

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Sustainability performance (or related nonfinancial data) has unique characteristics. It is less tangible and more qualitative than financial performance data—although sustainability data is often quantifiable, as reported by companies in sustainability and corporate social responsibility (CSR) reports. It is also more forward-looking, covering multiple time periods, and often more manually sourced. To improve confidence in sustainability performance data, a different “lens” on assurance and materiality may need to be taken relative to financial data, with professional judgment at the forefront. We believe the COSO principles on effectiveness—controls that are present, functioning, and integrated—could apply to all types of performance data, including sustainability, using professional judgment.

Yet “sustainability” has many—and often confusing or conflicting—definitions. Is it sustainability of the enterprise, thereby impacting reputation and “license to operate”? Is it about specific sustainability measures like climate control or deployment of human capital? Does it capture ESG measures? Is it all of the above? Despite the confusing and sometimes conflicting lexicon, which we don’t attempt to solve in this paper, there is one important commonality: Sustainability performance data, combined with financial data, is important for the organization to manage and to (voluntarily) communicate its value-creation capacity and capability to global stakeholders.

While various frameworks could be used to capture and communicate sustainability performance data, we chose to focus on the domains used by the Sustainability Accounting Standards Board (SASB): environment, social capital, human capital, business model and innovation, and leadership and governance.

This paper is not meant to be authoritative. It is intended to stimulate discussion and encourage debate on an increasingly important topic for organizations, investors, and the capital markets.

This paper simply shares the authors’ views on how the Framework could be used by organizations to improve confidence in sustainability performance data with the aforementioned qualities, adding value for internal and external decision making. We took a practical approach to this paper, leveraging many third-party resources, conducting interviews, and soliciting corporate case studies to support our thoughts and observations. Our goal is to help move the reporting ecosystem further along in the journey toward better utilizing, assuring, and communicating this type of data—with an emphasis on professional judgment and stakeholder learning. The bigger picture and context is to do our part to improve organizational capability, better satisfy investor needs, improve the effectiveness of capital markets, and, ultimately, serve the public interest.
Applying the COSO Internal Control—Integrated Framework to Sustainability Reporting

An enterprise’s management is responsible for providing full, accurate, and understandable information to capital markets and other stakeholders, including information related to material sustainability matters. Its ability to do so depends, in large part, on the design and effectiveness of the firm’s internal control—the processes, policies, procedures, and other safeguards it has put in place around accounting, reporting, and communication of information. Applying the same systematic rigor to measuring, validating, managing, and reporting material sustainability information that is typically applied to financial reporting should lead to greater corporate and investor/stakeholder confidence, organizational value, and capital markets’ effectiveness. The most widely used framework for establishing internal controls—and for evaluating and maintaining their effectiveness—is the 2013 COSO Internal Control—Integrated Framework.

The Framework is intended to help organizations achieve operations, reporting, and compliance objectives and to optimize the inevitable tension between the value creation and value protection activities. The Framework specifically references nonfinancial reporting objectives, suggesting that sustainability reporting objectives could be integrated into an organization’s existing internal control framework.

SEC registrants already have a control framework in place to evaluate and support assertions regarding the effectiveness of ICFR, as this is a required management certification. Therefore, an organization may find it most effective to leverage the control framework currently used in financial reporting to also establish internal control over the achievement of both internal and external sustainability reporting objectives.

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30 Committee of Sponsoring Organizations of the Treadway Commission, Governance and Operational Performance—Improving organizational performance and governance, February 2014.
As organizations increasingly move toward integrating sustainability information with their financial reporting, they are likely to find value in using a consistent control framework to encompass the achievement of multiple objectives, including those related to:

- Operations, compliance, and reporting
- Both financial and sustainability performance
- Both external and internal reporting and communications

What follows is a discussion of the Framework’s interrelated components, principles, and points of focus as they apply to the internal and external reporting of material sustainability information. An organization may wish to consider these areas of alignment as it integrates sustainability reporting objectives into its performance management systems, reporting cycles, and existing control framework.

In addition, the discussion is complemented by a variety of current, real-world examples intended to illustrate lessons learned and the progress along the maturity curve toward achieving integrated internal control over—and greater confidence in—sustainability reporting and performance measures. These examples are drawn from extensive outreach to organizations that are leading efforts to design and maintain effective systems of internal control around their sustainability reporting and other objectives. The examples are not intended to be prescriptive, but rather to provide insight into how the components, principles, and points of focus in the Framework may be applied to specific circumstances involving sustainability measures.

The discussion follows the Framework’s components in order:

1. Control Environment
2. Risk Assessment
3. Control Activities
4. Information and Communication
5. Monitoring Activities
A CLOSER LOOK: NOVO NORDISK

Insights from Europe, where integrated reporting is on the leading edge

As drug pricing has emerged in recent years as a headline risk for pharmaceutical companies—and a bipartisan rallying cry for politicians—the resulting regulatory and public scrutiny has underlined an often-overlooked fact of life for companies in the healthcare sector. Business success depends on a strong social license to operate. Novo Nordisk has long understood this fundamental component of its business model and, as a result, has integrated sustainability considerations into every aspect of its operations—including internal controls. Novo Nordisk, a global healthcare and pharmaceutical company based in Bagsværd, Denmark, specializes in treatment of diabetes, hemophilia, growth disorders, and obesity. It trades on the New York Stock Exchange and Nasdaq Nordic, reporting sales of US$15.9 billion in 2016. Although it is now recognized as a global sustainability leader—Harvard Business Review named the company’s CEO, Lars Rebien Sørensen, the world’s best-performing CEO two years in a row due in large part to his integrated approach to management and reporting—Novo Nordisk, which traces its roots back to the 1920s, didn’t arrive there overnight.

Although the company had taken a values-based approach to management since its founding, it formalized its commitment to sustainability in 2004 when it incorporated the idea of a “triple bottom line” into its Articles of Association, which states that Novo Nordisk “strives to conduct its activities in a financially, environmentally, and socially responsible way.”33 Because of this, sustainability has since become embedded in the company culture, including the Novo Nordisk Way, a set of guiding principles that underpins decision making within the firm and its drive toward becoming a sustainable business.

In 2008, the company began to explore how it might leverage the COSO Framework to achieve its sustainable business objectives more effectively, including those related to reporting. Novo Nordisk established a cross-functional team to apply the Framework’s components to its objectives and achieved cost-effectiveness by using a top-down, risk-based approach and materiality assessment to identify the most crucial areas to be addressed by the control framework. Project leader Cora Olsen, Global Lead TBL Reporting, recommends this approach to peers who are daunted by the potential scope—and cost—involved in establishing internal control over sustainability performance data. Start small, she suggests. “Pick your top five KPIs and let it grow and develop over time,” she says.

During the process, Novo Nordisk relied heavily on its Sarbanes-Oxley specialists to align its internal controls over sustainability performance data with its ICFR as much as possible. Breaking down walls between sustainability and finance is key, Olsen says, as members of the sustainability team “are the content experts for just one bit of the puzzle.” Led by established internal expertise in developing and maintaining controls, the team developed entity- and transaction-level controls, manual and automated controls, and preventive and detective controls—and documented everything. The system of internal control over sustainability performance data was launched in 2008 to support relevant (i.e., material) and reliable information, and the company has been refining its framework ever since as it learns and adapts.

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COMPONENT: CONTROL ENVIRONMENT

The control environment is the “control consciousness” of the organization. At most corporations, its tone is set by the board of directors and top management. This tone guides objectives related to both financial and sustainability reporting. A strong internal control environment sets the stage for the establishment and maintenance of processes and discipline to govern controls over financial, nonfinancial, and sustainability performance data. Clarifying the organization’s commitment to reliable reporting and communication is especially important when preparing sustainability information, as most information is currently collected by functions not historically connected to financial reporting or accustomed to its mature, rigorous control environment. While, increasingly, the CFO is considered the single control point for integrating financial and sustainability data for business performance and internal controls, the main point is that key sustainability metrics can be considered up front in the governance, strategy, and internal control design of the organization.