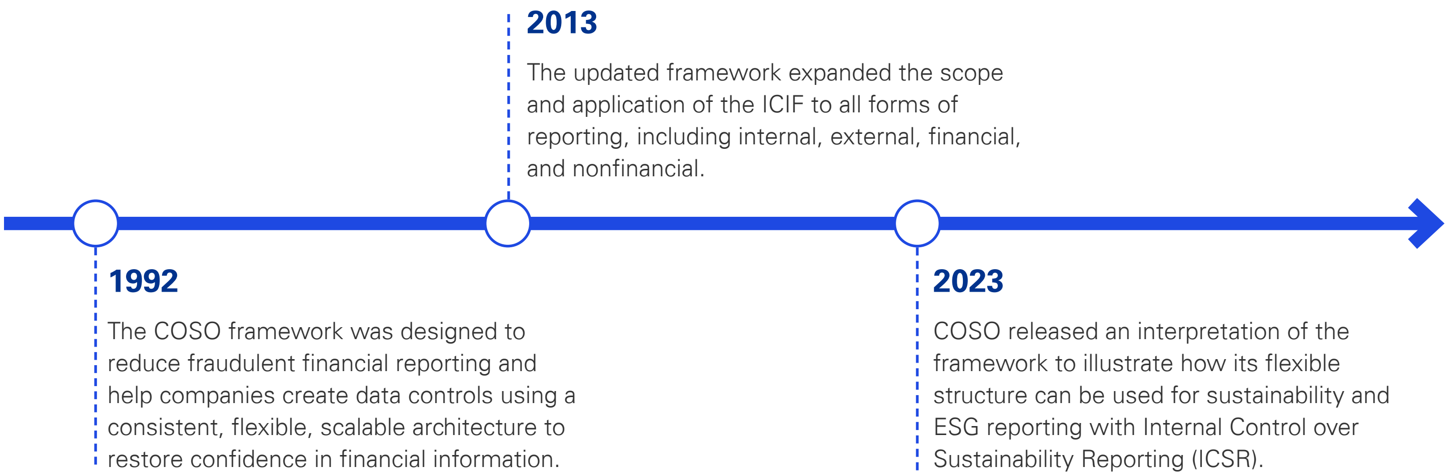
# COSO ICIF for ESG Reporting

**Building confidence in sustainable business information through the COSO Framework**




The Committee of Sponsoring Organizations of the Treadway Commission (COSO) developed the Internal Control—Integrated Framework (ICIF) as an infinitely adjustable control infrastructure, applicable across sectors and industries, that companies can adapt to their individual needs.

As more companies have released voluntary ESG reports and demand for sustainability data has increased, stakeholders have struggled with the reliability of the information being presented. The COSO ICIF brings consistency and reliability to both financial and nonfinancial data processes and can be implemented by businesses at the outset of their ESG reporting efforts and used to assess and reinforce existing processes.

In 2022, the U.S. Securities and Exchange Commission (SEC) proposed a rule to support the enhancement and standardization of climate-related disclosures. To meet these reporting requirements—and to meet other international ESG reporting requirements as well as demands for ESG transparency by investors—companies will need to consider implementing a (or enhancing an existing) system of internal controls that instills confidence that the compiled information is comprehensive, consistent, and reliable.

In response to the rise of domestic and international ESG reporting requirements, in 2023, COSO released an interpretation of how to apply its framework to sustainable business information. Given the proven success of COSO ICIF in both financial and nonfinancial reporting, we believe it is the best choice to support ESG reporting.

In this paper, we summarize how the components and principles of COSO's framework can be used to achieve ESG reporting objectives (i.e., an effective ICSR environment) and share our critical takeaways (key considerations) for each component. Although the COSO organization's 2023 interpretation of its framework is not a guide, ESG professionals can use our insights as they consider implementing robust control frameworks around their sustainability information or enhancing their existing frameworks.

**ICIF:** Internal Control—Integrated Framework | **ICFR:** Internal Control over Financial Reporting | **ICSR:** Internal Control over Sustainability Reporting

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# The need for an effective ESG reporting framework

Stakeholders and regulators are demanding an increasing amount of sustainability information from companies each year. While stakeholders have confidence in standard financial reports, ESG reporting—particularly voluntary reporting—has not yet earned their trust. This lack of confidence over nonfinancial ESG information can be caused by some, or all, of the following:

## 01 Qualitative information

Sustainability information can be more qualitative than traditional financial information. Some factors can't be adequately measured or monetized, so they have to be individually interpreted and reported. In the future, further research and innovation may yield new methods of evaluating this data.

## 02 Inconsistent or nonexistent data streams and data governance

Establishing new processes for gathering, summarizing, and analyzing ESG data for sustainability reporting, such as greenhouse gas emissions, water use, waste management, energy sourcing, energy usage, workforce turnover, or diversity can be difficult and result in collecting inconsistent data. The data might also be collected and measured by decentralized operational units in multiple geographic locations with immature or nonexistent processes and systems, casting doubt on its completeness and accuracy.

## 03 Inconsistent processes

Often companies combine several reporting frameworks, like the Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), and Task Force on Climate-Related Financial Disclosures (TCFD) and choose which disclosures to include from each. This not only makes developing consistent reporting processes difficult, but it also makes company-to-company comparison challenging, reducing investor confidence in the presented information. The creation of the International Sustainability Standards Board (ISSB) is a positive move toward consistency and alignment, and the finalization of the SEC proposed climate rule will also help promote reliable ESG reporting.

## 04 Increasing regulation

New legislation, regulations, and mandatory requirements continue to roll out around the world. Increased scrutiny of sustainable business information has heightened stakeholder interest in how companies manage ESG risks and opportunities and highlighted the lack of comparability between ESG reports.

## 05 Variation in technology platforms

There are several existing platforms that can help build solid controls and documentation, and others in development. These platforms often address one or a few topics (e.g., an emissions reporting system) rather than a comprehensive set. That means reporting teams often have to merge data from several processes and sources. These platforms have the potential to be helpful but must be used carefully because a poor control design or implementation can lead to unmitigated risks.

## 06 Third party data

Companies need to consider the reliability and quality of data obtained from third parties. This information may be sourced from anywhere along the value chain and may include previously unmeasured, unverified, and unreported third-party data. The lack of historical third-party reporting and lack of ownership by the requestor raise concerns over the completeness and accuracy of the data.

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# Why the COSO framework?

There are several benefits to the COSO framework:

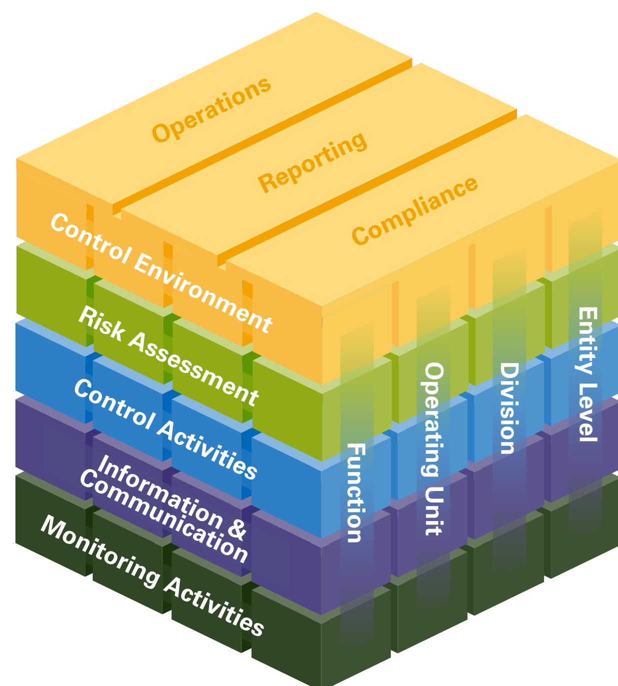
- COSO is one of the most widely used frameworks for designing and maintaining effective internal controls and can be used to establish standards for oversight and governance of ESG data used for external reporting and sustainable business management.
- Although COSO's ICIF originated in the U.S., it is also used internationally in countries such as Japan, Canada, and China, where there are similar mandates to the Sarbanes-Oxley Act (SOX) for internal control assessment and reporting.
- COSO's ICSR specifically accommodates nonfinancial reporting objectives.
- The COSO framework allows companies to use existing controls, processes, established methodologies, and internal expertise. Proven methodologies, approaches, and concepts from ICFR can be applied to all types of performance data, including sustainability. While there is still work to do to bridge the gap between ICFR and ICSR, in most circumstances, there is no need to start over.

# COSO components and principles



The COSO framework is represented visually by the COSO cube. Management can be reasonably confident that they will achieve their company's objective (whether operating, reporting, or compliance) by designing and implementing controls to address the five components of internal control at appropriate levels of the organization (function-specific up to entity-level). Within the COSO framework, there are five internal control components that each contain three to five principles (17 principles in total). Controls must be present and functioning to address all five internal control components and all 17 principles for a system of internal controls to be considered effective in providing reasonable assurance that the objective will be achieved. The COSO framework provides points of focus for each principle to help users interpret and apply the framework principles.

**The COSO Cube:**

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# Component 1:
## Control environment

The Control Environment is the set of standards, processes, and structures that serve as the foundation for all internal controls within an organization. A strong internal control environment helps establish and maintain processes and governance over financial and nonfinancial data. As ESG reporting often relies on data gathered from functions not historically connected to the rigor of financial reporting controls and governance, establishing a strong control environment with respect to ICSR will set the foundation for the full system of internal controls to function properly.

### Principle 1: Demonstrates commitment to integrity and ethical values

Companies can show their commitment to fair and accurate sustainability reporting through their mission and value statements, standards of conduct, operating principles, policies, procedures, and corporate communications. It's most effective when senior leadership and the board set the tone from the top by thoroughly communicating their sustainability commitment and demonstrating that they live by the same values and principles. Within their control environment, companies should consider developing a system to monitor and oversee compliance and be prepared to take corrective actions promptly and consistently, like they do for their existing ICFR programs.

To highlight how ICFR and ICSR overlap, consider a company's code of conduct. A common entity-level control within ICFR is management's requirement that all employees read and acknowledge it upon hiring and periodically thereafter. This existing control can help to address Principle 1 in both ICFR and ICSR if the sustainability commitment is included within the code of conduct. In most instances, the code of conduct conveys a commitment to ethics and integrity, as well as honesty and fairness in reporting. Since the objectives around ethical behavior and reporting would be consistent for financial and nonfinancial measures, this control can operate to demonstrate this principle in both ICSR and ICFR.

### Principle 2: Exercises board of directors' oversight responsibilities

The appropriate lines need to be drawn between sustainability reporting and governance for oversight of established responsibilities for ICSR. The board maintains its independence from the management of the organization with respect to sustainable business, the same as it does for all other aspects of the business. The board can also provide independent oversight for establishing and maintaining effective internal control over sustainability reporting.

There is some flexibility when considering how to establish appropriate oversight of sustainability information across the board and management committees. There is no "one size fits all" approach. For example, monitoring the effectiveness of the ICSR environment could be delegated to the audit committee, which is charged with oversight of financial reporting in the U.S. This is particularly true for companies that are moving toward integrating sustainability and financial reporting, such as for the disclosure of material risk factors in SEC filings.

Board or audit committee tasks may include reviewing the effectiveness of internal controls, especially when significant deficiencies or material weaknesses related to sustainability information have been identified, and conducting oversight of the independent auditor providing assurance over sustainability reporting.

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## Principle 3: Establishes structures, authority, and responsibilities

Clearly defining, documenting, and communicating how the organization is structured, what roles are involved, and where authority and responsibilities lie is critical. In many cases, this may require breaking down pre-existing silos between departments, or it may involve segregating duties that have traditionally been handled by a single individual or department. Sustainability reporting requires involvement by multiple roles in business units across the organization and is not the focus of a particular department or region. This highlights the need for cross-functional teams with formalized structures, authority, and responsibilities.

Chief financial officers (CFOs), their finance teams, internal audit, and internal control teams can play a significant role in supporting the design and implementation of ICSR, making use of existing ICFR where appropriate. In the case of sustainability information, applying professional judgment and providing a reasonable level of confidence is critical, which is an area where finance teams have experience and can play an integral role.

## Principle 4: Demonstrates commitment to competent human resources

Human capital is one of the most important company assets. Companies should consider a commitment to competence in hiring, training, and retention. This may involve implementing policies and procedures for recruitment and selection, such as background checks, requisite skill and experience assessments, or professional certification requirements. Consider adjusting human resources controls to detect ESG experience (e.g., corporate social responsibility, sustainability, previous roles that included ESG tasks, etc.) and flag applicants who can grow their skills and knowledge.

Implementing this principle involves cultivating a culture of learning and collaboration throughout the organization, developing a succession plan, and setting up training, career development, and incentive programs. Consider investing in training new hires and current employees with ESG reporting responsibilities, so they have the knowledge and skills they need to understand the rigor needed to support the reporting objectives.

## Principle 5: Enforces accountability

It is the responsibility of leadership to hold individuals accountable for their efforts toward achieving sustainability reporting objectives. After identifying the relevant risks, management should consider establishing a system of controls to hold employees in each business unit involved in the collection, validation, management, and reporting of sustainability information responsible through incentives, performance evaluations, or even disciplinary actions.

Taking into account extraordinary pressures like unrealistic goals, excessive workloads, or limited resources, management should consider setting reasonable performance targets. Sustainability reporting is most effective when it is integrated into all aspects of the business, including governance, strategy, and business model development, combined with an effective system of internal control over financial and sustainability reporting, and embedded into the DNA and culture of the company.

## Key considerations

- Evaluate the organizational structure and identify the areas most likely to be impacted by current and pending regulation.
- Assess the workforce and gauge if the present employees' collective skills can successfully navigate these new reporting regulations.
- Hire, train, and retain the right people with the right skills.
- Establish and communicate the structure, roles, and responsibilities to all involved in ESG reporting.
- Define realistic, attainable metrics that do not create undue pressure that could lead to fraudulent reporting.

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# Component 2:
## Risk assessment

It's crucial that companies identify and analyze risks that may prevent them from achieving their sustainability reporting objectives. Sustainability reporting is evolving quickly, therefore companies should consider modifying existing risk assessment processes to include an emphasis on company and industry-specific sustainability reporting. Key metrics should drive the risk assessment process. Companies should consider the focus of their sustainability reporting objectives and closely monitor the effectiveness of controls given changing expectations and regulatory developments.

### Principle 6: Specifies suitable objectives

When defining sustainability reporting objectives and corporate risk tolerance, leaders should consider internal and external inputs, regulatory and statutory requirements, industry standards and leading practices, and the needs of internal and external users. Identifying the applicable laws, rules, regulations, and frameworks applicable to sustainability reporting is a necessary step in defining objectives. Equally important is assessing the required level of precision by applying relevant materiality guidelines, which will help guide where control activities are needed to support the overall sustainability reporting objectives. Once established, it is essential to allocate the capital and resources necessary to achieve them.

When data is based on assumptions or estimates, ESG leaders should consider user needs (internal and external) and regulatory requirements (for external reporting) when determining the precision level required for effective internal and external reporting.

### Principle 7: Identifies and analyzes significant changes and emerging trends

After defining the sustainability reporting objectives, companies should consider the scenarios that could prevent their achievement and materially impact reporting. Then companies can determine how these risks can be managed using the available information, management's perspective of the risk, and their estimation of the significance of the potential impact to the business. For example, the accuracy or relevance of data may be impacted by evolving or emerging regulations, or risks resulting from data collection or validation.

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## Principle 8: Assesses fraud risk

One reporting risk is that someone could knowingly misstate information or misappropriate resources and corrupt the process. Companies should identify how this could happen and establish preventive measures.

Sustainability reporting often uses data obtained through nontraditional sources—typically outside of the company's existing systems used for financial reporting—and sometimes can be heavily reliant on manual efforts, like estimation, in areas where source data is not available. For these reasons, existing ICFR controls responsive to fraud risks may not be adequate to address the risks of fraud in sustainability reporting. ESG leaders should be especially aware of the risk of management bias and take the time to identify any possibilities for manipulation.

Pressure to meet stakeholder expectations, achieving targets tied to incentive compensation programs, and securing favorable borrowing terms through green lending arrangements can create incentives for greenwashing and fraudulent reporting. Companies should consider these factors when assessing fraud risk and designing ICSR programs.

To increase internal and external stakeholders' confidence in sustainability data, companies can build credibility by developing a strong culture of open communication, performing regular sustainability fraud risk assessments, and testing related controls intended to prevent fraudulent reporting, data manipulation, management bias or override, and corruption.

## Principle 9: Identifies and analyzes significant changes and emerging trends

Consider how external (e.g., legal and regulatory requirements, global/local economies, competition, changing technology, etc.) and internal factors (e.g., leadership changes, mergers and acquisitions, company profile, products and services, strategic direction, etc.) impact sustainability reporting risks.

For example, regulation around certain sustainability issues and personnel changes may render some controls outdated and in need of modification.

## Key considerations

- Define sustainability reporting objectives in sufficient detail to form the basis for a thorough risk assessment.
- Identify and analyze material risks to the achievement of sustainable reporting objectives.
- Consider the potential risk of fraud in sustainability reporting when performing the risk assessment over sustainability reporting.
- Continuously monitor for changes (internal and external) that could impact existing material risks or introduce new material risks to the achievement of sustainability reporting objectives.

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# Component 3:
## Control activities

As companies identify the risks to achieving their ESG reporting objectives and create policies and procedures to mitigate their impact, the resulting actions are control activities. They may be preventive or detective, manual or automated, and apply to either sustainable business or financial reporting processes. Examples include authorizations and approvals to prevent errors.

Due to the pervasive nature of sustainability reporting, many companies find they lack sufficient control activities. If companies do have existing activities, often they are manual, reliant on individual actions rather than automated processes, or not consistently applied. This causes variability in data quality and a lack of confidence in data reliability.

### Principle 10: Selects and develops control activities

After identifying key risks, companies may design new or use existing controls. Since sustainability reporting processes are still evolving, they often don't have sufficient controls, like the proper segregation of duties, authorizations, or reconciliations. If control owners are unfamiliar with compliance program requirements, they might have difficulty gathering compelling evidence to document ICSR performance.

Sustainability reporting technology systems sometimes lack automated checks, data analytics and validation, or secure access. Leaders should consider entity-specific factors, determine the relevant operations and reporting processes, and evaluate and implement a custom mix of control activity types and technology solutions.

A combination of different activities—preventive and detective, automated and manual—is often the most effective way to achieve sustainability reporting objectives.

If automated controls are not possible, verify that control operators are aware of their role in the control environment, have the knowledge and authority to perform the controls as designed and implemented, understand the importance of reliable sustainability information, and are trained to perform their control activities accurately and consistently. Where the control environment is largely dependent on detective and corrective controls, operators should continue to look to implement preventative controls as their ICSR program matures.

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## Principle 11: Selects and develops general controls over technology

Many companies use technology systems that operate outside of the financial reporting control environment to collect, manage and report sustainability information. Although these companies may have technology controls, they may not be enough to address material risks (e.g., data integrity and accuracy) to achieving sustainability reporting objectives. Companies may have to identify or develop additional control activities related to these systems and other data sources.

For example, some companies may still use ad hoc spreadsheets or emails to collect sustainability data. This may require the implementation of a variety of control activities, including reconciliations, version control, and access control.

## Principle 12: Deploys oversight through policies and procedures

Once companies identify and develop appropriate ESG reporting controls, they can be integrated into business processes and day-to-day activities through policies that define expectations and procedures that specify who, what, where, when, and how. These procedures may include defining roles and responsibilities and required reconciliations.

Once documented, communicated, and implemented, these policies and procedures determine accountability for the appropriate execution of controls, and can be linked to sustainability reporting objectives. Leaders should consider frequent evaluations and updates of these policies to ensure alignment with rapidly evolving ESG developments. It's also important for companies to identify and assign individuals to carry out policies and procedures who are competent and understand sustainable business objectives and ICSR.

## Key considerations

- Design the ICSR program and controls to be scalable to achieve the desired level of assurance. Remember to design controls that address future commitments and not just current metrics. Using the ICSR program can be beneficial in supporting potential internal or external assurance needs.
- Give control performers time to acclimate to initial expectations, so when more rigorous assurance is necessary, they are prepared.
- Develop and regularly update policies, procedures, and training to provide control performers with the tools they need to achieve ESG reporting objectives.

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# Component 4:
## Information and communication

Reliable, up-to-date information, including key performance indicators (KPIs) and real-time communication, is critical to understanding a company's business environment. Companies should evaluate whether there are systems and processes in place that identify, capture, and communicate accurate sustainability information.

### Principle 13: Uses relevant information

An effective ICSR program includes sustainability reporting controls to ensure the integrity and accuracy of information relevant to ICSR is evaluated. The information used to execute ICSR must be reliable enough to effectively mitigate any material risks that stand in the way of achieving sustainability reporting objectives.

This principle is critical to improving external sustainability reporting, identifying metric owners, and ensuring that the data supports the defined metric (i.e., relevant and reliable data is used). If ICSR operators use inaccurate or incomplete data, it could result in inappropriate conclusions in the performance of controls, and ultimately impact the achievement of ESG reporting objectives. The importance of defining and communicating metrics through policy and procedures is a critical component to obtaining the right data.

### Principle 14: Communicates internally

Companies should develop processes to communicate ICSR information to the board of directors, leadership and those responsible for ESG reporting processes and controls. Sharing progress on sustainability reporting objectives and ICSR program effectiveness increases engagement and progress toward meeting external reporting requirements. Disseminating sustainable business results and periodic ICSR program updates increases accountability within companies (as described in Principle 5).

### Principle 15: Communicates externally

Companies should maintain open lines of communication (inbound and outbound) addressing matters impacting controls over sustainability reporting. This communication can help companies identify external factor changes, so they can be considered and resolved timely within the companies' ICSR. This promotes transparency and builds confidence in the company's ESG governance and ESG reporting results.

## Key considerations

- Remember that one of the biggest differences between ICFR and ICSR is the source of data. Another is that the ESG metrics being measured in ICSR are often forward looking (e.g., targeted reductions in emissions and water pollution) rather than past transactional or historical financial reporting.
- Allow for the fact that nonfinancial ICSR information is often gathered from external sources or the result of complex internal calculations.
- Consider how to integrate sustainability data capture and controls into any future system discussions (e.g., ERP implementations) to scale the technology environment appropriately.
- Gauge the consistency, veracity, and completeness of the data for ICSR.
- Design and implement controls to mitigate the risk of inaccurate or missing ESG data to acceptable levels.

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# Component 5:
## Monitoring activities

For an ICSR program to be successful, it must include a defined, integrated set of controls to convey that all five internal control components and 17 principles are present and functioning. Monitoring activities are performed to assess whether controls are designed and operating effectively to support the ongoing assertion that all 17 principles are present and functioning.

### Principle 16: Conducts ongoing and/or separate evaluations

Evaluations can be ongoing, separate, or a mix of both. Ongoing evaluations can be routine operations that are built into business processes to react to changing circumstances in real time. For example, a company measuring energy consumption may embed parameters to flag unusual performance results. ESG leads should consider evaluating anomalies to determine whether control flaws exist and require corrective action.

A mix of ongoing and separate evaluations can be conducted by internal assurance functions such as internal audit or compliance. Separate evaluations are often performed in higher-risk areas to confirm the findings of ongoing evaluations and enhance underlying processes and controls. For example, a commercial bank's data security specialist may periodically evaluate the bank's compliance with IT standards.

As the market's understanding of the material impacts of many sustainability factors evolves, companies may wish to conduct more frequent, separate evaluations of relevant controls, like those related to a changing regulatory environment. As companies integrate sustainability information into statutory filings, monitoring activities support external sustainability reporting objectives.

Companies should consider implementing policies and training programs to teach employees in sustainability reporting roles what constitutes effective supporting documentation for the operation of controls. This increases internal monitoring effectiveness and oversight and supports external assurance engagements as ESG reporting moves toward limited and reasonable assurance.

### Principle 17: Evaluates and communicates deficiencies

Management and the board should consider assessing evaluation results from monitoring activities, communicate issues to the appropriate stakeholders, and monitor actions to ensure timely remediation. This may involve establishing protocols for reporting deficiencies and supervising corrective efforts. As sustainability reporting processes become more sophisticated, leadership and the board of directors may consider automation and analytic techniques to continuously monitor controls over key sustainability factors, allowing companies to identify unusual trends more quickly and efficiently.

## Key considerations

- Consider expanding the role of internal audit functions to include internal assurance of ICSR. Internal audit can assess the design, implementation, and effectiveness of the ESG data controls prior to any external assurance.
- Encourage the chief audit executive to collaborate with leadership to build an efficient, effective, risk based ICSR portfolio.

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# Conclusion

As ESG reporting expectations increase, the COSO framework provides a customizable, scalable, and reliable control framework that harnesses both financial and nonfinancial ESG data. The COSO ICIF has been the most universally accepted framework for financial reporting for more than 30 years. Now, its successful track record can help foster confidence and instill trust in ESG data, and, by extension, ESG reporting.

The COSO building blocks have not been changed but expanded to apply to ESG reporting data. With thoughtful consideration and cross-functional collaboration, companies should be able to efficiently leverage existing methodologies, processes and controls to the extent they can be applied to ICSR and identify remaining gaps where further controls are needed to effectively build out their ICSR program.

ESG reporting, which is now an imperative for many companies, requires substantial time and resource investment. Historically, ESG reporting in the U.S. has been, to some extent, inconsistent between companies and industries. The COSO ICSR provides a framework for designing and implementing a comprehensive, consistent, and reliable control framework over ESG information that can help build trust and confidence in sustainability information and ESG reporting.

## How KPMG can help

KPMG meets clients where they are on their ESG journey and creates custom solutions ranging from strategy to materiality and maturity assessments to setting ESG targets to data collection to reporting.

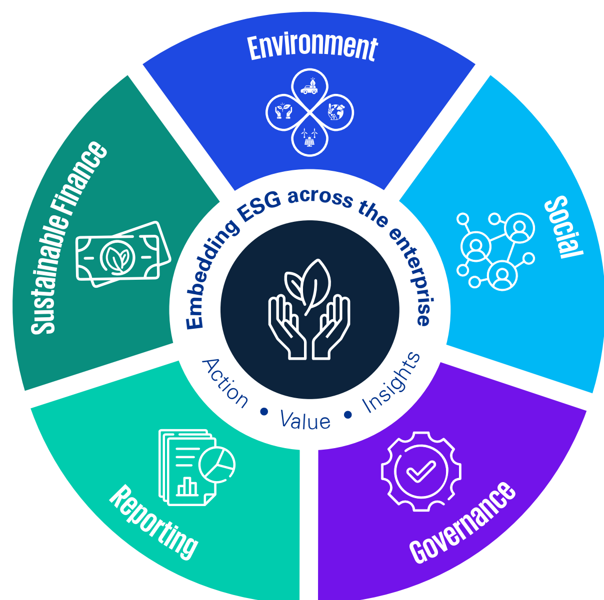
Our approach incorporates a risk management strategy to meet increasing pressures from stakeholders and develop plans to minimize the impact of future climate change events on our clients' businesses. We take a practical approach to our cost-benefit analysis to help prioritize ESG initiatives that enable our clients not only to meet their sustainability goals, but also to create financial value and a positive return on investment.

As your program evolves with this fast-moving topic, it will be important to have the right governance, people, process, technology and supporting internal control environment in place to be successful. We are here to support our clients as they continue on their journey to build out an effective ICSR program. KPMG is helping our clients assess whether their ESG governance structure is aligned with the COSO's framework.

**The Assessment may include consideration of the following:**

- Board oversight and committee structures,
- ESG reporting strategy and tone from the top,
- Materiality assessment and linkage between ESG strategy and ESG reporting strategy,
- Policies and procedures,
- Operational plan implementation (target operating model implementation), and
- Overarching ESG reporting process.

An effective ICSR environment will help companies to not only meet their regulatory objectives but realize the benefits of a compliant program.




This report is part of the KPMG ESG series covering topics under Environment, Social, Governance, ESG Reporting, and Sustainable Finance. Our ESG content series demonstrates that embedding ESG across the enterprise will turn ESG aspirations into action by leveraging insights from data to create value for your organization. This paper focuses on the linkage between all five topics and value creation. **For more on these, visit the KPMG ESG website.**

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