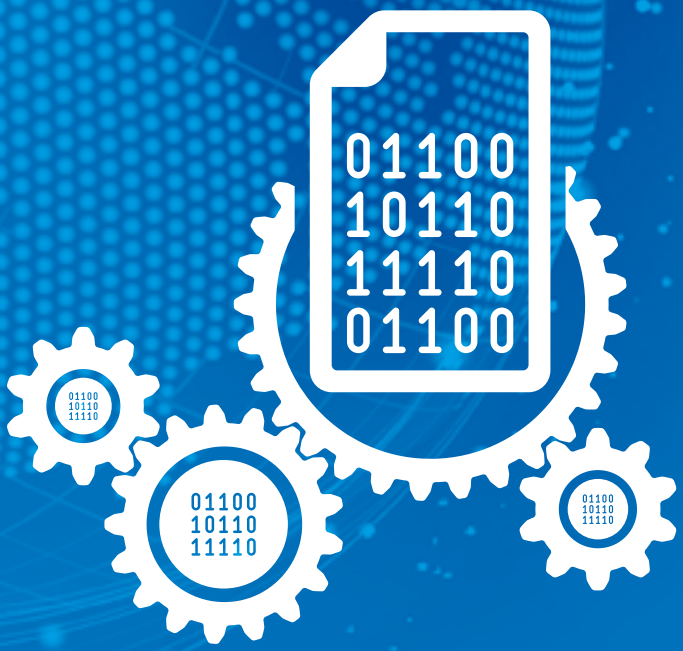
PRI Principles for Responsible Investment

INTRODUCING CONFIDENCE-BUILDING MEASURES TO PRI SIGNATORIES



UNEP FINANCE INITIATIVE | United Nations Global Compact

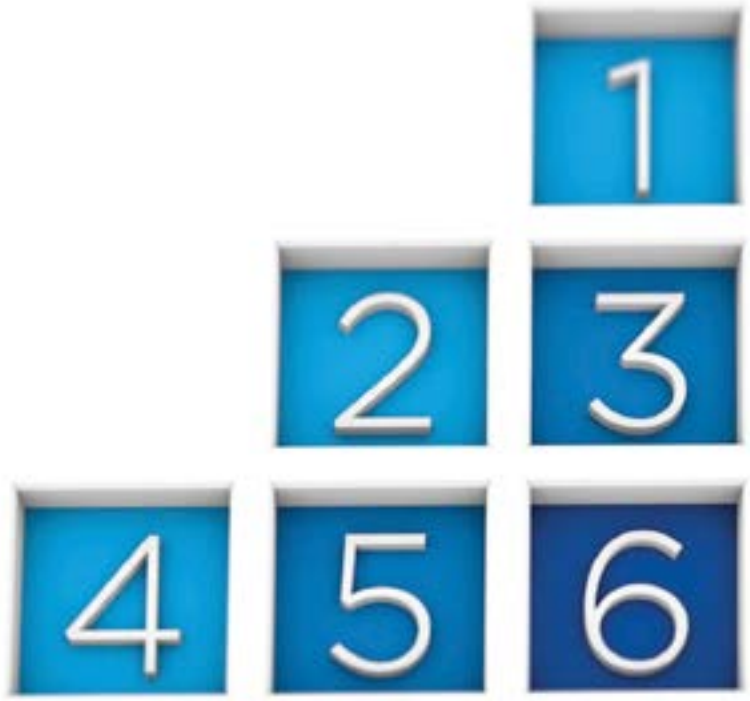
An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.



PRI's MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

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ASSURANCE WORKING GROUP

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CONTENTS

GLOSSARY

AWG	Assurance Working Group
CBMs	Confidence-building measures
COSO	Committee of Sponsoring Organizations
GRI	Global Reporting Initiative
IAASB	International Auditing and Assurance Standards Board
IFAC	International Federation of Accountants
IIA	Chartered institute of Internal Auditors
IIASB	International Internal Audit Standards Board
IIRC	International Integrated Reporting Council
LoD	Lines of Defence
UNGC	United Nations Global Compact

EXECUTIVE SUMMARY

This paper presents:

- The principal findings from the research and discussions undertaken by the PRI Assurance Working Group (AWG).
- The various ways of increasing the credibility and accountability of signatories' responses to the PRI Reporting Framework.
- A roadmap showing different stages of confidence-building measures (CBMs) that PRI signatories could adopt.

FINDINGS

Increasing the confidence of reported data and the quality of reporting systems is part of good governance and an important part of the PRI's commitment to increasing accountability and driving better data throughout markets.

DEFINITION: CONFIDENCE-BUILDING MEASURES

The paper uses this as an umbrella term for different practices, spanning from basic internal control mechanisms, to internal audit and third party external assurance. It emphasises increasing internal organisational confidence, as well as external stakeholders' confidence, that there is a rigorous and robust process to collect the information presented in external ESG reports, such as the PRI Transparency reports.

> "Implementing confidence building practices will further user and signatory trust and propel the ESG market into one that is more standardized and accountable. This will enable fluid dissemination of data transparency and sustainability in the market."
>
> Avantika Saisekar, Head of ESG and Sustainable Investments, The Wafra Group

The majority of signatories implement basic CBMs for their PRI reporting, while the use of advanced is rare and often limited in scope.

CBMs can range in complexity and rigour and PRI signatories understand and practice them in many different ways. The most common and least rigorous CBM is an internal review of the report, which is conducted by over 70% of signatories. In the majority of cases, the report is reviewed by senior management. However, the compliance team, which plays a key role in reviewing the data collection system and evidence to support what is reported, is involved in just 30% of cases. This suggests not all signatories have robust internal controls in place for ESG information. Third-party independent assurance, a more complex undertaking, is reported by just 10% and is typically applied to selected indicators. With this paper, we hope to encourage those that wish to advance their CBMs, and to reduce the gap of signatories that are not implementing any verification methods.

Governance and internal controls are an important first step to ensuring good quality data

The AWG agreed that strong governance systems are vital to better ensure that an organisation achieves its objectives and manages risks in doing so[1]. This will benefit the ESG reporting process and can work as a mutually enforcing feedback loop, enabling governing bodies within the organisation to make better decisions as a result of good quality ESG data.

Developing robust internal controls is the first step on the journey towards enhancing accountability of PRI signatories and credibility of their reported information. An organisation's confidence in its reporting is a direct result of the quality of its internal control environment. Applying effective internal controls specific to RI processes and to the collection of ESG information is an emerging concept compared to control systems for financial data and is hampered by the need for improved ESG information. Implementation of best practice is still relatively rare.

Internal audit and external assurance can substantially help organisations reach their objectives

CBMs can help organisations to reach their objectives more efficiently by identifying where improvements can be made to the business model and its processes. This will enable management to understand and reduce risks, and can contribute to outlining clearer areas of responsibility, such as ESG reporting and data collection.

Signatories can use internal audit to verify that their internal control mechanisms on ESG reporting, and those specific to RI processes are working as intended. This substantially helps organisations prepare for external third-party assurance of ESG information, and should result in a more efficient assurance process. As a next step, external assurance of those controls every five years compliments

1 IPPF (2012:1) Assessing Organizational Governance in the Private Sector

the internal auditors' work. The validation of reported information which is not within the scope of the internal audit function benefits more from external assurance as it provides the highest form of impartial assurance. External assurers can also provide guidance on best practices thanks to their exposure to many similar organisations. Internal audit and external assurance increase confidence in the reported ESG information.

Maximum value can be derived from internal audit of and external assurance of processes when targeted towards areas of the framework prioritised by the PRI

It's not necessary to assure and/or audit all information; nor does it have to be done annually. Where signatories seek to show leadership and their adherence to the Principles, the PRI provides a list of indicators that would be most impactful to assure. RI processes that are established – and hence remain unchanged for a couple of years – can be reviewed by an internal audit function team and/or external third party every three to five years. Information that is data-driven changes yearly and is more straightforward to assure but, would need annual review, while the underlying data collection process itself can be reviewed less frequently.

The PRI can support improved quality and format of data, even without a dedicated standard

The AWG's analysis also found that the format and variety of qualitative and quantitative data gathered from the reporting process was an obstacle to assurance. The Reporting Framework is designed to capture a variety of RI approaches. While providing more robust definitions aligned with future RI standards could make it easier for assurers to test signatories' responses against the provided metrics, this should be done carefully to avoid excluding some RI approaches. At present, the PRI is not seeking to develop an assurance standard, but welcomes recent developments from bodies with expertise in quality standards, such as the Swiss Association for Quality and Management Systems. The PRI looks forward to working with any such organisation to assist with the development of an RI assurance standard. Use of such standards will not only increase confidence in the signatories' ability to implement their commitment to RI, but will also give them a solid foundation to report quality ESG information.

Expertise must be built to counter a lack of consideration for RI processes in assurance standards

While assurance standards exist for ESG data, there is a lack of generally accepted internal control standards related to ESG processes that practitioners would use in their assurance engagements. Therefore, some investors use broader assurance standards for internal controls, such as ISAE 3402, which are more pertinent to service organisations such as investment managers or service providers who vote on behalf of their clients. While these standards increase confidence in reported information, they depend on assurers having the necessary expertise on RI processes, which is often limited. Advancing the use of various CBMs and increasing the confidence in RI-related information reported across industries is, however, increasingly being picked up on the agenda of various reporting frameworks such as the Global Reporting Initiative (GRI) and the International Integrated Reporting Council (IIRC), and standards bodies such as the International Federation of Accountants (IFAC) and the International Audit and Assurance Standard Board (IAASB).

CBMs play a part in the minimum requirements and leadership identification of PRI signatories

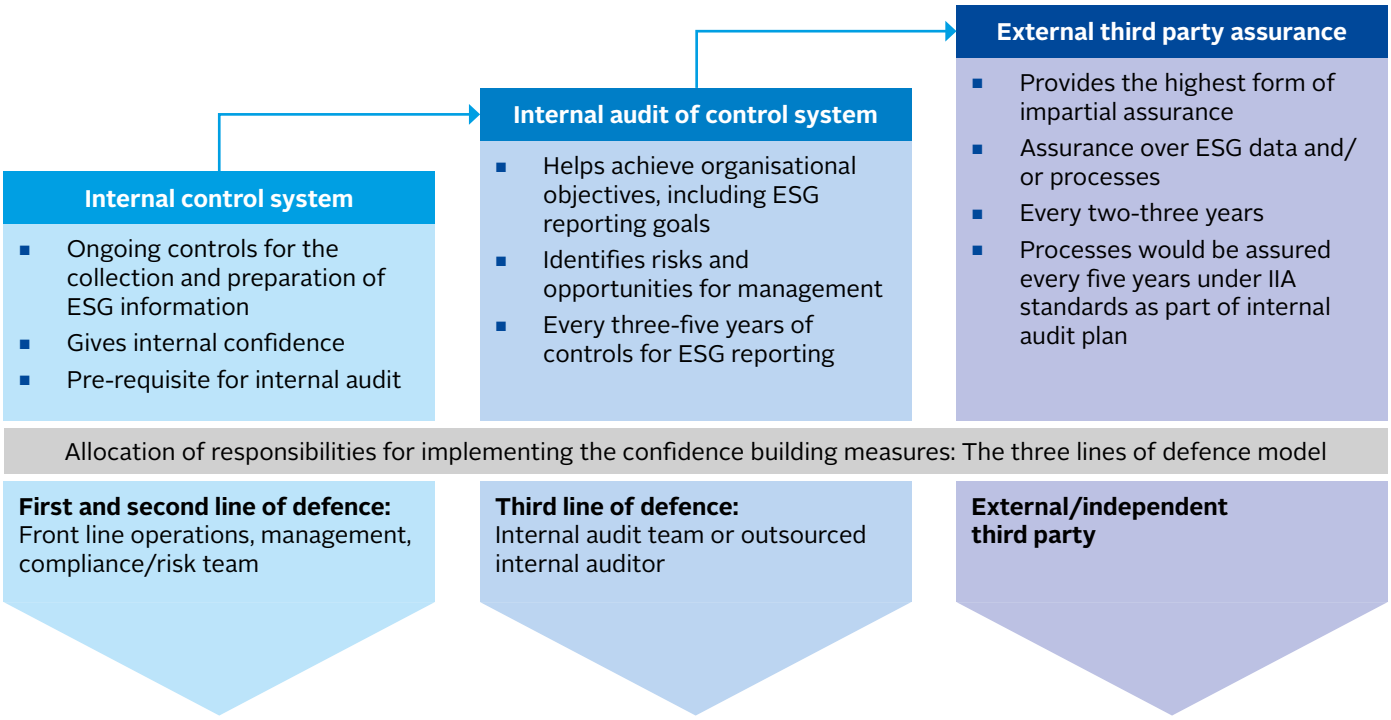
As part of the PRI's wider accountability initiative, the accuracy and credibility of signatories' reported information is a priority area. The PRI's work on introducing minimum requirements for signatories has been informed by the importance of robust governance structures and clear allocation of responsibility areas for RI implementation. All PRI investor signatories are required to have some staff with oversight of and implementation responsibilities for RI implementation. This paper addresses clear governance structures as pre-requisite for CBMs (such as internal audit and external third-party assurance). As the PRI revisits minimum requirements in the future, we will explore whether any CBMs might be introduced, based on what is practical, impactful, desirable and sensitive to additional resources needed by signatories.

Implementation of advanced CBMs will also likely feed into the identification of PRI signatory leaders. As the intention is for other signatories to learn from leading signatories, it will be important for them to demonstrate the robustness of their processes.

> "The Assurance Working group has brought together an esteemed international group of contributors that captured international best practice as well as regional geographic approaches in the recommendations. Feedback from signatories also ensured that the working group considered well established assurance practices as well as emerging assurance practices, enabling organisations at all levels to demonstrate confidence in their reporting."
>
> Margot Black, Corporate Responsibility and Sustainability Manager, Charter Hall

PRACTICAL RECOMMENDATIONS FOR SIGNATORIES

Figure 1. Phased approach to implementing confidence-building measures.



A phased approach to introducing CBMs is proposed, allowing signatories to adopt verification and assurance practices, depending on their organisational set-up, circumstance and market:

1. The first step is having an internal control system in place to ensure that accurate and credible information is collected and produced for ESG reports. This should also be seen as a pre-requisite for ensuring the most value is generated from other CBMs such as internal audit and external assurance. Organisations should think about how to allocate responsibilities for internal control mechanisms the three lines of defence model, (which address how specific duties related to risk and control can be assigned) is suggested as a sound approach.

2. Once robust internal control systems are in place, internal audit will independently examine whether internal controls are working as intended (risks and improvement areas identified) and are contributing towards ESG reporting objectives. It will also prepare organisations for more efficient and valuable external assurance. This is split into internal verification of the responses included in the PRI Transparency Report and internal audit of internal controls. While both are important they have different purposes and scope, with the latter underpinning the credibility of any data driven responses.

3. Finally, external assurance can give confidence that reported ESG information is credible or accurate, depending on the level of assurance. If organisations have not laid the groundwork by having robust internal control systems in place, ESG reports risk not being readily assured. This is split into external assurance of data based indicators, and of external assurance of internal controls related to process based indicators in the Reporting Framework. The latter ultimately provides the highest form of confidence-building measure.

In the absence of frameworks written for investors, the World Business Council for Sustainable Development's (WBCSD) internal framework for non-financial reporting can serve as a helpful guide for PRI signatories that wish to improve their internal control systems for preparing their PRI reports. This can assist them in the first step of the phased-in approach recommended by PRI.

WHY EXPLORE CONFIDENCE-BUILDING MEASURES FOR PRI SIGNATORIES?

PRI signatories, committed to reporting on their own activities via the Reporting Framework, have signalled support for increased signatory accountability, including further measures to verify information reported to the PRI. Discussions on what we collectively refer to as confidence-building measures (CBMs) have become a common theme thanks to the PRI's differentiation and accountability consultation in 2016, the PRI Board's subsequent high-level response to the consultation findings, and the recommendations brought forward by the independent report From Principles to Performance.

Concurrently, against a backdrop of increasing usage of ESG and other extra-financial data (sometimes referred to as 'non-financial'[2]) from both investors and companies, there are debates over the quality and veracity of this information. Investor expectations for disclosure, especially by asset owners from their investment managers, are increasingly expanding to include ESG information, such as responsible investment processes and ESG characteristics of portfolios. For this information to be incorporated into investment decision making such as investment management selection, it is critical that the information is consistent and reliable, particularly for investors to accurately report on their own impacts. Therefore raising quality control will help elevate the consideration of ESG data to the same level as financial information.

In June 2016, the PRI published PRI Signatories and Assurance, research mapping the various assurance and CBMs taken by signatories in the 2014/15 reporting cycle. A number of technical difficulties with assuring ESG information were identified, with a major impediment being the lack of clarity as to what constituted assurance within the context of ESG reporting, and a lack of standards on RI to assure against.

The AWG was set up in January 2017 to address the issues raised by the research, prioritising:

- advancing accountability and transparency;
- ensuring the credibility of PRI Reporting Framework responses;
- differentiating leaders from laggards, and;
- building greater stakeholder confidence.

The programme is a combination of research on current market practices, a review of best practice and possible solutions to be implemented for PRI reporting. This encompassed analysis of CBMs reported by signatories during 2017, as part of their PRI reporting commitments. The AWG members are a mix of PRI signatories, industry bodies and assurance providers. To read the full list of working group participants and the terms of reference, please visit the PRI website.

2 The PRI considers ESG information to be material and financial, and discourages use of the term 'non-financial'

CONFIDENCE-BUILDING MEASURES AND THEIR VALUE ADD

The different confidence-building practices can be summarised as:

- Governance and systems of internal controls – ensuring ESG reporting objectives are communicated by the organisation's highest governing body, that clear responsibility areas are outlined and that controls are embedded in routine, daily processes.
- Internal audit and verification – ensuring that the systems of internal control are verified by a separate, independent function.
- External assurance – provides the highest form of impartial assurance of data and processes.

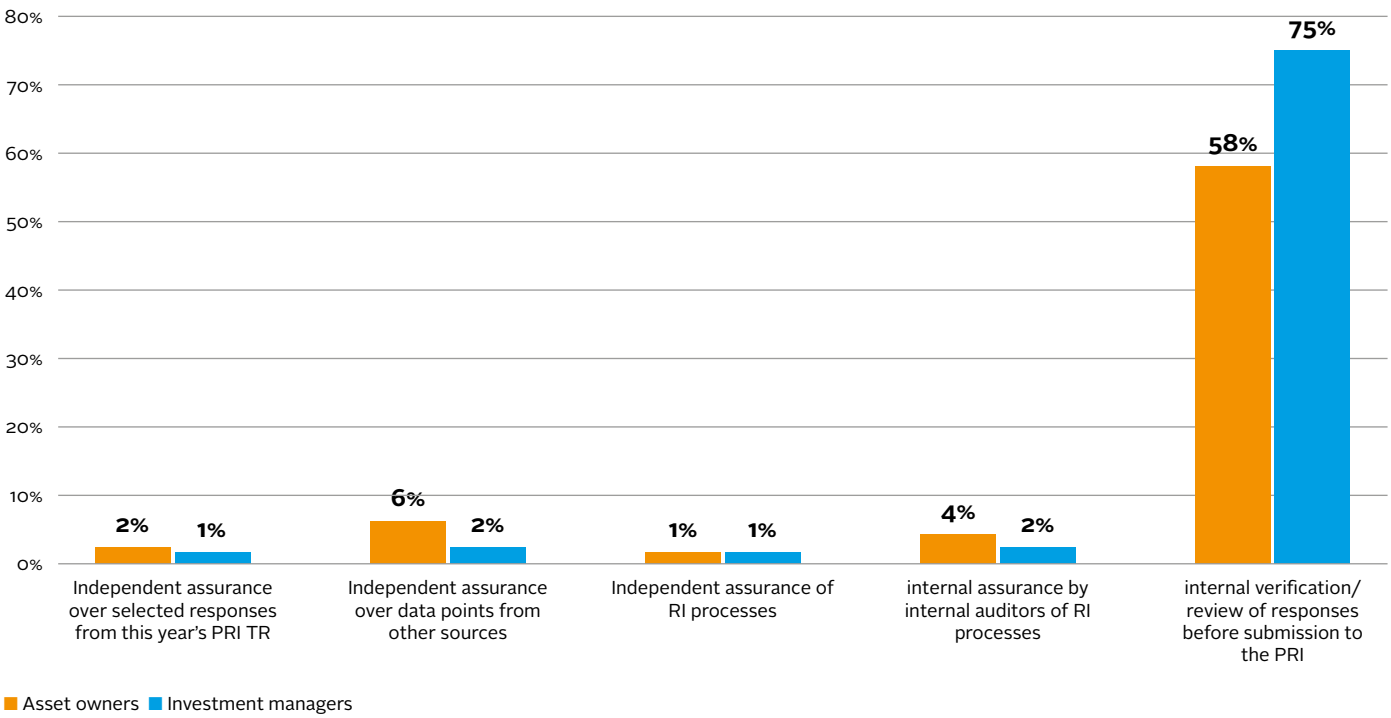
Other CBMs, such as RI labels and ESG audit of holdings are out of the scope of this paper as they are not directly related the PRI Reporting Framework.

In practice, organisations will be at varying stages of implementing CBMs, or may have different processes for different data. This paper aims to provide the possible next steps appropriate to different organisations. It identifies substantial value adds from implementation of verification methods. In general, these benefits include:

- Facilitating a review of practices and processes across the organisation, and highlighting where improvements can be made to achieve organisational objectives more efficiently.
- Identifying risks and opportunities in the internal data collection and reporting mechanism. This will enable management to understand and reduce risks and can contribute to developing clearer roles and responsibilities in the data collection process.
- Increasing confidence in the reported ESG information, both internally and externally.

The 2017 data shows that the majority of PRI signatories conduct the most basic CBMs consisting of internal verification over parts of their Transparency Report. The practice of more stringent measures such as third-party assurance on RI activities is generally less common. With respect to PRI reporting, measures would be needed to enable wider use of external third-party assurance by PRI signatories over parts, or the entire PRI Transparency Report, especially with regarding their RI processes (Figure 2).

Figure 2. Type of CBMs conducted for responses to the 2017 Transparency Reports (based on 1248 signatories).
Note: 29% of asset owners and 19% of asset managers did not conduct any CBMs.



A DRIVE FROM THE TOP – GOVERNANCE AND OPERATIONS

Strong governance systems are vital to better ensure that an organisation achieves its objectives and manages risks in doing so[3]. This holds true for reporting, which is part of the accountability mechanisms in an organisation.

GOVERNANCE: ROLES AND RESPONSIBILITIES

AT A GLANCE

- **Benefits:** creates a top-level demand for good quality ESG reporting
- **Challenges:** establishing a culture around the value add of having robust confidence building measures
- **Next step:** systems of internal control

BOARD AND SENIOR MANAGEMENT - SETTING OBJECTIVES AND OVERALL GOVERNANCE STRUCTURE

Strong governance should start with the expectations and ambitions set by the board (or trustees, or any other form of highest governing body within an organisation). In the case of investment managers that do not have a board, this role would be filled by the CEO or other C-level staff, such as the CIO. The expectations and ambitions set should reflect the board's culture and thinking. This culture and top-level demand sets the tone for the rest of the organisation and creates a mandate for management and others to implement the appropriate steps, such as for CBMs and ESG reporting.

The top-level of an organisation can set expectations for high-quality reporting to support governance, which can help create more efficient reporting processes with better quality information. This creates a positive feedback loop. There is no 'one size fits all' model for this principle, as every organisation should tailor its governance structure according to its specific needs. The PRI has picked up the need for clear roles in terms of oversight and implementation responsibilities of RI in its minimum requirements for signatories.

However, organisations often first need to realise and agree on the value-add of implementing CBMs, followed by clear delineation of roles and areas of responsibility. This provides the best conditions for reaching organisational objectives, including ESG reporting. Setting a strong basis is a step in the right direction towards enhancing credibility of information provided in external reports. Clear responsibility for outputs and processes enables tracing and verification of those outputs and processes.

PRACTICES AMONG PRI SIGNATORIES

RI accountability at the board, the CEO or other C-level staff is considered a preliminary component of building confidence in signatories' responses to their Transparency Report. It is therefore encouraging that 94% of signatories reported that their board/CEO or other C-level staff had oversight or accountability for their responsible investment. In addition, 63% of those signatories also reported that senior management is responsible for its implementation.

3 IPPF (2012:1) Assessing Organizational Governance in the Private Sector

SYSTEMS OF INTERNAL CONTROL – A PREREQUISITE FOR INTERNAL AUDIT AND EXTERNAL THIRD-PARTY ASSURANCE

Key steps	Example of actions
1. Understand the culture	■ Examine what the tone at the top is regarding responsible investment, risk identification and ESG reporting. Is there a top-level demand and is the value add of implementing CBMs clear? ■ Try and get an overall picture of how the issues have been prioritised so far by management and staff
2. Understand the organisational structure	■ Map out the organisational structure to understand how internal controls can fit into your unique context ■ Think about how a segregation of responsibilities for ESG reporting can be implemented within that context. Use the three lines of defence model as a guide to understand how you can separate responsibilities[4]
3. Establishing the current risk maturity of the organisation	■ Examine what control processes you might already have in place and what risk identification you have already conducted. These processes can be built on as part of the next step.
4. Formalise the system of internal controls and culture	■ Develop documents on policies, procedures, responsibility areas (use the three lines of defence as a guide) and workflows to manage expectations and create clarity internally. ■ Engage staff in the process to embed thinking across organisation. ■ Ensure sign-off and endorsement by board and C-level staff ■ Communicate across organisation to normalise process and create culture around it ■ Ensure documents are readily accessible by all staff
5. Perform risk assessment	■ Ongoing assessment of risks that might impact data quality for ESG reporting ■ Make whistle blower functions available ■ Segregate duties for approval of ESG reporting to mitigate fraud risks
6. Implement control activities to ensure data accuracy, validity and completeness	■ Implement a tracking system and/or record-keeping for ESG data ■ Compliance officers, internal controls specialist or similar functions can help to implement control activities ■ Document sources of information for ESG information ■ Enlist the help of automated checks and validation to help identify risks of inaccuracy in information
7. Inform and communicate about the process internally	■ Inform employees the on findings from the ESG reporting process in a timely way
8. Implement monitoring activities	■ Perform ongoing monitoring to ensure that control activities are functioning as intended. ■ Detect and correct errors in the control activities through regular management and supervisory activities that are built into routine operations ■ This step may include internal audit or external assurance activities

4 The three lines of defence model can serve as a guide to understand the separation of responsibilities for control activities within the organisation. To read more: COSO (2015:1) Leveraging COSO Across the Three Lines of Defence. https://www.coso.org/Documents/COSO-2015-3LOD.pdf

AT A GLANCE

- **Prerequisite:** support from the highest governing body – top-level demand for good quality ESG reporting, clearly outlined responsibilities within the organisation
- **Benefits:** creates internal confidence over ESG information, mitigates risks and ensures roles and responsibilities within an organisation work as intended
- **Challenges:** customising the system of internal control to fit your organisational structure; general lack of maturity in internal controls over ESG reporting processes(2018, IAASB)
- **Applicable framework:** COSO framework
- **Frequency:** ongoing
- **Next step:** internal audit of the control environment

DEFINITION: INTERNAL CONTROL

Internal control is defined by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) as "...a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance".

Systems of internal control generally aim to ensure that the agreed upon strategy, roles and responsibilities in an organisation work as intended and mitigate risks[5]. Having internal control systems in place helps organisations achieve their objectives more efficiently and are a necessary building block for more advanced CBMs such as internal audit and external third-party assurance. As with the UNGC recommendations on corporate ESG reporting[6], the PRI recommends that investors and service establish and strengthen their systems of internal control related to their responsible investment processes before seeking more advanced CBMs. In fact, an inadequate internal control environment runs the risk of adding to the workload of the external assurance provider and may result in increased fees as well as an "unfavourable assurance conclusion"[7]. An organisation's confidence in its reporting, including ESG information, is a direct result of the quality of its internal control environment.

The PRI recognises this is a key area of focus for PRI signatories as the International Internal Audit Standards Board (IIASB) has identified there is a general lack of internal controls over emerging forms of reporting processes, such as ESG reporting processes[8]. In the absence of guidance on internal controls over ESG information specific to the investment industry, the WBCSD internal control framework for non-financial reporting can serve as a helpful guide for PRI signatories that wish to improve their internal control systems for preparing their PRI reports.

The WBCSD framework is based on five components of the 2013 COSO Internal Control-Integrated Framework:

- control environment;
- risk assessment;
- control activities;
- information and communication;
- monitoring activities.

The five components have 17 underlying principles that explain in more detail how they can be implemented. Signatories could implement these components and principles to achieve two overarching benefits:

- It can help signatories develop robust internal controls for ESG reporting, to achieve higher internal and external confidence in their PRI reports.
- It can improve internal reporting so that the signatory has higher quality information to make investment decisions and better understand what their RI approach should be.

5 COSO (2014:2) Improving Organisational Performance and Governance. https://www.coso.org/Documents/2014-2-10-COSO-Thought-Paper.pdf

6 https://www.unglobalcompact.org/docs/communication_on_progress/Tools_and_Publications/Your_Path_to_External_Assessment.pdf

7 WBCSD (2016:13) Generating Value from External Assurance of Sustainability Reporting. http://wbcsdpublications.org/wp-content/uploads/2016/03/WBCSD_Redefining_assurance_guide.pdf

8 http://www.ifac.org/system/files/publications/files/IAASB-EER-Project-Proposal.pdf

THE CONTROL ENVIRONMENT

The control environment is dependent on the senior leadership and management setting the tone and communicating values about the relevance of ESG reporting for long-term strategic decision making. While financial reporting might be subjected to regulatory requirements (such as mandatory internal audit and external third-party assurance) for the production of accurate data, ESG reporting will often rely more on the control environment, ethical values and the culture of an organisation.

Practical measures include, but are not limited to:

- Clarifying and formalising the commitment towards ESG reporting in guidelines and policies.
- Ensuring internal transparency about the reporting process to create internal user trust.
- Clearly documenting the organisational structure and reporting lines for ESG reporting, including targets/action plans and incentives/rewards for how reporting should be conducted for the relevant organisational departments[9].

RISK ASSESSMENT

An organisation's regular risk assessment should include an assessment of risks or opportunities that might impact the data quality for ESG reporting.

Practical measures include but are not limited to:

- ongoing risk and quality assessment processes;
- whistle blower functions;
- a segregation of duties for approval of ESG reporting to mitigate fraud risks related to ESG reporting[10].

CONTROL ACTIVITIES

Control activities support risk management, and their type and application will vary according to organisation[11]. Risk and control functions, such as compliance officers, internal control specialists and other control/risk functions for ensuring quality of data will play an important part in enhancing the control environment and lowering risks[12]. Internal verification or review of ESG data by senior staff, the board or a particular department can also apply. Practical measures include, but are not limited to:

- defined and documented data collection processes;
- tracking systems and record keeping;
- documentation of sources of information for ESG data;
- automated checks, validation and secure access to data bases.

The above measures should be automated where practical.

It should be clearly defined how these activities add value to the ESG information with respect to data accuracy, validity and completeness[13]. If senior staff, the board or a particular department reviews the ESG information produced for a report, it is particularly important to consider whether this individual or group is/are independent of the ESG data collection process.

INFORMATION AND COMMUNICATION

The reporting process should facilitate the identification of relevant and reliable information and its timely, accurate communication. The first step is to decide what type of ESG information is material and a priority for the organisation to report on, and how this ties in with the board objectives on ESG reporting[14]. This should take into account what external stakeholders, such as the PRI, treat as material, the approach of which is based on the questions asked in the Reporting Framework and described in subsequent sections.

9 Herz, Monterio & Thomson (2017:21f) Leveraging the COSO Internal Control – Integrated Framework to Improve Confidence in Sustainability Performance Data

10 WBCSD Future Leaders Team (2013:8) Controlling Non-Financial Reporting. http://wbcsdservers.org/wbcsdpublications/cd_files/datas/capacity_building/flt/pdf/FLT_NonFinancial.pdf

11 WBCSD Future Leaders Team (2013:9) Controlling Non-Financial Reporting

12 IIA (2013:1) IIA Position Paper: The three lines of defence in effective risk management and control

13 WBCSD Future Leaders Team (2013:8) Controlling Non-Financial Reporting. http://wbcsdservers.org/wbcsdpublications/cd_files/datas/capacity_building/flt/pdf/FLT_NonFinancial.pdf

14 Herz, Monterio & Thomson (2017:39) Leveraging the COSO Internal Control – Integrated Framework to Improve Confidence in Sustainability Performance Data

MONITORING ACTIVITIES

Monitoring activities ensure that control activities are functioning as intended.

Practical measures include, but are not limited to:

- Basic and ongoing monitoring activities through regular management and supervisory activities that are built into routine operations.
- Self-assessments of the organisation's internal controls that will also identify opportunities for improvement[15].

While doing this, organisations should be vigilant of potential deficiencies in the control system and communicate those to individuals responsible for ESG reporting and to management, so that this can be incorporated into improvement action plans. These monitoring activities may include separate evaluations such as internal audit and/or external third-party assurance, which will be addressed below.

The five components of the COSO and WBCSD framework present a strong case for internal controls and how it helps organisations meet their objectives and enhance the credibility and quality of information for ESG reports. While an emerging concept, applying effective internal controls to the collection of ESG information is increasingly being picked up on the agenda of various reporting frameworks and standards bodies such as GRI, IIRC, IFAC and IAASB (see, for example, below[16] [17]).

THE THREE LINES OF DEFENCE – ALLOCATING RESPONSIBILITIES FOR INTERNAL CONTROLS

AT A GLANCE

- **Prerequisite:** support from the highest governing body – top-level demand for good-quality ESG reporting
- **Benefits:** clearly outlined responsibilities and roles that will contribute to the organisation efficiently reaching its objectives and identifying risks in the reporting process as well as the overall organisational activities
- **Challenges:** ensuring the three lines of defence are separated, especially the independent audit-function (this could be outsourced, see next section)
- **Applicable standard/ framework:** the three lines of defence model – IIA & COSO
- **Next step:** internal audit

The previous section identified the internal control measures that can substantially mitigate risks in achieving organisational objectives, and that can make a positive difference in reporting accurate and trustworthy ESG information in external reports. Underpinning the effective management of risk and control is the need for separation of responsibilities.

The Three Lines of Defence model (the model) serves as a guide to identify those roles[18]. The model is widely used by organisations of different sizes across the globe and enables groups to understand what their role is in addressing risk and control, and also how they might organise their work to eliminate gaps. The model[19] identifies three roles and the overall process should be under the oversight of the board, trustees or senior management[20] (Figure 3).

15 WBCSD Future Leaders Team (2013:13) Controlling Non-Financial Reporting. http://wbcsdservers.org/wbcsdpublications/cd_files/datas/capacity_building/flt/pdf/FLT_NonFinancial.pdf

16 PRI response to the consultation on Emerging forms of external reporting https://www.ifac.org/publications-resources/iaasb-project-proposal-emerging-forms-external-reporting

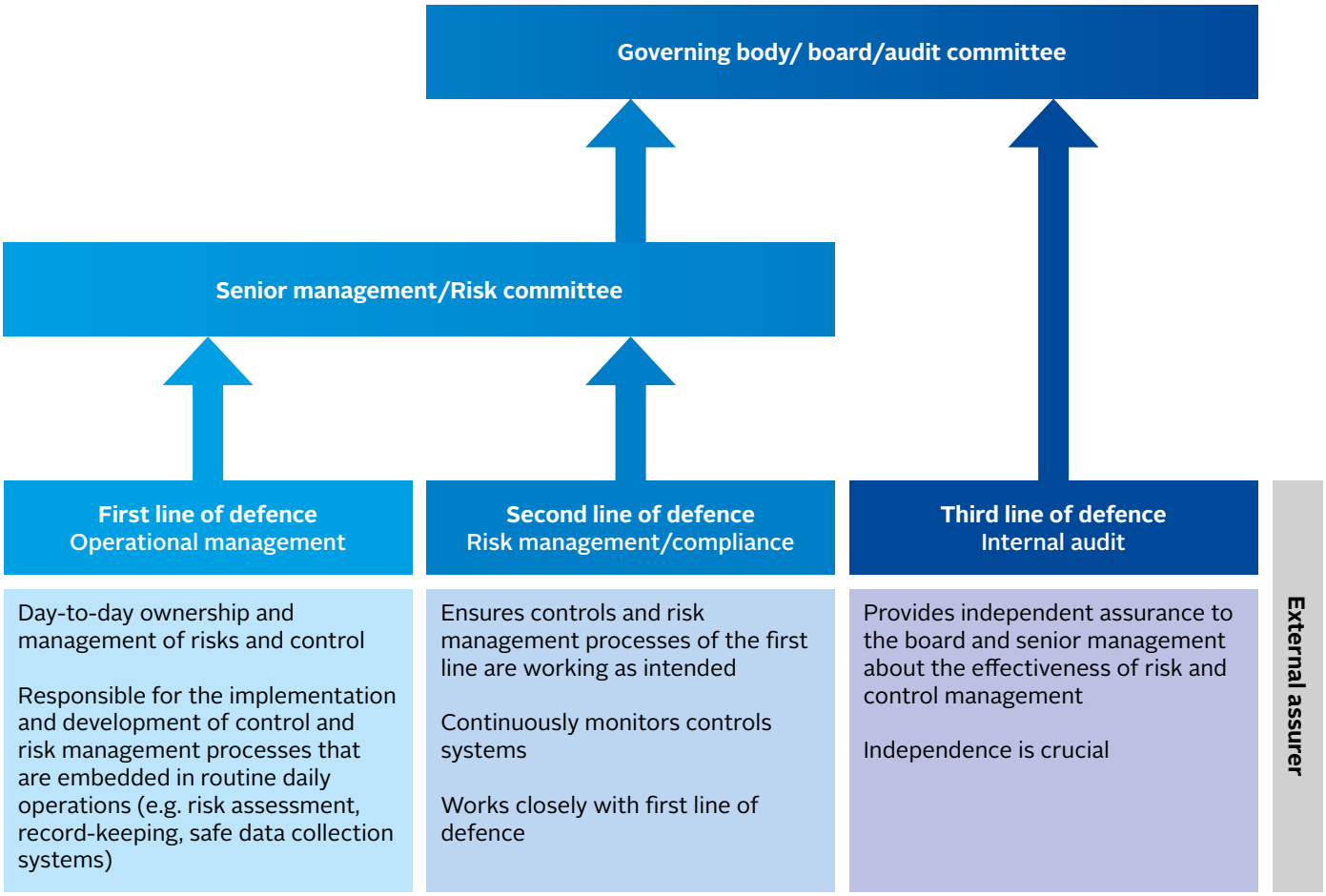
17 PRI response to IFRS consideration of broadening guidance on management http://www.ifrs.org/projects/work-plan/management-commentary/

18 COSO (2015:1) Leveraging COSO Across the Three Lines of Defence. https://www.coso.org/Documents/COSO-2015-3LOD.pdf

19 COSO (2015) Leveraging COSO Across the Three Lines of Defence. https://www.coso.org/Documents/COSO-2015-3LOD.pdf

20 The IIA is a UK body. Recommendations on the separation of responsibilities as outlined by the three lines of defence might vary between different jurisdictions.

Figure 3. The three lines of defence model.



IN PRACTICE: LARGE SIGNATORY WITH INTERNALLY MANAGED ASSETS

Line 1 – portfolio managers
Line 2 – compliance team
Line 3 – internal audit function

IN PRACTICE: SMALL SIGNATORY WITH EXTERNALLY MANAGED ASSETS

Line 1 & 2 – external portfolio managers/fiduciary manager, investment manager
Line 3 – internal audit function or contracted internal auditor for minimum three years but no more than six years
Senior management should be informed of the risk of lines overlapping and this should be communicated in any documentation on internal controls to external stakeholders

ASSESSMENT OF INTERNAL CONTROLS

INTERNAL REVIEW OF RESPONSES

Internal review or verification is often considered a pre-requisite for an internal audit. It is one of the control activities signatories can implement as part of their system of internal controls. The activities include sign-off by board or C-level staff, and review by a compliance (or equivalent) team and any other departments responsible for the implementation of the RI strategy and processes

AT A GLANCE

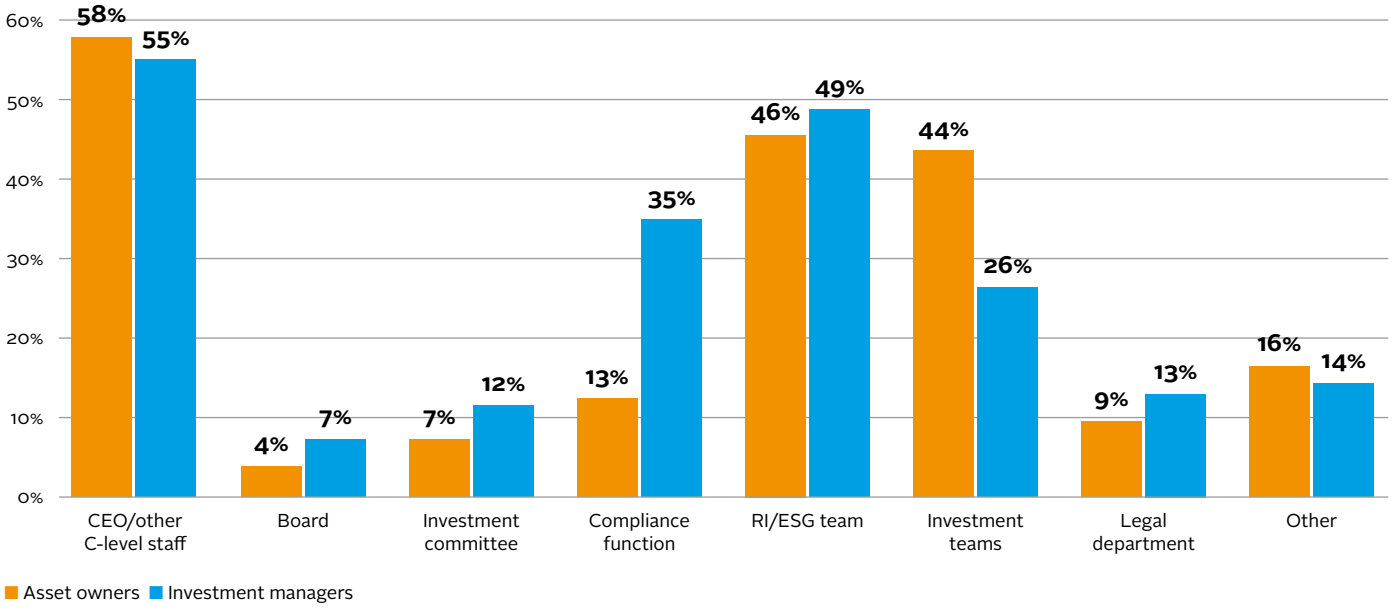
- **Prerequisite:** good governance for clear segregation of roles
- **Scope:** all responses. Review of process based information should be limited to the accurate description of those processes rather than their implementation.
- **Who can review:** internal staff with subject matter expertise that are independent from collation process. Senior management oversight is key.
- **Benefits:** relatively quick, minimal cost to the company.
- **Challenges:** the confidence depends greatly on having clear governance and review being impartial. This may be difficult in small organisations which are less likely to have the three lines of defence.
- **Applicable standards:** not applicable
- **Frequency:** yearly
- **Next step:** internal audit of RI processes and external data assurance

FINDINGS: INTERNAL REVIEW AMONG SIGNATORIES

Internal verification by senior staff, the board, a particular department or a working group of ESG information before the submission of a signatory's report to the PRI is the most basic common type of CBM implemented. 71% of signatories out of 1,248 that reported, use this form of control activity; 63% conduct it for their whole report. It typically involves two-three teams, the most common one being CEO/C-level staff (54%), followed by the RI/ESG (48%) and investment teams (30%). However, compliance teams were involved less than expected in these processes. For instance, 11% of asset owners reported that their compliance team reviews their PRI report. This could be because many asset owner signatories do not have compliance teams.

While internal verification is widely used among signatories, as a standalone practice it is not equipped to give robust confidence of ESG information to external stakeholders and because of the process heavy nature of the Reporting Framework, its confidence is limited to the description of the processes, rather than the implementation of those processes. However, in combination with other components of the internal control system, this practice is much more meaningful.

Figure 4. Responses from 158 asset owners and 634 investment managers who reported that they conducted internal verification of their whole Transparency Reports.



INTERNAL AUDIT OF INTERNAL CONTROLS

Key steps	Example of actions
1. Consider the value add	▪ Outline the value add of internal audit for your organisation ▪ Ensure that the board or other form of highest governing body endorse the audit function
2. Develop an internal audit plan	▪ Outline what should be audited, how key issues, business units, such as the first and second line of defence, and/or outputs should be prioritised (this is usually covered in the internal audit charter that is approved by the audit committee) ▪ Audit aspects of the review process conducted by the first and second line of defence ▪ Ensure the audit function understands how success is measured in your organisation ▪ Ensure the audit function is independent of the rest of the organisation
3. Execute the internal audit activity	▪ Communicate the audit progress across the organisation and the benefits of it ▪ Involve relevant teams
4. Communication	▪ Ensure that the culture of accountability and integrity is maintained by communicating the outcome of the audit activity and ensuring relevant teams are involved to help potential additional control measures

AT A GLANCE

- **Prerequisite:** system of internal controls established
- **Governance needed:** internal audit function or contracted internal auditor
- **Scope:** limited to most important processes based on asset class, asset allocation in that class, management style (internal or external), organisation type (service organisation such as investment managers or user entity as asset owner), and ESG investment strategies (e.g. screening if they only do screening).
- **Benefits:** helps an organisation achieve its objectives. Provides an objective perspective of the organisation's activities, identifies risks and opportunities for improvement.
- **Challenges:** time and financial resources. Difficult to communicate outcome externally as auditors' reports are mainly for internal management.
- **Example of standards:** ISAE 3402/SSAE 18/ AF01/06 depending on country or IIA's international standards
- **Frequency:** ongoing as audit team conducts deep dives on a group of processes at any one given time. However, each control is reviewed every three-five years.

The internal audit should be conducted by the internal audit function (the third line of defence), and forms one of the monitoring activities organisations perform as part of their internal controls system. One of the most important benefits of internal audit is that it helps an organisation – whether small or big[21] – achieve its objectives "by bringing a systematic and disciplined approach to evaluating and improving the effectiveness of governance, risk management, and control processes"[22]. In this respect, internal audit can, for example, benefit signatories in their ESG reporting process by:

- Helping the board or senior management to self-assess governance practices (e.g. whether there are clear responsibilities allocated for ESG reporting).
- Identifying deficiencies and providing advice on how to improve undeveloped governance practices.
- Observing and assessing risks, control design and operational effectiveness.
- Providing an early warning system for undesirable practices that the organisation can manage before they become too severe.

21 IIA (2013:5) IIA Position Paper: The three lines of defence in effective risk management and control

22 IPPF (2012:2) Assessing Organizational Governance in the Private Sector

DEFINITION: INTERNAL AUDIT

The Chartered Institute of Internal Auditors (IIA) define internal audit as: "...an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."

Having a robust internal audit function is considered a foundation to any external audit or assurance engagement. The UNGC specifies in its guidance that members aiming for their Communication of Progress (COP) to meet the GC Advanced level, should undergo an internal audit[23].

Apart from already having an internal controls system in place, organisations should also consider the business case for the internal audit activity. It will substantially help if the board or another highest governing body already have created a top-level demand for it, and will then also help secure resources for the audit.

Other key steps include developing an internal audit programme that outlines what the organisation will audit, how they will prioritise key issues, business units or outputs. The auditors should also have a clear idea of how the organisation measures success and other criteria so that this can be used during the audit activity.

The frequency of auditing internal control systems for the collection and reporting of ESG information should be decided by each individual organisation according to their capacity and resources. While internal audits are ongoing, the AWG found that an individual process should be reviewed every three-five years, with more frequent audits applying to processes of either highest importance, complexity or degree of change.

Sharing auditing outcomes across the organisation is a crucial step. With that information, the teams where areas of improvement have been identified can develop additional control measures to ensure the processes will work as intended. During the auditing process, it is also important to inform relevant teams of the audit and how it will benefit the organisation.

FINDINGS: INTERNAL PROCESS AUDIT AMONG SIGNATORIES

Internal audit of controls related to RI processes appears to be rare among PRI signatories. Just 4% of 1,248 signatories reported in their 2017 report that they conducted an internal audit or a third-party assurance of their internal controls specific to RI processes. This could be attributed to the lack of RI-specific standards of internal controls. However, the AWG expected this figure to be higher, as a vast majority of signatories' reports had been reviewed by a CEO. It would be expected that a sign-off at that level would be supported by an internal audit function.

The responses from those 47 signatories revealed which RI processes are most often reviewed. These were focused on the overarching RI strategy, RI governance roles and responsibilities, active ownership practices in listed equity (voting and engagement), as well as some aspects of ESG integration such as exclusion lists as part of screening.

IN PRACTICE: ALTERNATIVES TO AUDIT FUNCTION FOR SMALL ORGANISATIONS

In some smaller and less complex organisations, the responsibilities of the first and second line of defence might be combined. For the third line of defence, small organisations without the resources to employ a fully independent internal auditor can outsource part of, or the whole, audit function for a limited amount of days per year. The AWG also highlighted that some organisations can make use of internal verification and review functions. In such cases, the board, trustees and/or senior management should take extra precautions in assessing the risks of this structure and how it might affect the quality of internal control risk assessment and ultimately the organisation's ability to efficiently achieve its reporting objectives. While not the equivalent to an independent internal audit function, it can provide a solution for particularly resource constrained organisations.

26 https://www.unglobalcompact.org/docs/communication_on_progress/GC_Advanced_COP_selfassessment.pdf

EXTERNAL ASSURANCE

Obtaining third-party assurance over financial disclosures is common practice among investors, as it is a regulatory requirement in most markets. It is also used by service organisations to demonstrate to their clients the implementation of operational risk controls over outsourced financial services. For PRI signatories, external assurance of ESG information provides the highest form of confidence that the reported information is reliable and relevant. As such, signatories would obtain third-party assurance over their RI processes/ESG information to provide stakeholders, e.g. plan beneficiaries, with credible information, demonstrate leadership and differentiate themselves from their peers. In addition, investment managers and fund of funds would obtain third-party assurance to provide their clients with the confidence that submitted information can be used to make decisions, for example, as part of requests for proposals or due diligence questionnaires.

KEY COMPONENTS

In a standard definition, assurance should:

- be conducted by someone not involved in preparing the subject matter;
- have pre-defined criteria to evaluate the subject matter against;
- use an appropriate standard;
- result in a written conclusion, stating a level of confidence that the intended audience can have in the data or process.

LIMITED VS REASONABLE LEVEL OF ASSURANCE

External assurance can be provided at either a reasonable or limited level. A reasonable level would provide a higher level of comfort over the reliability of the information, similar to a financial statement audit. This aims to result in a positive opinion that the information in the report is correct. A limited level of assurance engagement[24], which is less detailed, results in a negative statement by the assurance provider and could be adequate for the yearly assurance of ESG data-based information.

Although reasonable assurance is more resource intensive, it would allow for the review of the internal controls for which the assurer can then provide the following positive statement: "the processes are effective at meeting the desired outcome". Finally, signatories can benefit from best practices external assurers can provide as identified from their line of work with many other clients.

DATA VS PROCESS ASSURANCE

The PRI Reporting Framework consists of data and process-based questions. Data questions are specific to the reporting year, while processes will typically remain the same for several years. In the following sections, third-party independent assurance is split into data assurance and process assurance. As per the PRI's 2016 paper on assurance, the relevance of process assurance should be substantiated by relating it to specific PRI framework indicators, as well as clearly defining "outcomes of the assurance as well as changes that have been implemented or will be implemented as a result". Both can be conducted to either a limited or reasonable degree.

As with internal audit, external assurance of data-based information should be differentiated from process-based information. This is because process-based information plays a more important role thanks to their dominance among the indicators and the purpose of the Reporting Framework in evaluating signatories based on their processes.

Assurers asked by clients to assure their data and/or processes reported in their Transparency Report should use the definitions, examples and, where provided, criteria from the explanatory notes in the Reporting Framework when evaluating their clients' responses. As the Reporting Framework does not form an RI standard, however, the explanatory notes for some indicators may not provide detailed criteria leaving some room for subjective interpretation by auditors. As and when RI standards evolve, these can facilitate the assurance process further.

LEGALLY REQUIRED EXTERNAL ASSURANCE

Some markets have regulatory requirements on non-financial data reporting (e.g. South Africa) and/or operational risk controls auditing of financial service firms. Future developments of current voluntary regulations and expansion of mandatory regulations are expected and could make this more relevant in the future. Signatories are encouraged to check what applies in their country through the PRI regulatory database for further information.

24 Result in a negative form of opinion, such as "nothing has come to our attention that causes us to believe that internal control is not effective, in all material respects, based on XYZ criteria".

Key steps	Example of actions
1. Consider the value add	■ Outline the value add of external assurance for your organisation ■ Ensure that the board or other form of highest governing body endorse the assurance engagement ■ Internal audit function will require this every five years as part of IIA's international standards used to provide assurance of internal controls
2. Develop an external assurance plan	■ Outline the period and milestones of the assurance engagement ■ Outline assurance criteria which forms the basis of the scope to be undertaken by the assurer (key items, boundaries, definitions, references etc.)
3. Select an external assurer provider	■ Engage assurers through a competitive procurement process ■ Ensure proper industry qualifications and experience relevant to your report
4. The provider executes the assurance engagement	■ Establish regular meetings with the assurance provider to monitor progress against project timeline and budget
5. Communication	■ Discuss the assurance conclusion with your provider – go through feedback to identify future improvements ■ Communicate the outcome of the assurance engagement across the organisation and other stakeholders ■ Develop plan on how to make improvements in the organisation based on the risks found in the assurance outcome

EXTERNAL ASSURANCE OF RESPONSES TO ESG REPORTS

AT A GLANCE

- **Prerequisite:** internal verification of responses to PRI report
- **Scope:** data-based indicators that are key to the organisation, prioritised by the PRI and/or reported to other users such as a regulator. Such information can be assured against PRI criteria as defined in explanatory notes of the Reporting Framework or, if applicable, as per regulatory requirements
- **Benefits:** can provide comfort that processes and policies described exist, as well as confirming simpler type of information such as existence of policy documents, disclosure of policies, percentage of votes that were co-filed on a resolution
- **Limitations:** only provides assurance that information reported is correct, not that the investor is responsible
- **Assurance level:** limited level at first which gradually increases to reasonable assurance for most significant items.
- **Applicable assurance standards:** ISAE 3000, AA1000 AS
- **Frequency:**
  - **yearly:** for data that affect whether a signatory will trigger some other indicators
  - **two-three years:** e.g. policies, disclosure of policies and results of engagements

A detailed review of existing non-financial assurance standards is covered by the Audit and Assurance Faculty in 2008[25]. This expands on different type of non-financial reports such as what is found in annual reports or corporate responsibility reports. Assurance standards specific to investors' RI reports fell within the "other types of reports" and focused on ISAE 3000. Another applicable assurance standard of ESG reporting is the Accountability AA 1000 assurance standard.

25 https://www.icaew.com/-/media/corporate/files/technical/audit-and-assurance/assurance/assurance-on-non-financial-information.ashx?la=en

As metrics-based information is specific to the reporting year, assurance of some of the data would be yearly. The data capturing system would also be audited at an interval of every three-five years or as and when there are significant changes to the standard or the system itself.

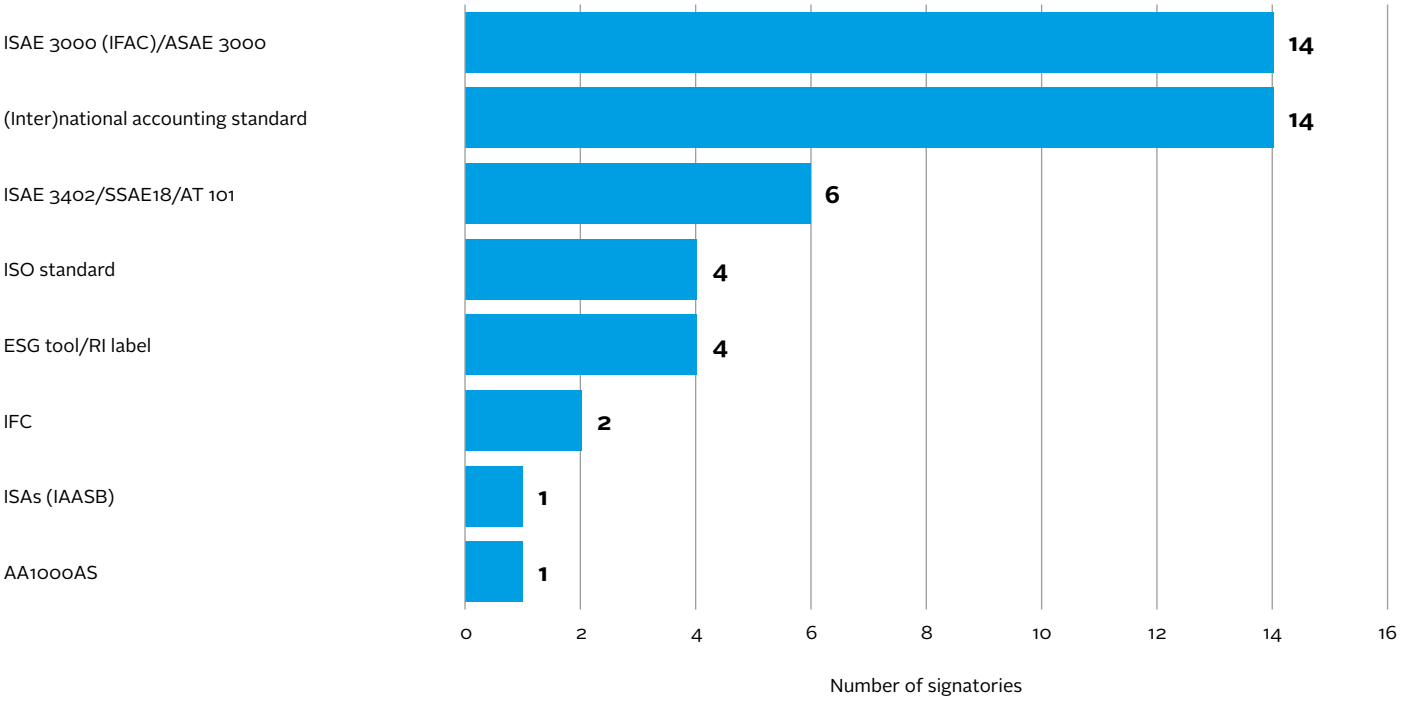
REPORTING AND MANAGEMENT STANDARDS

While assurers use assurance standards to conduct a third-party independent assurance, signatories can facilitate this process by using ESG reporting standards to produce their ESG reports, and relevant management standards that cover their RI processes. The table below provides ESG reporting and management standards that may be of interest to signatories.

Table 1. Examples of reporting and management standards for ESG information.

Standard type	Type of information covered	Examples of standards
Reporting	Sustainability	International Financial corporation (IFC), global investment performance standards (GIPS, the SRI composite option)
	Environmental	ASAE 3410 (climate specific), Forestry Stewardship Council (forestry assets), CDP
Management	Quality	ISO 9001
	Environmental	ISO 14001 (for infrastructure and property assets)

Figure 5. Standards used for third party assurance of Transparency Reports.

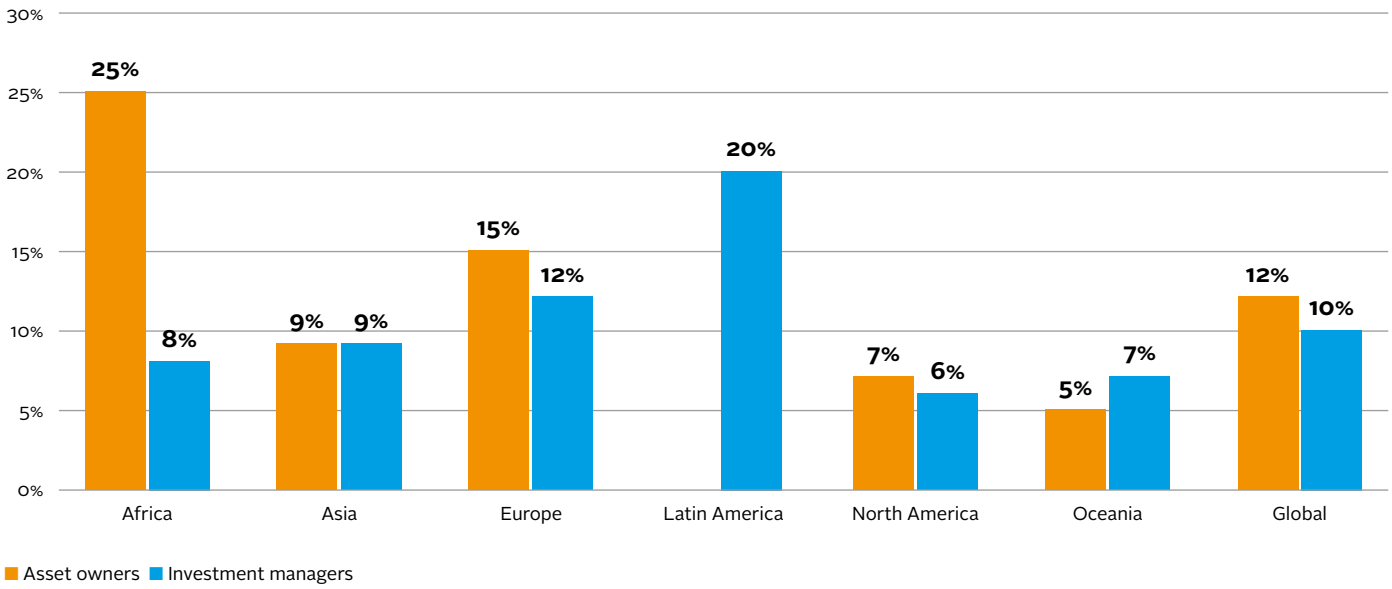


FINDINGS: EXTERNAL ASSURANCE AMONG SIGNATORIES

11% of signatories reported that they conducted third-party assurance or internal audit of their 2016 and/or 2017 Transparency Report, or would do so for their 2017 responses. In most cases this applied to selected responses rather than the whole report. To a degree, this is expected as PRI reports include financial data, which are assured in most countries as part of regulation to publish annual accounts. Signatories assured at different levels (limited and reasonable) and used a variety of standards, with ISAE 3000 being the most widely-used non-financial one.

Variations in uptake of this practice due to the different organisation sizes were small Among both asset owners and investment managers, this ranged from 6% to 15%, with the highest uptake observed among the largest ones. Regional variations were more notable. European and African asset owners were more likely to report doing so (15% and 25% respectively) than Oceanian and Latin American ones (<5%). Among managers, this ranged from 12% for Europeans to 6% and 7% for American and Oceanian ones respectively. Uptake among Latin American managers was particularly high (20%). This could be driven by increased scrutiny from clients due to lower level of trusts. Alternatively, it could reflect the advanced practices of the small number of PRI signatories in that region compared to the more diverse base in Europe and North America.

Figure 6. Third party assurance among PRI signatories.



PRIORITISED INDICATORS FOR THIRD PARTY ASSURANCE

Below, the PRI has identified the most important data-based indicators from the 2018 Reporting Framework[26] that signatories who seek external assurance should focus on. They include metrics-based ones that change on a yearly basis, and descriptive ones that provide details on a signatory's strategy and approach to RI. The AWG recommends the frequency of assurance should generally reflect how frequently the information changes. As such, descriptive indicators can be assured every two-three years instead of every year.

26 To find the corresponding indicators of Reporting Frameworks post 2018, refer to our "changes" excel file available here

ORGANISATIONAL OVERVIEW:

- asset volume (OO 4.2)
- asset class allocation (OO 5.1, 5.2, 7.1, 7.2)
- breakdown of externally managed assets in segregated mandates and pooled funds (OO 8.1)
- implementation of active ownership activities in listed assets (OO 10.1)
- implementation of ESG incorporation activities in all assets (OO 11.1 and OO 11.2)
- breakdown of listed assets in active and passive investments (OO LEI 1.1, OO FI 1.1, OO SAM 1.1)
- asset-class characteristics (e.g. OO PR 1.1, OO PE 1.1)

STRATEGY AND GOVERNANCE:

- existence of RI approach/policy and if publicly available (SG 1.1, 2.1 and 2.3)
- disclosure of asset class specific RI information to clients and public (SG 19.1)
- objective setting (SG 5.1, 5.2, 6.1)
- ESG trends inclusion in scenario analysis (SG 13.1)
- asset allocation to environmental and social themed areas (SG 15.2, 15.3)

ESG INCORPORATION & ACTIVE OWNERSHIP OF LISTED AND NON-LISTED ASSETS:

- AUM covered by different ESG incorporation strategies (FI 1.1, LEI 1.1, PE 1.1, PR 2.1, INF 2.1)
- ESG incorporation in passively managed listed equities (LEI 11.2)
- policies for each ESG incorporation strategy per specific asset
- engagement policy and data (LEA: 1.1, 11.1)
- voting policy and data (LEA 15.1, LEA 21.1, 23.1-23.4, SAM 7.1)

ESG PORTFOLIO CHARACTERISTICS OF LISTED AND NON-LISTED ASSETS:

- thematic bonds (FI 8.1)
- private equity assets (PE 2.1, 3.1, 3.2, 5.1, 6.1, 8.1. 8.2, 9.1, 9.2, 13.1, 16.1,17.1)
- property assets (PR 9.1, 10.1, 11.1, 12.1, 13.1)
- infrastructure assets (e.g. INF 3.1, 8.1, 10.1, 12.1, 15.1, 16.1)

FINDINGS: DATA ASSURED AMONG SIGNATORIES

Signatories most commonly assure the following type of data:

- **Organisational overview:** most of it, e.g. all financial data (assets under management) and other operational data (e.g. staff numbers)
- **Strategy and governance:** most of it e.g. policy and governance processes
- **Active ownership:** engagement and voting figures and policies.
- **Incorporation strategies:** processes and for screening exclusion list
- **Externally-managed assets:** appointment, monitoring

EXTERNAL ASSURANCE OF CONTROLS RELATED TO ESG PROCESSES

AT A GLANCE

- **Prerequisite:** system of internal controls established and audited by internal audit function
- **Scope:** RI specific processes should be assured at high/reasonable level when conducted for providing confidence to external stakeholders such as the PRI, limited level acceptable for internal purpose
- **Benefits:** highest form of impartial assurance, guidance on best practices
- **Challenges:** time and financial resources, limited to very specific processes
- **Frequency:** every two-three years for ESG processes considered the most material based on internal audit function own's risk assessment and PRI recommendations.
- **Examples of standards:** ISAE 3402/SSAE 18/ AF01/06 (country dependent)

STANDARDS AVAILABLE

There are a limited number of assurance standards for the review of ESG processes. Most of the standards reported are used for assuring either financial or non-financial data which investors would include either in the PRI reports, annual report or other sustainability reports (e.g. SASB or GRI report). At the time of writing, the most widely used standard applicable to ESG processes is ISAE 3402 (which overlaps with SSAE 18) for service organisations. Asset owners can request this from their managers or service providers as shown in Figure 6.

Other theme-specific assurance standards are starting to emerge, such as ISAE 3410 on climate change. Along with developments in assurance standards, progress in responsible investment management standards adapted from ISO 9001 can help signatories structure their RI processes as part of their core management systems and facilitate third-party independent assurance.

In 2019, the IIASB is also planning to release a guide for assurers on applying the ISAE 3000 standard, mentioned in the previous section as the main standard applicable for data-based information. This guide will address key challenges, including some particularly pertinent to the PRI Transparency Report:

- assertion of subject matter information;
- assurance of qualitative information;
- evaluation the maturing of controls and reporting systems;
- competence expected of accountants.

Table 2. Examples of assurance standards relevant to RI processes.

Assurance standard type	Examples of standards
Internal controls of service organisations	ISAE 3402, SSAE 18, AT 101, AAF 01/06 (ICAEW), IIA's international standards and IPPF*
Climate specific	ISAE 3410 or national equivalent (assurance engagements on greenhouse gas statements)

*The IIA's international standards used by the internal audit function mandates that the internal audit function mandates that the internal controls are subjected once every five years to an external audit

FINDINGS: ASSURANCE STANDARDS USED AMONG SIGNATORIES

Among the wide range of standards listed by signatories, ISAE 3000 was the most common one specific to non-financial information. (Inter)national accounting standards were common too as they are used to assure annual reports. Few reported assurance standards specific to internal controls for service organisations. Many signatories understood this question to refer to management standards such as ISO 14001 and ISO 9001 against which they had received certification.

PRIORITISED PROCESS-BASED INDICATORS FOR INTERNAL AUDIT/EXTERNAL ASSURANCE

As a good practice, the AWG recommends that signatories should assure RI processes every three-five years or sooner if these have changed to demonstrate that these are implemented as described. However, the AWG recognises that it is not practical or effective to assure all processes. Instead, the AWG recommends that signatories start with fundamental processes the PRI identifies as the most important to provide confidence that the signatory implements the Principles along with the processes most material to the signatory. In many ways, this should mirror the logical structure of the Reporting Framework. This is split into modules pertinent to all signatories (organisational overview, strategy and governance) and modules that are driven by asset allocation, management style and ESG incorporation/active ownership practices. The PRI has identified key processes and their corresponding indicators for internal audit/external assurance in the tables below.

These are grouped into:

- overarching strategy and governance (applicable to all assets)
- active ownership processes in directly managed assets
- ESG incorporation in directly managed assets
- ESG processes in directly non-listed assets
- ESG processes for indirectly managed assets

Table 3. Prioritised strategy and governance processes for internal audit/external assurance of related internal controls and corresponding indicators.

Category	General or applies to all assets	Strategy and governance (SG)	Caveat - scope for assurance
Policy	RI policy and coverage	1.1	
Disclosure	Publicly available RI policy or guidance documents	2.1	
Fiduciary managers	RI factors in the monitoring of fiduciary managers	12.5	Review and implementation of process
Disclosure	Disclosure of ESG information specific to asset class activities to public and clients/beneficiaries	19.1	

Table 4. Prioritised active ownership processes for internal audit/external assurance of related internal controls for directly managed listed assets and corresponding indicators.
Note: direct management for listed equity reflects only the management for active ownership.

Category	Active ownership information	Listed equity active ownership (LEA)	Direct-Fixed Income (FI)	Caveat - scope for assurance
Engagement	Engagement policy	1.1	17.1	Process of creating and approving policy
	Objectives for engagement activities	04.1-4.4 06.1-6.4		Implementation process of objective setting
	Process for sharing engagement insights with internal/external managers	9.1	16.6	Implementation of formal process of sharing insights
	Number of companies engaged with, intensity of engagement and effort	11.1 11.2	(15.1)	Limitations for fixed income indicator – information must be as detailed as for listed equity indicator
(Proxy) voting	Voting policy	15.1		Process of creating and approving policy
	Shareholder resolutions	23.1		Process of (co-) filing resolutions

Table 5. Prioritised ESG incorporation processes for internal audit/external assurance of related internal controls for directly managed listed assets and corresponding module indicators.

Category	Description	Listed equity incorporation (LEI)	Fixed income (FI)	Caveat - scope for assurance
Screening	Types of screening applied	4.1	4.1	Process of updating screening applied and implementation of screening
	Processes to ensure fund criteria are not breached	6.1	7.1	
Thematic	Types of thematic funds/ mandates	7.1	8.1, 8.2	
	Actions taken when bond proceeds are not disbursed as described		9.2	Implementation of relevant policy or formal process, tracking system must be in place
	Processes to assess impact of thematic investments		10.1	Implementation of relevant policy or formal process
Integration	Processes to ensure integration analysis is robust	9.1	3.1	
	Aspects of analysis ESG information is integrated into	10.1	12.1	Evidence for fixed income indicator must mirror detail asked for listed equity indicator
Passive	ESG factors in index construction (passive investments)	11.2		

Table 6. Prioritised RI processes for internal audit/external assurance of related internal controls for directly managed non-listed assets and corresponding module indicators.

Category	Description	Private equity (PE)	Property (PR)	Infrastructure (INF)
Policy	Responsible property/ infrastructure or private equity policy	2.1	1.1	2.1
	Fund placements refer to RI policy	3.1	2.1	3.1
Investment selection	ESG issues impacted your PE/ PR/INF investment selection processes	8.1	6.1	9.1
Selection, appointment and monitoring of third-party managers /operators	ESG issues in your selection, appointment and/or monitoring of third-party PR/INF managers		7.1	10.1
Post-investment	ESG issues in post-investment activities		8.1	11.1
	Proportion of assets with ESG performance targets	9.1	9.1	12.1
	Proportion of property occupiers that were engaged with		12.1	16.1
Impact	ESG issues impact on financial/ ESG performance	18.1	15.1	17.1
Disclosure	Disclosure of ESG issues in pre-exit	13.1		

Table 7. Prioritised RI processes for internal audit/external assurance of related internal controls for indirectly managed assets and corresponding module indicators.

Category	Description	Selection, appointment and monitoring (SAM)	Caveats - scope of assurance
Manager selection	Evaluation of RI documents from managers as part of manager selection	2.1	Implementation of relevant policy or formal process containing that information
	Evaluation of alignment between manager approach to own strategy	2.2	
	Use of scores, weights and targets	2.4	Implementation of relevant policy or formal process
	Evaluation of manager engagement approach	3.2	
Manager appointment	Actions if ESG requirements of externally managed portfolios are not met	4.4	Implementation of relevant policy or formal process
Manager monitoring	RI information from managers typically reviewed	5.1	Implementation of relevant policy or formal process
	Measures to monitor compliance and progress of managers	5.2	
	Active ownership information from managers typically reviewed	6.1	Implementation of relevant policy or formal process
Impact	Measures taken to ensure managers follow best practices	8.1	Implementation of relevant policy or formal process

FINDINGS: PROCESSES ASSURED AMONG SIGNATORIES

Signatories who reported they conduct third-party assurance of their internal controls did so for the following RI processes:

- Strategy and governance: policies and main overarching RI processes
- Active ownership: voting policy and processes, engagement processes
- ESG incorporation strategies: screening processes (e.g. to prevent breaches)

IN PRACTICE: ASSURANCE OF RESPONSES AND CONTROLS RELATED TO RI PROCESSES

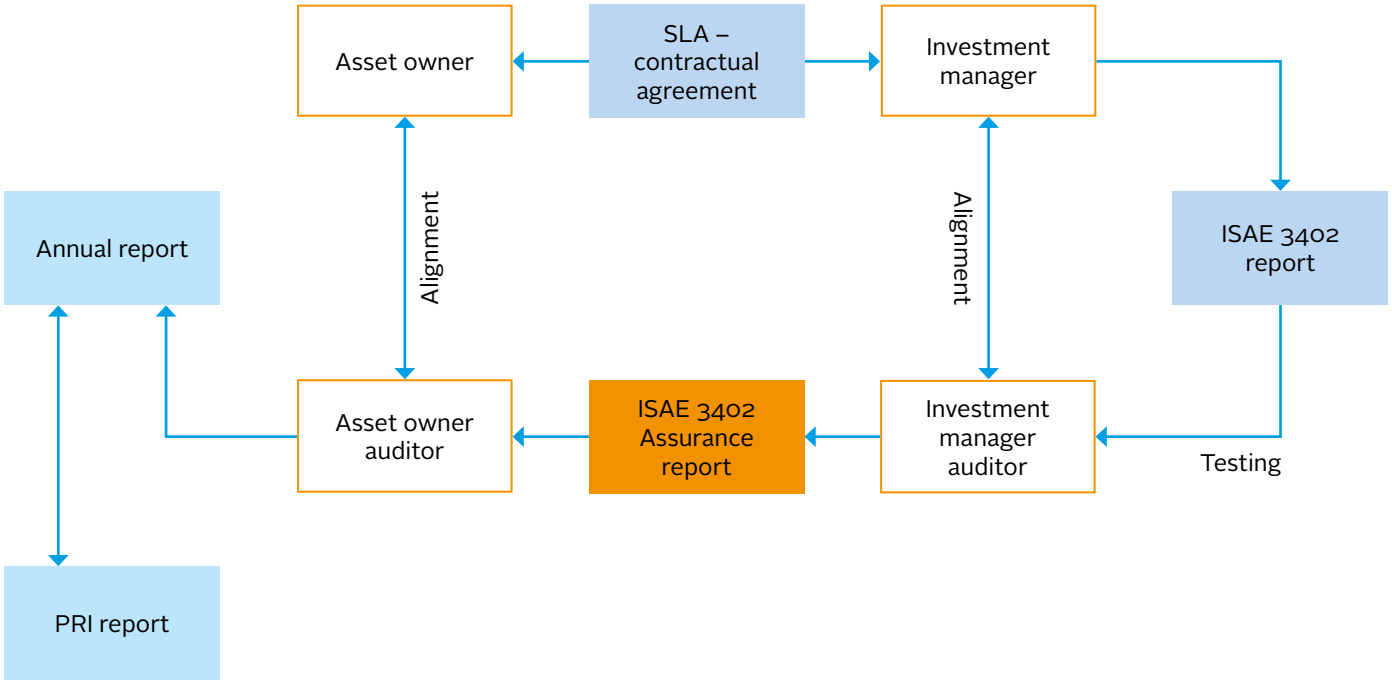
This signatory's answer to what data was assured by a third-party auditor highlights the steps involved in external assurance: 1) risk assessment by auditor based on relevant modules completed 2) sample testing of data with highest risks and 3) finally evaluation of the internal controls.

> "The auditor conducted a risk and materiality assessment on all mandatory indicators in modules Organisational Overview (OO), Strategy and Governance (SG), Indirect - Manager Selection, Appointment and Monitoring (SAM), Direct - Listed Equity Active Ownership (LEA) [...]. Based on this assessment, the auditor conducted a detailed sample testing of the underlying data for the indicators with the highest risks and the highest materiality. Furthermore, the auditor has evaluated the completeness and accuracy of the reported figures and assessed the routines and internal controls related to the reporting of data in the PRI report."

Signatory's response on third-party assurance of selected data in their 2017 Transparency Report

In the case of outsourced services such as is commonly the case for casting voting, investors can demonstrate that their internal controls are robust by seeking the appropriate level of assurance by their service providers as demonstrated in Figure 6.

Figure 7. Providing assurance of internal controls of an asset owner or manager through their manager's or service provider's ISAE 3402 assurance reports (adapted by E&Y 2013, Implementing and Maintaining ISAE 3402).



EVALUATION OF THE REPORTING FRAMEWORK AGAINST EXTERNAL ASSURANCE

The AWG conducted an exercise on how appropriate the Reporting Framework indicators are to a third-party external assurance process. The findings highlighted that this depended on:

- characteristics of assurance engagement (data or process assurance, market regulatory requirements)
- the type of indicator (data based, qualitative non-process based, process-based)
- the level of assurance sought (limited or reasonable)
- availability of an assurance standard

The Reporting Framework already provides explanatory notes for all indicators to reduce subjective interpretation of key RI terms and processes, and could enable assurers to provide statement of limited assurance, or where standards exist statement of limited assurance against a standard. Reasonable assurance, which would be sought if the scope was to review the implementation of controls, at this stage would depend on a degree of subjective interpretation by auditors.

Where the indicators' explanatory notes provide the following information, assurers could assure those indicators:

- examples of answers that are deemed acceptable to the question (sets criteria);
- examples of what it excludes/is out of scope (sets criteria);
- definition for qualitative terms used throughout: e.g. systematic vs occasional, "leading";
- reference to other detailed guidance either published by the PRI or other organisations with which the PRI seeks to align on reporting (e.g. GRESB for property, OECD on active ownership).

In addition, the AWG recommended:

- Clear definitions for key underlying concepts such as responsible investment and how ESG issues are defined (do they vary depending on companies invested in or are there universal minimum aspects that apply to all investors?)
- Once criteria are set for key concepts consistently referred to in the Reporting Framework, such as "RI policy", the subsequent questions should link to them instead of introducing terms such as "activities" that are harder to define.

While the PRI does not seek to become a standard, the PRI will seek to improve and align its definitions and work with standard providers to limit subjectivity in the assurance process. The AWG also agreed it was not necessary or advisable to modify all indicators because they are qualitative. Instead, the AWG recommends the identification of key indicators that should be assured because of the impact they carry. Secondly, the AWG highlighted that some indicators capture qualitative information that provides important insight into the culture, ethics and rigour of an organisation but are not designed to be assured.

ROADMAP FOR SIGNATORIES

There are several options for signatories to strengthen the confidence of their responses to the Reporting Framework as reviewed in the above sections. Signatories can choose what is the next step for them based on where they sit in the roadmap (Figure 1) and also depending on what the purpose of the assurance is, as highlighted in the table below.

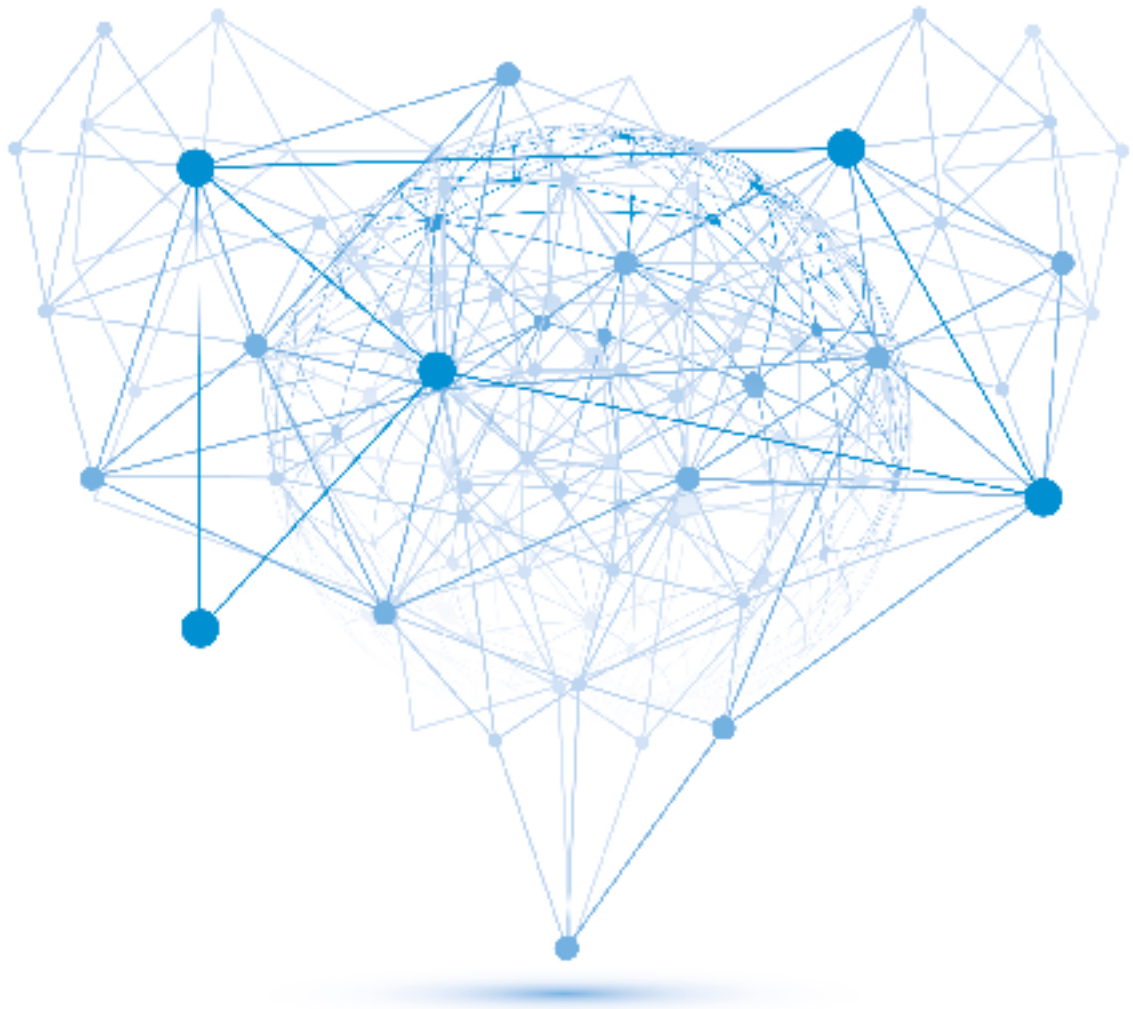
Table 8. Confidence building measures and their purpose.

Purpose	Confidence-building measures expected	Range of Indicators
Provide confidence to current and potential clients that signatory's senior management has oversight of RI	Internal verification with sign-off by board or CEO	All indicators
Provide confidence to the PRI that signatory meets the minimum requirements that will come into force in 2018 as part of the PRI accountability work[27]	Internal verification as per three lines of defence that is overseen by board/ CEO/ c-level	Limited to those identified for minimum requirement purposes
Provide confidence to external data users/clients that PRI reports are credible	Internal audit /external assurance of controls related to RI processes Internal verification of data by compliance/equivalent team & CEO	Range of indicators based on combination of factors: a) specific to assets that cover majority of AUM of signatory b) size of signatory c) indicators identified as most relevant ones within module by the PRI

27 The increased accountability of the PRI is one of our focus areas in the next ten-year blueprint. The PRI is set to implement minimum requirements for membership in 2018 alongside ways to highlight leadership and best practice. The methodology for identifying signatories that are at risk of not meeting minimum requirements, and to identify leaders within the industry will be based on responses to a selection of indicators from the Reporting Framework that will be confirmed in 2018. Read more on: https://www.unpri.org/report/accountability

THE PRI'S NEXT STEPS

- As part of the PRI's wider accountability work, the accuracy and credibility of signatories' reported information is a priority area. We will explore which CBMs will become a requirement in the future, based on what is practical, impactful and desirable, and sensitive to additional resources needed by signatories. The AWG could be tasked with looking at:
- CBMs in the context of PRI minimum requirements (RI generally or E/S/G specific policy covers over 50% of AUM, senior management oversight of RI).
- CBMs in the context of leadership identification by reviewing in more detail a subset of the indicators, such as those specific to active ownership or climate change.
- Releasing a short guide specific to responsible investment on establishing strong internal controls as the first step of a phased approach presented in this paper.



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The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UNEP FINANCE INITIATIVE

United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

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United Nations Global Compact