



INTERNAL AUDITS, THE KEY IN CHANGING TIMES

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Good morning.

Thank you Sonsoles and thanks to the Institute of Internal Auditors for its invitation. It is a pleasure to be here with you all once again. Also, the programme seems particularly interesting to me this year, with speakers who are to reflect on artificial intelligence and geopolitics, offering a broad view of the challenges posed by the current economic and financial environment. I already indicated last year how the complexity of the environment emphasizes the role of audit committees and, in particular, that of internal auditors. In fact, I highlighted at the time how internal auditors are the keystone to the proper performance of audit committees.

In companies this is the function which, when performed properly, provides essential added value as it ensures the quality of the information, risk assessment and the proper operation of internal controls. That is why it is necessary to underpin its independence and to ensure it has the necessary resources.

That stated last year is more important than ever. The relevance of the audit function continues increasing and I wish to insist on this from three points of view, three factors that, if I may say so, could lead to the perfect storm and thus require the utmost attention.

The increase in regulatory requirements: information on sustainability

First of all, we are experiencing an important new wave of regulatory obligations. From among these, those related to information on sustainability should be highlighted as, perhaps, they are the most important development, one that marks a watershed moment in non-financial reporting.

This development is already a reality, since the new Directive on sustainability reporting was published towards the end of last year and will be first applied next year, 2024.

In fact, the Spanish Government has just initiated the public consultation process to adapt our legal system to the new European requirements. I encourage you to participate in such consultation.

I will not go into the details of the regulation. You are aware that it broadens the information breakdown and establishes new EFRAG standards as the models of reference for corporate reporting. The first batch of these standards is expected to be approved shortly. I am referring to two cross-cutting standards applicable to all sustainability matters and to the ten specific thematic guidelines on environmental, social and governance issues¹. Sectoral standards and those specific to SMEs will be left for next year.

Drawing up these standards is not being an easy task, given the complexity of the subject and the urgency of its preparation. EFRAG is aware of these difficulties and has made an effort to take existing practices into account, therefore reducing the preparation costs for companies that use different frameworks at present. Furthermore, initial transition periods will probably be applied regarding the climate change standard, periods during which requirements will be relaxed, for example, among other options, allowing certain non-quantitative information on the impact of climate change on results, assets and the financial situation to be withheld for three years.

In any case, we will have to wait for the final text to see these details. We should recall, for instance, that ESMA has positioned itself by indicating that this should only be allowed in the cases in which obtaining this information is truly impossible. I am confident we will get to know the final version shortly.

Apart from the new standards, corporate reporting related to taxonomy continues increasing. In the 2022 reports, published this year, companies have provided for the first time the percentage of their economic activities that are aligned with the taxonomy, may this be regarding turnover, investments in capital expenditure (CapEx) or in operating expenses (OpEx). That is, the percentage of their economic activities that significantly contributes to the climate change mitigation and adaptation targets, while complying with the minimum social and governance guarantees. This information must be verified as it is included within the non-financial information statement.

Therefore, we are seeing important regulatory developments.

Increasing requirements and responsibility

The second element of this perfect storm is the fact that the level of requirements in risk control and management keeps increasing. Business models are increasingly complex, with decentralised organisational structures, and there being new and greater risks, such as those resulting from digitalisation.

¹ More specifically, they are two cross-cutting standards applicable to all sustainability-related subjects (ESRS1 and ESRS2) and ten specific technical rules: five on environment, 4 on social issues and one on good governance.

The demand for improved risk control is clearly growing within the scope of cybersecurity. There is a constant threat of cyber-attacks, making cybersecurity one of the main challenges for all institutions, both public and private.

To confront this challenge we need to continuously improve and review the controls and measures implemented, so as to protect the companies and the data of users and citizens.

In this area, I would like to mention the future Code of good governance in cybersecurity being developed by the Spanish National Cybersecurity Code. We believe that, in terms of corporate governance, it could serve as reference to identify the initiatives to carry out regarding corporate cybersecurity. And it could also be a guide for business administration bodies and managers of companies, to train board and senior management members, making them aware of their role and responsibility concerning cybersecurity.

Speed and intensity of the changes

The third and final factor to be highlighted is the record-breaking time in which we are addressing all these changes, particularly with regard to sustainability issues.

This undoubtedly involves a significant advance, both quantitatively and qualitatively, thanks to which we have more and better information on the environmental and social risks of companies.

But we also know that the intensity and speed at which all this is being built will put its integrity at risk. There will surely be errors and problems along the way, requiring adjustments and tweaks in the future. After all, within a very short period of time we seek to put the controls and rigour of sustainability information on the same level as those of financial information, a framework that took over fifteen years to build.

All these elements I have mentioned, the new regulation, the increasing requirements and responsibility, and the intensity of the changes, emphasize the importance of a good corporate governance and of the audit function.

At first, I simply referred to these as the “perfect storm”, which may seem an exaggeration. This is true. In fact, many of these requirements will be introduced gradually, to aid their implementation. The verification of sustainability information will be moderate at first, in 2027 it being expected for the European Commission to consider whether to increase the assurance level to reasonable. On the other hand, proportionality criteria are being followed to enable the adaptation of smaller firms.

But I do allow myself to exaggerate as the very short period of time available to us is precisely that which must be employed to adapt internal control systems to the new reality.

Now is the moment for companies still lacking a proper internal control system for sustainability information to allocate resources for this purpose. The aim is to have

solid internal procedures, capable of collecting, controlling and verifying all the information companies have.

This can be relatively simple for larger companies that are used to these processes, but it becomes a mammoth task for other, smaller firms. This is also the case for departments unaccustomed to these types of process. The business model is also a factor to be considered. For this reason, I insist on the importance of ensuring a solid corporate governance, with the highest ethical and control standards.

It is here where internal audit committees play a leading role, as they have a global view of all the risks that may affect the company and can help to manage these in an integrated manner, without considering each risk independently, but the business model of the company as a whole. This is essential in the case of cybersecurity risks.

And also regarding sustainability information, which must be within their scope and responsibility. In turn, internal auditors will have to include the challenges related to the new information in their annual audit plans and, for example, perform a materiality assessment for ESG risks, evaluate the leniency of the controls, review the KPIs and metrics used, or the contents of the sustainability reports and their coherence with the financial information reports.

On our part, from the CNMV we will strive to help companies in this transition.

We are already doing so with regard to non-financial information and also regarding corporate governance.

As recommended by our Code of good governance for listed companies, over 85% of listed companies already have an internal control and risk management unit or department under direct supervision by the audit committee.

On the other hand, we intend to update the Technical Guide on audit committees, as already announced in our activity plan. This Guide is from 2017, six years ago, its update therefore being appropriate to include all these regulatory changes. Our aim is to have a draft and to commence the public consultation in the fourth quarter of this year. A large part of the update will be focussed on reviewing the role of the committees regarding sustainability, in terms of reporting quality, integrity and the efficiency of internal risk management systems, together with the interrelationship with the external verifier of such information.

Conclusion

Now to sum up. We have a thrilling future before us, one full of new challenges, such as those deriving from digitalisation and sustainability, which will surely reward us all, each of our respective roles, aiding our growth as a country and a society. Thank you once again for the invitation and I hope you enjoy the event.