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ESG Assurance: Fundamentals to Increase the Credibility of ESG Reporting

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Introductions



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Timeline of ESG Reporting & Assurance Standards

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Timeline of ESG Reporting & Assurance Standards

1997

- The Global Reporting Initiative (GRI) is launched, providing a standard for business, governments, & other organizations to better understand & communicate their ESG impacts.

2000

- CDP was established as the 'Carbon Disclosure Project' asking companies to disclose their climate impact.

2001

- The Greenhouse Gas Protocol (GHG Protocol) was launched, providing a framework for organizations to report their GHG emissions.

2003

- The International Standard on Assurance Engagements (ISAE) was issued & serves as the standard for assurance over non-historical financial information.

2006

- The ISO 14064 publication was initially published & specified the principles & requirements at the organization level for the quantification & reporting of GHG emissions & removals.

2009

- The GRESB (Global Real Estate Sustainability Benchmark) Standards were established & provided a means of assessing ESG performance of assets & portfolios.

2011

- The Sustainability Accounting Standards Board (SASB) is founded, developing industry-specific sustainability accounting standards for ESG performance.

2014

- The EU introduces the Non-Financial Reporting Directive (NFRD), requiring large companies to report on their ESG performance.

2015

- GHG Protocol corporate standard was revised with Scope 2 guidance to measure & report emissions from purchased or acquired electricity, steam, heating, & cooling.

2017

- The AICPA published the original "Sustainability Attestation Guide" to provide guidance for CPAs to conduct attestation engagements related to sustainability information.

2022

- SEC proposed a Climate-Related Disclosure rule which would require publicly traded companies to disclose their GHG emissions & any climate-related risks to their operations.

2023

- The International Sustainability Standards Board (ISSB) issued its first two IFRS Sustainability Disclosure Standards - IFRS S1: General Requirements for Disclosure of Sustainability-related Financial information & IFRS S2: Climate-related Disclosures.

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ESG Reporting & Assurance Motivation

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ESG Reporting & Assurance Motivation



Industry Best
Practice

Regulations

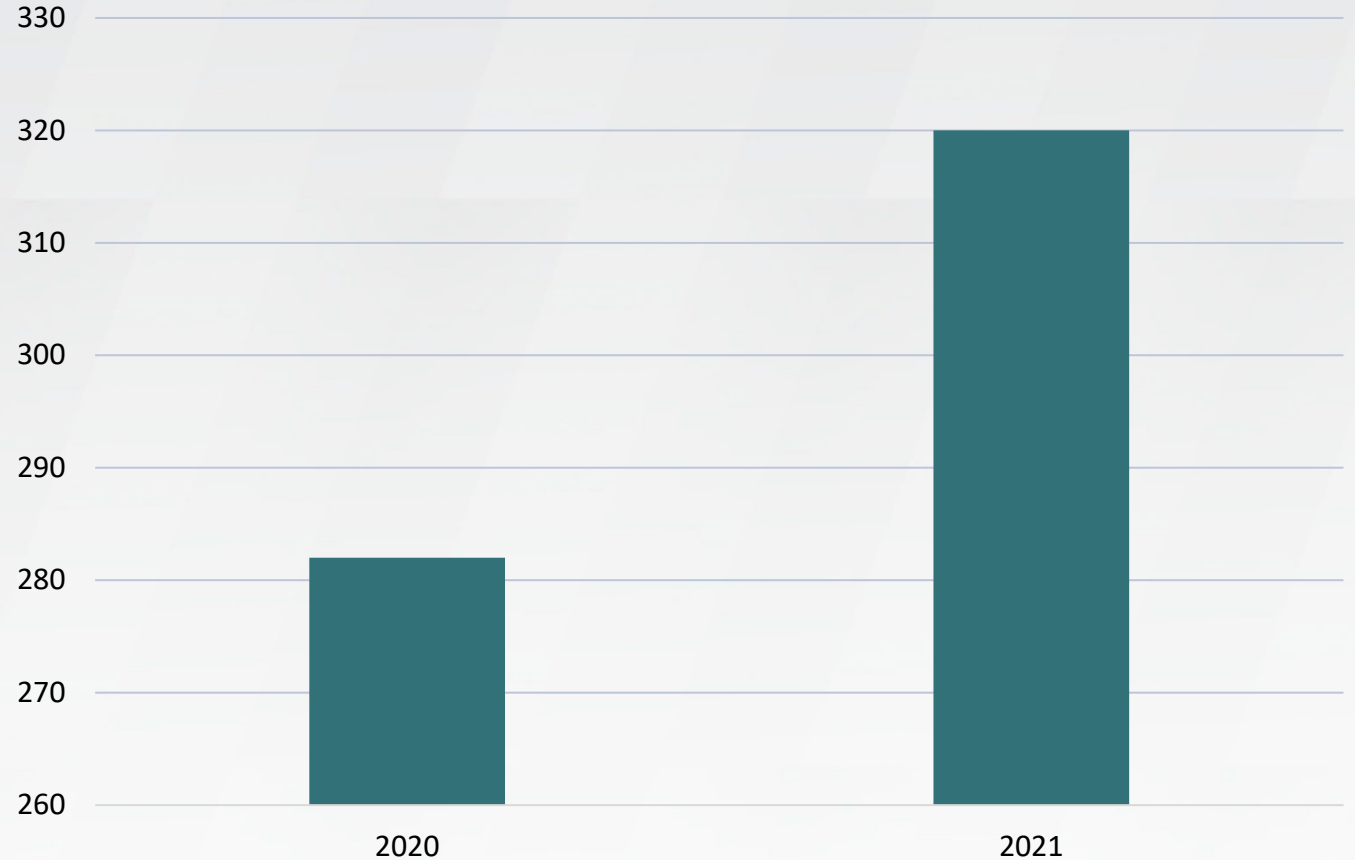
Stakeholders

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Industry Best Practice

- 99% of S&P 500 companies reported ESG-related information
- 13% increase in S&P 500 Index companies receiving assurance or verification over certain ESG metrics from 2020 to 2021
- 65% of reporting companies obtained assurance over some ESG information

Disclosed Obtaining Assurance or Verification



Source: S&P 500 ESG Reporting and Assurance Analysis, CAQ, 2022

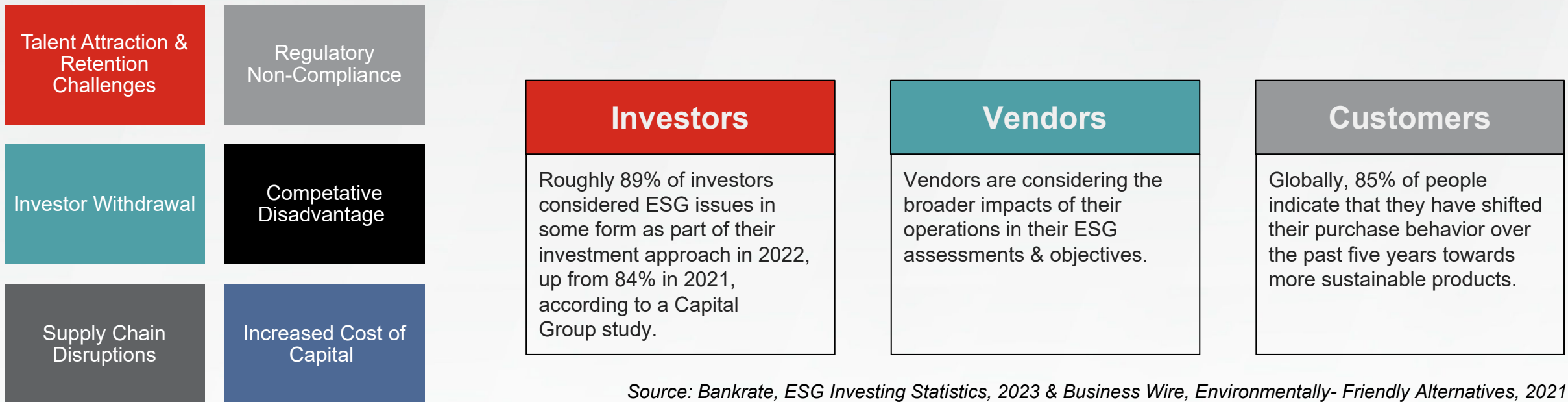
Regulations

Regulating Body	Proposed Regulatory Name	What?	Who?	When?
SEC	The Enhancement and Standardization of Climate-Related Disclosures for Investors	Proposal to require annual disclosure of how businesses are assessing, measuring, & managing climate-related risks. Includes phased-in assurance requirements for Scope 1 & Scope 2 GHG emissions	U.S. publicly-traded companies	Proposed: 03/21/2022 Expected Disclosure Compliance Dates: First fiscal year after the rule is finalized
Federal Acquisition Regulation	Federal Supplier Climate Risk and Resilience Rule	Required disclosure of Scope 1 & Scope 2, & in some cases Scope 3 GHG emissions, climate-related financial risks & set science-based emissions reduction targets	Federal governmental contractors with awards over \$7.5 million	Proposed: 11/14/2022 Expected Disclosure Compliance Dates: One year after publication of the rule.
European Union (EU)	Corporate Sustainability Reporting Directive (CSRD)	<ul style="list-style-type: none"> • Prepare & submit a CSRD performance report • Track & disclose the required information, covering various ESG topics • Taxonomy tagging of digital data • Third-party assurance 	EU companies with: <ul style="list-style-type: none"> • Over 250 employees • More than 40€ million in annual revenue • More than 20€ million in total assets • Publicly-listed equities & have more than 10 employees or 20€ million revenue Non-EU companies with more than 150€ million annual revenue within the EU & which have at least one subsidiary or branch in the EU exceeding certain thresholds	Passed: 11/28/2022 Disclosures: Starting FY 2024 – FY 2026

Stakeholders

Assurance on ESG data offers advantages comparable to that of a financial statement audit, instills trust among stakeholders in the ESG reporting's accuracy, & grants valuable insights into how an organization can improve its internal processes & controls.

In the short-term, companies that fail to obtain assurance on their ESG performance could face



Source: Bankrate, ESG Investing Statistics, 2023 & Business Wire, Environmentally- Friendly Alternatives, 2021

Components of ESG Assurance

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Components of ESG Assurance

Components of ESG Assurance	ESG Example	Financial Example
Level of Assurance	Limited assurance review	Audit (<i>i.e.</i> , reasonable assurance)
Subject Matter	GHG emissions data	Financial statements
Reporting Criteria	GHG Protocol	Generally Accepted Accounting Principles (GAAP)
ESG Assurance Procedures	Performing inquiries & analytical procedures	Confirmations, vouching to invoices, & other transaction documentation
Opinion	Negatively worded	Positively worded

Level of Assurance



Limited Assurance

- Most common type of ESG assurance
- Referred to as a “review”
- Involves inquiries, analytical procedures, & other procedures



Reasonable Assurance

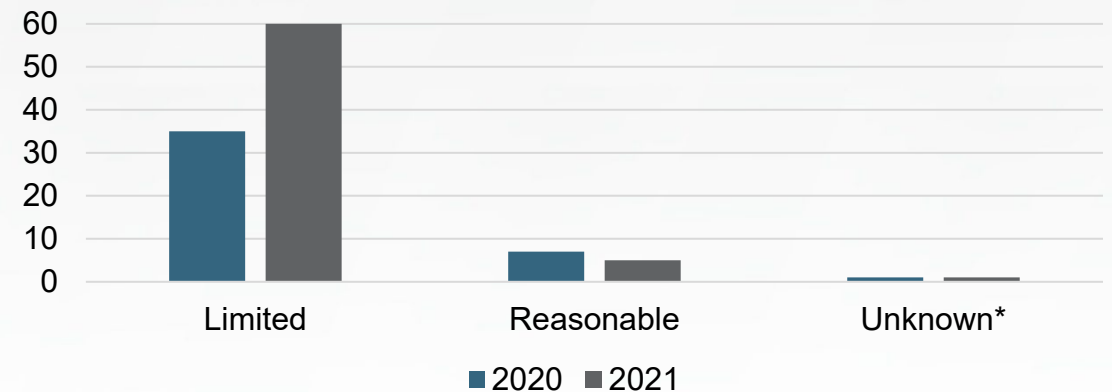
- Referred to as an “examination”
- Involves tracing information to supporting documents & performing recalculations



Agreed-Upon Procedures

- May be beneficial if the organization has specific procedures to be performed on reported information

Level of Assurance From Public Company Auditors



Source: S&P 500 ESG Reporting and Assurance Analysis, CAQ, 2022

Subject Matter

GHG Emissions

Employee Safety
Metrics

Energy Usage

Water Usage

Philanthropic
Donations

Ecological Impacts

Waste Volumes

Employee
Demographics

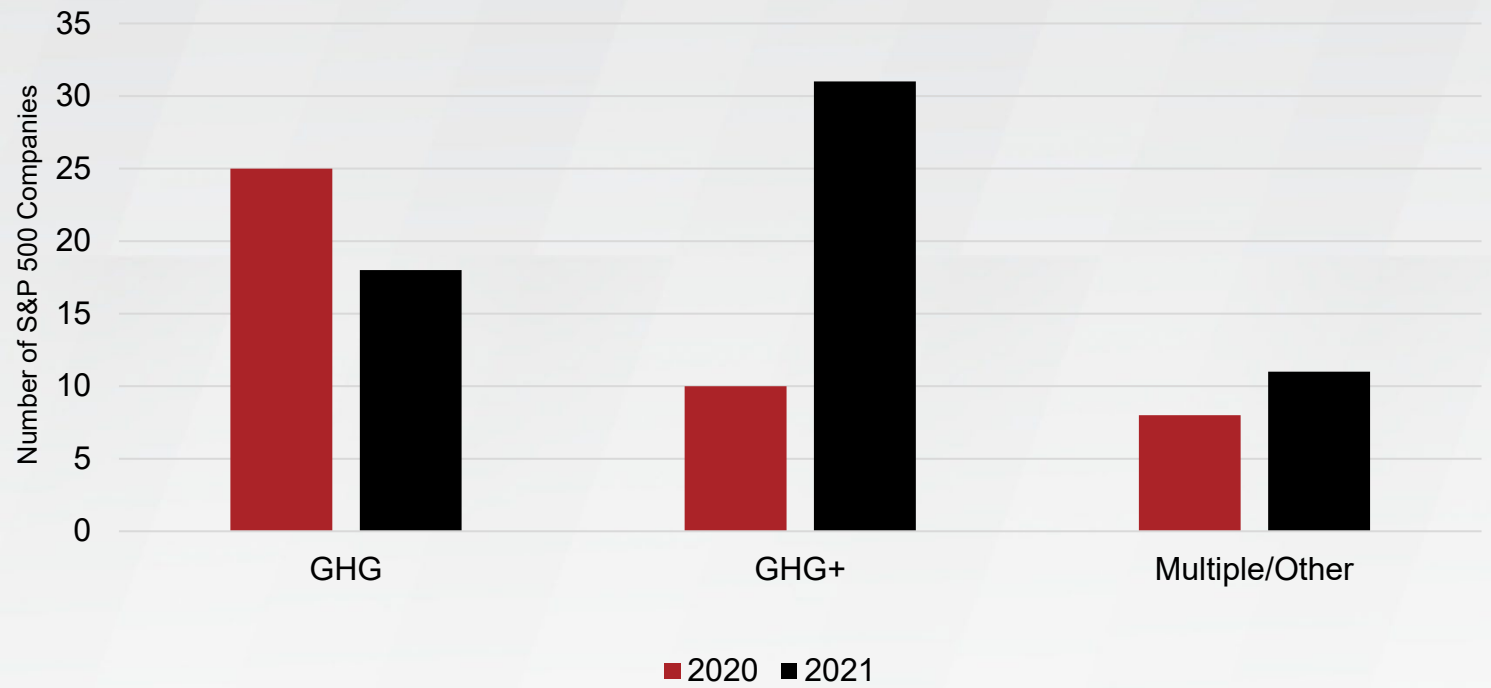
Full Sustainability
Report

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External Assurance Statistics – Subject Matter

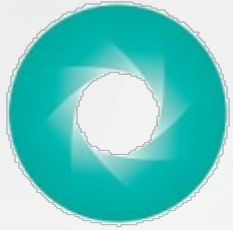
- GHG emissions are the most common ESG metric to undergo assurance
- In 2021, companies expanded the scope of information subject to assurance – shifting from mostly seeking assurance over only GHG emissions to mostly obtaining assurance over GHG+, meaning GHG emissions & one to three other ESG metrics, e.g., water, energy, waste metrics

Scope of Assurance – Public Company Auditors



Source: S&P 500 ESG Reporting and Assurance Analysis, CAQ, 2022

Reporting Criteria

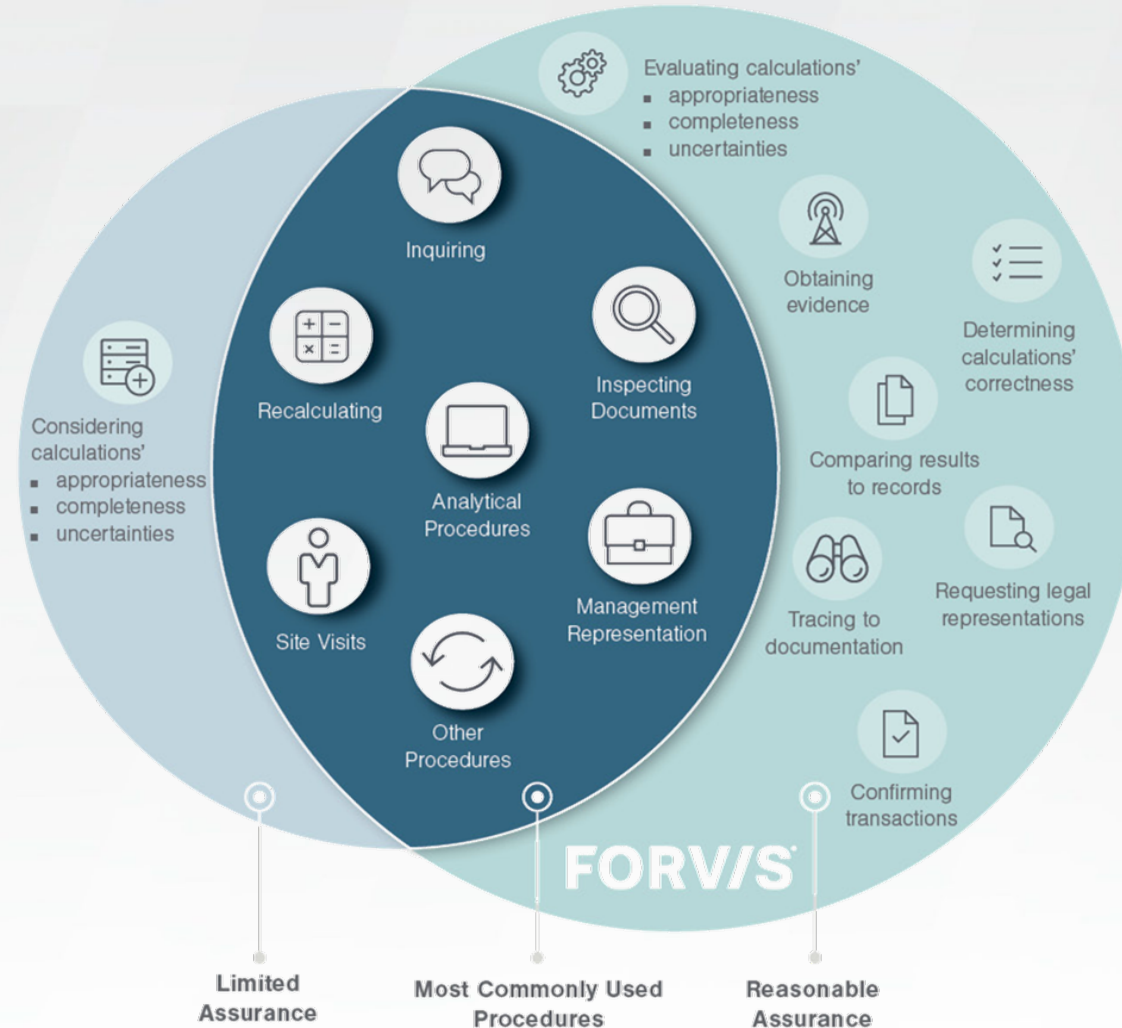


GREENHOUSE
GAS PROTOCOL



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ESG Assurance Procedures



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Example of Analytical Procedures & Inquiries Using CDP Questionnaire



Identify the reasons for any change in your gross global emissions (Scope 1 & 2 combined), & for each of them specify how your emissions compare to the previous year.

	Change in emissions (metric tons CO2e)	Direction of change in emissions (Submit: Increased Decreased or No Change)	Emissions value (percentage)	Please explain calculation
Change in renewable energy consumption				
Other emissions reduction activities				
Divestment				
Acquisitions				
Mergers				
Change in output				
Change in methodology				
Change in boundary				
Change in physical operating conditions				
Unidentified				
Other				

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Opinion

Limited Assurance	Reasonable Assurance
Negatively Worded: <i>“We are not aware of any material modifications that should be made to the subject matter in order for it to be presented in accordance with the criteria.”</i>	Positively Worded: <i>“The subject matter is presented in accordance with the criteria in all material respects.”</i>

Unqualified

Qualified

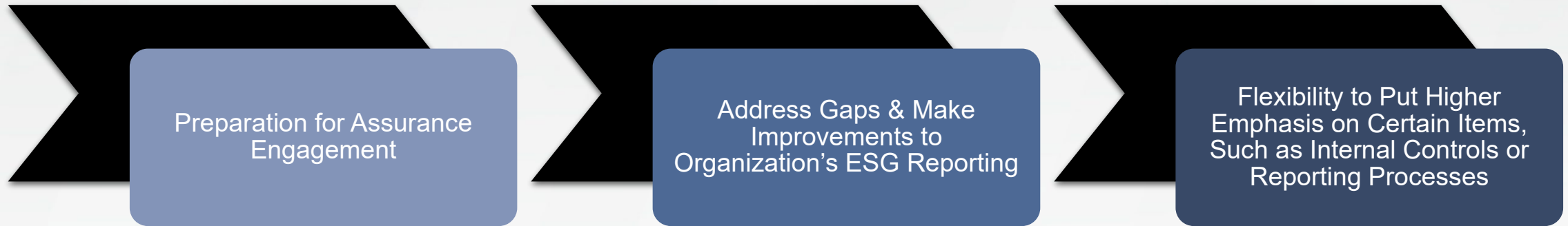
Adverse

How to Prepare for Assurance

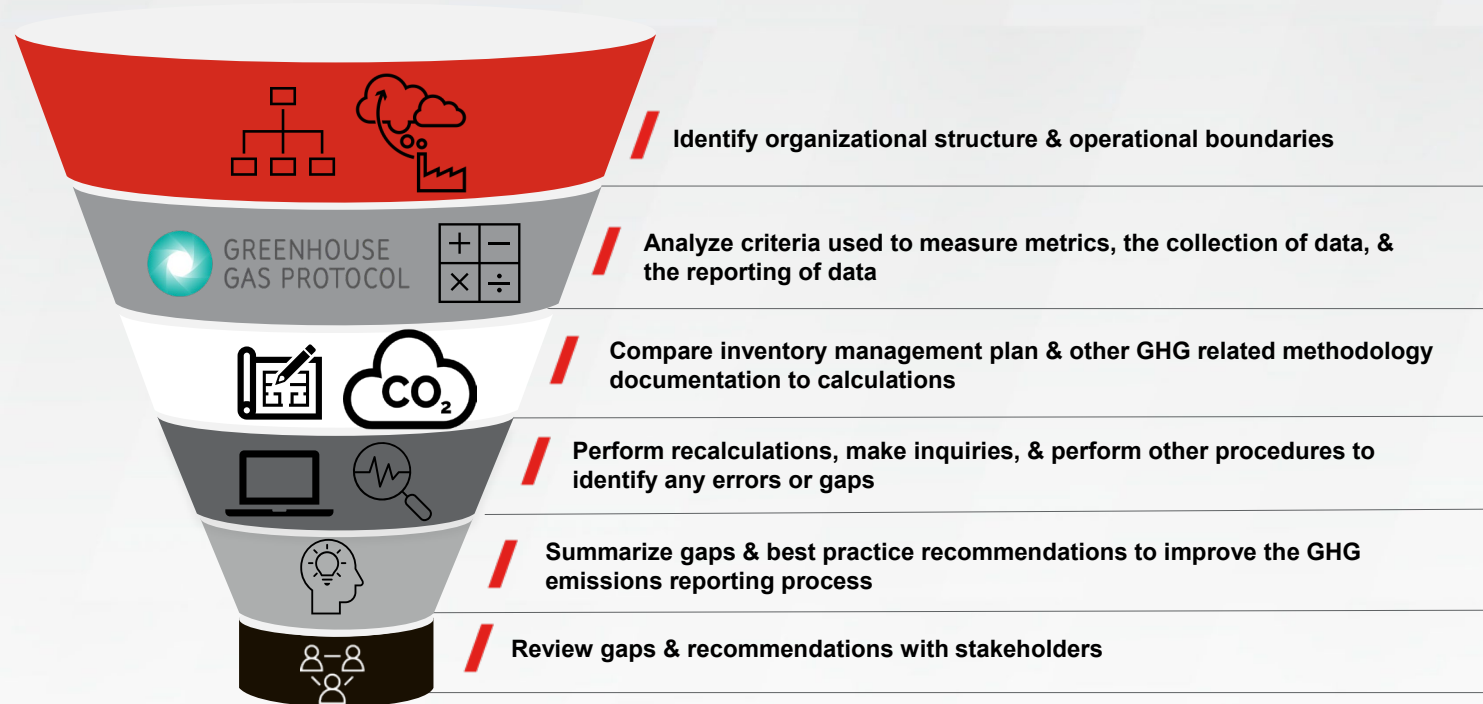
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Purpose of ESG Assurance Readiness



Assurance Readiness Assessment of GHG Emissions



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Documents to Draft for ESG Assurance

Document	Description	Value
Inventory Management Plan (IMP)	<ul style="list-style-type: none">▪ This document is flexible & includes<ul style="list-style-type: none">– Boundary information– Methodologies & emission factor sources– Data management, data collection, & calculation procedures, including roles & responsibilities– Base year recalculation policy– Assurance status	<ul style="list-style-type: none">▪ Assists with accurate data reporting▪ Establishes data collection procedures▪ Promotes transparency of data▪ Provides guidance to employees
SOC (System & Organization Controls) Report Analysis	<ul style="list-style-type: none">▪ Analyze SOC reports of vendors critical for ESG reporting<ul style="list-style-type: none">– To assess whether user entity internal controls are in place– To gain comfort that the system is operating as expected	<ul style="list-style-type: none">▪ Evaluates controls over ESG data▪ Assesses service provider performance

COSO's Internal Controls over Sustainability Reporting (ICSR)

A system of principles for effective internal controls when applied across operations, reporting, & compliance at every level of an organization

The Committee of Sponsoring Organizations

- American Accounting Association (AAA)
- American Institute of Certified Public Accountants (AICPA)
- Financial Executives International (FEI)
- The Institute of Internal Auditors (IIA)
- The Institute of Management Accountants (IMA)



The COSO CUBE

Source: The 2013 COSO Framework & SOX Compliance, COSO, 2013

Accounting is the process of measuring & categorizing information according to certain generally accepted principles that ensure that the information actually represents what it purports to.



COSO Components for ICSR

Control Environment	The policies, procedures, standards , & processes that management has established, including integrity & ethical values
Risk Assessment	Determines the risks & opportunities facing an organization & whether they'll have a material impact on a company's relationship with investors, employees, customers, & communities. Shapes planning for policies & procedures to mitigate that risk
Information & Communication	Information & communication cover both internal & external communication . Internally, controls only work if internal people know what to do, when to act, & what to do if there is a concern. Externally, it's about describing your controls environment so stakeholders can trust your data
Monitoring	The assurance efforts performed by management, compliance, & auditors
(Existing) Control Activities	Control activities are the specific actions management uses to enact & enforce the policies & procedures for reliable, auditable data

**Software enforces
internal controls.**

**It is not an internal
control itself.**



Software Evaluation Considerations

Financial Data Experience

Ease of Use

Strong Integration Options

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Greenhouse Gas Fundamentals

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GHG Assurance Serves Business Goals



GREENHOUSE
GAS PROTOCOL

Managing GHG risks & identifying reduction opportunities

Public reporting & participation in voluntary GHG programs

Participating in mandatory reporting programs

Participating in GHG markets

Recognition for early voluntary action

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Source: EPA, GHG Inventory Development Process and Guidance, 2022

Calculating GHG Emissions (Example)

Global Warming Potential (GWP)

A measure of how much energy the emissions of one ton of a gas will absorb over a given period, relative to the emissions of one ton of carbon dioxide (CO₂).

General Equations

Calculated Emissions = Activity Data * Emissions Factor (/ by conversion factor if applicable)

CO₂e = Sum of (GHG Emission * GWP Factor)

CO₂e Calculation Example

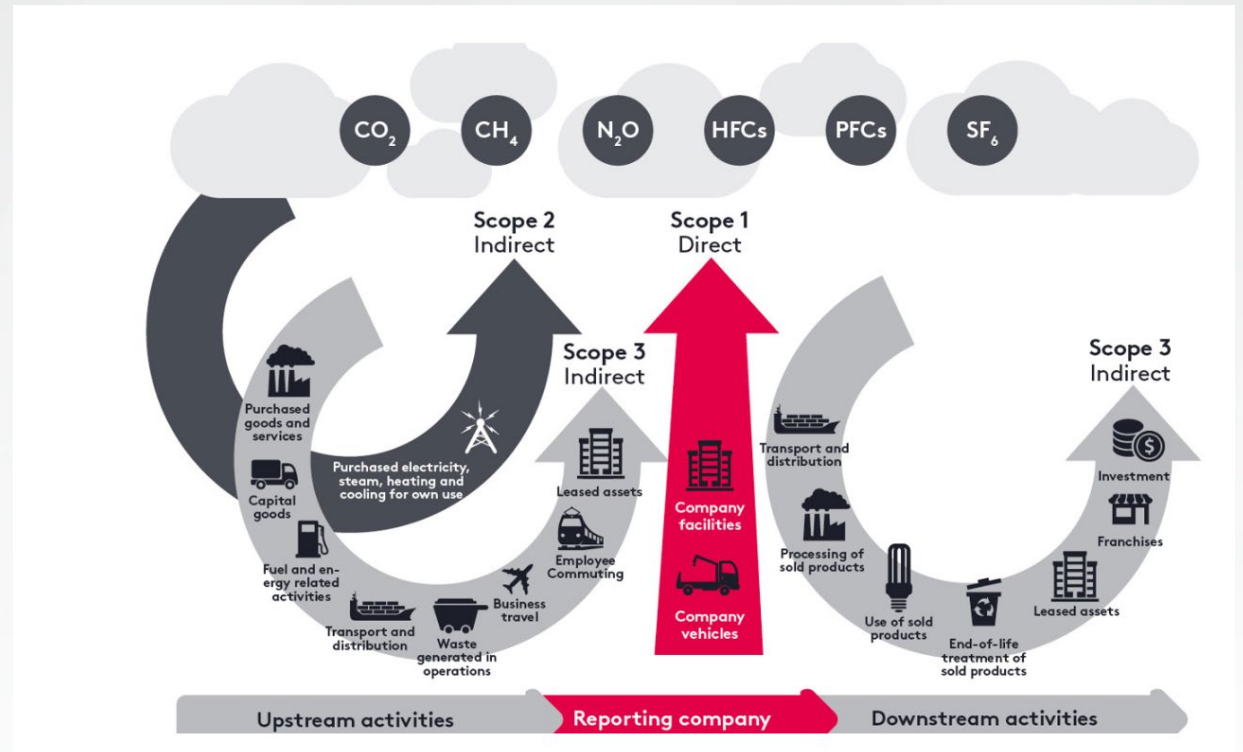
GHG	Metric Tons	GWP	Metric tons CO ₂ e
CO ₂	10,000	1	10,000
CH ₄	10	21	210
N ₂ O	.5	310	155
		Total CO₂e	10,365

Reporting Boundaries

Organizational Boundary

Operational Control	100% of operations activity that the entity has operational control over
Financial Control	100% of operations activity that the entity has financial control over
Equity Share	% of operations activity based on the entity's % of equity in the operation
Financial Statement Boundary	The same boundary used for the entity's consolidated financial statements

Operational Boundary



Source: Adapted from World Resource Institute

Key GHG Emissions Required Information per the GHG Protocol



Outline of organizational & operational boundaries chosen



Total Scope 1 & 2 emissions - independent of GHG trades



Emissions data for the six GHGs separately in metric tonnes & in tonnes of CO₂ equivalent



If Scope 3 is included, a list specifying which types of activities are covered



Year chosen as base year, & an emissions profile over time that is consistent with & clarifies the chosen policy for making base year emissions recalculations



Appropriate context for significant emissions changes that trigger base year emissions recalculation



Methodologies used to calculate or measure emissions

Common Risks of Material Misstatements

Risk of Material Misstatement	How to Address
Inaccurate use of emission factors	<ul style="list-style-type: none">▪ Use up-to-date & appropriate emission factors
Improper calculations	<ul style="list-style-type: none">▪ Ensure data is appropriately linked in spreadsheets▪ Ensure totals include the appropriate information
Lack of support for key assumptions	<ul style="list-style-type: none">▪ Maintain supporting documentation for key assumptions used in the calculations
Insufficient internal controls or inadequate data collection	<ul style="list-style-type: none">▪ Implement robust data collection processes & procedures▪ Review SOC 1 reports of critical vendors for reporting
Incomplete GHG emissions inventory or inadequate identification of boundaries	<ul style="list-style-type: none">▪ Properly include all locations & emissions sources▪ Properly define organizational & operational boundaries

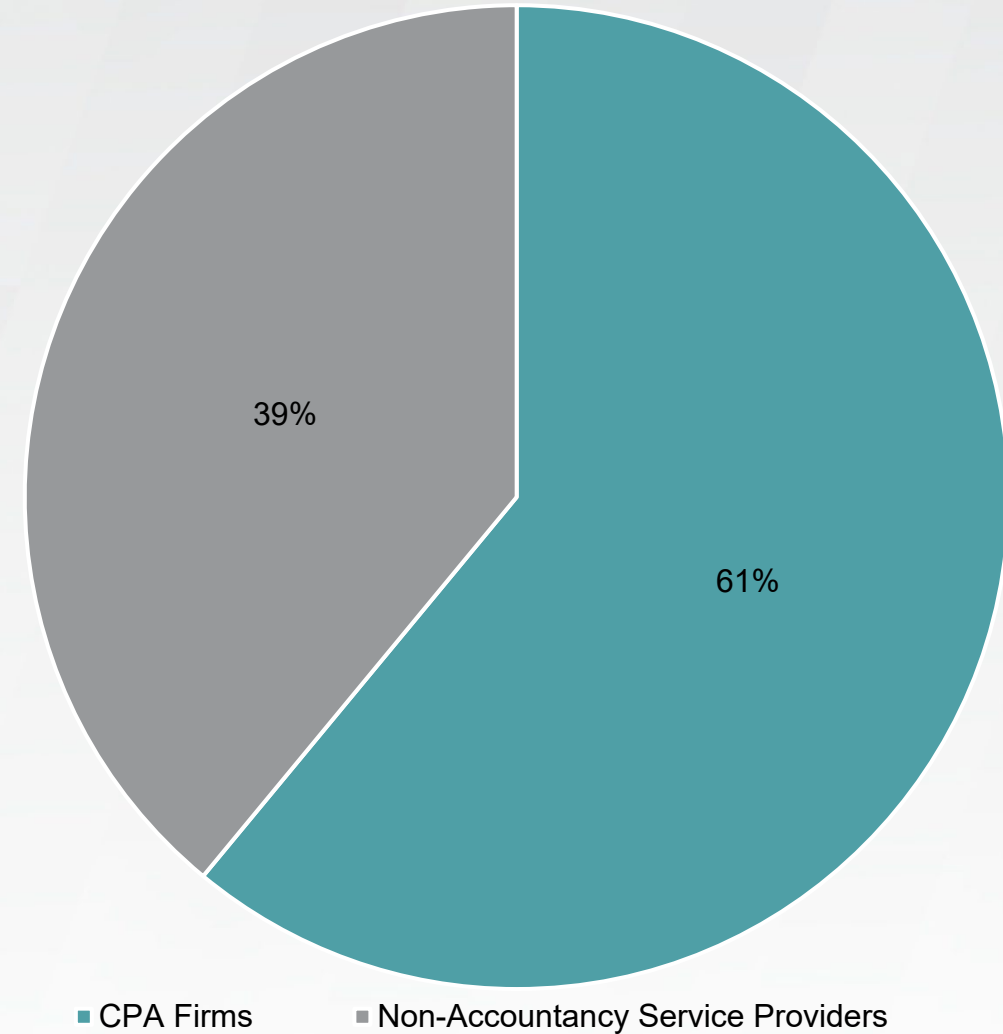
Overall Value of Assurance

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- 61% of ESG assurance services were performed by professional accounting firms
- Professional accountants have high professional standards, including independence, & are subject to regulatory oversight
- The majority of ESG assurance reports provided by audit firms were conducted by a company's existing assurance provider

ESG Assurance Providers



Source: More Companies Obtaining Independent Assurance on Sustainability Data, AICPA, 2022

Overall Value of Assurance

Internal

- Decreases the risk of having to restate prior-year calculations
- Increased confidence in reported information
- Enhanced internal accounting & reporting practices

External

- Greater stakeholder trust in the reported information
- Creates positive drivers to pursue GHG emission reductions across the value chain
- Facilitates input from stakeholders to prioritize the reduction of emissions
- Encourages companies to stay accountable, reduce risk, & create value

Selecting an Assurance Partner

Integrity, Objectivity, & Commitment to the Public Interest

- Commitment to **professional ethics & independence requirements**
- Obligation to **safeguard the public interest**
- Adherence to continuing professional education, **specialized training**, & quality control systems

Independent 3rd Party/ Structured Close & Restatement Processes

- CPA firm's opinion stands as a **reliable assessment** of the **organization's sustainability performance**
- Understanding of a **structured close & restatement processes**.

In-Depth Knowledge of Business Operations, Internal Controls & SOX Controls

- Keen understanding of your **business operations & internal controls**, facilitating smoother ESG assurance engagements
- Identify potential **improvements** to enhance ESG reporting & align it with well-established frameworks like **COSO**

Compliance with Attestation & Reporting Requirements

- Trends towards **integrated reporting** frameworks highlight ESG information increasingly being included in financial statements
- Following **recognized standards**, like **AICPA's** attestation standards, CPA firms **provide comprehensive & consistent** ESG assurance

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Any Questions?



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