ESG and the Accountant

Navigating Challenges and Maximizing Opportunities

May 2024

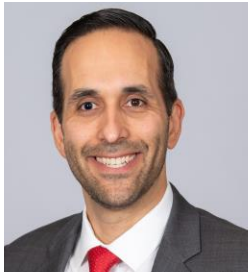
Agenda

1. ESG Refresher

2. Market Feedback & Regulatory Reporting

3. Accountants in ESG

4. Common Hurdles and Opportunities in ESG



Omar Rodriguez
Senior Manager, Trust Solutions - ESG & Sustainability

Background
- Senior Manager, PwC, Trust Solutions – ESG & Sustainability
- BBA Accounting and Executive MBA
- CPA and SASB FSA Credential-holder
- TXCPA Board of Directors
- El Paso Opera Board of Trustees
- UTEP AIS Advisory Council

Summary of Experience
- Assurance (Financial and Non-Financial), ICFR, Accounting Advisory, ESG Reporting, Baseline GHG emission calculations
- Industries: Technology, NFPs/Higher-Ed, Energy-Utilities, Oil & Gas, Financial Institutions

1 ESG Refresher

Brief Refresher: Sustainability Reporting

Definition: Sustainability reporting refers to the practice of **disclosing** an organization's environmental, social, and governance (ESG) performance.

Importance: It allows **stakeholders to assess** an organization's commitment to sustainable practices and its impact on society and the environment.

Environmental

- Climate change
- Natural resources
- Pollution & waste
- Environmental opportunities

Social

- Human capital
- Product liability
- Stakeholder opposition
- Social opportunities

Governance

- Corporate governance
- Corporate behavior

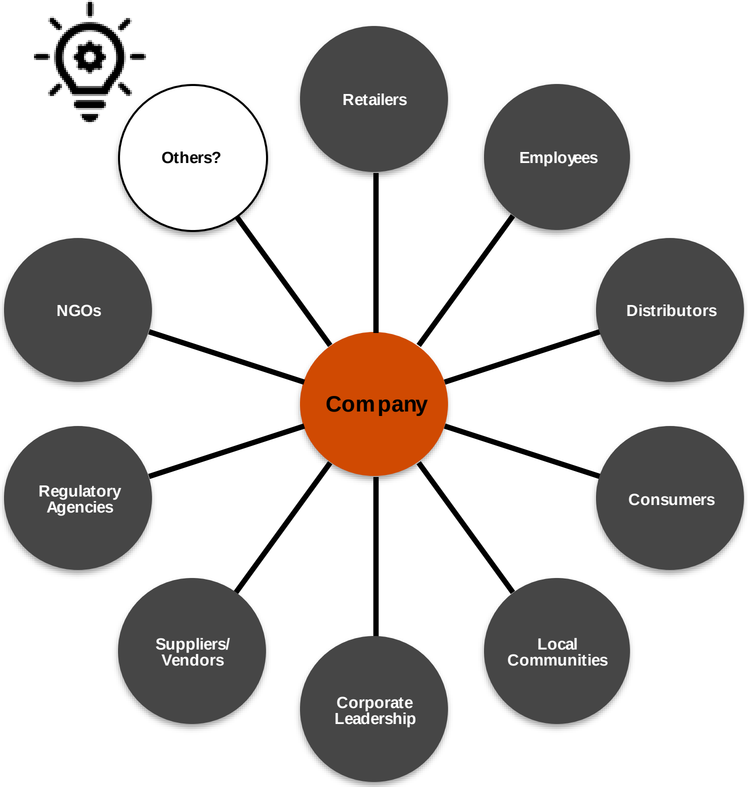
ESG investing has been around since the 1960s.

Stakeholders and Materiality

A Company will likely have many stakeholders. Addressing **material topics** starts with identifying the key stakeholders that will use or be affected by a company's activities.

Stakeholders

- Individuals or groups that have interests that are affected or could be affected by an organization's activities
- Common categories of stakeholders for organizations are consumers, **customers**, **employees, local communities**, shareholders and other investors, suppliers, trade unions, and vulnerable groups.
- **Materiality**: material information reasonably capable of making a difference to the conclusions reasonable stakeholders may draw when reviewing the related information.



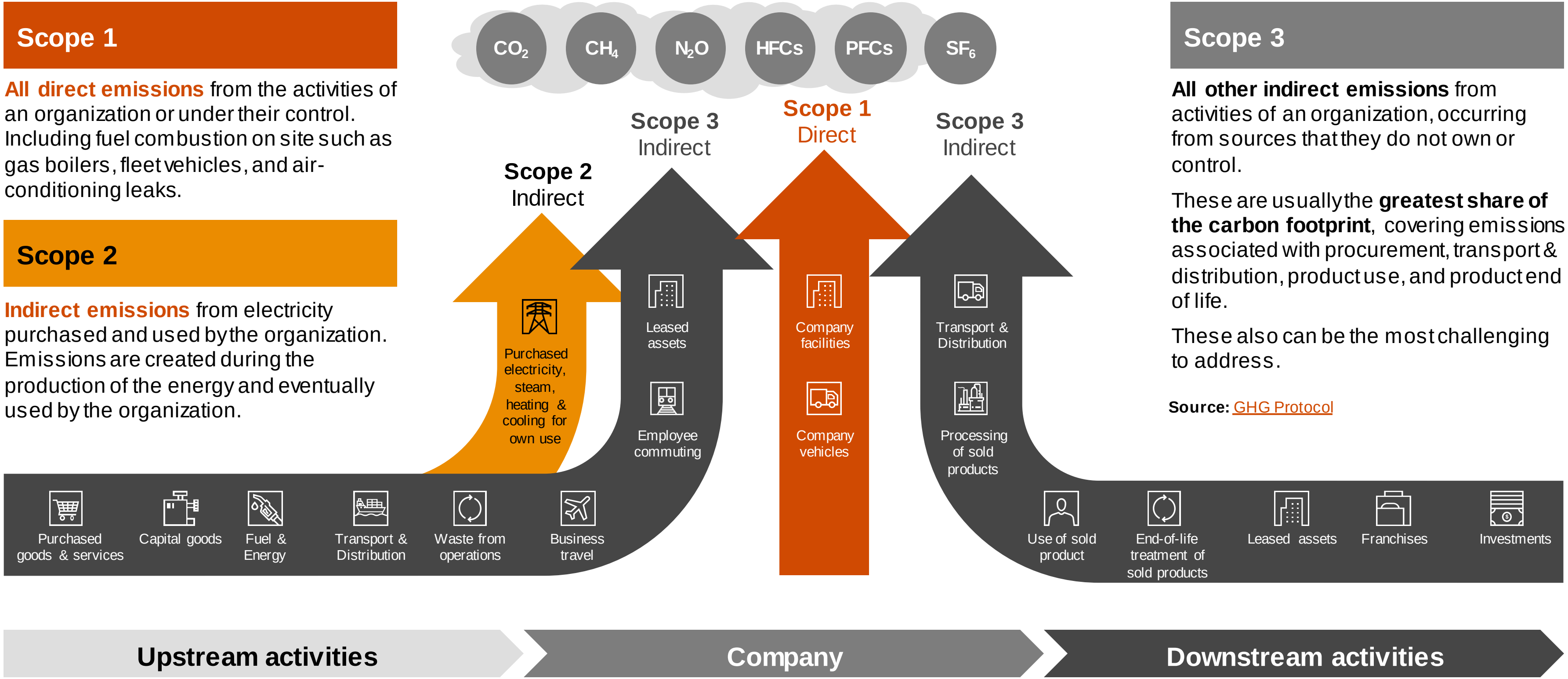
A quick overview of GHG Emissions

Scope 1

All direct emissions from the activities of an organization or under their control. Including fuel combustion on site such as gas boilers, fleet vehicles, and air-conditioning leaks.

Scope 2

Indirect emissions from electricity purchased and used by the organization. Emissions are created during the production of the energy and eventually used by the organization.



Scope 3

All other indirect emissions from activities of an organization, occurring from sources that they do not own or control.

These are usually the **greatest share of the carbon footprint**, covering emissions associated with procurement, transport & distribution, product use, and product end of life.

These also can be the most challenging to address.

Source: GHG Protocol

Adopted from https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf

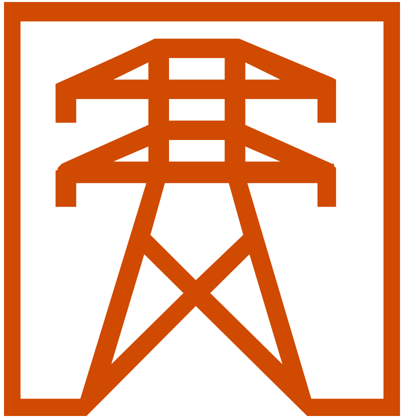
Scope 1 & 2 Example - at home

Scope 1 - direct emissions from fuel combustion

AC Unit ***Refrigerant Emissions***	**Personal Car** ***Mobile Emissions***	**Propane from BBQ** ***Stationary Combustion***	**Water Heater** ***Stationary Combustion***

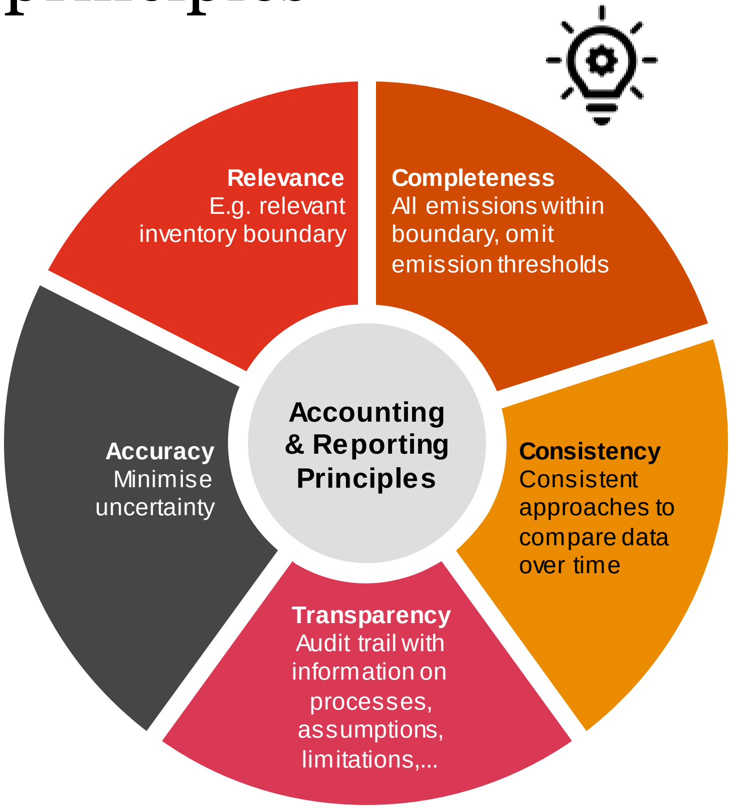
Example: Activity Volume x Emission Factor x Global Warming Potential = MTCO2e

Scope 2 - Grid-supplied electricity



Note: Scope 2 emissions also typically includes purchased steam, heat and cooling (Scope 2 = all purchased energy)

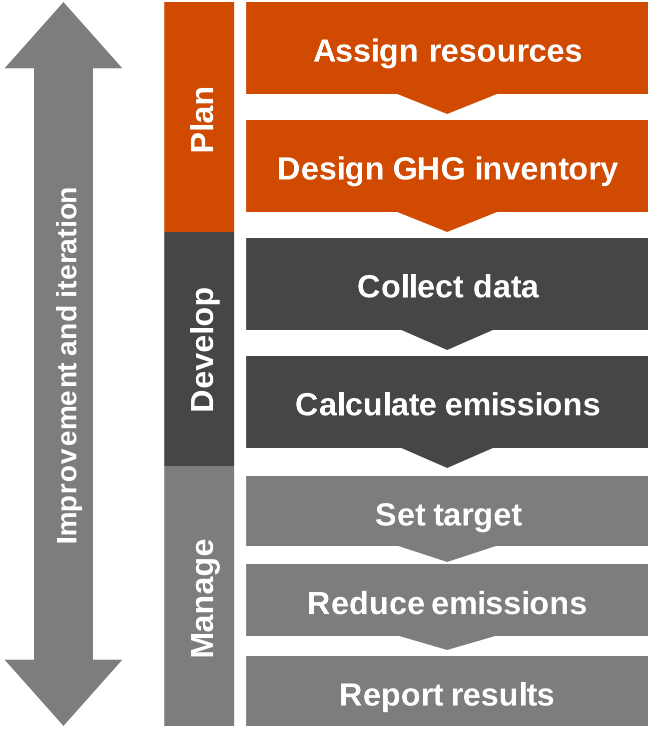
Key objectives behind GHG accounting & reporting principles



GHG Protocol aligns with general financial accounting and reporting principles/standards

Putting these principles into practice will ensure GHG inventory quality.

Bring the typical auditor mindset for GHG emissions assurance engagements, although we perform “limited” versus “reasonable” assurance



2 Market Feedback and Regulatory Reporting

The ESG landscape is shifting fast – requiring an urgent and coordinated response...

The landscape of active and proposed ESG regulation is broad and covers many topics*

March 2024 → Final SEC rule on climate-related disclosures adopted

January 2024 → California bill AB1305 came into effect, mandating increased transparency for those operating in CA transacting in the voluntary carbon market

December 2023 → European Commission adopted a "delegated directive" to increase the CSRD size thresholds for assets and revenue for companies by 25%

October 2023→ California passed three climate bills requiring (1) greenhouse gas (GHG) emissions reporting in compliance with the Greenhouse Gas Protocol (GHG Protocol), (2) climate-related financial risk reporting, and (3) voluntary carbon market disclosures

Illustrative examples

- SEC Climate-Related Disclosure
- SEC Human Capital Disclosure
- SEC Cybersecurity Disclosure
- Calif. Transparency in Supply Chains Act
- Calif. Climate Corporate Data Accountability Act
- Canada Climate-Related Disclosure Rule
- CA Transparency in Supply Chains Act
- Mexico Disclosure Guidance on Building a Strategy towards Carbon Neutrality
- Mexico Corporate Governance Code

- EU Corporate Sustainability Reporting Directive (CSRD)
- EU Corporate Sustainability Due Diligence Directive (CSDDD)
- EU Non-Financial Reporting Directive (NFRD)
- EU Energy Efficiency Directive (EED)
- EU Taxonomy
- EU Pay Transparency Directive
- EU Carbon Border Adjustment Mechanism (CBAM)
- France Domestic Due Diligence Directive
- UK Sustainability Disclosure Requirements (SDR)
- UK Streamlined Energy and Carbon Reporting
- UK Modern Slavery Act
- UK and EU Member States – Extended Producer Responsibility
- Climate-related financial disclosure: exposure draft legislation

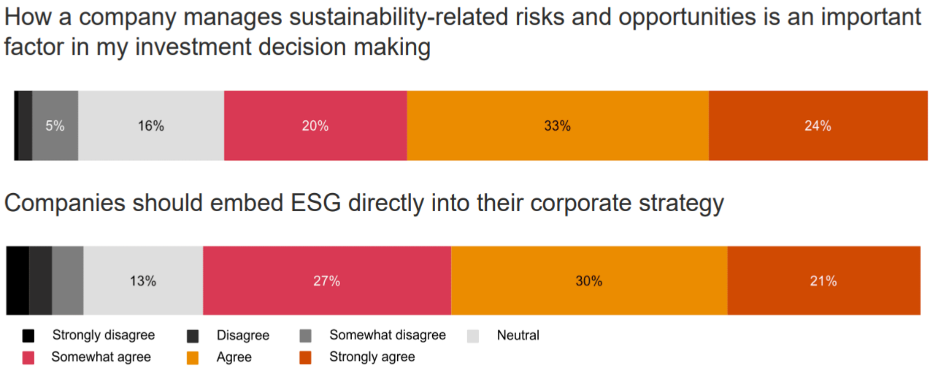
*This represents an illustrative sample of active and pending regulatory considerations covering a range of topics for informational purposes only. The application and impact of laws can vary widely based on the specific facts involved. Determining applicability is often complex and may require legal assistance to consider the specific applicability criteria and thresholds, including at the legal entity and holding company level.

Themes from PwC’s 2023 Global Investor Survey

Highlights from US Investors - views on sustainability reporting

US investor views on sustainability reporting

Question: In thinking about the companies you invest in or cover, please indicate how much you agree or disagree with the following statements.



- **57% of investors** think that how a company manages **sustainability risks and opportunities** is an **important factor in investment decision-making**
- Roughly half of investors think companies should embed **sustainability directly into their corporate strategy**
- Note that this aligns to CEO survey which noted that 45% of CEO’s are concerned about their own company’s **viability in the next 10 years**

[PwC’s 2023 Global Investor Survey]

Themes from PwC’s 2023 Global Investor Survey

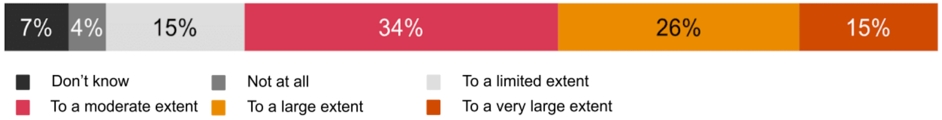
Highlights from US Investors – Concerns about Trust

Trust in information to assess management of risks and opportunities

Question: To what extent do you trust investor-focused communications in assessing how the companies you invest in or cover, in general, are managing the risks and opportunities facing their business?

Unsupported claims on sustainability performance

Question: In your view, to what extent do the following sources of information within corporate communications contain unsupported claims about a company's sustainability performance (e.g., on environmental and social issues)?



Note: Percentages shown may not total 100 due to rounding

- Roughly half of investors do not have high degree of trust in corporate reporting
- 75% of investors believe that there are at least a moderate amount of **unsubstantiated claims in sustainability reporting**
- 86% of US investors believe that **independent, reasonable assurance** would give them confidence

PwC’s 2023 Global Investor Survey

“Big three” regulatory ESG reporting requirements

	US - Securities and Exchange Commission (SEC)	European Union - Corporate Sustainability Reporting Directive (CSRD)	Rest of World - International Sustainability Standards Board (ISSB)
Applicability	SEC registrants	“Large” entities and groups meeting employee, turnover and/or balance sheet thresholds	To be determined by adopting countries
Scope of disclosure	Global - Companies with publicly traded securities registered with the SEC	Entity basis with potential consolidation exemptions, global starting 2028	Entity basis
Where to disclose	Annual report (10-K), and financial statement footnote if impact of climate change meet threshold	Management’s discussion section in annual statutory report	Management’s discussion section in annual statutory report
Topics	Focused on Scope 1, Scope 2 GHG and climate risks/impacts	Spans across E, S and G (12 standards, GHG/climate is 1 of those), based on double materiality assessment	GHG and climate risks/impacts for year 1, then E, S and G as determined to be financially material
Timing	Phased in approach starting with large accelerated filers in 2025	Directive adopted in Dec. 2022 and reporting standards (ESRS) finalized in July 2023. Countries have until June 2024 to transpose into national laws. Application starts Jan. 2024, however delayed to 2025 for most non-public EU entities	Standards finalized June 2023, pending country adoption with potential application starting Jan. 2024
Assurance	Footnote subject to assurance and internal controls (e.g. SOX) and GHG in 2029 for large accelerated filers	1st year limited, reasonable TBD after 2028	To be determined by adopting countries
Updates	March 2024, the SEC adopted final rules but paused the ruling on April 4th.	Several member states have begun the process of transposing the rulings into national law. At least 4 member states have added or modified the CSRD’s requirements when transposing it into national legislation	COP 28 resulted in ~ 400 organizations from 64 jurisdictions committing to advancing the adoption or use of the ISSB’s climate-related reporting at a global level. IFRS S2 is also seen as the successor to TCFD.

LINK: Navigating the ESG Landscape: Comparison of the "big three" sustainability frameworks

US Updates – California climate disclosure bills

	AB 1305 — Voluntary carbon market disclosures	SB 253: Climate Corporate Data Accountability Act	SB 261: Greenhouse gases: climate-related financial risk
Primary topic	(1) Emissions claims, (2) use of carbon offsets, and (3) sale of carbon offsets	Scope 1, scope 2, and scope 3 greenhouse gas emissions	(1) Climate-related financial risks and (2) measures a company has adopted to reduce and adapt to such risks
Framework	Not applicable	Greenhouse Gas Protocol	Task Force on Climate-Related Financial Disclosures (TCFD)
Scope	Entities that (1) operate and make emissions claims within California, (2) buy or sell carbon offsets in California	Business entities with annual revenue over $1 billion that do business in California[1]	Business entities with annual revenue over $500 million that do business in California[1, 2]
Where filed	Publicly available on company's website	Publicly available digital platform	Publicly available on company's website
Assurance	No, although certain disclosures required about any independent third-party verification obtained	Yes, phased requirements beginning with limited assurance	No
Compliance date	January 1, 2024, with information updated at least annually	Annual reporting of scope 1 and scope 2 in 2026 (on prior fiscal year information); scope 3 starting in 2027	On or before January 1, 2026 and biennially thereafter

[1] A partnership, corporation, limited liability company, or other business entity formed under the laws of any US state or the District of Columbia, or under an act of Congress.
[2] Insurance companies are exempt from SB 261 because they are required to prepare TCFD reports under National Association of Insurance Commissioners standards.

New York and Illinois have proposed emissions reporting aligned with California. New York also has a bill that would require climate-related risk disclosures for financial institutions.

US Updates – AI, FAR, and COSO

AI Environmental Impacts Act of 2024

- AI is gaining heavy attention; this includes attention in its environmental impacts. S. 3732, 118th Congress 2D Session. In Summary:
  - i. EPA would carry out a study on the environmental impacts of AI
  - i. The Director of the National Institute of Standards and Technology to convene a consortium on such environmental impacts;
  - ii. Develop a voluntary reporting system for the reporting of the environmental impacts of artificial intelligence.

COSO Framework

- Virtually all public companies listed on U.S. exchanges follow the Committee of Sponsoring Organizations of the Treadway Commission (COSO) **framework to comply with Sarbanes-Oxley** and is **considered a generally accepted framework for controls**
- The COSO published **supplemental guidance** to help companies implement an effective **internal control over sustainability reporting (ICSR)** using the COSO Internal Control—Integrated Framework (ICIF)
- The framework provides a **roadmap and tools** which aim to facilitate the process of disclosing non-financial information
- COSO ICSR

Federal Acquisition Regulation (FAR)

- Case Number 2021-015 Department of Defense (DoD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA) contracts
- ****Requires "significant" and "major" contractors** to disclose Scope 1 + Scope 2 Greenhouse Gas (GHG) emissions. "Major" federal contractors also need to disclose **climate risk assessment process**, **risks identified**, and science-based emission-**reduction targets** (validated by a third party, the **Science Based Targets initiative (SBTi))**
- Disclosure would be via **CDP Questionnaire** and shall be made publicly available (e.g. website)
- Contracting officers required to treat a significant or major contractor as **non-responsive for noncompliance**
- Latest official update: Public comment review report due date extended to 5/22/2024

- Case Number 2022-006 outlines a **proposed policy** that DOD, GSA, and NASA agencies shall **procure sustainable products and services to the maximum extent practicable**
- **Considered practicable, unless an agency cannot**: (1) competitively and **timely acquire** a product (2) meet **reasonable performance requirements**; or (3) acquire a product or service at a **reasonable price**.
- For ENERGY STAR® or FEMP-designated products, a price is reasonable if it is **cost-effective over the life of the product** taking energy cost savings into account. This standard maintains existing exceptions to the statutory mandates to purchase certain energy-efficient products, biobased products, and products containing recovered material. This rule proposes to apply this standard of what is "practicable" to the other categories of sustainable products and services.
- Latest official update: **03/20/2024** Final rule to FARSEC for preparation of FAC.

**For the purposes of the FAR rule, an offeror is considered a "significant contractor" if the offeror received $7.5 million or more, but not exceeding $50 million, in Federal contract obligations (as defined in OMB Circular A-11) in the prior Federal fiscal year as indicated in the System for Award Management (SAM). "Major contractor" is greater than $50million.

3

Accountants in ESG

Considerations for CPAs

Increase in the use of, reliance on, and expectations for ESG reporting

Greenwashing and Incentives to misreport

Overextending on goals

Competitive landscape

New data, new systems, calculations, and significant estimates

Invoice data beyond $

Over reliance on new systems

Change in estimate vs. method vs. errors

Many regulatory requirements across multiple jurisdictions

SEC vs. CSRD vs. ISSB vs CA vs ???

Misalignment risk

Compliance risk

Assurance = Trust

Limited vs. Reasonable Assurance

CPA vs. Non-CPA

Impactful topic that the pipeline wants (maybe)

Assurance in ESG – Levels of assurance

Within non-financial information, commonly provide two levels of assurance:

Limited assurance

In a limited assurance engagement, the practitioner gathers **sufficient appropriate evidence** to conclude that the subject matter is **plausible in the circumstances**, and gives a report in the form of a **negative assurance**.

Reasonable assurance

In a reasonable assurance engagement, the practitioner gathers **sufficient appropriate evidence** to conclude that the subject matter **conforms in all material respects** with identified suitable criteria, and gives a report in the form of a **positive assurance.**

As a Certified Public Accounting firm, CPA's comply with US professional auditing standards and provide limited assurance over non-financial information in accordance with the AICPA clarified standards AT-C 210.

[CAQ - S&P 500 ESG Reporting and Assurance Analysis](https://www.thecaq.org/sp-500-and-esg-reporting)
Updated June 2023
99% of S&P 500 reported ESG-related information

source: https://www.thecaq.org/sp-500-and-esg-reporting

The State of Play - IFAC

FOREWORD

The **goal of sustainability disclosure must be information,** including the processes in place to prepare it, that is on par with financial reports**. We believe professional accountants will play a significant role in enabling comparable, reliable, trustworthy sustainability reporting as well as its assurance**. For example, for the third consecutive year, when a company chooses an accountancy firm for a sustainability assurance engagement, it's more likely to be the same firm (73% in 2022) as their statutory auditor. In conducting these engagements, **professional accountants use standards set in the public interest**—including quality management, ethics, and independence—developed by the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA). Transitioning from **voluntary to *mandatory*** requirements for reporting and assurance will be a significant change—requiring enhanced rigor in **data collection, systems, processes, internal controls, and governance** within companies that must prepare to fulfill new legal requirements. This is where our profession will rise to the challenge. We hope this research about global trends and current market practice is helpful for regulators, policy makers, standard setters, and all reporting and assurance practitioners.

KEY FINDINGS: 2019 | 2020 | 2021 | 2022

	2019	2020	2021	2022
reported some ESG information	91%	92%	95%	98%
of assurance was limited	83%	82%	80%	82%
obtained some level of assurance	51%	58%	64%	69%
*of firms applied ISAE 3000 (Revised)**	88%	94%	95%	92%
assurance engagements conducted by firms	63%	61%	57%	58%
of other service providers applied ISAE 3000 (Revised)	34%	39%	38%	38%

* Including all standards issued by accounting and audit bodies—such as the AICPA's attestation standards and IAASB's ISAE 3410—Firms applied accounting and audit body standards, 96% in 2019, 96% in 2020, 99% in 2021, and 99% in 2022.

Source: https://www.ifac.org/knowledge-gateway/contributing-global-economy/discussion/state-play-sustainability-assurance

Internal audit’s role in ESG reporting

Internal audit can provide comfort over ESG to their organization and external parties such as investors by assessing the design and effectiveness of internal controls over the ESG program, linking ESG risks to enterprise risks, and verifying the completeness and accuracy of data used in ESG reporting and disclosures.

Adoption of generally accepted ESG standards drives alignment across the organization

Policies & procedures

Assess reporting criteria, metric definitions, metric processes and procedural guidelines. Assess 3rd party contractual requirements with ESG and internal policies.

Ratings from 3rd parties (i.e., MSCI) use reported ESG data

Data management

Assess processes and tools related to data collection, quality, access and organization - focusing on completeness and accuracy.

Investors rely on metrics as indicators of long-term risk-adjusted returns

Calculations & estimations

Assess processes, inputs and assumptions used to calculate a metric, including estimation methodologies.

Formal processes and controls ensure reliable ESG data

Control design & review

Assess internal controls around the data collection, calculation, and reporting of the ESG metric, including management review and IT systems.

Misstatements pose financial and reputational risks

Consolidation & disclosure

Assess the tools and processes used to consolidate all metrics in preparation for external disclosure.

4 Common Hurdles and Opportunities

Common challenges faced with ESG reporting

Undefined and manual processes

Many processes are manual and undefined which usually lead to errors, stress within an already stressed workforce, and missed opportunities

Fragmented source systems and sporadic requests

Stressed reporting systems and surprise requests are never good ingredients in a fast paced reporting environment

Lack of transparency and unified vision

Requesters, providers and users of ESG data often lack an understanding of the data's purpose - this often leads to misalignment in messaging

Other

This is a wild card. Third party reliance, data ingestion, heavy estimates and significant assumptions, and ill-defined timelines often plague attempts at reporting trust and quality

What we are seeing as possible solutions or leading practice trends…

Undefined and manual processes

- **Avoid overreaching** - align institutional strategy to people and **rightsize the approach**
- Create a **reporting infrastructure** to support publicly communicated goals and accomplishments - **hint: ask financial reporting teams**
- Build on **existing controls and policies** related to reporting
- Processes + controls

Fragmented source systems and sporadic requests

- **Tech and data** are key here. Consider existing data architecture when evaluating software solutions to build **scalable and integrated solutions**
- Confirm that solutions include **end-to-end traceability** between source data, reports and disclosures
- **Simplicity leads to understanding** - choose your tools wisely

Lack of transparency and unified vision

- Establish **clearly defined roles and communicate** expectations
- Update current **operational policies** to better align with future goals related to sustainability
- **Increase and upskill** the workforce to support data collection, calculation, and reporting
- This is a **cross-functional effort** - involve **all stakeholders and data owners**

Other

- Data collection is one thing, **data ingestion** is another that is important to consider (e.g. **aggregate and analyze data**)
- Sustainability and ESG KPIs are often estimates that require significant assumptions. Having a **process or basis of preparation in place** is key for **repeatable calculations**
- Subsidiaries or internal teams go rogue and **duplicate efforts** with often **misaligned results or conclusions**

Enhancing ESG processes & controls to meet rigors of mandatory reporting

Overall trend: Increasing need for formalized ESG reporting processes and controls similar to financial reporting

Policies & procedures

- Enhance Inventory Management Plans (IMPs)
- Document metric-level policies, processes and data flows
- Define roles, responsibilities, and hand-offs
- Identify critical path and accelerate reporting timelines

Data management

- Identify IT dependencies: systems, reports, interfaces, configurations, etc.
- Enhance and integrate data collection processes
- Increase frequency of data collection
- Develop data consolidation processes
- Implement data archival & retention standards

Calculations & estimations

- Document and verify calculation methodology, inputs, and assumptions
- Prepare for manual adjustments & data cleansing
- Apply estimation methodologies consistently

Control design & review

- Formalize control activities to improve consistency & precision
- Implement IT controls for systems supporting reporting
- Corroborate and reconcile data sources
- Identify 3rd party dependencies
- Generate and retain supporting evidence

Consolidation & disclosure

- Align with standards
- Integrate with financial reporting process
- Verify consistency across reporting channels
- Navigate disclosure review committees
- Obtain third-party assurance

Example ESG Risks and Opportunities

Risks

- Climate change and environmental impact
- Natural resource depletion
- Pollution and waste management
- Supply chain management and labor practices
- Human rights violations
- Product safety and quality
- Cybersecurity and data privacy
- Regulatory compliance and legal issues
- Reputation and brand damage
- Stakeholder engagement and community relations

Opportunities

- Innovation in sustainable products and services
- Energy efficiency and renewable energy adoption
- Waste reduction and recycling initiatives
- Diversity and inclusion in the workforce
- Employee health and well-being programs
- Ethical sourcing and responsible supply chain management
- Philanthropy and community investment
- Transparent governance and board diversity
- Stakeholder engagement and partnerships for positive impact
- Long-term value creation through sustainable practices

Thank you