ESG: A new era in practice opportunities

Insights from the AICPA and CPA.com ESG Symposium

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Inside

Introduction

While environmental, social and governance (ESG) issues have increasingly been added to organizational agendas over the past several years, new and emerging reporting mandates and continued pressure from stakeholders are making ESG a top priority. At this year's AICPA and CPA.com ESG Symposium—the second annual gathering of more than 60 representatives from companies, firms, standard setters, regulators and technology providers in the ESG ecosystem—much of the discussion focused on the value that CPAs can deliver in this space. "Rising market demand for ESG services is providing significant opportunities for the accounting profession," said Erik Asgeirsson, president and CEO, CPA.com.

Purpose-built ESG business services—consulting, implementation, engineering and IT services that are chiefly designed to drive sustainability-related outcomes—are expected to grow from nearly $38 billion in 2023 to almost $65 billion in 2027, according to **International Data Corporation**, which called it "one of the fastest growing spaces in the business world."

The portion of companies globally that report having a long way to go to be ready for ESG assurance to meet new regulatory requirements, according to a **KPMG survey**.

Three of the top 100 firms below the Big Four in attendance estimated that ESG services would be at-least a $100 million service line.There's reason to believe that opportunities in the ESG services arena could have a proportionate impact on smaller firms, as well. This will happen because these small business clients are in supply chains to larger companies that must comply with the regulations. They may be expected to meet certain ESG requirements and report certain metrics and progress to remain in the supply chain of these larger companies. Since smaller businesses don't have the internal resources necessary to meet their larger business partners' expectations, they may look to their trusted advisors for help.

And while climate change can be a controversial topic for some, it's undeniable that pending legislation and the market environment will have an impact on businesses that cannot be ignored. The accounting profession is perfectly positioned to provide the measurement, reporting and assurance that will enable good decision making, noted Barry Melancon, CPA, CGMA, AICPA & CIMA president & CEO.

Firms will face hurdles within this space. An intricate set of drivers—stakeholders' expectations as well as national, regional and global regulations and legislation—have created complexity. Uncertainty is expected to persist in this complex ecosystem, and it may often be influenced by factors that the profession can't control, according to Melancon. Useful and effective ESG reporting will depend on commonly accepted standards, which are beginning to emerge. "CPAs have the opportunity to offer data-driven solutions," he said.

An advocacy role

The AICPA has long called for business reporting that goes beyond financial issues alone, Melancon noted, and a global answer makes the best sense. That's why the profession took on an important advocacy role in the development of the International Sustainability Standards Board (ISSB), which is supported by the IFRS Foundation. The ISSB has issued the first two global standards related to sustainability reporting. The intent was to create a new system of reporting with as much commonality of application as possible that could be used around the world. Stakeholders believe the board has achieved that goal. Calling them "a major step towards consistent, comparable and reliable sustainability information," the International Organization of Securities Commissions (IOSCO), an association of organizations that regulate the world's securities and futures markets, endorsed the ISSB standards, a significant affirmation of their value. IOSCO went on to call on its 130 member jurisdictions, which regulate more than 95% of the world's financial markets, "to consider ways in which they might adopt, apply or otherwise be informed by the ISSB standards."

For the AICPA, the overarching goal of all these efforts is to help position firms as leaders in this space, said Susan Coffey, CPA, CGMA, CEO—Public Accounting, AICPA & CIMA. "People turn to us because of our expertise and knowledge," she said.

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A turning point in reporting regulation

Regulators are laying down the law when it comes to ESG. For many years, companies that disclosed sustainability information have been able to follow any one or more of a wide variety of existing frameworks and, in the absence of mandates, they have been able to follow some or all guidance in those frameworks. That can hinder comparability and consistency and raise questions about reliability. However, firms and their clients should be aware of a range of recent and pending developments that are changing the game when it comes to sustainability regulation and reporting. In addition to the new global ISSB reporting standards mentioned in the introduction, there are several other developments to watch.

California climate-change reporting laws. Two new laws are among the latest and most significant actions yet taken by regulators or legislators, setting a new mandate on reporting a company's climate footprint. One law will require companies with more than $1 billion in annual revenues to publicly disclose their scope 1, 2 and 3 greenhouse gas (GHG) emissions. Companies will also have to gain third-party assurance on their reporting. Another requires companies with more than $500 million in annual revenues to submit annual reports on climate-related risks and how they are mitigating them.

The laws are poised to have an impact well beyond the state's borders. Among other things, they apply to companies headquartered both within and outside California that do business in the state. Since California's economy would rank as one of the largest in the world if it were a country, the size of its market would scope in around 10,000 companies. In addition, while proposals by the U.S. Securities and Exchange Commission (SEC—see below) would apply only to publicly traded registrants, the California laws impact private businesses as well. Smaller companies that are not directly subject to the requirements could still be affected. As part of a larger business' value chain, they may be expected to provide their own emissions data to their larger clients or customers (see the box on "Meeting stakeholder expectations"). The proposed SEC rules have drawn some criticism, but by the time they are finalized, many U.S. businesses may already be required to make extensive climate-related disclosures under the California laws.

California law allows for assurance by a CPA and requires engagements to be performed in accordance accordance with professional standards. CPA standards provide a well-established framework firms can use to comply with the requirements.

SEC proposed climate-disclosure rules. The SEC's stated goals include ensuring that investors have access to complete, consistent and comparable climate-related information in making their investment decisions. The proposed rules call for SEC registrants to disclose information that includes:

- Scope 1, 2 and 3 emissions. For accelerated and large accelerated filers, scopes 1 and 2 emissions would be subject to independent assurance to be phased in over the near-term.
- Climate-related risks and their actual or reasonably likely material impacts on the registrant's business, strategy and outlook.
- The company's governance of climate-related risks and related risk management approaches.
- Climate-related financial statement metrics and related disclosures.
- Details on climate-related targets and goals.

While some of the disclosures mirror guidelines that already exist in other widely-followed frameworks, the SEC's disclosures would become mandatory for publicly traded companies when finalized.

The commission has declined to give a timeline for publishing the final rules. During a speech in Sept. 2023, SEC chair Gary Gensler noted that the commission is particularly focusing on issues that have been raised related to the proposed inclusion of scope 3 emissions, which some critics have questioned because of potential high compliance costs.

European Union (EU) reporting requirements. The European Sustainability Reporting Standards (ESRS) were adopted in July for all companies subject to the Corporate Sustainability Reporting Directive (CSRD), which apply to EU as well as non-EU organizations that have significant operations in the EU. In October EU legislators voted to incorporate these 12 standards into EU law, with an effective date of January 1, 2024. While climate-related issues receive much of the attention in many proposed and existing frameworks, the ESRS encompasses the full range of ESG issues. According to the European Commission, the standards offer a high level of interoperability with International Sustainability Standards Board and the Global Reporting Initiative guidance.

Scoping out the requirements

When it comes to climate-related requirements:

Scope 1:

Refers to a company's direct GHG emissions.

Scope 2:

Includes indirect emissions related to purchased electricity or other types of energy.

Scope 3:

Encompasses emissions associated with upstream and downstream activities in the organization's value chain.

The value of CPA assurance

Reporting and assurance are potential massive drivers of demand for ESG services. But while the global assurance market is growing, the percentage of assurance reports being performed by the profession has actually declined in recent years. A total of 57% of ESG assurance engagements were conducted by audit firms, according to a survey by IFAC and the AICPA & CIMA, compared with 63% two years earlier. "It's going in the wrong direction for the profession," noted Ami Beers, CPA, CGMA, senior director—Assurance and Advisory Innovation, AICPA & CIMA. The competition in this market includes various non-CPA providers, such as those offering verification of some type of ESG effort, consulting, engineering and non-CPA assurance.

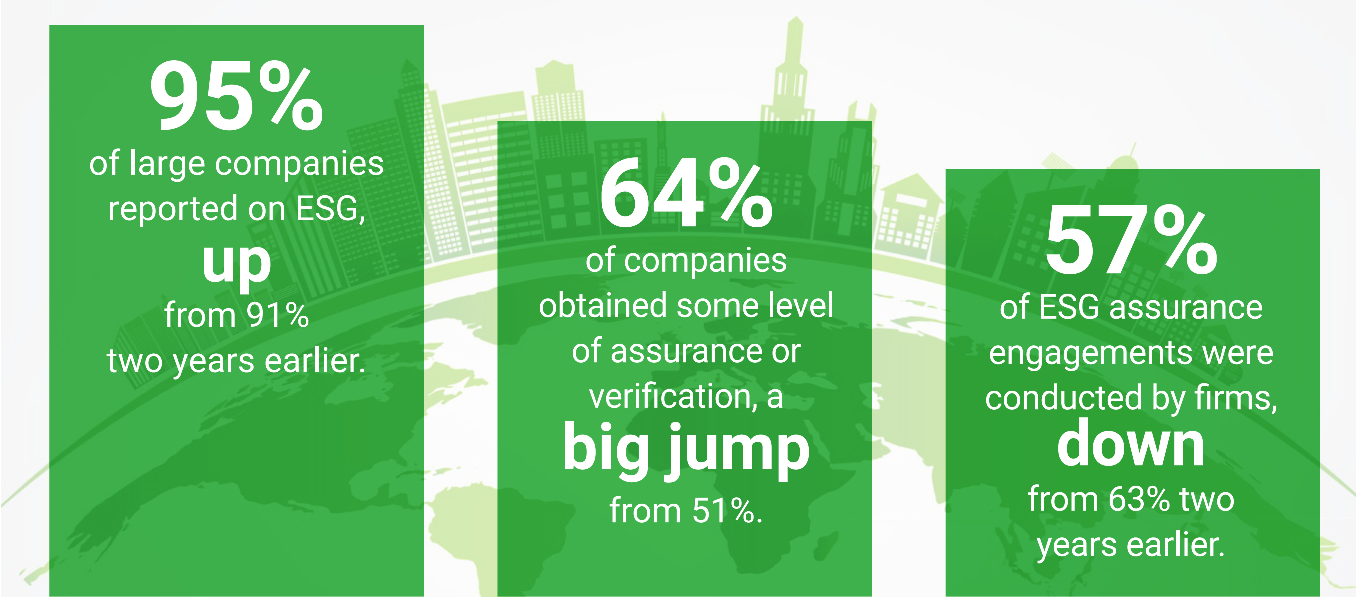
A key concern about this trend is the knowledge gap between CPAs and other service providers. Consultants and engineers with expertise in ESG areas may have less experience in the many facets of proper assurance.

Among the arguments in favor of ESG assurance done by CPAs are:

- The profession's attestation standards, which have been supporting assurance of nonfinancial information for decades.
- The profession's oversight structure for engagements through quality management and peer review, which sets it apart. "A lack of oversight for other service providers is a point of AICPA advocacy," Beers said.
- The profession's independence requirements. While CPAs are accustomed to maintaining independence in assurance engagements, other service providers may not do so. In fact, mandatory independence requirements may ultimately drive some non-CPAs out of this market if it forces them to change the way they work with clients.

Expected growth in demand for ESG assurance

The most recent data available shows that:



Source: [The State of Play: Sustainability Disclosure and Assurance](), IFAC and AICPA & CIMA, February 2023.

More companies may turn to accountants for assurance as their needs mature and broaden. At present, many companies that are seeking assurance for the first time are focusing largely on GHG or other emissions, according to a study of global sustainability practice by the International Federation of Accountants (IFAC) and the AICPA & CIMA. "That tends to be an area where companies turn to consultants or other service providers," said David Madon, CPA, IFAC director, public policy and regulation.

As assurance mandates grow, companies will likely seek assurance over a wider scope of topics—within other environmental topics and in social and governance areas. Since many other service providers specialize in specific aspects of ESG, the need for a broader perspective should lead to more opportunities for accountants. A Center for Audit Quality analysis of S&P 500 companies found that companies are increasingly more likely to gain assurance over topics such as water, energy, waste, employee health and safety, human capital disclosures and others—a trend that is expected to continue.

At the same time, as mandates grow, "we'll see companies take steps to enhance the quality of their ESG reporting by, for example, improving systems of internal control surrounding ESG reporting," said Desiré Carroll, CPA, CAQ director, professional practice, a shift that should naturally lead them to CPAs. At the same time, "as the need for connectivity between financial and ESG information becomes more important, the public company auditor who performs the financial statement audit is well positioned to provide assurance in a connected way," she said.

Keep in mind that if a client will be seeking assurance, it will require data and processes that are audit-worthy. CPAs should expect that many may need time to build thorough and reliable ESG data collection systems, internal controls and internal audit structures, Madon said.

Accountants are the best choice to perform engagements that connect sustainability assurance with financial statement audits, based on accountants' rigorous and widely accepted professional, quality management and ethical standards. The CAQ analysis found that 90% of U.S. companies that obtained ESG assurance from a public company auditor used the same firm that performed their financial statement audit. The global survey by IFAC and the AICPA & CIMA found that 70% of the time companies that obtained sustainability assurance from a professional accountant engaged their statutory auditor to review their ESG disclosures.

"The move from voluntary to mandatory assurance will be a potential game changer for the profession versus other assurance providers," Madon said. "The profession should feel confident we're well positioned to provide that business."

IOSCO has encouraged international boards to develop global sustainability assurance standards. While accountants have turned to the International Auditing and Assurance Standards Board's (IAASB) International Standard on Assurance Engagements 3000, Assurance Engagements Other Than Audits or Reviews of Historical Financial Information for guidance in ESG assurance, a new proposal, International Standard on Sustainability Assurance 5000, General Requirements for Sustainability Assurance Engagements is directed specifically at any type of sustainability engagement. It addresses a wide range of topics, including fraud, non-compliance with law and regulations, risk assessment, internal controls and other information. The Auditing Standards Board has a working group to review and comment on the proposal.

The AICPA & CIMA provides a range of related resources for practitioners, including a new authoritative attestation engagement guide on greenhouse gas emissions information and climate-related financial disclosures.

Quantifying the value in finance

CFOs attempting to get their arms around ESG issues are working to understand and quantify the factors involved. As CFOs continue to seek a financial ROI for sustainability programs, many may be ignoring the societal push from stakeholders, including employees and customers. However, there are solutions that can help determine value and respond to expanding stakeholder expectations.

A Harvard Business Review article offered one possible solution, a Return on Sustainability Investment (ROSI) analytic method to use in measuring financial returns on sustainability efforts. The impact of understanding these metrics can be significant. As the authors, a professor and a researcher at the NYU Stern Center for Sustainable Business, note, “nonfinancial metrics such as carbon emissions can reveal hundreds of millions of dollars in sustainability-related savings and growth.” In addition, quantifiable sustainability efforts can be a differentiator in the marketplace, appealing to talent and customers or business partners who have a commitment to sustainability efforts.

The authors set forth nine drivers of corporate financial performance that can be enhanced through sustainability strategies: innovation, operational efficiency, sales and marketing, customer loyalty, risk management, employee relations, supplier relations, media coverage and stakeholder engagement. As part of the ROSI process, the article recommends identifying the company’s current sustainability strategies and related changes in operational or management practices, ascertaining and quantifying the benefits and determining the overall monetary value. If finance can evaluate and communicate the value of company sustainability initiatives, it can better articulate their impact and value. The NYU Center’s site offers more ROSI resources and tools. The section in this report on “8 steps to building an ESG service line” describes other hurdles for finance teams, including resource limitations and timing of investment and returns.

If finance can evaluate and communicate the value of company sustainability initiatives, it can better articulate their impact and value.

8 steps to building an ESG service line

How can CPAs benefit from the opportunities in this practice area? These best practices can help firms launch or enhance their ESG practice.

1. **Executive sponsorship** is critical if the ESG services team is going to have sufficient resources, including adequate staffing and access to sales, marketing and other resources, said Andries Verschelden, co-founder and CEO of Good.Lab, an ESG performance solutions provider (see more about Good.Lab's partnership with CPA.com in "Powering ESG service lines forward.")

2. **Pick the right team leader.** Verschelden advises companies to identify and empower an internal leader who is savvy about the firm's inner workings and has experience in building practices or the potential leadership skills to do so. Then team that leader up with an expert in technical ESG issues. In recruiting for the team, keep in mind that an ESG practice:
   - Can be a hiring advantage among professionals who are seeking a deeper purpose in their work.
   - Can include a variety of professionals in addition to CPAs.

3. **Partner whenever possible.** Since CPA firms are not experts in operations outside of financial processes or developing a decarbonization plan, they should be sure to focus on leveraging their own expertise. However, through a collaboration with an ESG consulting group or technology company, firms can find the technical or technology expertise they need without having to build from the ground up. This approach can also enable firms to provide the technology-enabled consulting clients will be seeking. An acquisition of a company with specialized expertise is another option.

4. **Don't store the practice in a silo.** ESG issues will touch on areas that include assurance, audit and tax, as well as industry specialties, said Chris Tower, CPA, who recently retired from his position as managing partner, Sustainability & ESG, at BDO. The ESG service line should be able tap into expertise and cooperation throughout the firm as needed.

5. **Build a practice based on market demand, not simply on firm capabilities.** Firms may have many practice strengths, but the first and most important question to ask is, "What are the clients in your strongest industry areas actually seeking?"

6. **Meet clients where they are.** Most have likely never bought an ESG solution before, so they will have questions about budget and processes. Consider starting with a low-cost solution, such as an assessment or a diagnostic around compliance readiness, for example, to establish the firm as a trusted advisor. "Chances are if you do that right, they will come to you for future ESG needs," Verschelden said.

7. **Understand internal hurdles for clients.** Because the return on ESG efforts may be difficult to quantify and may not be immediately clear, companies often have to wrestle with the timing mismatch between making an investment and seeing a return. CPAs may need to help articulate the benefits that ESG information can offer to companies, including a deeper perspective on their business and improved decision-making. Another consideration is that, as reporting and assurance become mandatory, companies may tend to see them as new compliance burdens. However, "companies have to take a longer-term view and understand the true value of the information to investors," said Madon.

8. **Provide your own sustainability report.** "If you launch a service line without an introspective effort you're making a mistake," Tower advised, given the insights and credibility that sustainability reporting can provide.

Three key services clients are seeking

There are a few core services that most companies are looking for now.

1. **ESG strategy building.** Most midmarket companies are seeking advice on enhancing their approach to ESG issues and addressing any mandates. The answers and the type and scope of solutions will be very different for a manufacturing company and a professional services firm, and for companies that are or are not facing compliance mandates. The company may need a roadmap and help in determining any sustainability targets and in understanding how to benchmark its efforts against its competitors and overall industry. In addition, a playbook on meeting compliance requirements can help companies address requirements.

2. **Addressing GHG emissions** measuring and reporting, and understanding the carbon footprint. Companies will be seeking measurement and reporting advice and data assurance from their CPA firm, as well as advice to help them choose the best technology platform for these efforts.

3. **Understanding climate risk considerations** and establishing a governance and management structure to manage and report on the risks and opportunities. The California Climate Accountability Package, for example, requires companies to consider the financial impact of physical changes caused by climate change and how those changes impact the business. Other considerations should include issues such as the cost of transitions away from fossil fuels to renewable energy throughout an organization's operations. Most midmarket companies have not been measuring the financial impact of climate risk, providing an opportunity for accounting firms to help companies put a plan in place during the run up to the 2026 reporting deadlines.

Powering ESG service lines forward

Business model strategy is a key component in rolling out any new service. With that in mind, CPA.com has partnered with Good.Lab, an ESG performance solutions provider, on a practice development program to help firms accelerate their entry into the ESG advisory services market. The program launched in 2023 with an initial cohort of five firms from the AICPA Major Firms Group to develop a firm practice services roadmap that will enable firms to create service delivery plans and cultivate a practice. A second cohort is planned for 2024.

To provide more of the training firms need, the AICPA & CIMA and the University of Oxford's Saïd Business School are offering a **new executive management program** in sustainability for accounting and finance professionals. The AICPA & CIMA provides a variety of other sustainability-related professional development opportunities, including an **ESG & Sustainability Conference**. For other related tools, turn to the **AICPA & CIMA Climate & Sustainability/ESG resource center**.

Meeting stakeholder expectations

Many entities of all sizes already must meet sustainability reporting standards set by customers or business partners. For example:

- Amazon's Supply Chain Standards Manual requires suppliers and service providers "to behave in a lawful and responsible manner, protect the environment, act safely and responsibly, and safeguard worker rights." The 21-page manual covers a supplier code, audit requirements and a corrective action plan, among other topics.
- In its Supplier Expectations Compliance Areas, Walmart sets forth a lengthy list of U.S. and global supplier requirements in areas that include consumer protection, environmental health and safety, health and wellness product safety, and conflict minerals compliance, among others.
- The federal government's proposed Federal Supplier Climate Risks and Resilience Rule would set forth climate-related reporting requirements for companies with more than $50 million in annual contracts and separate rules for those with annual contracts between $7.5 million and $50 million. The world's largest single buyer of goods and services, the government bought over $630 billion in a recent fiscal year.

Solving the matrix

CPAs should think of the ESG landscape as a matrix with a complex set of drivers. Demand for reliable and assured ESG information will only continue, opening up a significant range of opportunities for firms. CPAs can add tremendous value to the market, but they will face competition, at least in the near-term.

Other challenges in this space include pressure on some fronts to push back on corporate reporting requirements as well as political controversy about climate change in the United States. In the end, though, "if companies have good measurement and reporting, they should be able to make good decisions," Melancon said. "As a profession, we need to be a player in helping society to make those decisions."

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