Strengthening Your Financial Management: Considerations and Best Practices

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ESG and You: Preparing your organization for success

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Agenda

Learning objectives

- Define ESG and its main pillars
- Understand the primary drivers of ESG-related initiatives
- Understand key actions you can take to develop and support your organization’s ESG journey

ESG overview

Environment

Climate change, greenhouse gas/carbon emissions, environmental policies, energy/renewable usage, water usage, land protection, biodiversity, waste management, etc.

Social

Diversity, equity & inclusion policies, wage gaps, health & safety, human rights and child labor protections, data privacy, community relations, employee engagement, well-being etc.

Governance

Board composition, executive compensation, leadership diversity, stakeholder engagement, data security, ethics, bribery and corruption, lobbying, political contributions, etc.

ESG drivers

Recruitment and Retention

Employees may want their employer to be ESG conscious

Expectations and Reputation

Key stakeholders may want the organization to lead and engage in ESG-forward activities

Business and Risk Management

There is an expectation that ESG initiatives will become cost effective and therefore become prudent financial decisions

Current ESG landscape – reputation, recruitment, retention

83%

of consumers think organizations should be actively shaping ESG best practices.

86%

of employees prefer to support or work for organizations that care about the same issues they do.

76%

of consumers will discontinue relations with organizations that treat employees, communities, and the environment poorly.

Source: PwC Consumer Intelligence Series June 2, 2021

Polling question #1

Current ESG landscape

Not-for-profits

- Colleges and universities are leading the charge with ESG
- Many are publishing their own sustainability reports
- According to the Association for the Advancement of Sustainability in Higher Education (AASHE), over 1,000 colleges and universities participate in the Sustainability Tracking, Assessment and Rating System (STARS)
- ESG is a significant factor for students and employees
- Students are accounting for a school's commitment to ESG in their final decision
- Employees want to work for not-for-profits that promote an ESG culture

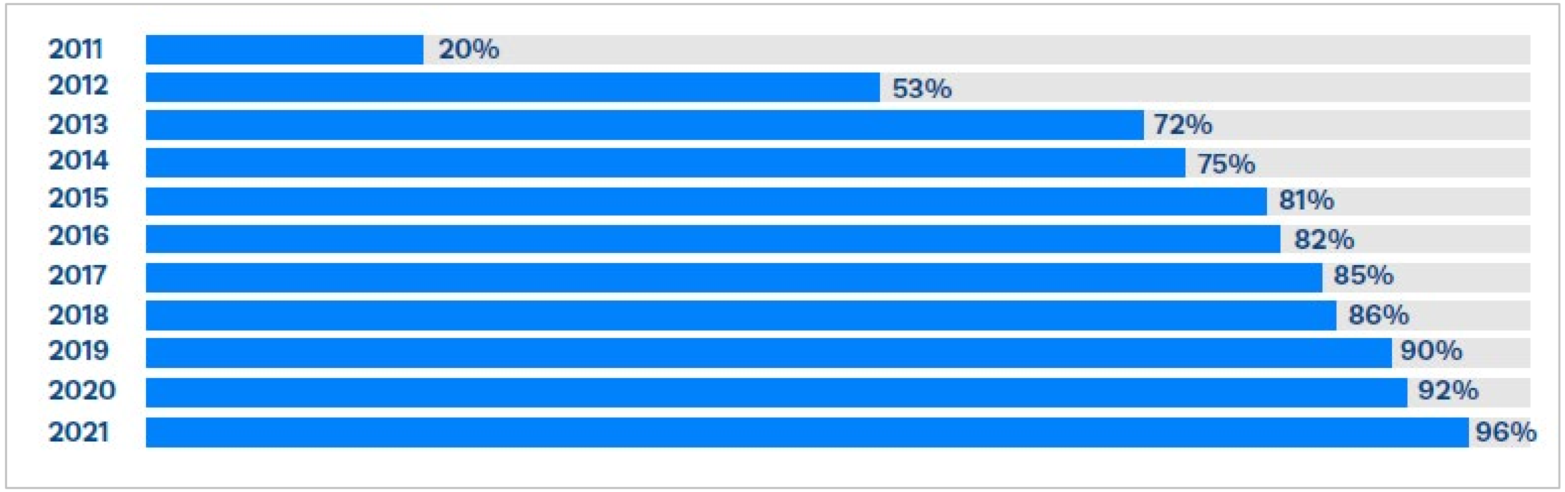
Source: https://www.aashe.org/news/aashe-releases-2020-sci/

Current ESG landscape

Sustainability reporting

All-time high:

- 96% of S&P® 500
- 81% of Russell 1000®



Source: 2022 Sustainability Reporting In Focus (ga-institute.com)

Current ESG landscape

Regulations and standards

1

International Sustainability Standards Board (ISSB)

Created 11/3/2021 by the International Financial Reporting Standards (IFRS) Foundation trustees to establish common global disclosure requirements

2

The U.S. Securities and Exchange Commission (SEC)

Also looking to establish common disclosure requirements for U.S. companies and organizations

3

Target finalization for initial work is 2023

While compliance will directly affect the largest organizations first, it is estimated that everyone will be affected within 5-10 years

Journey

EXPLORE	COMPLY	LEAD	INNOVATE
Learning	**Risk/Audit management**	**Strategic**	**Purpose-driven**
Research	Standards	Materiality	Leading
Knowledge-share	Data	Directed	Cultural
Informal	Assigned role	Intentional	Operationalized
Individual	Ratings	Integrated	Transformational
Small teams	Some reporting	KPIs	
Frameworks		Brand	

Actions

1. Survey key stakeholders, find out what is important to them
2. Identify and prioritize the most important relevant issues with the greatest potential impact
3. Understand what types of data and information would be beneficial to know; plan how to collect and analyze it and/or improve existing reporting
4. Consider how ESG risks and opportunities impact your organization
5. Familiarize yourself with standards and frameworks, benchmark what other leaders in your industry are doing, foster collaborations

Polling question #2

Key takeaways

Uncertainty	**There is currently lots of uncertainty in the ESG space.** The narrative is rapidly evolving and there are many different players from varying perspectives – regulators, standard-setters, investors, consumers, communities, etc.
Demand is growing	**Constituents are increasingly looking for more from their organizations.** Key stakeholders want to interact with or work for organizations that align with their values; many may decide to only donate to, invest in, volunteer with, work for, or buy from organizations with a demonstrated commitment to ESG.
Inaction is still a decision	**The level of uncertainty and rapid pace in which the ESG space is evolving can be daunting.** However, there are steps that organizations can take now that will help them prepare while the ESG space continues to evolve.
Actions you can take today	**Strategize, designate, and explore.** Conversations amongst the board and management can happen now. Start crafting your ESG strategy. Designate an individual to keep apprised of ESG trends. Explore the ESG space within the context of your strategy—this exploration may lead to revisions of your strategy.

Resource

Key concepts and acronyms

Concept / Acronym	Meaning
Carbon neutral	Perfect balance between carbon dioxide emissions and what can be absorbed by the atmosphere
DEI (or DEIBA)	Diversity, Equity and Inclusion (or Diversity, Equity, Inclusion, Belonging and Accessibility) refers to frameworks, policies, and procedures for fair treatment and full participation of all people in organizations
ESG	Environmental, Social, and Governance refers to a host of primarily non-financial risks and opportunities in everyday operations that may affect an organization’s resilience and performance
ESG framework	Framework is structural, providing the overall objectives, topics, and processes for an organization’s ESG strategy and initiatives; often voluntary and flexible
ESG standards	Standards are a detailed set of criteria and requirements; may be mandated and regulated, and differ by industry
KPI	Key Performance Indicators measure an organization’s success against a set of targets or standards
Materiality assessment	Identification, analysis, and prioritization of ESG issues important to an organization’s stakeholders for maximum performance benefit
Scope 1, 2, 3 emissions	Scope 1: direct emissions from organizational operations (e.g., heating buildings, driving vehicles) Scope 2: indirect emissions from an organization’s energy purchase and use Scope 3: indirect emissions from an organization’s customer and supplier activity
Sustainability	Ability to meet present needs without compromising future needs

Resource

Creating your ESG program

	Overview
1	Understand which ESG topics and metrics are important for your organization
2	Select frameworks, if needed
3	Collect ESG data needed to report against selected frameworks
4	Analyze data, identify initiatives, and set goals
5	Audit data and publish reports and disclosures (may be optional)
6	Operationalize program, initiatives, goals and action plans
7	Continue to monitor progress and update reporting

Source: AuditBoard.com

Resource

ESG Reporting

Framework	Focus
GRI Global Reporting Initiative	Corporate and social responsibility with a strong emphasis on transparency and materiality, especially on social issues
SASB Sustainability Accounting Standards Board	Integrated reporting with financial accountability (industry-specific standards)
TCFD Task Force on Climate-Related Financial Disclosures	Climate change risks
UNSDG United Nations Sustainable Development Goals	Global partnership across sectors and industries to achieve sustainable development of all (17 Global Goals)

Source: How to Choose an ESG Reporting Framework

Resource

Sample standard and key performance indicators

Sample ESG Scorecard – **Nonprofit**

armanino

Use this scorecard to identify the ROI and KPIs for the UN's Sustainable Development Goals (SDGs) applicable to nonprofit organizations.

	United Nations Sustainable Development Goals		Return on Investment	KPIs
Environmental	#11	Sustainable Cities & Communities	• **Global Impact:** Commit to sourcing 100% of operational electricity needs from renewable sources. • **Organizational Impact:** Attract and retain eco-conscious donors and government grants.	% of energy consumption that is renewable
	#12	Responsible Consumption & Production	• **Global Impact:** Support the overall optimization of urban systems to create inclusive, safe, sustainable and disaster-resilient cities. • **Organizational Impact:** Increase access to services and programs for constituents.	Track the number of services or programs that remain available to constituents during natural disasters or human disruptive activities
Social	#3	Good Health & Well-Being	• **Global Impact:** Align human resources policies with principles of human rights. • **Organizational Impact:** Improve employee recruitment and retention in a tight labor market via HR policies and benefits.	Does the organization make health coverage available to the family and community members? If yes, how many people have benefited from this service?
	#5	Gender Equality	• **Global Impact:** Empower and promote the economic inclusion of all, irrespective of age, sex, disability, race, ethnicity, origin, religion, economic or other status. • **Organizational Impact:** Attract and retain socially conscious donors.	Report current employee demographic data and goals to increase hiring and promotion of underrepresented populations
	#10	Reduced Inequalities		
Governance	#16	Peace, Justice & Strong Organizations	• **Global Impact:** Comply with laws and seek to meet international standards; require and support business partners to do the same. Invest endowment in ESG funds. • **Organizational Impact:** Attract and retain socially conscious donors.	Document the organization's values, principles, standards and norms of behavior such as codes of conduct and codes of ethics
	#17	Partnerships	• **Global Impact:** Encourage and promote effective public, public-private and civil society partnerships, building on the experience and resourcing strategies of partnerships. • **Organizational Impact:** Obtain corporate and civic sponsorships and utilize the power of corporate communications teams to share the organization's impact on the community.	Track the number of collaborative partnerships with government and corporate entities

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CECL applies to NFPs too!

Susan Weber | Emily Parker

Learning objectives

You will be able to:

- Understand differences between current GAAP and CECL (Current Expected Credit Loss, ASC Topic 326 – Credit Losses)
- Identify core requirements of CECL
- Assess how the changes may impact not-for-profit organizations

What is affected

ASU 2016-13 Financial Instruments – Credit Losses (Topic 326)

Financing receivables

- Held-to-maturity (HTM) debt securities
- Receivables from revenue transactions (Topics 605, 606, 610)
- Reinsurance receivables (Topic 944)
- Receivables from repurchase and securities lending agreements (Topic 860)
- Net investments in leases recognized by lessor (Topic 842)
- Off-balance sheet credit exposures (guarantees, loan commitments)

Note: also applies to acquired financial assets either purchased or through a business combination – special considerations apply

Background

ASU 2016-13 Financial Instruments – Credit Losses (Topic 326)

Incurred Loss (1975–2022)

- Credit losses recognized when loss event has likely taken place (probable, incurred)
- Ignores or underestimates risk of loss in the future

Current Expected Credit Loss (2023)

- Estimate expected credit loss over the life of in-scope financial assets
  - Removes “probable” threshold
  - Requires forward-looking estimates
  - Captures probable and expected loss
- Applies to a broad range of financial assets, measured at amortized cost
- Presented as the net amount expected to be collected (change in net assets)

How is it different

1. Pooling by common risk characteristic(s)
2. New estimation requirements and methods
3. All in-scope assets should be evaluated for reserve
4. Financial statement disclosures

Calculation methods

- Discounted Cash Flow (DCF)
- Weighted Average Remaining Life (WARM)
- Vintage (Aging Schedule)
- Roll Rate (Migration) Analysis
- Probability of Default
- Snapshot (Static Pool)

https://www.berrydunn.com/webfiles/CECL-Methodologies-Guide.pdf

Forecasts and Reversion

- Consider, identify, and document economic forecast impact:
  - How do economic conditions affect your expectations of loss?
  - What economic conditions or factors matter most?
  - Who provides forecast(s) for those conditions?
  - What forecast source(s) have you determined are reasonable?
  - How far into the future have you determined the forecast(s) to be supportable?
- For periods beyond which forecasts are deemed reasonable and supportable, revert to historical loss information for the remaining life of the financial asset

Collateral-Dependent Financial Assets

When foreclosure is probable, fair value of collateral is used to determine expected credit losses

Credit losses limited to the difference between fair value of collateral – adjusted for costs to sell and credit enhancements (e.g., guarantees) – and amortized cost basis

Individually analyzed loans are to be removed from collective (pool) estimations

Disclosures

- Accounting policies and elections
- Credit quality information
- Allowance for credit losses (ACL)
- Past-due status
- Non-accrual status
- Purchased financial assets with credit deterioration (PCD)
- Collateral-dependent financial assets
- Off-balance-sheet credit exposures

Disclosures

Key components of disclosures

What isn't changing

What's new

Next Steps

- Help ensure your developed methodology is well-documented, including rationale and support for your elections and choices
- Help ensure related policies, procedures, and internal controls over CECL estimates are updated, and support staff understands the changes
- Determine the level of detail needed to meet disclosure requirements
- Review sample disclosure language in advance of year-end

3

Maintain Internal Controls and Avoid Common Audit Pitfalls

Mark LaPrade

Learning objectives

- To provide some tips to maintain strong internal controls in the current environment
- To provide a summary of some common audit pitfalls for not-for-profits

Internal Controls Over Financial Reporting

What are Internal Controls?

Process vs. Internal Control

- **Process –** completes or performs a specific function or procedure
- **Control –** prevents a process from operating improperly or detects and corrects when the process fails
- Controls systems should provide reasonable assurance that financial statements are reliable and prepared in accordance with the reporting framework
- Organization should evaluate the internal controls on a routine basis to ensure that controls are still functioning properly
  - Turnover of key personnel
  - Economic changes
  - Hybrid/remote workforce

Five Components to an Internal Control Environment

Control Environment

Risk Assessment

Control Activities

Information and Communication

Monitoring Activities

Segregation of Duties (SOD)

- Divide responsibility within a critical process to more than one person or department
  - Authorization
  - Custody of assets
  - Record keeping
  - Reconciliation
- Should be considered for each significant transaction cycle
- SOD can be challenging in a small organization
- High turnover in key positions

Considerations to Optimize the Internal Control Environment

Electronic Signatures

- Shortens turnaround time for signatures
- Eliminates the need to reintroduce paper into the workflow
- Offer enhanced security
- Prevent documents from being saved on untrusted servers

Electronic Payments

- Eliminates paper waste
- Availability of different payment options (ACH or wire transfers)
- Review who has the ability to make electronic payments
- Make sure approvals are properly documented

Electronic Approvals

- Manual approvals can be the most common delay in an organization
- Hard copies are prone to loss
- Out-of-office approvers can cause delays
- Approvals can be done via email, but make sure they are retained as support

Considerations to Optimize the Internal Control Environment

Use of a Lockbox

- Payments are sent directly to financial institution
- Employees post check based on reports provided by the financial institution
- Process cash receipts more quickly
- Removes custody from the SOD over cash receipts

Positive Pay

- Check fraud detection service related to payment processing
- Bank matches checks issued by the organization to those it is presented for payment
- Helps to automate bank reconciliation
- Simplify the accounts payable process
- Reduced risk related to disbursements

Workflow Automation

- Reduce time spent on repetitive tasks
- Reduces the risk of human error
- Increases productivity
- Less time is spent routing documents to employees for approvals

Considerations to Optimize the Internal Control Environment

Data Protection

- Ensure data is encrypted at all times
- If data is compromised, it will be inaccessible to attackers

Access Control

- Sensitive data should only be access by authorized employees with legitimate reasons to access it
- Review audit logs to scan for suspicious behavior
- Review user access rights for each transaction cycle on a regular basis

Data Retention and Storage

- Document retention policy to serve as a guide for when documents can be destroyed deliberately
- Cloud storage can be more cost effective, but does have its own risks
- Know where your data is stored and how people are accessing it

Polling question #1

Common Audit Pitfalls

Common Audit Pitfalls

1. Financial statement optimization by removing immaterial or duplicative disclosures
2. Documenting eligibility for the Employee Retention Tax Credit under the Government Orders test
3. Documentation of review of journal entries prepared by management
4. Documentation of the review of payroll change reports

Common Audit Pitfalls

5

Preparation and documentation of review of account reconciliations

6

Documentation of the formal closing process

7

Reviewing suspension and debarment for payments to vendors and employees over $25,000 reimbursed by federal government

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Missing programs on the Schedule of Expenditures of Federal Awards

Questions?

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