

Building an Anti-Fraud Framework



VBA 2022 IA Seminar
May 2022

Building an Anti-Fraud Framework

Did You Know...

ANTI-FRAUD CONTROLS

The presence of anti-fraud controls is associated with

↓ **LOWER** fraud losses **AND**  **QUICKER** fraud detection

Nearly **HALF** of cases occurred due to:

Lack of internal controls

OR

Override of existing controls

29%

20%



ONE PERPETRATOR
\$57,000
Median loss



TWO PERPETRATORS
\$145,000
Median loss



THREE OR MORE PERPETRATORS
\$219,000
Median loss

*Source: 2022 Global Study on Occupational Fraud and Abuse



Why Develop an Anti-fraud Framework

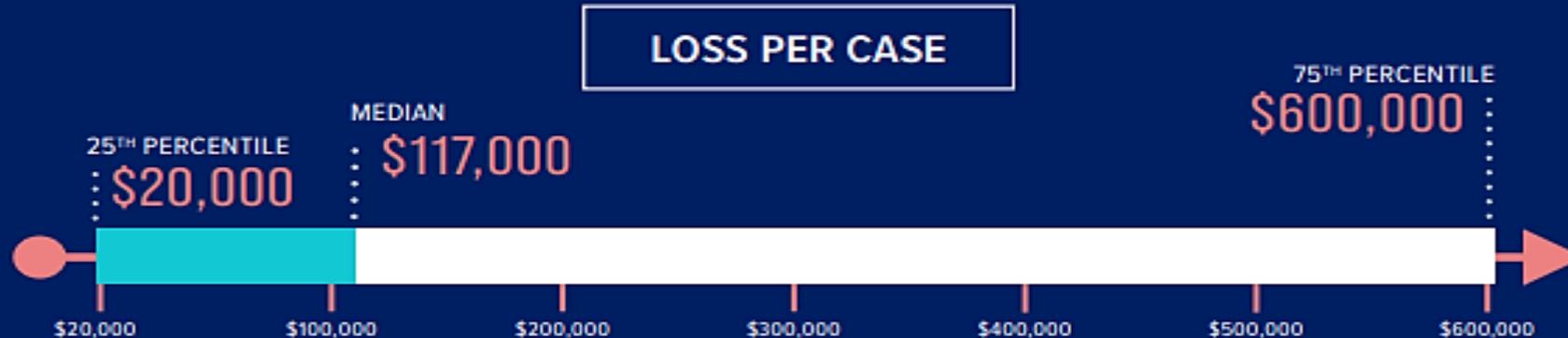
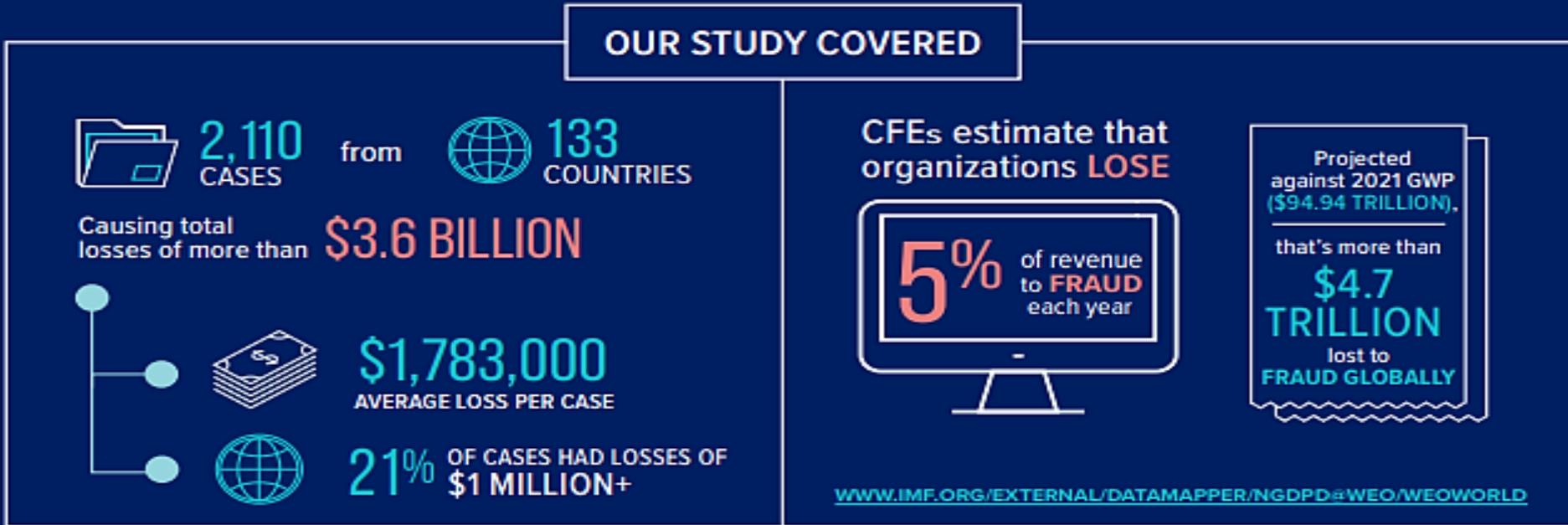
- Per the ACFE's 2022 Report to the Nations, CFEs estimate that organizations lose an estimated 5% of revenue to fraud each year. Investing in fraud prevention programs today will save your company revenues lost to fraud in the future
- External auditors and industry regulators are evaluating your programs
- Protect your company, your Board of directors, your employees and your shareholders
- Reduce fraud losses. Good fraud programs help deter and discourage fraud.

Cost of Occupational Fraud

The Association of Certified Fraud Examiners' (ACFE) 2022 Report to the Nations reported the following:

- The CFEs who participated in our survey estimated that the typical organization **loses 5% of revenues in a given year as a result of fraud**. To place their estimate in context, if the 5% loss estimate were applied to the 2021 estimated Gross World Product of \$94.95 trillion, it would **result in a projected total global fraud loss of over \$4.7 trillion**.
- The total loss caused by the 2,110 cases in the study **exceeded \$3.6 billion**, with an average loss per case of **\$1.783 million**.
- **The median loss for all cases in the study was \$117,000. Approximately 21% resulted in a loss of at least \$1 million.**
- Of the 2,110 cases in the study, 351 cases related to the banking industry (the largest reporting sector in the study) with a **median loss of \$100,000**.

Cost of Occupational Fraud



Polling Question

1

According to the ACFE's recent global study on occupational fraud, the average loss per case among the 2,110 cases in the study was approximately:

- A. \$1.8 million
- B. \$100,000
- C. \$150,000
- D. \$1,000,000

Concealment of Occupational Fraud

TOP 5 CONCEALMENT METHODS USED BY FRAUDSTERS



39%

Created fraudulent physical documents



32%

Altered physical documents



28%

Created fraudulent electronic documents or files



25%

Altered electronic documents or files



23%

Destroyed or withheld physical documents



12% of cases did not involve any attempts to conceal the fraud

EVIDENCE



57%

OF CASES involved the creation of fraudulent evidence

Created fraudulent evidence



57%

Altered existing evidence



52%

Deleted or destroyed evidence



37%



38%

OF CASES involved concealment methods affecting BOTH physical and electronic evidence.

Both physical and electronic evidence



38%

Electronic evidence



22%

Physical evidence



18%

CONCEALMENT BY POSITION



48%

of executive-level perpetrators **DESTROYED** evidence.



61%

of managers **CREATED** fraudulent evidence.

The percentage of cases involving **CORRUPTION** is on the **RISE**



33%

2012

50%

2022

FRAUDSTERS are **COLLABORATING MORE**



1 Perpetrator

58%

2012



42%

2022



2+ Perpetrators

42%

2012



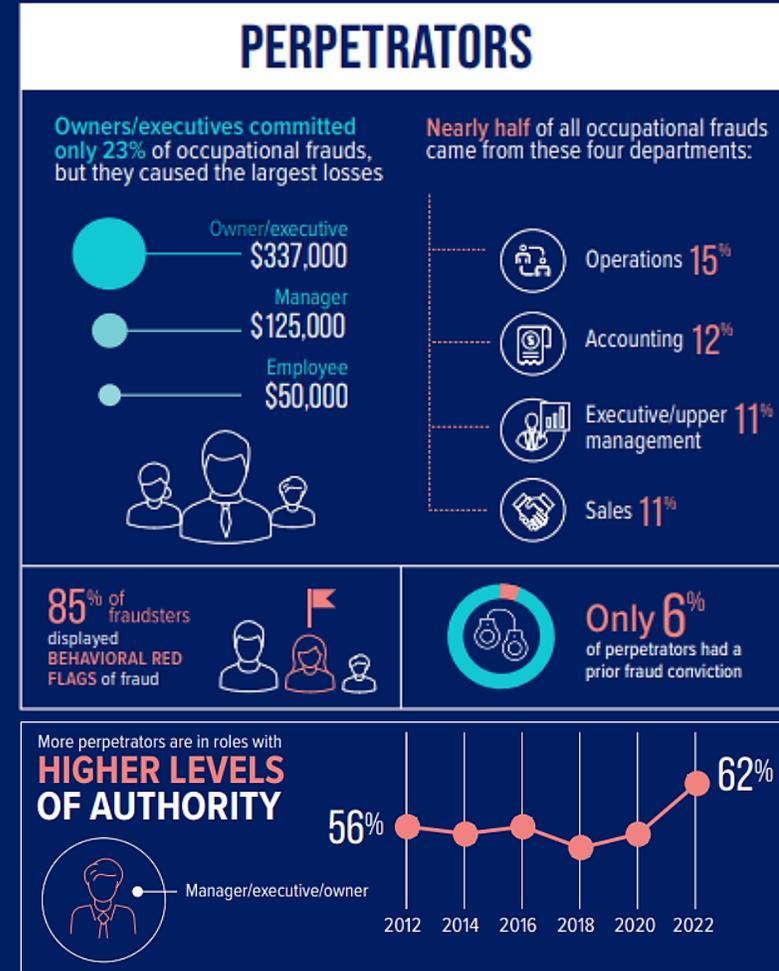
58%

2022

Fraud Losses by Types of Perpetrators

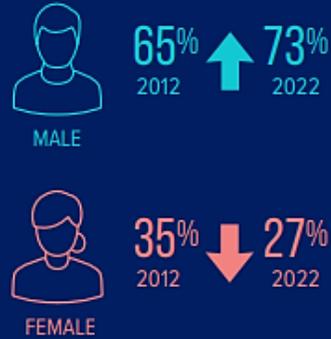
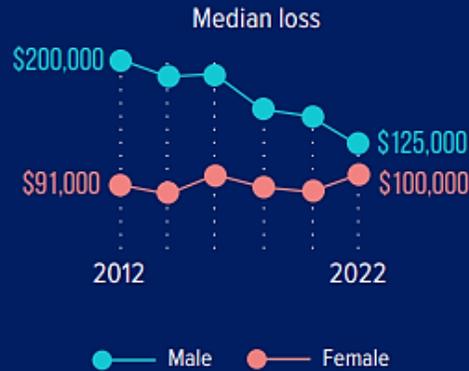
Perpetrator's Position

- The perpetrator's level of authority within an organization tends to strongly correlate with the size of a fraud. Owners/executives accounted for only 23% of the frauds in our study, but the median loss in those cases (USD 337,000) far exceeded the losses caused by managers and staff-level employees. This is consistent with our past studies, all of which found that losses tend to rise in tandem with a fraudster's level of authority. Owners/executives are generally in a better position to override controls than their lower-level counterparts, and they often have greater access to an organization's assets. Both of these facts might help explain why losses attributable to this group tend to be so much larger.



Profile of Fraudster

MEN are perpetrating an **INCREASING** percentage of **FRAUDS**, but the gap in **LOSSES** has **NARROWED**.



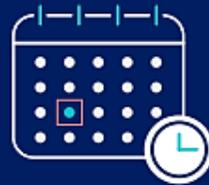
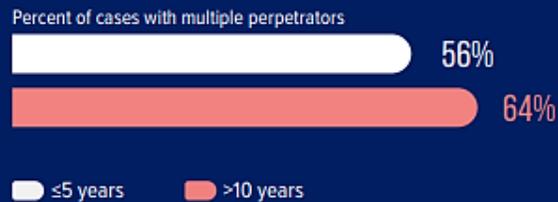
Long-tenured **FRAUDSTERS** steal almost **3X MORE**



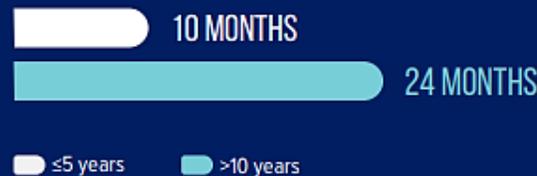
Even when **COMPARING FRAUDSTERS** with similar **LEVELS OF AUTHORITY**, **LONG-TENURED FRAUDSTERS** caused **MUCH LARGER LOSSES**



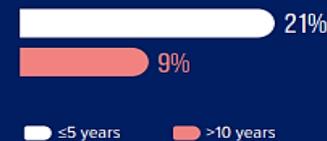
Long-tenured fraudsters are more likely to **COLLUDE**



Long-tenured fraudsters **TAKE LONGER TO CATCH**



Less-tenured fraudsters were **MORE THAN TWICE AS LIKELY** to have been previously **FIRED** or **PUNISHED** for fraud-related conduct

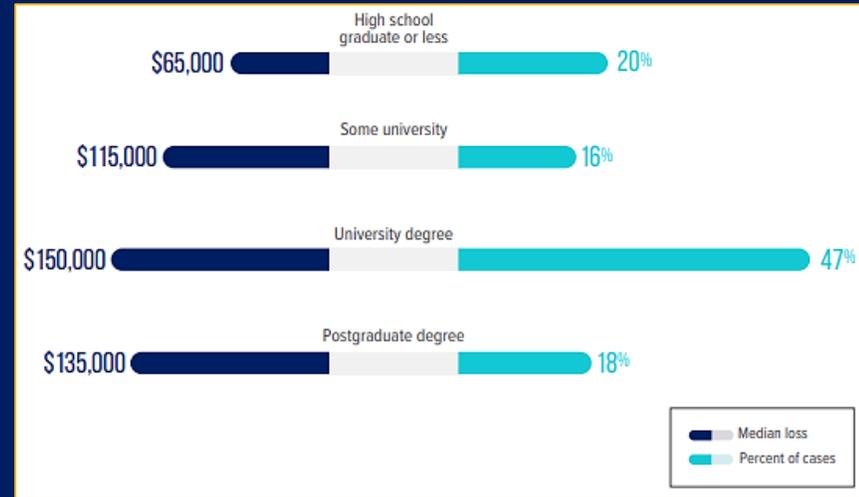


Less-tenured fraudsters were more likely to have a **CRIMINAL RECORD**



Profile of Fraudster

These **6 RED FLAGS** were much more common among long-tenured employees



- ▶ The age distribution of fraud perpetrators in our study resembles a bell curve with the majority of frauds (54%) having been committed by people between the ages of 31 and 45.
- ▶ Median losses, on the other hand, tended to directly correlate with age. Only 3% of fraudsters were over the age of 60, but the median loss in this group was USD 800,000, which far surpassed any other age category

Polling Question

2

What is the most common red flag among long tenured employees?

- A.) Family Problems
- B.) Living Beyond Means
- C.) Bullying or Intimidation
- D.) Unusually close with a Vendor

Anti-fraud Framework



Fraud Pentagon™

Today's fraudster is clever, cunning, and operating in an environment ripe for criminal activity.

- Economic unrest is making it easier for skilled employees to find ways to set fraud in motion--and they are finding cunning ways to do so.
- Senior management has to take an offensive stance against fraud and have a clear plan to minimize the impact when fraud does occur. The fraud triangle developed by Donald R. Cressey has now morphed into a Fraud Pentagon™.



Five Elements of the Fraud Pentagon™

- Knowing what may provoke an employee, even an otherwise lawful individual, to blur the line between legal and illegal activity is the key to effectively fighting fraud.
- Famed criminologist Donald R. Cressey first identified three elements – **opportunity, pressure (or motivation) and rationalization** – as the “fraud triangle” in the 1950s to explain why people commit fraud.
- Fraud is more likely to occur when someone has an incentive (pressure or motive) to commit fraud, weak controls provide the opportunity for a person to commit fraud, and the person can rationalize the fraudulent behavior (attitude).



Fraud Pentagon™

In today's world, we have to expand the fraud triangle to a five-sided Fraud Pentagon™, where an employee's skill and arrogance must be factored into the conditions generally present when fraud occurs.

- Skill is an employee's ability to override internal controls, while arrogance is an attitude of superiority and entitlement that believes that the rules and controls do not apply.
- Talent and confidence play a major role in determining whether an employee today has what it takes to see fraud through.



Benefits of an Anti-fraud Framework

Minimize long-term impact of costs of fraud to your company

Stave off regulatory investigations

Protect shareholder value

Maintain high investor confidence

Keep a positive profile in the press

Protect yourself and employees

Protect employee retirement and pensions

Keep audit fees down

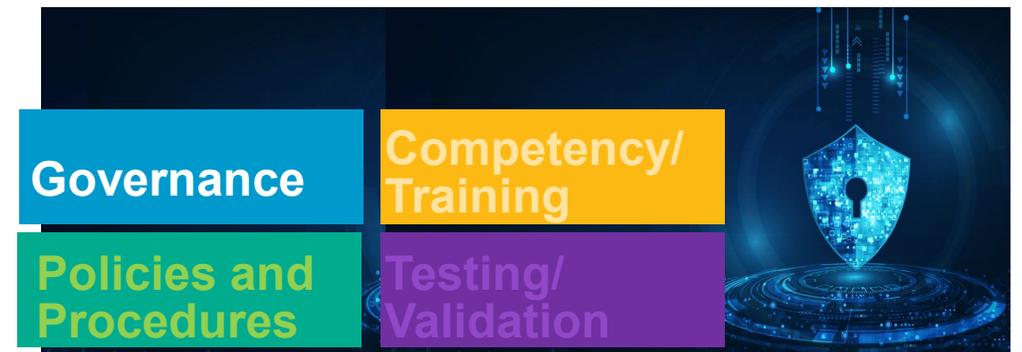
Four Cornerstones of an Anti-fraud Framework

- Governance – The effective top down oversight and direction establishing the proper “tone at the top”
- Policies and Procedures – The Board approved policies related to fraud prevention and detection
- Competency/Training – Fraud awareness training throughout the organization
- Independent Testing/Validation – Periodic testing and validation of fraud systems and capabilities



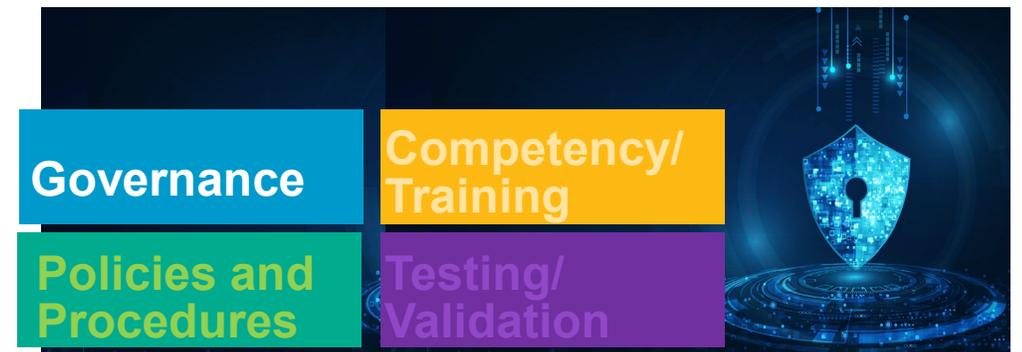
Governance

- Strong corporate culture and ethics based on integrity
- Code of Conduct/Ethics
- Conflict of Interest
- Fraud Policy
- Board and audit committee oversight
- Effective and educated board and audit committee



Governance

- No deviations from legal or ethical standards accepted
- Good leadership
- Participative top management
- Open lines of communication
- Audit reporting to highest level
- Environment in which employees believe that dishonest acts will be detected, are not tolerated, and are punished



Policies and Procedures

- Requirement to comply with all laws and regulations
- Explicit guidance regarding making payments to obtain contracts, holding pricing discussions with competitors
- Environmental discharges
- Relationships with vendors
- Maintenance of accurate books and records



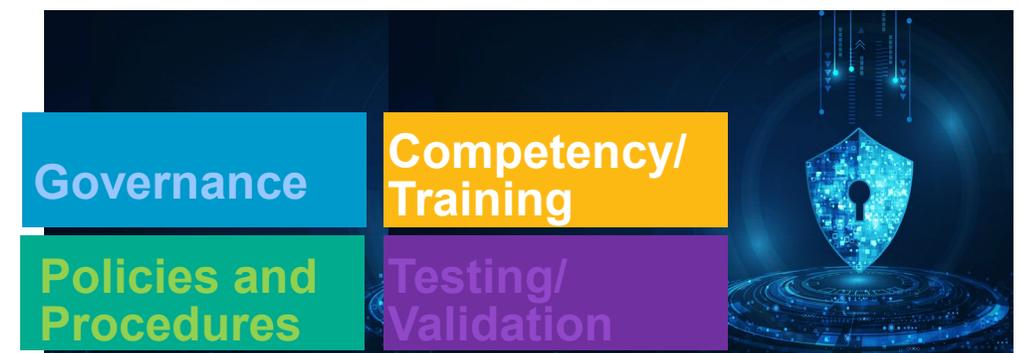
Policies and Procedures

- Specific measures implemented to deter fraud
- Establish and maintain procedures to detect fraud
- Encourage employees to report any suspicion of fraud
- Investigate all suspected fraud
- Report all suspected fraud to appropriate authorities
- Assist authorities in the prosecution of fraudsters
- Recover all assets illegally obtained



Competency/Training

- New employees trained at hiring on institution's values and code of conduct
- Fraud red flags – specific to employees' daily responsibilities
- Duty to communicate certain matters and types of matters to be communicated, including actual or suspected fraud, with examples
- Information on how to communicate those matters – hotline, independent third party, etc.
- Specific to an employee's level with the institution, geographic location, and assigned responsibilities



Training - Initial Detection of Frauds

FIG. 10 HOW IS OCCUPATIONAL FRAUD INITIALLY DETECTED?

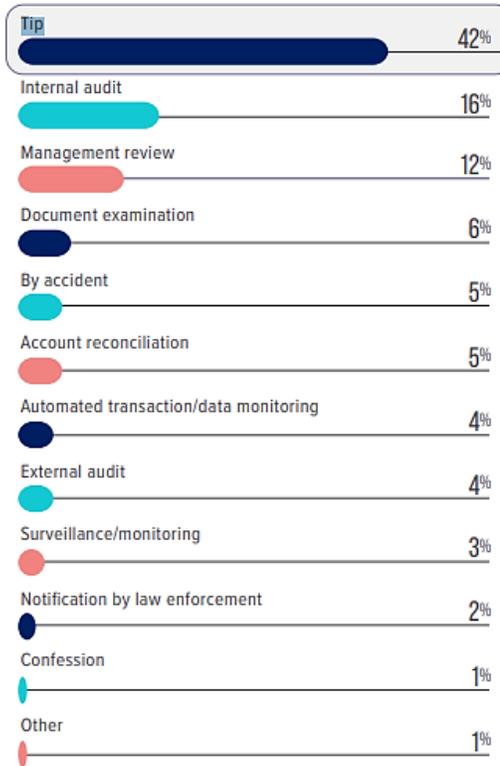
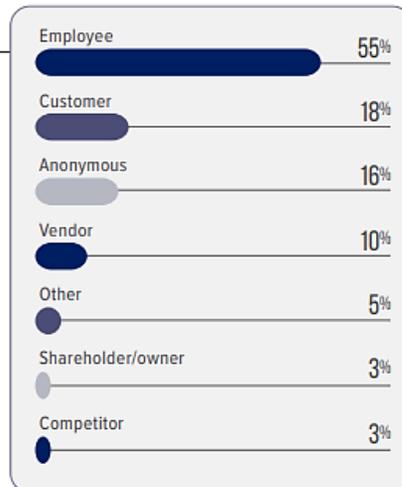


FIG. 11 WHO REPORTS OCCUPATIONAL FRAUD?



8% of fraud cases involved THE USE OF CRYPTOCURRENCY

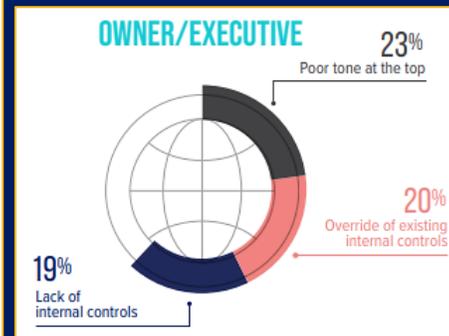
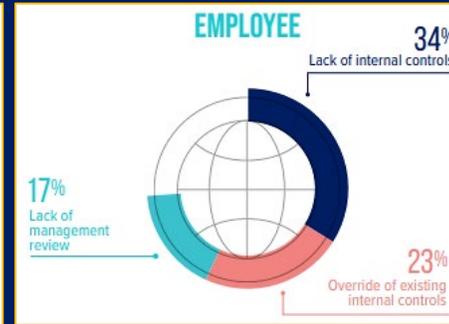
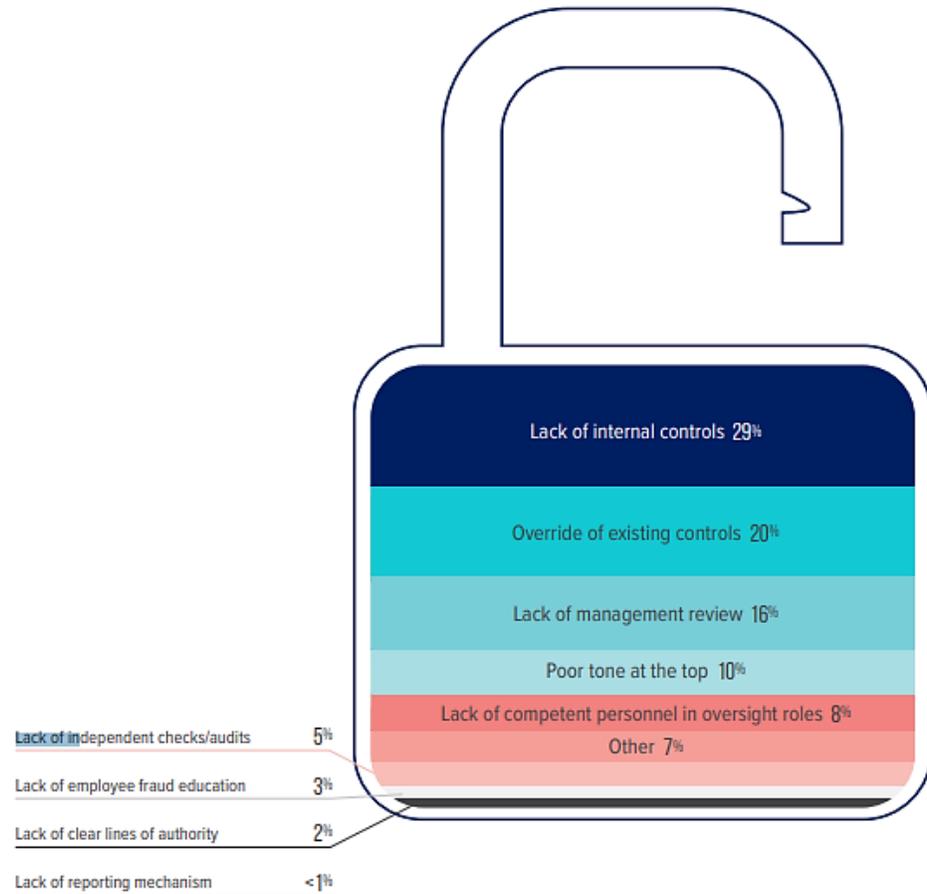
Among these cases, cryptocurrency was most commonly used for:



*Source: ACFE 2022 Report to the Nations

Training - Causes Related to How Frauds Occurred

FIG. 29 WHAT ARE THE PRIMARY INTERNAL CONTROL WEAKNESSES THAT CONTRIBUTE TO OCCUPATIONAL FRAUD?



*Source: ACFE 2022 Report to the Nations

Independent Testing/Validation

- Complete a Fraud Risk Assessment
 - Identify all applicable areas
 - Determine likelihood and impact of fraud losses
 - Identify “gaps” in fraud responses
- Determine appropriate fraud responses (ex. internal controls) have been implemented in areas identified as posing a higher risk of fraudulent activity
- Determine appropriate controls (automated or manual) exist over computer generated information



Independent Testing/Validation

- Determine appropriate internal controls over the financial reporting process have been established
 - Fraudulent financial reporting by upper level management usually involves override of internal controls
 - Higher-level review of financial reporting by lower levels of management and employees
 - Evaluate the financial results reported by individual departments or subsidiaries
 - Unusual fluctuations in results of departments, or lack of expected fluctuations, may indicate potential manipulation
- Implement fraud specific tests/reviews in both the operating units and within the internal audit function



Polling Question

3

Which of the following is not a cornerstone of an Anti-Fraud Network?

- A.) Governance
- B.) Policies and Procedures
- C.) Neither of these are cornerstones of an Anti-Fraud Network
- D.) These are both cornerstones of an Anti-Fraud Network

Fraud Vulnerability Assessment





Overall Entity Assessment

The Overall Entity Assessment is a global view of how the organization is structured/managed to combat fraud

- This assessment takes into consideration a number of elements including the “Tone at the Top”, company-wide policies/procedures, internal factors and external factors.



Fraud Awareness Training

In preventing and detecting fraud, there is a direct correlation between an organization's effectiveness and the overall awareness of its employees/managers

- Simply put, the more employees and managers know about fraud and fraud schemes, the better equipped they will be to prevent and detect a fraudulent situation
- Fraud training can take on a more global approach and/or be directed specifically to a business unit



Business Unit/Process Assessment

Similar to the Overall Entity Assessment, the Business Unit/Process Assessment is designed to give a specific view of how the business unit / process is structured / managed to combat fraud

- The assessment would include many of the topics in the Overall Entity Assessment, but only as they apply to a particular business unit/process
- The selection of which Business Units/Processes to review might be identified through the Overall Entity Assessment or through actual fraud loss experience



Integrated Fraud Detection & Prevention Techniques

Related to both the Overall Entity Assessment and the Business Unit/Process Assessment, the integration of specific fraud prevention and detection techniques will need to be deployed at the global and business unit/process level

- Implementing these techniques might include the establishment of policies/procedures, business re-engineering and software solutions
- The company should establish the right mix of controls and techniques to mitigate the risk of fraud within the organization

Control Environment

- Organizational structure of institution
- Management's philosophy and operating style
- Integrity, ethics, and competence of personnel
- External influences that affect operations and risk management practices
- Attention and direction provided by the Board of directors and its Committees

Polling Question

4

Around what % of fraud do you think gets detected by anonymous tip hotlines?

A.) 20%

B.) 90%

C.) 40%

D.) 75%

Fraud Hotlines



- The ACFE 2022 Report to the Nation on Occupational Fraud and Abuse found that 42% of frauds were detected by hotlines, which was nearly 3x as many cases as the next most common method
- In fact, researchers noted that organizations without anonymous reporting mechanisms suffered median losses that were more than twice as high as organizations where such mechanisms had been established

Fraud Hotlines

- Determine your institution's needs
- The set up of the hotline is very important for maximum effectiveness
- Service 24 hours days, 365 days a year
- Announcing the hotline
- Initial communication from CEO to provide proper emphasis and importance
- Available to employees, customers, and vendors
- Handling tips completely and anonymously
- Develop a reporting structure with built in checks and balances



Hiring and Promoting Employees

- Conduct background investigations on individuals being considered for employment or for promotion to a position of trust
- Thoroughly checking a candidate's education, employment history, and personal references
- Periodic training of all employees about the institutions values and code of conduct



Hiring and Promoting Employees

- Incorporating into regular performance reviews an evaluation of how the individual has contributed to creating an appropriate workplace environment in line with the institutions values and code of conduct
- Continuous objective evaluation of compliance with the entity's values and code of conduct, with violations being addressed immediately



Evaluation - Fraud Risk Assessment



- Identify business units/processes, including entity level or a global view, to assess
- Identify possible fraud risks/scenarios within each assessed area. Be sure to include internal and external fraud situations
- Identify fraud responses (internal controls, physical protections, detection tools, etc.)

Evaluation - Fraud Risk Assessment



- Identify any “gaps” where a fraud scenario does not have an adequate fraud response
- Measure the individual fraud scenarios based on impact and likelihood
- Value the individual fraud scenarios as a group to arrive at the assessed area’s overall fraud susceptibility

Evaluation - Fraud Red Flags

Organizational

- Weak Corporate Culture and Ethics
 - No Code of Ethics or Code not enforced
 - No policy on Conflict of Interest
- Lack of Board Oversight
 - Ineffective and/or uneducated Board or Audit Committee
 - Absence of clearly defined authority
 - Weak leadership
 - Dominant top management
 - Crisis management



Evaluation - Fraud Red Flags

- Employees
 - Rapid turnover
 - No rotation of duties/employees (only person who can perform duties)
 - Insufficient staffing
 - Lack of accountability
 - Unusual activity
 - Defensive attitude
 - Living beyond means



Evaluation - Fraud Red Flags

- Employees
 - Lack of vacations/leave
 - Unusual work hours
 - “Holding” work during vacation
 - High debts
 - Never out of balance – balancing perfectly all the time
 - Secretive, territorial



Evaluation - Investigation

- Validate assertions
- Be prepared to face obstacles and risks
- Bring the issue to the attention of the appropriate supervisor, if applicable
- Don't always confront after one finding - many times, there's more



Evaluation - Investigation

Anticipate management's reaction to fraud

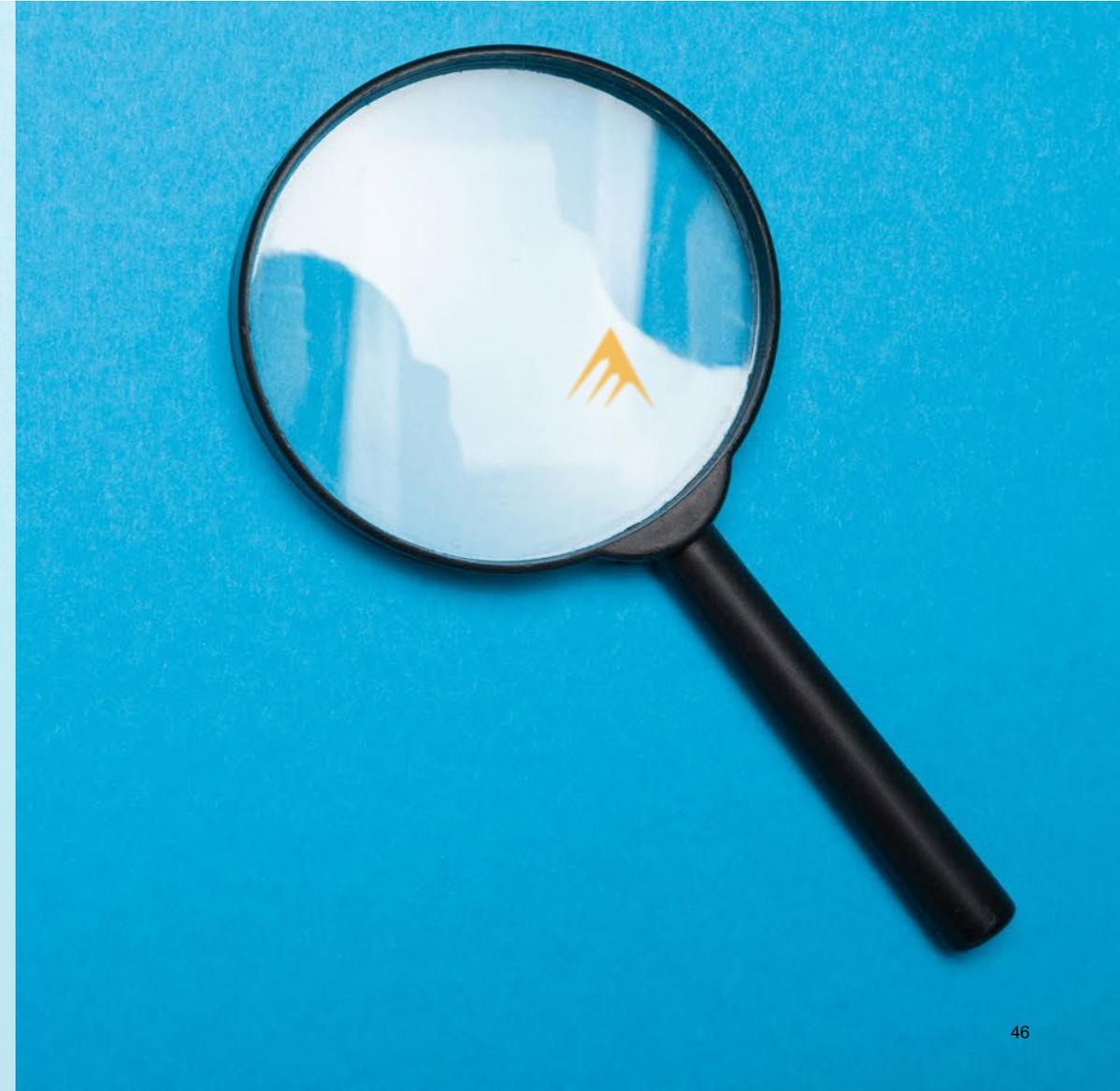
- Denial, anger, rationalization, depression, acceptance

Assemble team to investigate – Should have collective knowledge

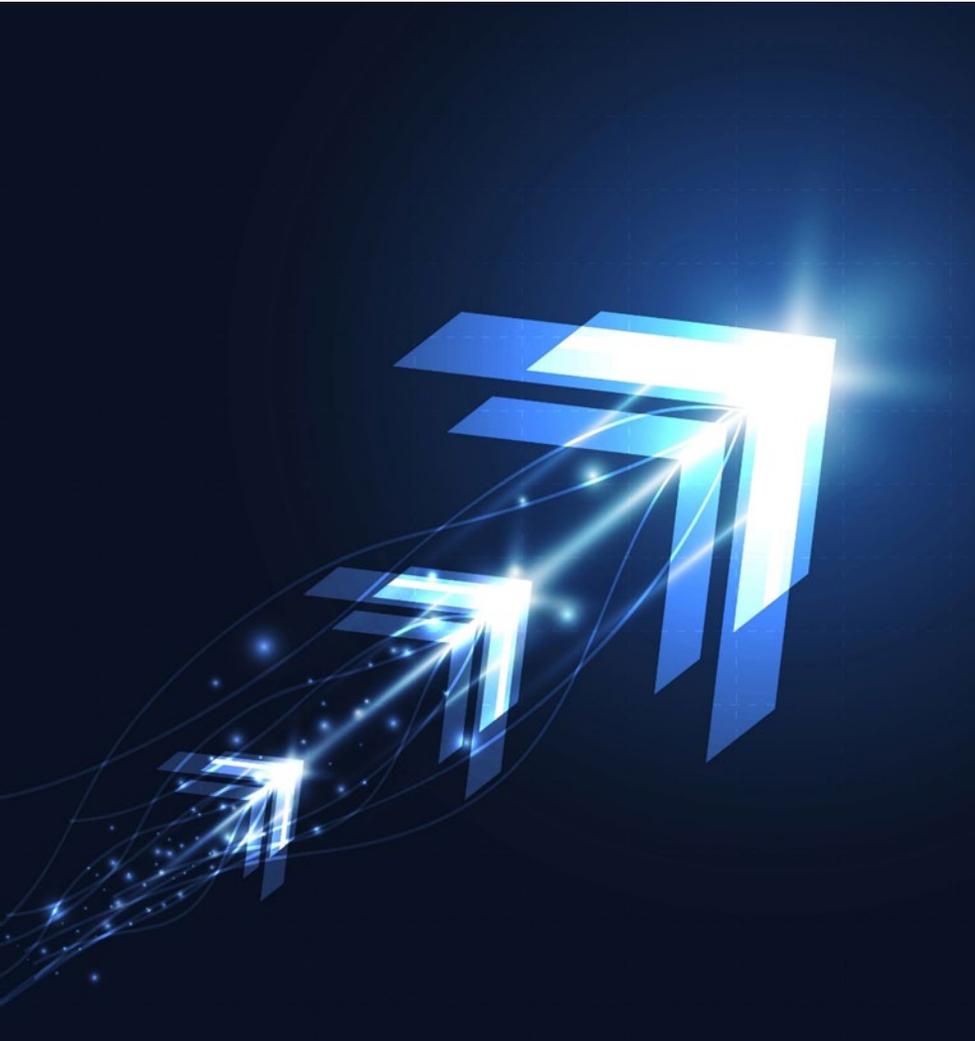
- Internal Audit
- External Audit
- Legal Counsel
- Human Resources
- Security

Communicate on a “Need to Know” basis

- Discreetly
- With sensitivity
- Keep workpapers secure



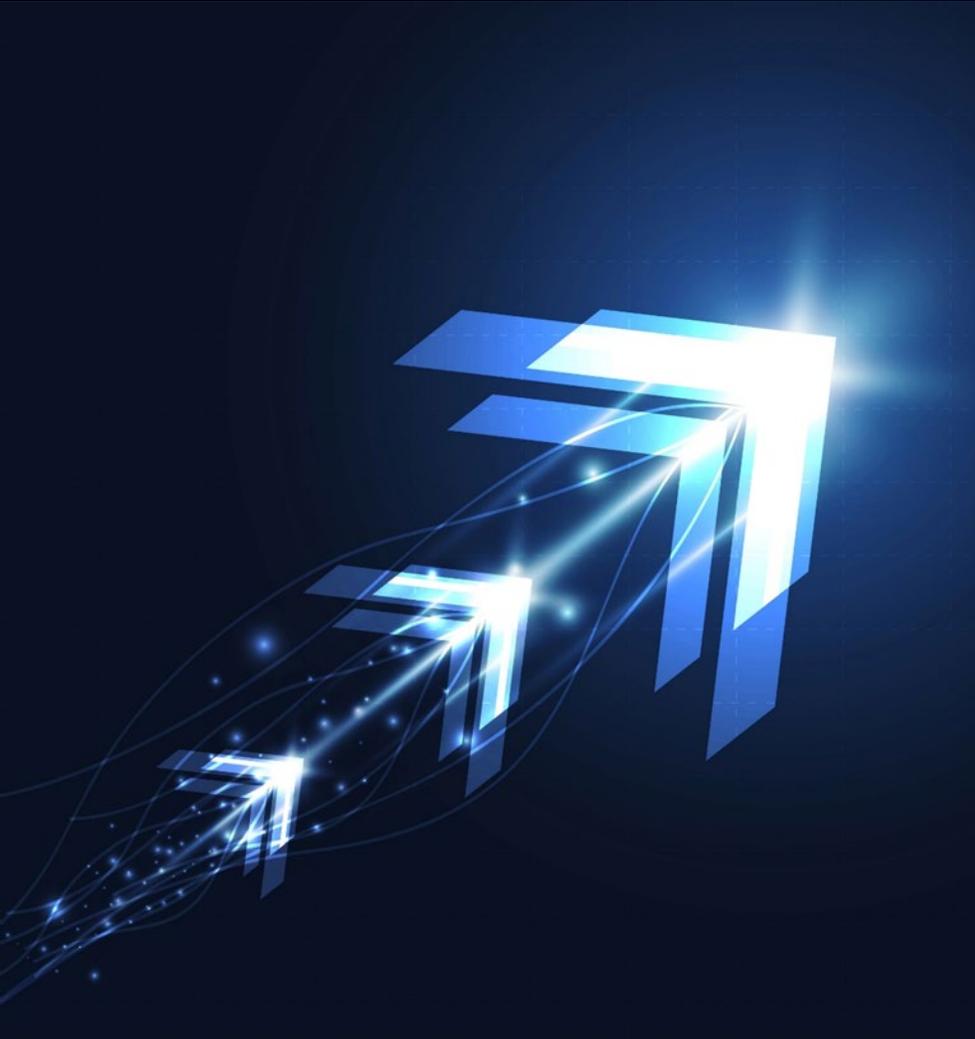
Response



Establish effective internal controls

- Segregation of duties
- Mandatory vacations
- Performance reviews
- Prohibition of insider transactions
- Conflict of interest policy – require full disclosure
- Employee expense account reviews
- Surprise audits/inventories/inspections
- Selective hiring practices through background investigations and reference checks
- Effective employee assistance programs

Response



- Appropriate and consistent actions should be taken against violators
- Relevant internal controls should be assessed and improved
- Communication and training should occur to reinforce the entity's values, code of conduct, policies, and expectations

Reporting

- Clearly distinguish between conclusions (fact based) and opinions (supposition)
- Avoid any opinions relating to guilt or innocence
- Ensure evidence follows all legal requirements
- If providing originals, always maintain copies
- Safeguard all evidential matter



Reporting

Presentation of Information

- Chronological
- By Transaction
- Use Exhibits effectively
- Clearly establish chain of custody of all evidential matter



Thank you!



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ESG Insights

Virginia Banker's Association IA Seminar

May 12, 2022

Discussion Topics



- ESG Overview
- Business Case
- Standards and Frameworks
- ESG Journey and IA Considerations
- Director Considerations



ESG Overview

Polling Question

1

What is your familiarity level with ESG and its impact on the banking industry?

- a) Very familiar and ready to learn more.
- b) Somewhat familiar and ready to learn more.
- c) Not familiar with the term and ready to learn more.

What is ESG?

Centers around three core concepts that measure the sustainability and ethical impact of a company.

ENVIRONMENTAL



How business operations impact the environment (and vice versa)

- Natural resource management - energy, materials, and product compliance
- Impact of climate change including greenhouse gas (GHG) emissions and net-zero strategies

SOCIAL



How an organization's operations affect its people and communities

- Social considerations, such as human rights due diligence, labor practices, and community investments
- Human capital management including culture, training, and compensation

GOVERNANCE



How a company behaves and governs

- Leadership, transparency, board diversity and ethics
- Governance considerations, such as stakeholder engagement and anti-fraud policies

Different names, similar concept

Sustainability

Environmental, Social, Governance (ESG)

Corporate Social Responsibility (CSR)

Impact

Responsible



Business Case

What we're hearing from our clients

Questions on “where do I start” and “how complex does my risk / materiality assessment need to be?”

Closely monitoring evolving regulatory requirements while advancing planning

Creating more structure around data and controls related to ESG reporting

Building out cross functional ESG teams – including IA

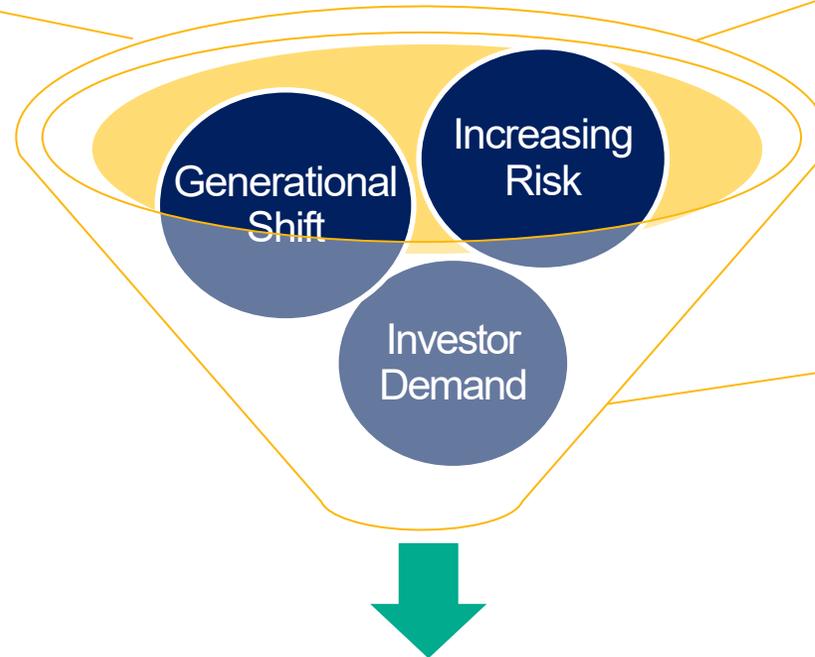
Clients seeking internal and external audit needs for ESG programs and initiatives

Looking to step up their game on reporting initiatives, adopting an official reporting framework such as SASB and TCFD

How ESG is Shaping the Business Environment

Millennials and Generation Z will become primary “investor class” over the next few decades, shifting expectations

Impact from climate change is unavoidable—creating volatility and increasing likelihood of losses & disruption of business



Consumer & investor demands, along with increased risk, shift investor demand for non-financial information.

Competitive & Regulatory Pressure

ESG Statistics/Research/Polls

- A report by the National Association of Corporate Directors found that almost 80% of public-company boards engage with ESG issues in some way, mainly to ensure links to strategy and risk.
- Investors also are shifting their focus. A **JPMorgan Chase & Co. report** asserts that the pandemic could prove to be a major turning point for ESG investing long-term. It noted that 71% of investors thought it was ‘likely’, ‘rather likely’, or ‘very likely’ that “a low probability/high impact risk, such as COVID-19, would increase awareness and actions globally” of the need to address risks such as those associated with climate change and biodiversity losses.
- **Reuters** reported that “ESG funds now account for 10% of worldwide fund assets.” A very significant percentage in a short time frame.
- 87% of Americans are in favor of companies reporting their climate-related risks according to a recent study by **Ceres**

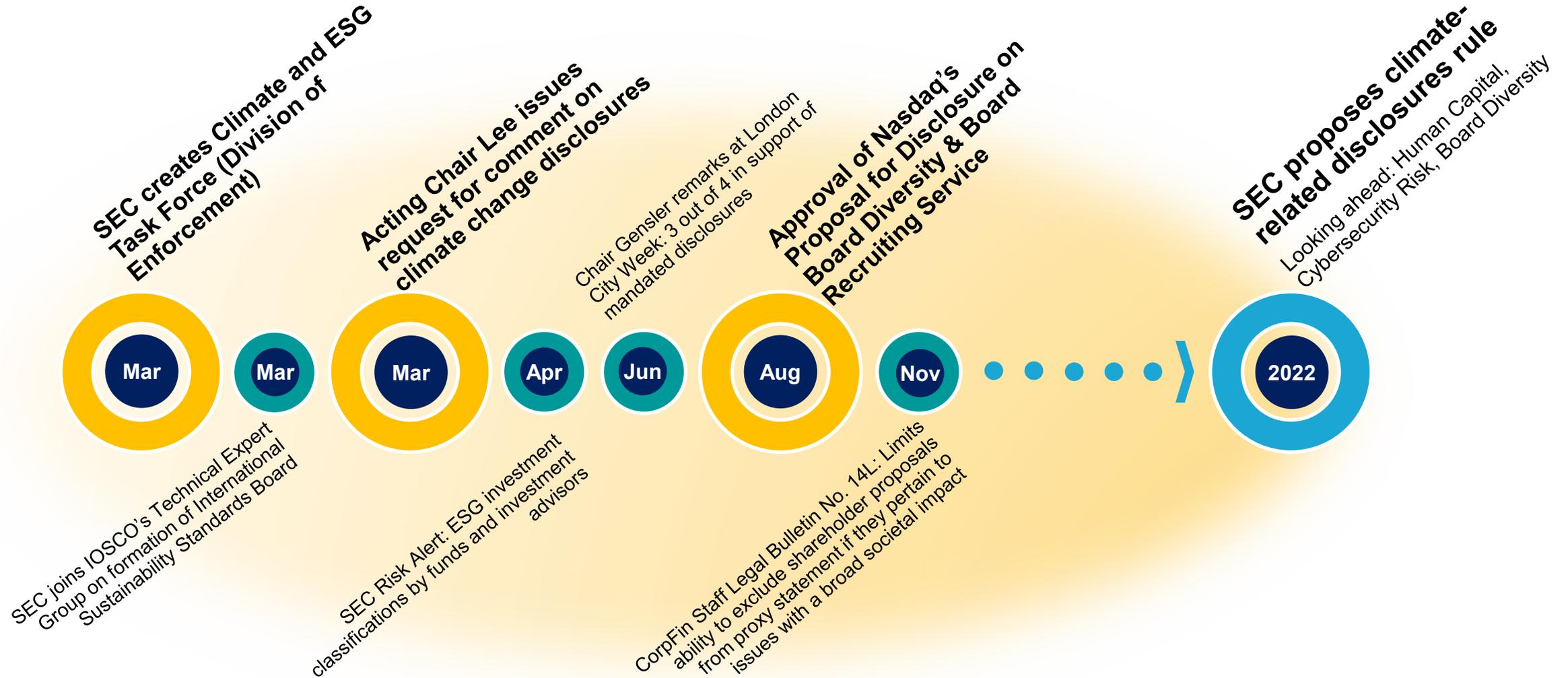


The Current Landscape

Increased competitive and regulatory pressure on ESG is shaping the business environment...

- SEC proposed new disclosure rules requiring domestic and foreign companies to include a variety of climate-related disclosures in registration statements and periodic reports, including assurance requirements
- Future expected SEC rule proposals for Human Capital, Cybersecurity Risk, and Board Diversity
- Plethora of ESG frameworks and voluntary standards resulting in inconsistent reporting and benchmarking
- Rising scrutiny on accuracy and transparency of ESG reporting—transition of ESG disclosures to investor-grade quality

2021-2022 Timeline of SEC Milestones on ESG



SEC Climate-Related Disclosures Proposal Highlights

SEC's climate disclosure proposal requires domestic or foreign registrants to include registration statements and periodic report disclosures including but not limited to:

- Governance and oversight of the management of climate-related risks
- Quantitative measures of the entity's greenhouse gas (GHG) emissions*
 - Scope 1 and 2 emissions of accelerated and large accelerated filers would be *subject to assurance*
 - Scope 3 emissions disclosure is required when material or when included in an entity's GHG emissions reduction commitment or target
- Climate-related financial statement metrics and disclosures in the notes to audited financial statements, including:
 - Disaggregated information on a financial statement line-item basis about transition activities and the impact of climate-related events
 - Information about estimates and assumptions used in the financial statements

* Some of the proposed disclosures and related assurance requirements would be phased in over time based on filer status and the type of GHG emissions disclosure scope. A smaller reporting company (SRC), as defined in Regulation S-K, would be exempt from disclosure of Scope 3 GHG emissions.

SEC Commissioner Recent Comments

3 Key Considerations for Climate Change Disclosures		
Consistency	Compatibility	Reliability
Uniform standard for disclosure across public entities	Defined common and standardized metrics to be compared across companies	Level of assurance over accuracy of disclosure

Polling Question

2

What is your organization's next step to move closer to adhering with the SEC's climate disclosure proposal?

- a) Setting strategy for managing climate-related risks
- b) Collecting, quantifying and validating climate-related data
- c) Assurance plan for climate-related reported data (i.e., GHG emissions)
- d) Not sure at this time



Standards and Frameworks

ESG Frameworks & Standards

There are a number of frameworks, voluntary standard setters and measurement criteria in the ESG ecosystem. Market participants and regulators recognize there is a need for convergence, and it's starting.



ESG Standards: SASB & GRI



		Intended Use	Benefits	At-a-Glance
Standards: Specific, replicable and detailed requirements for “WHAT” should be reported for each topic	Sustainability Accounting Standards Board (SASB) Standards ³²	Can be used to identify, manage, and communicate financially material sustainability information to investors	Enables companies to report financially material metrics that are industry specific to meet the needs of investors globally and may be used as a basis for suitable criteria in an attestation engagement	Supports presentation of financially material information globally to inform capital allocation decisions
	Global Reporting Initiative (GRI) Standards	Can be used to help businesses understand and communicate the impact of business on critical sustainability issues to a broad range of stakeholders	Enables companies to report the impact of their social and environmental activities to various stakeholders and may be used as a basis for suitable criteria in an attestation engagement	Supports presentation of socially material information that can be tailored to cultures and geographies

SASB and GRI



Key takeaways:

- GRI Standards support broad and comprehensive disclosures by providing the framework and supporting standards for a comprehensive understanding of the organization's impacts on economy, environment, and society including financially material impacts.
- SASB's Standards offer an industry-focused perspective by identifying the subset of issues that are reasonably likely to be financially material for the typical company in an industry.
- Each set of standards, therefore, **complement** rather than act as a substitute one another.
- Using the GRI and SASB Standards together can offer a holistic picture of corporate performance, bringing sustainability and financial information more closely together
- Reporting with GRI and SASB can meet the needs of a broad range of stakeholders, with expanded disclosure to increase user engagement
- Taken together, GRI and SASB Standards offer a company a practical approach to reflect on and disclose their material issues and impacts

Task Force on Climate-Related Financial Disclosures



- In 2017, the TCFD released their recommendations designed to assist companies in providing better, more accurate and consistent climate-related financial risk disclosures.
- The recommendations are structured around four areas that represent the core elements of how organizations operate: governance, strategy, risk management, and metrics and targets.
- Key Features of Recommendations:
 - Adoptable by all organizations
 - Included in financial filings
 - Designed to solicit decision-useful, forward-looking information on financial impacts
 - Strong focus on risks and opportunities related to transition to lower-carbon economy

Material Topics in the Banking Industry*

- Greenhouse gas (GHG) emissions (universal)
- Data Security
(data security risks, data breaches)
- Financial Inclusion & Capacity Building
(loans outstanding, loans past due, no-cost retail checking accounts, financial literacy initiatives)
- Incorporations of Environmental, Social, Governance
- Factors in Credit Analysis
- Business Ethics
(legal proceedings, code of ethics, etc.)
- Systemic Risk Management



* Based primarily on [SASB standards](#), with exception of GHG emissions which is expected to be universally material.





ESG Journey & IA Considerations

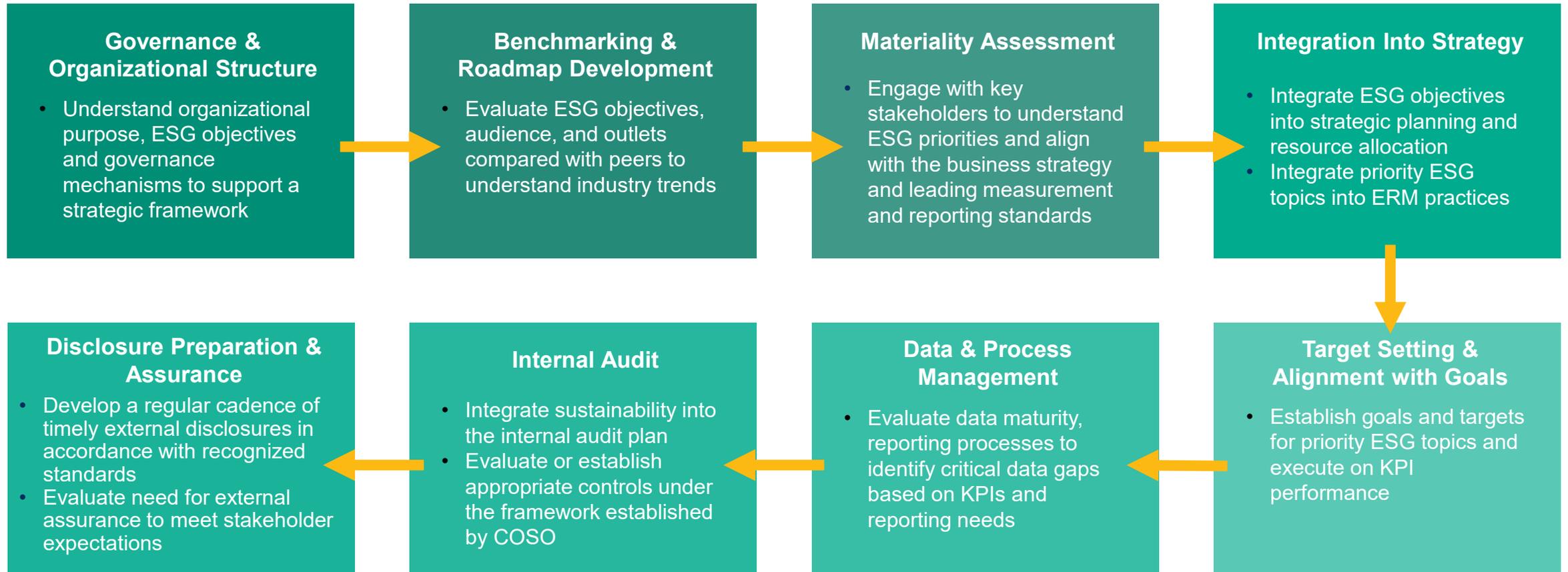
Polling Question

3

Does your institution publish an ESG Related Report?

- a) Yes, we have a robust ESG Report
- b) Yes, but it is limited
- c) No, but we plan to publish soon
- d) No, and we do not plan to do so

The Journey of ESG Integration and Disclosure



Internal Audit's Role

Build trust and confidence, and provide assurance, in climate and ESG disclosures, just like the assurance provided for financial disclosures.

- With IA's experience navigating changing regulatory environments and their access to valuable nonfinancial data, they can help entities move forward in a responsible manner in all phases of the journey.
- By employing high quality testing of controls, IA adds value to the ESG story and keep the entity accountable and prepared for the active regulatory environment.



Internal Audit's Role

Adding value through assurance and advice.

- Provide assurance on the effectiveness of ESG risk management and reporting
 - Review reporting metrics for relevancy, accuracy, timeliness, and consistency
 - Review reporting for consistency with formal financial disclosure filings
 - Conduct materiality or risk assessments on ESG reporting
 - Incorporate ESG into audit plans
 - Build an ESG control environment
 - Recommend reporting metrics
 - Advise on ESG governance
- Frameworks: GRI, SASB, TCFD... **and leverage COSO**



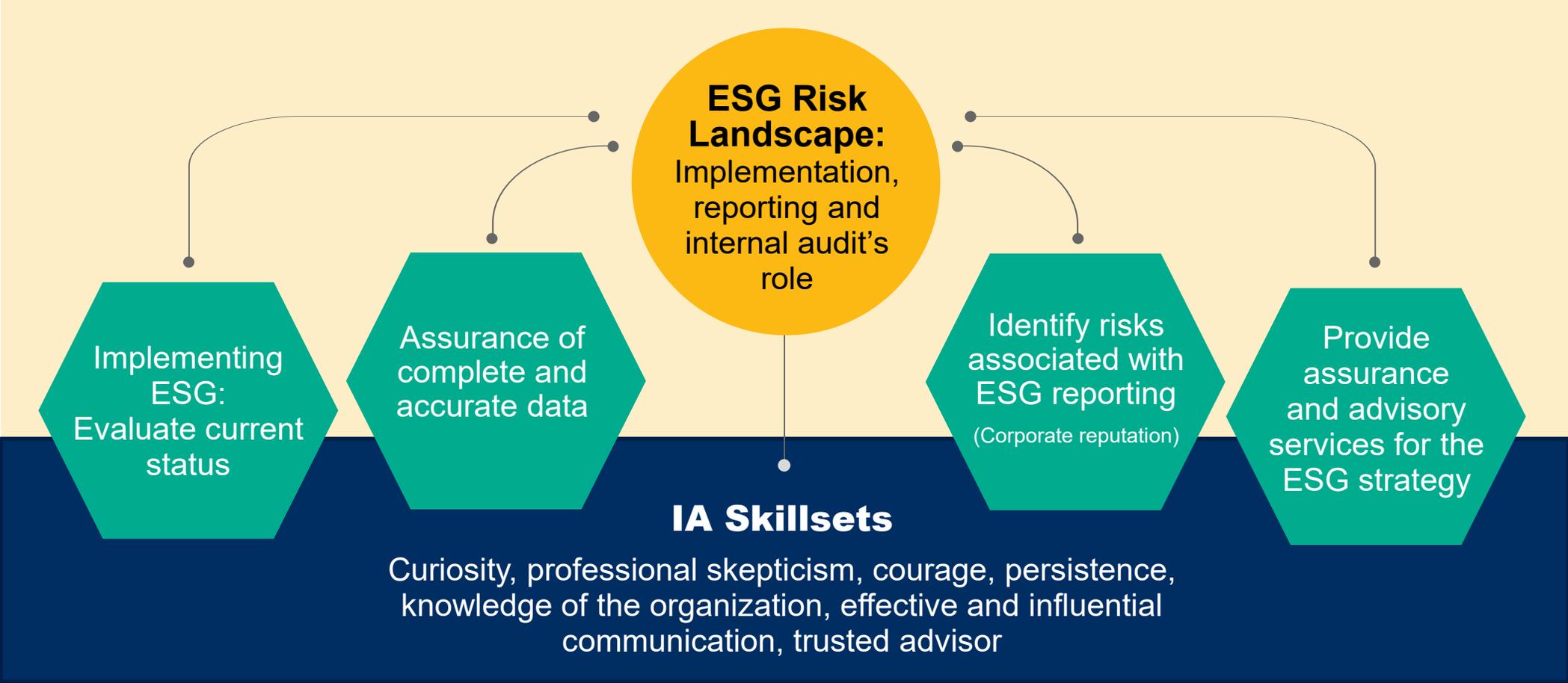
Study will help organizations apply the
COSO
Internal Control – Integrated Framework
to sustainability reporting for
effective internal control.

Internal Audit's Role – Challenges to Overcome

- ▶ Understanding the scope of ESG risks
- ▶ Implementing models and frameworks for related controls and processes
- ▶ Overcoming uncertainty about reporting and reporting standards
- ▶ Managing ESG risk holistically across the organization

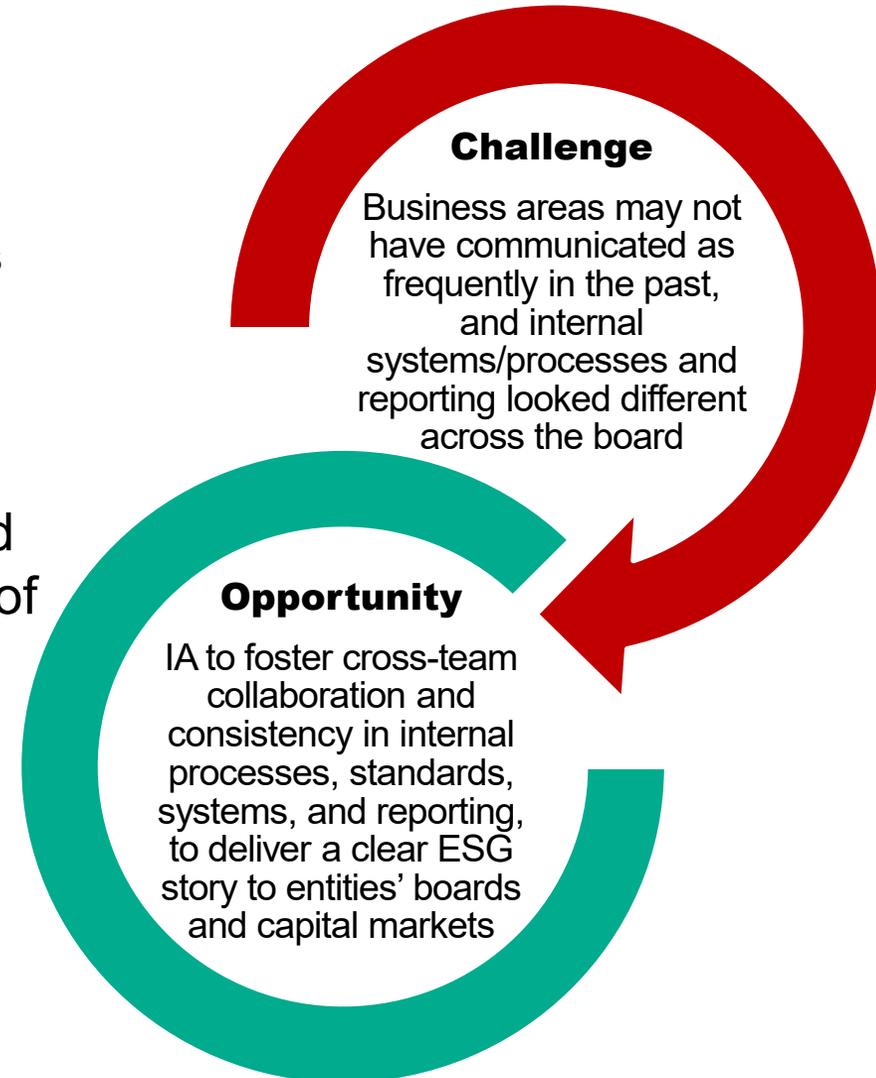


Internal Audit's Role - Approach



Internal Audit's Role – Implement: Evaluate current status

- ▶ Take stock of what's already in place at your organization regarding ESG
 - ESG topics may already be established at your organization through required regulatory requirements (i.e., OSHA, DOL, EPA, D&I Initiatives etc.)
- ▶ Identify a management system to formalize ESG processes and controls
- ▶ Establish cross-functional teams, socialize ESG and align strategy to develop a common understanding of the ESG issues, risks, stakeholders, systems, processes and controls



Internal Audit's Role – Assurance of complete & accurate data

Governing bodies will be looking for assurance over complete and accurate ESG data.

- ▶ Consider from where the data is originating.
- ▶ Ensure robust management systems and strong control environment exists – same level of rigor as financial reporting controls.
- ▶ Design assurance independent and objective processes that ensure relevant and reportable non-financial information is assessed for completeness, accuracy, validity, and relevance.

Internal Audit's Role – Identify Risks

Some risks to consider . . .

Internal Audit is positioned to provide value by assisting in the risk identification process and reviewing internal controls for coverage and effectiveness.

- ▶ Corporate Reputation – ESG failures
- ▶ ESG risk is not considered with the same focus and rigor as other financial disclosures
- ▶ Reporting beyond minimum standards and increasing stakeholder expectations that don't align to practice – aggressive, unrealistic ESG agendas
- ▶ Inconsistent, unreliable and incomparable reporting data
- ▶ Regulatory pressure

Internal Audit's Role – Assurance & Advisory



Assurance

- IA to play a similar role with ESG reporting as it did for internal controls over financial reporting for SOX 404
- Begin conversations with management in areas that “need work” to be assurance ready in order to meet regulator expectations (emerging issues)
- ESG related assurance and assessment engagements will fall under the purview of IA



Advisory

- Identify issues and risks and discuss them with management and the board – obtain consensus and buy-in
- Take pulse of ESG risk appetite, benchmark, assess resource requirements, regulatory and reporting considerations, framework selection considerations
- Develop KPIs and offer insight and best practices for ESG program strategy, considering alignment to business strategy and goals

Polling Question

4

What is your organization's biggest hurdle in connection to ESG?

- a) Lack of risk and control framework
- b) Lack of skills and expertise in the ESG area
- c) Unclear and inadequate regulation
- d) A combination of all the above



Director Considerations

Questions for Board Members

- Is ESG an essential part of the organization's culture? Does your organization socialize ESG at all levels?
- Has the board reevaluated mission-critical risks associated with ESG, in light of the pandemic?
- Does the board have the information it needs to assess ESG risks?
- Does the company have appropriate internal controls, policies, personnel in place to track and disclose ESG information?
- What good governance approaches have been most effective during the last two years that can be applied to ESG governance?
- Is ESG reporting being done today? Does the company publish ESG related information publicly?



Resource (CAQ): <https://publication.thecaq.org/rotaesg/esg-considerations-and-questions-for-boards/>

Thought Leadership

- **ESG: The Growing Challenge and Opportunity (May 2021)**
<https://www.crowe.com/uk/insights/esg-the-growing-challenge-and-opportunity>
- **Driving Sustainability and Growth: Learning from Formula E's Success (June 2021)**
<https://www.crowe.com/global/insights/art-of-smart/driving-sustainability-and-growth-learning-from-formula-es-success>
- **Six Steps to Create a Culture of Sustainability: Tips from Formula E (June 2021)**
<https://www.crowe.com/global/insights/art-of-smart/six-steps-to-create-a-culture-of-sustainability-tips-from-formula-e>
- **Insights to guide your ESG Strategy (November 2021)**
<https://www.crowe.com/insights/insights-to-help-guide-your-esg-strategy>
- **Identifying efficiencies in your ESG strategy (December 2021)**
<https://www.crowe.com/insights/asset/i/identifying-efficiencies-in-your-esg-strategy-recording>
- **ESG news in the new year (February 2022)**
<https://www.crowe.com/insights/asset/e/esg-news-in-the-new-year-webinar-recording>
- **Crowe Forbes articles:**
 - How To Leverage Strengths When Building An ESG Program (January 2022)
 - ESG Program Maturity: Four Stages (January 2022)
 - 4 Reasons ESG Means 'Green' To Private Equity (January 2022)
 - 5 Things Decision **Makers Need To Know About ESG In The New Year (January 2022)**
<https://www.forbes.com/sites/crowe/2/?sh=189fe8144ead>
- **SEC proposes climate-related disclosures: A closer look**
<https://www.crowe.com/insights/asset/s/sec-proposes-climate-related-disclosures-a-closer-look>



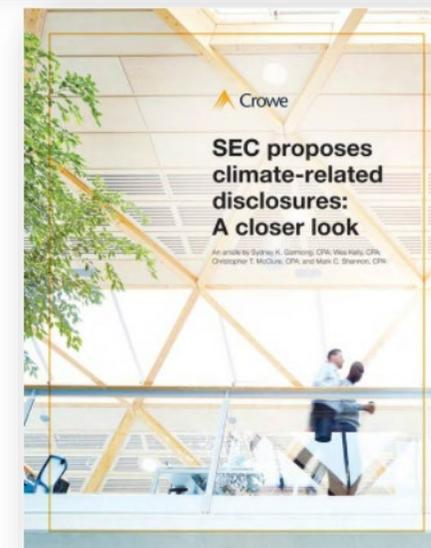
Featured insights



WEBINAR

ESG news in the new year

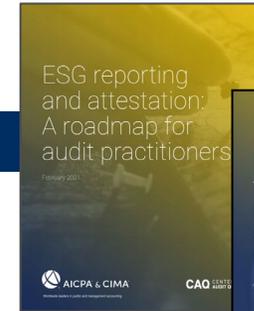
On Feb. 9, 2022 Chris McClure, Gregg Anderson, and Sonia Barros from Sidley presented "ESG news in the new year".



Additional ESG resources

CAQ and AICPA

- **“ESG Reporting and Attestation: A Roadmap for Audit Practitioners” (February 2021)**
 - <https://www.thecaq.org/esg-reporting-and-attestation-a-roadmap-for-audit-practitioners/>
- **“Key Actions for Establishing Effective Governance Over ESG Reporting” (April 2021)**
 - Conducting materiality or risk assessments; Board oversight and integration into ERM and overall strategy
 - https://www.thecaq.org/wp-content/uploads/2021/04/caq_key-actions-for-establishing-effective-governance-over-esg-reporting_2021-04.pdf
- **“S&P 100 and ESG Reporting” (April 2021)**
 - All provided some ESG information, most in a separate stand-alone report
 - <https://www.thecaq.org/sp-100-and-esg-reporting/>



IIA

- **“Internal Audit Plays Critical, Collaborative Role in ESG Reporting” (February 2022)**
 - <https://www.theiia.org/en/content/communications/press-releases/2022/february/internal-audit-plays-critical-collaborative-role-in-esg-reporting/>
- **“The ESG Landscape Part 1” (February 2022)**
 - <https://www.theiia.org/en/content/articles/global-knowledge-brief/2022/the-esg-landscape-part-1/>
- **The ESG Risk Landscape Part 2: Implementation, Reporting, and Internal Audit’s Role (March 2022)**
 - <https://www.theiia.org/en/content/articles/global-knowledge-brief/2022/february/the-esg-risk-landscape-part-2-implementation-reporting-and-internal-audits-role/>





Thank you!



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