



Insights on sustainability in the Federal Market

An analysis of applying
COSO ICSR leading
practices at Federal
agencies.



Introduction

Big changes are on the immediate horizon in the federal sustainability landscape as federal agencies now face increased pressure to incorporate sustainability metrics into their objectives, operations, outcomes, and reporting processes. Some examples include the Federal Accounting Standards Advisory Board (FASAB) considering new rules on sustainability reporting¹, new requirements emplaced upon federal agencies to report on mandated sustainability goals, and the Inflation Reduction Act (IRA) of 2022 requiring agencies to embed equity and environmental justice into their grants programs². Additionally, some federal agency leaders, as part of their performance evaluations, may be held accountable to incorporate sustainability objectives in their organizations. Leaders who have not yet established or updated objectives, operations, outcomes, and reporting processes to meet current and planned federal sustainability requirements are already at a disadvantage operationally and from a peer performance evaluation perspective. Internal controls must be designed and implemented to mitigate potential risks across the agency, and to monitor the outcomes of these operational updates to measure progress.

The United States Government Accountability Office's (GAO) Green Book lays out government-wide criteria to provide federal agencies with an internal control framework to successfully achieve their objectives through the identification and mitigation of risks via organizational and program level controls, including controls over financial reporting. However, the Green Book does not provide explicit guidance on how to incorporate sustainability into federal agencies' internal control environments. In 2023, The Committee of Sponsoring Organizations of the Treadway Commission (COSO) provided the private sector with additional guidance around sustainability reporting in their Internal Control over Sustainability Reporting (ICSR) framework. This paper provides insights into how federal agencies can establish the necessary sustainability measures and reporting capabilities. If done properly, incorporating sustainability measures

can reduce climate and social-related risks, improve associated reporting, and enable compliance with impending requirements.

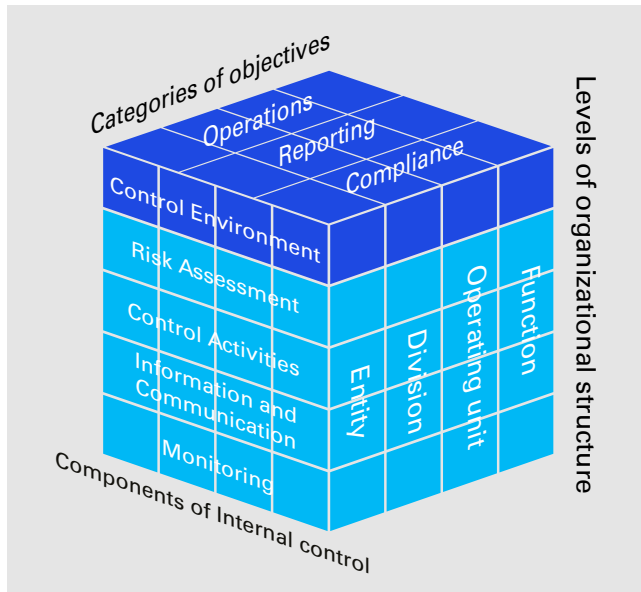
In this paper, KPMG LLP (KPMG) provides insight on how federal agencies can incorporate the COSO ICSR's concepts into their existing enterprise risk management framework. This may also assist federal agencies in building a robust internal control environment that facilitates compliance with the Green Book while getting ahead of the upcoming sustainability reporting compliance requirements currently being considered by FASAB. This paper enables federal agencies to identify additional risks and opportunities that are specific to sustainability practices. KPMG has provided internal control solutions to federal agencies for several decades leveraging our combination of deep commercial industry and government experience to help identify risks, integrate new operational, financial reporting and compliance requirements, and measure progress against these objectives.



¹ December_12_13_2023_minutes.pdf (fasab.gov), pages 6 – 7

² FACT SHEET: One Year In, President Biden's Inflation Reduction Act is Driving Historic Climate Action and Investing in America to Create Good Paying Jobs and Reduce Costs | The White House

Component 1—Control Environment



to mission success and integrating that into organizational culture, government leaders augment their workforce’s ability to understand the impact of their actions against progress toward these goals.



To effectively mature a sustainability-focused control environment, federal agencies should leverage the guidance provided in the GAO Green Book and incorporate a sustainability lens, similar to the COSO ICSR guidance. Federal agencies will need to carefully evaluate their organizational structure and revise key internal processes to effectively achieve sustainability-related goals and meet evolving compliance metrics.

Let’s explore the key considerations that federal agency leaders should be thinking about to establish a responsive control environment that enables the organization to get ahead of the forthcoming sustainability requirements:

1 Upholding Ethics and Integrity

Federal agency leaders must prioritize ethics and integrity, setting the tone at the top and cascading the messaging throughout the organization. It is imperative for federal agency leaders to determine their sustainability priorities, such as achieving 100% carbon pollution-free electricity usage by 2030. They must also emphasize the importance of an organization-wide commitment led by the tone at the top. By deciding what sustainability considerations are most important and critical

Key Considerations—Control Environment



It is leadership’s responsibility to define sustainability priorities aligned with the agency’s mission and underscore its importance throughout the organization.



Identification of untracked metrics (i.e., quantifying the impact of climate-related risks) will enable agency leaders to update systems and processes to account for these in the future.



Upskilling and acquiring sustainability minded employees is mission critical.

2 Optimizing Organizational Structure

As a federal agency leader, oversight of people, processes and technology is the cornerstone of success. It is equally crucial to identify risks and proactively address potential gaps in your internal controls to meet agency requirements pertaining to emerging sustainability requirements, such as the goal of achieving zero emissions by 2050. There may be specific metrics related to utility usage, DEI targets, or the impact of climate-related events and risks that current systems and processes are not equipped to track. Adjusting the current operating model to enable sustainability reporting and controls over these activities assists in meeting rapidly changing regulatory requirements, specifically with FASAB nearing a decision on additional climate related financial reporting requirements. Without proper systems, processes, and related internal controls infrastructure in place, federal agency leaders will be left scrambling to establish and implement these updates in an extremely condensed timeframe. The Department of Defense has been proactive in creating sustainability-related policies and procedures, setting an example for other agencies to follow³.

3 Strengthening Talent Acquisition and Retention

Enhancing sustainability efforts requires a skilled workforce. Federal agencies must identify the requisite skillsets necessary to enable their organizations to meet changing regulations and to remain competitive in attracting talent with expertise in sustainability as well as upskilling their current workforce. Retention is improved when federal agencies offer on-demand trainings that interest their workforce. By offering timely, relevant trainings on sustainability topics such as the General Services Administration (GSA) Sustainable Facilities Tool⁴ reporting systems, federal agency leaders provide their workforce with the necessary knowledge and skills, driving progress toward sustainable operations. Establishing Green Roles, or positions specialized in implementing sustainability initiatives throughout the organization, can also increase adoption success and reduce rollout burden.

4 Aligning Performance with Accountability Expectations

Federal agency leaders may soon be evaluated against their impact on federal agency sustainability goals (i.e., tying performance evaluations to organizational sustainability results). Properly integrating sustainability metrics and goals into training, goal setting, and employee evaluation processes increases employee initiative to drive progress on federal agency sustainability objectives. For example, if a procurement employee's performance is assessed directly against the number of energy savings performance contracts they award, there is an increased incentive for seeking out and awarding these types of contracts in alignment with the overarching mission. Federal agency leaders should ensure that all employees understand the importance of sustainability and their individual roles in achieving sustainability objectives. This alignment of performance with accountability helps foster a sense of ownership and responsibility among employees.

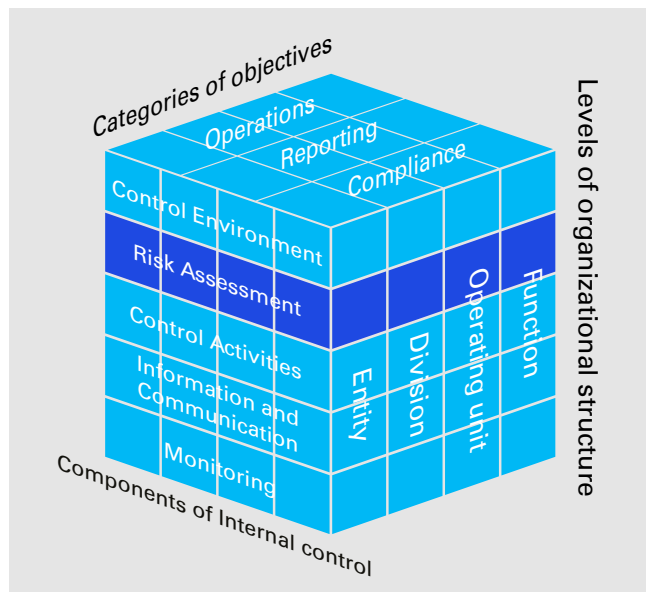
By implementing these steps, federal agencies can navigate the changing reporting landscape, enhance their sustainability efforts, and establish a strong control environment to enable the other components of an internal control system. KPMG, a recognized leader in sustainability reporting and supporting federal agencies, can assist in reviewing, planning, and executing strategies to develop effective sustainability reporting requirements and support the success of agencies' mission-critical activities. By embedding sustainable operating practices and employing a robust control environment, federal agencies can contribute to their sustainability goals, mitigate related risks, and most importantly, maintain public trust in their fiscal and operational stewardship.

Have you considered your agency's risk management approach, including risk appetite and tolerance?

³Federal Agencies Leading by Example | Office of the Federal Chief Sustainability Officer

⁴SFTool - Sustainable Facilities Tool—GSA Sustainable Facilities Tool

Component 2—Risk Assessment



To properly consider sustainability risks during the regular risk assessment cycle, federal agency leaders must aim to identify, analyze, and manage potential risks to their organizations’ sustainability goals and outcomes. This requires considering environmental, social, and economic aspects of operations which may vary depending on the federal agency’s mission, the regulatory environment, and the current socio-economic context which is rapidly evolving.

The three top considerations should include:

1 Environmental Impact and Climate-related Risks

This involves assessing how climate change could impact a federal agency’s operations, assets, and mission fulfillment. Leaders need to consider both direct impacts such as increased frequency of extreme weather events affecting federal agency assets and indirect impacts like regulatory changes aimed at mitigating climate change. This also includes evaluating the organization’s carbon footprint, energy usage, waste production, and water usage, and identifying risks related to each factor.

Figure 1

Federal agencies may identify a goal to reduce Scope 1 emission by 50% by 2030. To do so, they would need to identify potential risks in meeting that goal, such as the inability to retrofit certain military installations to be more energy efficient. That agency would need to then determine if they will accept, reduce, or mitigate the risks associated with reaching the 50% reduction target.

2 Social and Governance Factors

Social and governance-focused activities align with a federal agency’s overarching mission of promoting the general welfare of its constituents. It places the focus on governing for the people. The social and ethical aspects of sustainability, including labor practices, community engagement, and governance structures must also be carefully considered. For federal agency leaders, this means assessing risks related to public perception and the social impacts of operations. It also involves evaluating a federal agency’s governance practices around sustainability to ensure there are clear and adequate policies and procedures in place to support sustainability goals and manage risks related to potential governance failures.

Regulatory and Compliance Risks: Federal agencies know that they must comply with a wide range of environmental laws and regulations. A sustainability risk assessment should include a thorough review of current compliance levels and an analysis of how potential changes in sustainability laws or regulations could affect the agency. This includes staying ahead of new standards or practices that could impact federal agency operations or which must be driven through to reporting requirements and changes in agency financial reports.

While these three considerations are critical, it remains essential for federal agency leaders to adopt a holistic view that integrates these aspects into a comprehensive risk management strategy that is flexible enough to adapt to new information and changing conditions. As a supplement to the GAO Green Book guidance, the COSO ICSR provides some insight into this topic for large scale private sector entities by suggesting that sustainability objectives should be tied to the mission, values, and social responsibility goals and then integrated into broader strategy. For reporting on sustainability, COSO recommends that sustainable business risks to the organization’s performance be mitigated based on how material it is to their operations and define the level of acceptable deviation against stated sustainability goals⁵. Federal agencies already must determine how sustainability impacts development of performance metrics to enable accountability.

Additionally, performing risk assessments inclusive of sustainability considerations can provide insight into internal, external, and residual risks that may impede mission progress. Has your agency considered the types of fraud that could be perpetrated in sustainability initiatives, and do you know how to prevent, detect, and respond? In one example from the COSO ICSR,

employees can be pressured by management to demonstrate progress against goals, which may not be the reality. This pressure may induce select staff to misrepresent certain key performance metrics, potentially leading to fraudulent reporting of sustainability data to management.⁹ Agency management has a similar duty to consider the potential for fraud, and an obligation to prevent a work culture that encourages fraudulent behavior, when identifying, analyzing, and responding to risks.

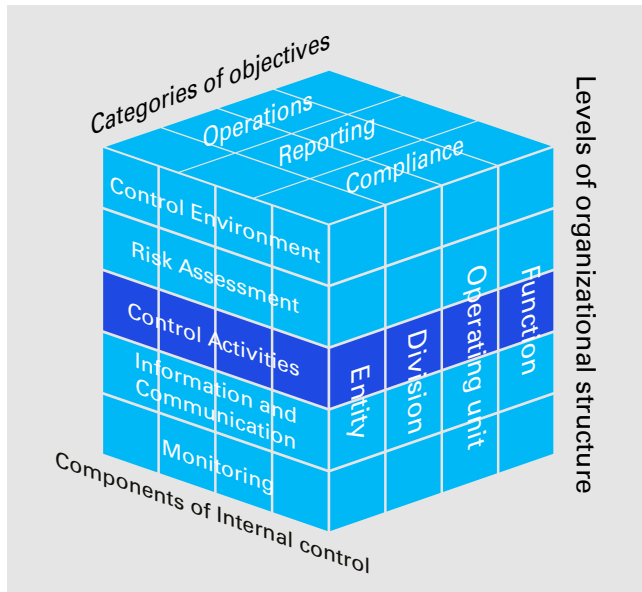
KPMG draws upon our federal and commercial experience to guide our clients through a complex sustainability landscape, enabling them to effectively identify, analyze, and respond to significant changes that could impact their internal controls. Federal agency management may need assistance to identify and understand which trends, laws, and regulations they will be responsible for addressing and incorporating into their agency’s operations.

What’s next? Control Activities add the next layer to internal control processes. It is important to remember, all five objectives of the Cube are necessary for federal agencies to be successful.



⁵Note that in this context, materiality will need to be defined by each federal agency in alignment with their current reporting processes and pre-established thresholds.

Component 3—Control Activities



Federal agencies need to begin assessing their control activities now to manage and mitigate identified risk effectively. This includes developing controls to mitigate sustainability-related risks, including general controls over technology, and deploying oversight through tightly coordinated policy and procedural updates. For example, if you are asked about the potential risk of flooding at your agency’s facilities due to sea-level rise, are you equipped to provide a substantiated response? Alternatively, would the facilities be inundated by flooding before it comes to the agency leader’s attention that a significant control gap regarding this risk exists? Control activities are an essential part of driving progress toward sustainability goals and remaining compliant with relevant laws and regulations. The top three control activities typically include:

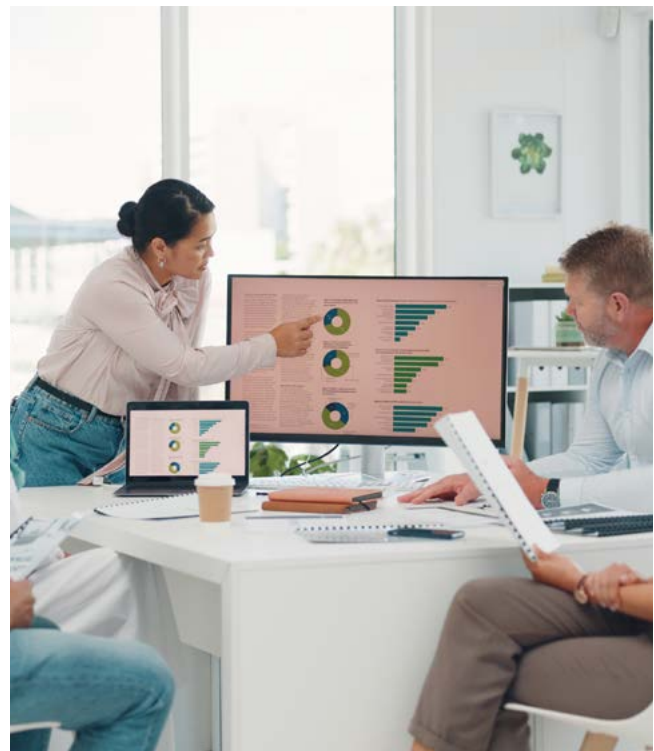
1 Establishing Policies and Procedures

One of the fundamental control activities is the development and implementation of policies and procedures that support sustainability goals. This includes creating guidelines for energy usage, waste management, procurement of sustainable materials, and other relevant operations. These policies and procedures should be clearly communicated to all employees and stakeholders

to ensure understanding and compliance. They serve as a foundation for consistent and sustainable practices across the organization. Regular review and updates of these policies and procedures are necessary to adapt to new regulations, technologies, and best practices in sustainability.

2 Monitoring and Reporting

Continuous monitoring of sustainability metrics and regular reporting are crucial control activities. Federal agency leaders should establish systems to track performance against sustainability goals, such as reductions in energy consumption, water usage, greenhouse gas emissions, and waste generation. This involves the use of tools and technologies to collect and analyze data, providing insights into the effectiveness of sustainability initiatives and identifying areas for improvement. Regular reporting, both internal and external, aids in transparency and accountability. It also helps in engaging stakeholders and can contribute to the overall improvement of sustainability practices.



3

Training and Awareness Programs

Educating employees about sustainability goals, policies, and best practices is a key control activity. This involves developing and implementing training programs that enhance awareness and understanding of sustainability issues. Training should cover the importance of sustainability, the specific actions employees can take to contribute to sustainability goals, and the proper procedures for reporting sustainability data or concerns. By fostering a culture of sustainability, federal agency leaders can ensure that employees are motivated and equipped to make decisions that support the organization's sustainability objectives.

Effective control activities are about creating a structured approach to managing risks and leveraging opportunities. Control activities help federal agency leaders embed sustainability into the core operations of their organization, aligning efforts to mitigate environmental impacts. Control activities also support agencies to comply with regulations, and achieve sustainability goals so they are systematic, effective, and supportive of the organization's mission. Continuous improvement through regular review and adjustment of control activities is essential to adapt to changing circumstances and to enhance sustainability performance over time.

If a federal agency fails to adequately control its energy usage, it may face public scrutiny and negative publicity, leading to reputational damage. On the other hand, if a federal agency properly tracks and reports its energy usage, it can demonstrate its commitment to sustainability, retain public confidence, and serve as an effective steward of taxpayer dollars. KPMG stands ready to assist federal agencies in performing a gap analysis to identify areas where the agency's current control activities may not sufficiently address sustainability-related risks and where additional controls may be required. This analysis can help the agency create a roadmap to implement new and improved control activities for both financial and non-financial sustainability reporting.

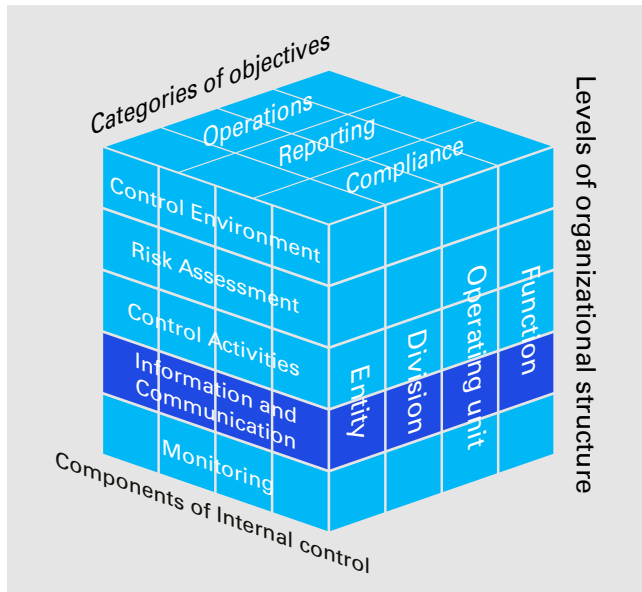
KPMG can also provide guidance to federal agencies related to policy and procedure development by providing guidance and

experience. These policies can be aligned with industry standards and best practices to ensure that the agency is meeting regulatory requirements and demonstrating a commitment to sustainability. In addition to developing policies, KPMG can also assist federal agencies in creating detailed procedures that provide step-by-step guidance on how to implement the different sustainability reporting tasks. These procedures can cover areas such as data collection, analysis, reporting, and monitoring and can help to ensure that sustainability reporting is carried out consistently across the organization.

What comes next? Objective 4 of the Cube focuses on Information and Communication which are necessary to institutionalize critical initiatives.



Component 4—Information and Communication



The emphasis on sustainability reporting continues to grow, and the COSO ICSR framework and GAO Green Book each provide a strategic guide to strengthen controls in information and communication as an integral component of an effective internal control system. Ultimately, the flow of information and the effectiveness of communication are crucial for accurately identifying, assessing, and addressing sustainability-related risks. Proper governance requires robust information and communication processes with both internal and external stakeholders, which can significantly enhance the effectiveness of sustainability initiatives and build intrinsic support. Some of the top considerations in this component of the cube include:

1 Stakeholder Engagement and Communication

Internal: Effective communication channels within the organization to share information, updates, and feedback related to sustainability efforts fosters a culture of sustainability and ensures that each part of the organization is aligned and contributing toward common goals. Open channels for internal communication should also promote a “speak up” culture and support tenets of ethics and integrity which can be effective in reaching sustainable objectives of employee welfare and diversity, equity, and inclusion.

External: Interaction with external stakeholders, including regulatory bodies, suppliers, taxpayers, and the community, is essential. This can involve sharing sustainability reports, participating in forums, and seeking external insights and expertise. External communication helps to align the organization’s efforts with broader sustainability standards and expectations and can enhance reputation and stakeholder trust while enabling the agency to make informed decisions.

2 Accessibility and Quality of Sustainability Data

Confirming that all relevant parties have access to necessary data on sustainability practices and risks is crucial. This involves creating mechanisms for easy access to data for all stakeholders involved, from top management to operational staff. The data used in sustainability risk assessments must be reliable, accurate, and timely. Federal agency leaders should implement rigorous data quality management practices, including regular audits and validations, to improve the integrity of the data. High-quality data is essential for making informed decisions, identifying trends, and monitoring progress towards sustainability goals.



3

Integration of Sustainability into Organizational Processes

Integrating sustainability considerations into decision-making processes and strategic planning is crucial. This means embedding sustainability information and risk assessments into everyday organizational processes, from procurement to product development and beyond. Communication strategies should include the integration of sustainability metrics into performance reports, strategic plans, and risk management frameworks. By making sustainability an integral part of the organizational culture and decision-making processes, federal agency leaders can ensure that sustainability goals are consistently considered and advanced across all operations. Federal agencies should also consider whether sustainability reporting aligns with government policies and initiatives, such as executive orders or agency specific guidance and whether they may need to prepare reported data for third party entities, such as voluntary disclosure (SASB, GRI) or compliance requirements.

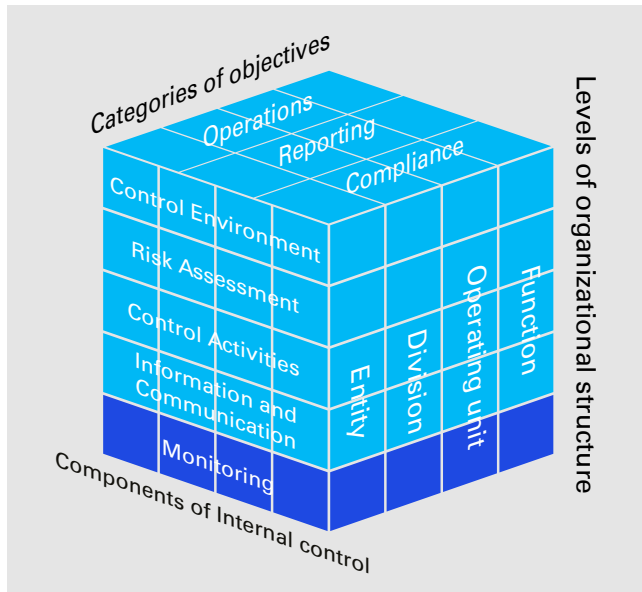
Federal agencies should introduce control activities to identify and mitigate risks associated with data integrity, reducing the likelihood of inaccurate or incomplete data which could negatively impact decisions and sustainability reporting. Sustainability data often must be collected from multiple sources to be aggregated and analyzed in a way to inform processes and decisions. KPMG can provide digital technology, such as data visualization tools, to track and present Key Performance Indicators (KPIs) as well as monitor sustainability performance metrics. Federal agencies should look to existing internal auditing plans to consider integrating sustainable objectives into audits and due diligence processes which are integral to transparent compliance and reporting.

Data elements for sustainability reporting include raw, derived, and functional data; some examples include carbon dioxide equivalents, kilowatt hour usage, British thermal units (raw data) and greenhouse gas emissions, electric vehicle fleet usage, and carbon-pollution free electricity metrics (derived/functional data).

Federal agencies face unique challenges and considerations when implementing the COSO ICSR framework as public interest contributes to a heightened responsibility for accountability. By leveraging KPMG's experientise, technology solutions, and thought leadership, federal agencies can enhance their sustainability reporting capabilities and drive progress toward sustainability goals.



Component 5—Monitoring



As highlighted above in Component 3, federal agencies must proactively develop control activities to effectively address the ever-changing landscape of sustainability-related risks. The objective of monitoring is to assess the design and operation of internal controls and identify any deficiencies, weaknesses, or gaps that may exist. This is achieved through a systematic and ongoing process of evaluating the effectiveness of an organization’s internal controls, as well as the reliability and integrity of reporting. Federal agency leaders should consider the following steps to provide appropriate oversight of sustainability initiatives through monitoring activities.

1 Continuous Monitoring and Regular Assessments

Continuous Monitoring: Implement systems and processes that allow for the continuous monitoring of sustainability initiatives and risk mitigation efforts. This includes tracking the performance of sustainability-related controls and activities to confirm they are functioning as intended. The use of technology, such as data analytics and automated monitoring tools, can facilitate real-time oversight of sustainability metrics.

Regular Assessments: In addition to continuous monitoring, conduct regular, formal assessments of the sustainability program. These assessments should evaluate the effectiveness of the program in meeting its objectives, the relevance and accuracy of risk assessments, and the performance of control activities. Regular assessments help in identifying areas of improvement and in adapting strategies to evolving sustainability challenges and objectives.

2 Alignment with Strategic Objectives and Risk Management

Monitoring activities should be closely aligned with the organization’s strategic objectives and integrated into the overall risk management framework. This means sustainability risks and performance indicators should be considered alongside other strategic risks and objectives, promoting a holistic approach to risk management and organizational performance. Federal agencies also need to update the risk management framework and strategic objectives based on the outcomes of monitoring activities. As sustainability risks evolve and new challenges emerge, it is crucial that these changes are reflected in the organization’s strategic planning and risk management practices. This adaptive approach enables sustainability efforts to remain relevant and effective over time.



Leverage feedback from both internal and external stakeholders to inform monitoring efforts. Engaging with employees, suppliers, customers, and other relevant parties can provide valuable insights into the effectiveness of sustainability initiatives and areas of risk that may not have been fully considered. Consider involving external auditors, independent reviewers, or the agency's Office of Inspector General to help evaluate the sustainability program. An independent review can provide an impartial assessment of a program's ability to identify and mitigate appropriate risks, implement sustainability controls and enable effective operations. An outside view provides objective recommendations and actions that can enhance an agency's ability to meet its goals and objectives. This can also bolster credibility and stakeholder confidence in the organization's sustainability efforts.

Federal agency leaders should design their monitoring processes to be flexible and responsive, enabling the organization to quickly identify and address sustainability risks and opportunities. By aligning their monitoring efforts with the principles outlined in the COSO ICSR and GAO Green Book, federal agency leaders can ensure that their sustainability programs are not only compliant but also effective in achieving their intended outcomes, contributing to the broader goals of environmental stewardship and sustainable development within the federal sector.

Ongoing evaluations are embedded within the daily operations of the organization and are often overseen or performed by management. These evaluations may include regular management reviews, supervisory activities, and KPIs to monitor the effectiveness of internal controls. Separate evaluations, on the other hand, are performed by individuals or teams independent of the function being evaluated. All monitoring evaluations should assess the presence and effectiveness of the components of internal control, which enable a federal agency to meet its sustainability goals.

KPMG collaborates with federal agencies to design and implement comprehensive evaluation plans for their oversight systems regarding sustainable

operational activities. These activities encompass a wide range of focus areas, including conducting risk assessments, performing control self-assessments, testing key controls, and reviewing management reports. These activities help confirm that controls are properly designed, implemented, and operating effectively. To effectively monitor internal controls, a federal agency's management should establish a formal monitoring program that outlines the responsibilities, process, and frequency of monitoring activities. This program should be regularly updated to reflect changes in the organization's risks and control environment. KPIs are another useful tool in ongoing evaluations. These indicators can be quantitative or qualitative and provide a means of measuring the effectiveness and success of internal controls. For instance, an organization may track the percentage of errors or exceptions identified during transaction processing or the number of control deficiencies reported by employees. By monitoring these indicators, federal agency leaders can promptly address any issues that may arise.

KPMG recognizes the dynamic nature of sustainability risks and understands that control gaps may arise due to various factors such as evolving risks, operational changes, or new regulations. Organizations need to identify and understand the laws and regulations that are relevant to their operations. This may include industry-specific regulations, tax laws, data protection regulations, labor laws, or environmental regulations. By keeping abreast of changes in legislation, organizations can update their control activities accordingly. Proper monitoring of compliance with laws and regulations helps organizations adhere to legal requirements, minimize risks associated with non-compliance, and maintain a strong control environment. By consistently monitoring compliance, organizations can detect and address control gaps, strengthen their internal controls, and demonstrate a commitment to ethical and lawful conduct. KPMG can help federal agencies identify these control gaps through thorough evaluations. By effectively communicating these deficiencies to relevant stakeholders, agencies can sanction appropriate corrective actions to address them promptly.

This monitoring process confirms the effectiveness of implemented measures in meeting the sustainable organizational objectives of a federal agency. By focusing on assessing the results of the control activities, communicating deficiencies, and monitoring corrective actions, a federal agency can promote effective oversight and continuous improvement in sustainable business practices.



Conclusion

KPMG leverages our decades of experience across industry, federal, state, and local governments to help our clients address emerging needs, pivoting their agencies from one focused on just keeping pace, to one that is future-ready and capable of anticipating what is to come. Our seasoned professionals come from government, industry, non-profits and think tanks, harnessing our combined experiences to help you make transformative changes, and even the simple day to day operational updates, that can make a big impact. Please visit our website for additional information on how we can help. KPMG has also been recognized with numerous awards and accolades including those in advancing technology, artificial intelligence and automations which go hand in hand with our internal audit and enterprise risk management suite of services.

Contact us

Tim Comello
Partner, Federal
Advisory Risk Services
E: tcomello@kpmg.com

Marcus Melton
Managing Director, Federal
Advisory Risk Services
E: marcusmelton@kpmg.com

Safa Khaleq
Managing Director, Federal
Advisory Risk Services
E: skhaleq@kpmg.com

Misti Cary
Director, Federal Advisory
Risk Services
E: mcary@kpmg.com

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Considerations for Federal Agencies





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