ICGN
International Corporate Governance Network
Inspiring good governance & stewardship

ICGN Investor Viewpoint

The assurance of sustainability reporting

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1. Introduction

Many jurisdictions are adopting mandatory requirements for companies to report sustainability information, notably in accordance with global standards. This is something investors have been calling for, as they need high quality and comparable corporate sustainability disclosures to make informed investment, risk management, and stewardship decisions.

Yet many investors are concerned that corporate sustainability disclosures may contain some unsupported claims, sometimes referred to as "greenwashing".[1][2] To enhance trust in the quality and reliability of companies' sustainability reporting, assurance of this information by an independent third party plays a crucial role.

This Viewpoint starts with a guide to understand assurance of sustainability reporting, before setting out investors' expectations on the preparation of sustainability reporting, and on the quality of external assurance. Finally, it presents some questions investors may ask company boards, as part of their stewardship dialogue.

2. Understanding assurance of sustainability reporting

From voluntary to mandatory sustainability reporting and assurance

In the past few years, there has been a consolidation of corporate sustainability reporting standards. The ISSB was created under the IFRS Foundation, with the mission to deliver a global baseline of sustainability disclosures, focused on the needs of investors and market participants. In June 2023, the ISSB released its first two standards. Since then, more than 20 jurisdictions made commitments to introduce these standards in their legal or regulatory frameworks[3], some of which require the assurance of the information by a third party.

Some markets have adopted their own standards and requirements. In the European Union, the Corporate Sustainability Reporting Directive (CSRD) establishes the regulatory framework for reporting sustainability information, with a 'double materiality' perspective.[4] Around 50,000 companies will have to report information according to detailed reporting standards. The CSRD requires limited assurance of the reporting in the first years, before potentially moving to reasonable assurance from 2028, following an assessment by the European Commission.

In March 2024, the Securities and Exchange Commission (SEC) in the United States issued a rule requiring companies to provide climate-related disclosures in their annual reports and registration statements. Companies are asked to obtain a third-party attestation of disclosed

[1] PwC (2023), "Global Investor Survey 2023". 94% of investors surveyed believe that corporate reporting on sustainability performance contains at least some level of unsupported claims, often referred to as greenwashing.
[2] There is no global definition of greenwashing. The European Supervisory Authorities (ESAs), for instance, understand greenwashing *as "a practice where sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial services. This practice may be misleading to consumers, investors, or other market participants". ESMA (2023), "*ESAs put forward common understanding of greenwashing and warn on risks"
[3] IFRS (May 2024), "Jurisdictions representing over half the global economy by GDP take steps towards ISSB Standards"
[4] Directive - 2022/2464.The CSRD incorporates the concept of 'double materiality'. This means that companies have to report not only on how sustainability issues might create financial risks for the company (financial materiality), but also on the company's own impacts on people and the environment (impact materiality).

Scope 1 and 2 Greenhouse Gas (GHG) emissions, with a phase-in period for large companies to achieve reasonable assurance.[5]

While Governments and regulators are moving towards mandatory sustainability reporting and assurance, some companies are also doing this voluntarily, often in response to requests from investors. This has been mostly limited assurance, and over only a subset of information.[6]

Assurance may be provided by accounting firms or other assurance providers (for example ISO Certified providers, consultants, etc.). IFAC finds that companies in the EU are more likely to use audit firms for assurance than other jurisdictions. In the UK, Asia and the US, other providers tend to conduct the assurance.[7]

Sustainability reporting: complexities and challenges

Sustainability reporting can be challenging for preparers, as some of the information comes from the company's value chain (over which the reporting entity has no or limited control). Moreover, data might be unavailable or inaccurate; the use of third-party databases is widespread, and the reporting contains complex estimates and assumptions. Sustainability information includes both quantitative and qualitative elements, as well as forward-looking information (such as scenario analysis). It covers a broad range of topics (from climate change, biodiversity, to human rights risks) and, for some of these, methodologies are still at a preliminary stage.

Many companies worldwide are still at the beginning of their sustainability reporting journey, and regulatory frameworks are evolving, leaving uncertainties. Companies are developing their understanding of how to conduct sustainability materiality assessments and how to collect the required data. Internal processes and controls over sustainability reporting are invariably less mature than for the preparation of financial information. This increases the risk of misstatements, due to fraud, errors or 'over-optimism' by management. This also means that the information is not always 'ready for assurance'.

Levels of assurance and types of conclusions

Assurance of sustainability reporting is not new, but, with the introduction of mandatory requirements, many more companies will have their reporting assured.

Given that many companies are still building capacity to improve the quality of their data and processes, most regulators are proposing a phased approach to assurance. This means that, initially, we will often see limited assurance. As for the conclusions, experts anticipate that assurance engagement may result in modified conclusions for many companies, for instance for their reporting under the new European legislation.[8]

Therefore, it is important for investors to understand the level of the assurance provided and the conclusions of the assurance provider.[9]

➢ *Limited and reasonable assurance*

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[5] 33-11275-fact-sheet.pdf (sec.gov). For large accelerated filers (LAFs) and accelerated filers (AFs), that are not otherwise exempted, information about material Scope 1 emissions and/or Scope 2 emissions must be disclosed. An assurance report at the limited assurance level is required, which for an LAF, following an additional transition period, will be at the reasonable assurance level.

[6] IOSCO (2023), "Report on International Work to Develop a Global Assurance Framework for Sustainability-related Corporate Reporting"; IFAC, AICPA&CIMA (2024), "State of Play of Sustainability Disclosure and Assurance, 2019-2022", The report highlights that the rate of assurance across jurisdictions increased from 51% in 2019 to 69% in 2022.

[7] Idem

[8] Based on ICGN Secretariat's conversations with assurance providers and market participants

[9] This section is largely based on IFAC (2024), "Sustainability Assurance: What to Expect". We also consulted KPMG Global (2024), "Limited vs reasonable assurance over ESG", IOSCO (2023), "Report on International Work to Develop a Global Assurance Framework for Sustainability-related Corporate Reporting", and Accountancy Europe (2022), Sustainability Assurance under the CSRD

- **The higher level is 'reasonable assurance'** (also referred to as 'examination' in the United States), in which the assurance provider affirms that the information reported is materially correct - with a high, but not absolute, level of confidence. Among other activities, the assurance provider seeks to understand and test the internal processes and controls, assesses risks of material misstatements, checks samples of data (tracing information to source documents to confirm accuracy), performs recalculation, etc. This is comparable to an audit of financial statements. It is more likely to discover errors or misstatements in the reporting and provides a much greater level of confidence to the companies, its investors, and stakeholders, than limited assurance. Because of its nature, a reasonable assurance engagement will require more resources (including cost and time commitment) from the company.
- **With 'limited assurance'** (also referred to as 'review' in the United States), the assurance provider states that they are not aware of anything that indicates that the information is materially misstated. The same types of assurance processes and procedures are performed, but the assurance provider will rely more on information provided by management (with fewer tests and lower scrutiny of the data) This is not comparable to an audit of financial statements.

➢ *Different types of conclusions, or opinions*

- **Unqualified conclusion**: This is the most desirable conclusion, whereby the assurance provider concludes that the sustainability reporting is presented in accordance with the applicable reporting standard. They conclude that the information is fairly represented in all material respects (i.e. reasonable assurance) or that nothing has come to the provider's attention that the information is not presented fairly (i.e. limited assurance).
- **Modified conclusion**: This indicates that there is an error, disagreement, or a lack of sufficient evidence identified. It means something needs to be highlighted to the company's investors and stakeholders. There are different types of 'modifications':
  - **Qualified conclusion**: Effects, or possible effects, of a misstatement or scope limitation are material but not pervasive.
  - **Disclaimer of conclusion**: A material or pervasive scope limitation exists that precludes the practitioner from obtaining sufficient, appropriate evidence to form a conclusion.
  - **Adverse conclusions**: The sustainability information is misstated, and the misstatement is material and pervasive.

3. Investors' expectations

Board oversight and robust processes for assurance readiness

Investors expect sustainability reporting to be prepared by companies with the same rigor and ethical approach as financial statements, with sign-off from the board of directors. Generally, this is not currently the case. IFAC notes that only 56% of companies covered in their research disclosed board-level oversight of sustainability reporting, and 22% board-level oversight of sustainability assurance.[10]

The board of directors should ensure that management has introduced robust procedures, systems and processes to collect the data, and document the information. There must be adequate training and good coordination of the various functions involved in the reporting. Strong internal controls and risk management systems must be in place; this will best support high-quality assurance of the information. The board must ensure that the information fulfils “decision-usefulness” criteria: it must be represented faithfully, be comparable, verifiable, timely and understandable.[11]

As part of its oversight role, the board should seek to understand, among others, how the materiality assessment has been conducted, the state of the company’s preparedness, the regulatory framework, as well as investors and stakeholders’ expectations. The board should ensure that there is consistency and connectivity between information reported in financial statements and broader sustainability reporting.

Although practices may vary, boards may assign the responsibility for the oversight of sustainability reporting and assurance to a specific committee whose members have the appropriate skills, independence, and time availability. This should be reflected in public mandates and committee terms of reference. Given its role in overseeing statutory reporting, a fully independent audit committee may be well-placed to oversee sustainability reporting (and ensure consistency of information) or work jointly with another committee responsible for this. Many investors do not take a stance on how boards should organise their work, however, they need transparency to trust that the board is effectively overseeing sustainability reporting and to be able to hold the board accountable (e.g. vote against the Chair of the relevant committee).

High quality external assurance

While several jurisdictions are promulgating mandatory assurance, there is currently no consistent approach to assurance engagements. Investors expect high quality assurance, based on the following elements.

- *Selection of the assurance provider*

The board should ensure that a rigorous process is in place to select the sustainability assurance provider, based on objective criteria, including competence, ethics, and independence. The board should monitor the work of the assurance provider and engage with them, as appropriate. We note that, when transposing the CSRD into national legislation, France introduced a shareholder vote on the nomination of the sustainability assurance provider. Although not widespread, this is an interesting governance mechanism to ensure accountability to investors.

- *Global standards and strong regulatory oversight*

ICGN welcomes the work of the IAASB in proposing a global baseline for sustainability assurance engagements and of the IESBA in developing an ethics framework for sustainability reporting and assurance, including independence standards. We encourage national regulators to adopt these upcoming international standards, in order to have consistency in assurance engagements globally, regardless of who conducts the assurance.

[10] IFAC, AICPA&CIMA (2024), “State of Play of Sustainability Disclosure and Assurance, 2019-2022

[11] The same fundamental qualitative characteristics and enhancing characteristics apply to useful sustainability-related information in IFRS Sustainability Disclosure Standards (defined in appendix D in IFRS S1) and in ESRS (Annex B of ESRS 1).

Effective oversight of all assurance providers by regulators will also be important, to ensure proper implementation and sustained adherence to these standards.

Investors need the confidence that all assurance providers - whether they are professional accountants or not - follow a rigorous process, conduct assurance engagements of high quality, and apply high ethical and independence standards.

➢ *Independence*

The assurance provider must be independent of the reporting entity. As for auditors of financial information, the assurance provider must be free of any influence, interest and relationship that could impair professional judgment or objectivity. It will be crucial that assurance providers meet high standards of independence and ethics, and we welcome the work of IESBA in developing global standards for this purpose. Moreover, we believe the assurance provider must be instructed by the board of directors, rather than the executive team, and view the company's investors as their ultimate clients.

➢ *Expertise*

Providers of sustainability reporting assurance should ensure that engagement teams have strong expertise in sustainability matters (including knowledge in sustainability-related topics, materiality assessment, and reporting frameworks), capabilities in assurance skills and techniques, and experience in exercising professional scepticism.

We acknowledge that sustainability covers a broad range of issues, and that the assurance provider may benefit from external expertise to carry out the engagement. When using external experts, the assurance provider should retain full responsibility over the assurance engagement. The practitioner should also verify the objectivity of experts they use, as well as their competence, ethics, and professional reputation.

➢ *Connectivity with financial statements*

Investors expect consistency and connectivity between the disclosures in the financial statements and those in sustainability reports.[12] We believe it is important that the practitioners responsible for the assurance of sustainability information and the auditors in charge of the audit of financial reporting communicate effectively. Ideally, the two opinions should be released at the same time, in the statutory annual report and accounts.

➢ *Transparency*

The assurance provider should disclose the level and scope of the assurance engagement, significant matters that influenced the assurance, the ethics and independence standards applied, and professional judgment applied. Investors call for greater transparency on the subject evaluated and criteria used, as well as the level of analysis and testing that has been conducted, in particular for limited assurance. In cases of modified conclusions, investors need clarity on how the assurance provider reached this conclusion. As is the case for the audit of financial reporting, it may be beneficial to disclose 'critical/key assurance matters', providing transparency on the most important judgments or factors that influenced the assurance process and final opinion.

➢ *From limited to reasonable assurance*

Investors' views may vary on whether companies should seek assurance for all their sustainability disclosures or only a subset of information, and the level of assurance needed.

[12] ICGN (2023), "ICGN Viewpoint on Reflecting Climate Change in Financial Statements"

However, IOSCO observed in its engagement with investors that, "while limited assurance may be the more realistic objective in the short term, investors typically see reasonable assurance as the long-term target"[13]. Reasonable assurance is particularly important for financially material information and metrics on which there is a globally agreed methodology (e.g. GHG emissions). A phased-in approach, starting with limited assurance and then moving to reasonable assurance, and extending the scope of the information being assured, could be the way forward. This would help bring sustainability disclosures on par with financial disclosures.

4. Stewardship dialogue

ICGN encourages investors to engage in a constructive dialogue with investee companies, with the objective of creating long-term value for beneficiaries or clients.

Questions that investors may consider asking company boards, related to the sustainability reporting and assurance, include:

1. How does the board organise itself to oversee sustainability reporting? How does it ensure that it has the relevant knowledge?
2. How is the board overseeing the implementation by management of strong internal controls for sustainability reporting?
3. How is the materiality assessment performed? What conclusions did company management reach and why? How often will it be reviewed?
4. How has the board ensured consistency between the sustainability and financial reporting (i.e. were material sustainability factors reflected in financial reporting assumptions and judgments)?
5. How was the assurance provider selected? How was independence ensured?
6. How does the board interact with the assurance provider? How frequently?
7. Has the assurance provider informed the board about any omissions, misstatements or difficulties faced during the engagement?
8. If the company has received modified conclusions in its assurance report, what is the reason for this? Which measures is the company implementing to remediate the situation?

5. Conclusion

In the future, investors are likely to increasingly hold company boards accountable if sustainability reporting is not prepared with the same rigor and ethical approach as financial statements. Reasonable assurance of this information may well become the norm.

Currently, we are in a transition period, where companies and assurance providers are building capacity, global standards are being adopted and must be implemented, and market participants are developing their understanding of sustainability assurance. Some experts anticipate a 'wave' of qualified opinions in the short term, and investors will need to decide how to interpret these assurance reports and engage constructively with companies.

In this Investor Viewpoint, we stress the need to ensure that companies introduce robust governance and internal controls, and that external assurance is of high quality, regardless

[13] IOSCO (2023), "Report on International Work to Develop a Global Assurance Framework for Sustainability-related Corporate Reporting", p.18.

of who conducts it. This is key to foster trust in corporate sustainability reporting - investors need reliable information for their investment and stewardship decisions, and for their reporting to beneficiaries and clients.

About this Viewpoint

ICGN Viewpoints provide opinion on emerging corporate governance issues and are intended to generate debate, whilst not defining a formal ICGN position on the subject.

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