



The Role of Auditors in Company-Prepared ESG Information:

A Deeper Dive on Assurance

March 2021

CAQ

www.thecaq.org

We welcome your feedback!

Please send your comments or questions to info@thecaq.org

Overview

Companies are increasingly tackling complex problems facing society in the form of environmental, social, and governance (ESG) commitments and practices. Such developments have caused what has been referred to as a “fundamental reallocation of capital.”¹ Some questioned whether the COVID-19 pandemic would disrupt investor focus on ESG matters; instead we saw COVID-19, among other recent events, accelerate interest in ESG topics. Asset flows into sustainable funds in the United States continued at a record pace through the fourth quarter of 2020 to nearly \$51 billion, more than two times higher than asset flows attracted to sustainable funds in all of 2019, according to Morningstar.²

In July 2020, the Center for Audit Quality (CAQ) released *The Role of Auditors in Company-Prepared ESG Information: Present and Future*, which gives an overview of what ESG reporting is, how investors are using the information and how public company auditors are well positioned to enhance the reliability of ESG information. This publication builds on those concepts and provides more detail about the range of assurance³ services that can be provided to enhance confidence in ESG information, why assurance on ESG information might be needed, and questions that boards should consider when planning to obtain assurance on ESG information.

¹ See Larry Fink’s 2021 [annual letter](#) to chief executives of the world’s largest companies.

² See https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Global_Sustainable_Fund_Flows_Q3_2020.pdf?utm_source=eloqua&utm_medium=email&utm_campaign=&utm_content=25660.

³ For purposes of this publication, the term *assurance* means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. The term *attestation* as used herein is when assurance is provided by an auditor under the American Institute of CPAs Statements on Standards for Attestation Engagements.

WHAT ARE THE AUDITOR'S CURRENT RESPONSIBILITIES RELATED TO ESG INFORMATION?

For audits of US public companies, the Public Company Accounting Oversight Board (PCAOB) sets forth requirements and guidance for auditor involvement when other information is included in a document with the audited financial statements. The auditor's responsibility with respect to information in a document that contains the audited financial statements does not extend beyond the financial information identified in the auditor's report. The auditor has no obligation to perform any procedures to corroborate this other information.

However, PCAOB auditing standards do require that the auditor read the other information in documents containing audited financial statements, including ESG information, and consider whether such information, or the manner of its presentation, is materially inconsistent with information appearing in the financial statements. For example, if a company discloses ESG-related goals and any progress in achieving them in the Management's Discussion & Analysis section of an annual report on Form 10-K, the financial statement auditors would only be required to read the presented ESG information for consistency with the financial statements or material misstatements of fact; the auditors would not be required to perform audit or review procedures directly on that ESG information. A material misstatement of fact is a high threshold and given the nature of ESG information it may be highly unlikely the auditor would be aware of a misstatement of fact given such information is outside the scope of an audit of financial statements and internal control over financial reporting (ICFR).

In addition, sustainability reports and ESG information often are included in company reports that do not include the audited financial statements. In these instances, the auditor has no responsibility for the ESG information as part of the financial statement or ICFR audits.

WHY MIGHT A COMPANY SEEK ASSURANCE ON ESG INFORMATION?

There are many reasons why a company and its stakeholders may find third-party assurance on its ESG information useful. For example:

- ✦ Boards of directors may want to assess whether public facing disclosures about ESG are of a high quality, as these issues are increasingly seen by investors as a window into business viability and the future of company performance.
- ✦ Investors are increasingly focused on ESG information because they find such information helpful in understanding a company's long-term value creation strategy, and the information enables them to manage their investments based on ESG risks and opportunities. Third-party assurance can enhance the reliability of ESG information by providing insight into the reliability of management's assertions, data, and disclosures.
- ✦ Management may want to seek assurance from a third-party to obtain another perspective on its ESG reporting and associated processes. Assurance from a third-party over ESG information can enhance management's confidence in the integrity of the company's disclosed ESG information—the data, processes, procedures, expertise, and oversight necessary to produce reliable ESG information.
- ✦ Other stakeholders including customers, suppliers and prospective employees also may rely on a company's ESG information to make decisions and assurance by a third-party could enhance the reliability of such information. For example, information on a company's sustainability practices in the supply chain may determine whether a customer purchases a product or chooses to purchase it from a competitor.
- ✦ Assurance of ESG information may impact a company's rankings and ratings on sustainability indices (e.g., Dow Jones Sustainability Index).

WHY ENGAGE A PUBLIC COMPANY AUDITOR TO PROVIDE THIRD-PARTY ASSURANCE?

Assurance providers range from public company audit firms that provide independent, objective, standards-based attestation services to engineering or consulting firms that provide "certification" or "verification" services.

A review or examination attestation engagement performed in accordance with the American Institute of CPAs (AICPA) Statements on Standards for

Attestation Engagements (“attestation standards”) from a public company audit firm results in the issuance of an independent accountant’s report. Like the audits of financial statements and ICFR, attestation of ESG information by a public company auditor can provide an objective and impartial assessment of the assertions, data, and other disclosures made by management. Obtaining any level of assurance by public company auditors is standards based and involves gaining an understanding of processes, systems, and data, and then evaluating evidence and the results of the procedures in order to form a conclusion.

Third-party assurance of ESG information in the form of an attestation engagement from a public company auditor often is differentiated from other forms of assurance because public company auditors:

- + Are required to be independent of the companies they audit, in accordance with applicable independence standards. Other service providers may or may not be required to adhere to an independence framework that is consistent, monitored and well defined.
- + Are already skilled in gaining an understanding of a company, its business cycles and processes, and how the company creates value, through experience gained from financial statement and ICFR audits. This results in less management time and resources needed to educate another service provider.
- + Typically have access to knowledge and specialists that encompass most areas of ESG information and are not limited to providing assurance only over a specific specialty (e.g., greenhouse gas emissions).
- + Are required to plan and perform attestation engagements with professional skepticism.
- + Are experienced in reporting on compliance with various established standards and frameworks.
- + Have a long history and experience of independently evaluating information that is then used in making capital allocation decisions.
- + Are required to maintain a system of quality

CAN A PUBLIC COMPANY USE THE SAME INDEPENDENT ACCOUNTING FIRM FOR ITS FINANCIAL STATEMENT AUDIT AND ATTESTATION OVER ITS ESG INFORMATION?

Yes, performing a review or examination engagement of a public company’s ESG information is considered a permissible service for the independent accounting firm performing the financial statement audit, subject to pre-approval from the audit committee. The performance of review or examination attestation services by an independent accounting firm requires that firm to meet certain independence requirements.

control that is designed to provide the public company audit firm with confidence that its auditors complied with professional standards and that the reports issued by the public company auditor are appropriate.

- + Are required to adhere to continuing professional education, ethics, and experience requirements, including attending specialized training.

Other service providers may or may not consistently maintain a system of quality control that is monitored and well defined or adhere to such rigorous professional education and experience requirements.

WHAT ESG INFORMATION CAN BE IN THE SCOPE OF AN ATTESTATION ENGAGEMENT?

Attestation engagements on ESG information performed by public company auditors in the United States are generally performed under the AICPA attestation standards. An attestation report results from an engagement in which the auditor obtains assurance that a subject matter is measured, evaluated or presented in accordance with certain criteria (e.g., a breakdown of water withdrawal by source and amount from water-stressed areas in megaliters in accordance with Global Reporting Initiative 303: Water and Effluents). The ability of a public company auditor to perform an attestation engagement depends significantly on

the appropriateness of the ESG information being evaluated and the suitability and availability of the criteria used as a measurement tool as required by the AICPA attestation standards. Other types of service providers that provide assurance on ESG information are not bound by the same requirements.

With respect to ESG information, quantitative metrics that are clearly defined and are reported in accordance with ESG standards, such as those put forth by the Sustainability Accounting Standards Board or the Global Reporting Initiative can lend themselves to being in the scope of an attestation engagement performed by public company auditors. Certain qualitative statements related to ESG that cannot be measured or evaluated against a set of criteria may not be within the scope of an attestation engagement. For example, a statement such as “We are one of the most sustainable companies in the world” likely would not be one that a public company auditor could provide assurance on given that this information may not be capable of consistent measurement or evaluation and sufficient appropriate evidence would likely not be available to support this statement.

WHAT LEVEL OF ATTESTATION SERVICE CAN BE OBTAINED ON ESG INFORMATION?

An entity’s determination as to the level of attestation service needed or desired will be informed by various factors, including management’s objectives in presenting the information, management’s readiness for an attestation engagement, the company’s intended audience, and the needs and expectations of potential users. When considering an attestation engagement over ESG information, it is important to think through the desired level of assurance that management and those charged with governance are seeking from such engagement:

+ Examination engagement: Consists of an examination performed by a public company auditor resulting in an independent opinion indicating whether the ESG information is in accordance with the criteria, in all material

respects. An examination engagement is the closest equivalent to the reasonable assurance obtained in an audit of financial statements and is more thorough than a review engagement.

+ Review engagement: The objective of a review engagement is to obtain limited assurance and for the public company auditor to express a conclusion about whether any material modifications should be made to the ESG information in order for it to be in accordance with the criteria. Review engagements are substantially less in scope than examination engagements.

WHAT IS A READINESS ASSESSMENT ON ESG INFORMATION?

Public company auditors can also provide a separate ESG information readiness assessment, performed as a consulting engagement in accordance with the AICPA consulting standards, although it is not an attestation service. Once a readiness assessment has been completed, the company may be able to obtain an independent view as to whether the selection of an ESG reporting framework, its reporting processes, internal controls, evidence available, and governance related to ESG information provide the basis for an attestation engagement at the desired level of assurance.

ESG ASSURANCE QUESTIONS FOR BOARDS OF DIRECTORS

Board oversight of an entity’s ESG reporting is critical for establishing and maintaining good governance, policies, and controls over the ESG reporting process. Board involvement in a company’s decisions related to the assurance of ESG information is equally important. For those companies that already have started reporting ESG information and are considering an attestation engagement, boards may want to ask the following questions:⁴

- + What is the purpose and objective of the attestation engagement on ESG information?**
- + Who are the intended users of the ESG information and related attestation report?**

⁴ For companies that have not started reporting ESG information, see the CAQ publication [The Role of Auditors in Company-Prepared ESG Information: Present and Future](#) for additional considerations.

- + Why do the intended users want or need an attestation report on the ESG information?
- + What are the potential risks associated with a misstatement or omission in the ESG information?
- + Does the company have a clear understanding of what ESG information the intended users want or need to be in the scope of the attestation engagement?
- + What level of attestation service (examination or review engagement) will help the company achieve its objective?

Once the above questions can be answered and the objectives and purpose of seeking an attestation engagement are clear, it is important that companies next consider whether they are ready for either an examination or review attestation engagement. Boards may consider the following questions with respect to assurance readiness of ESG information:

- + What are the company's policies and processes with respect to the gathering and reporting of ESG information? What is the maturity of the company's supporting data?

- + Who in the company has responsibility for and oversight of the identification, accumulation and reporting of ESG information? Is there interaction with the financial reporting process?
- + What is the state of the company's internal controls related to capturing and reporting ESG information? Have these controls been tested by others in the past (e.g., internal auditors)? Are they as robust as the process for the financial statements?
- + What disclosure controls and procedures and related documentation and evidence are available to support the ESG information to be assured?

CONCLUSION

Investors are increasingly aligned—through a desire to understand a company's long-term value creation plan and to obtain credible, standardized ESG information—to support long-term risk assessments. In their public interest role, regulated, independent public company auditors are called on to enhance the reliability of company-reported financial information. Similarly, given the growing use of ESG information by investors, public company auditors are well suited to enhance the reliability of ESG information. •