NAVIGATING CHALLENGES IN ESG ASSURANCE

It is critical for companies to anticipate complexities as the reporting landscape evolves.

ESG assurance, also known as assurance over non-financial data, is a nascent and evolving field. There is diversity in practice in terms of the information subject to assurance and the level of assurance sought. As a result, well-intentioned professionals may have very different understandings of what ESG assurance encompasses, and companies may report ESG data covering a wide variety of topics and indicators, many of which may be subjective or qualitative. These factors can cause challenges and confusion for companies seeking attestation of their ESG data.

This article — part of a BDO series on ESG assurance — addresses key challenges companies can expect to face when seeking assurance on their ESG data and provides guidance to manage these challenges and associated risks.

MORE ON BDO'S ESG ASSURANCE ARTICLE SERIES:

Learn more about the competitive importance of ESG assurance and considerations for companies seeking attestation on their ESG data through BDO's seven-part series of insights, which will cover the following topics:

- The Path to ESG Reporting and Attestation Readiness
- ESG Assurance: A Competitive Differentiator
- Which Level of Assurance is Best for Your ESG Reporting?
- Challenges in the ESG Assurance Environment
- Preparing Your Control Environment for ESG Reporting and Attestation*
- Managing Your ESG Data Towards Third-party Assurance*
- Sustainable Finance and ESG Assurance*

*Coming soon

Consistency in Reporting

In these still-early days of ESG assurance, consistency and standardization remain challenging. In financial reporting, a single framework — Generally Accepted Accounting Principles (GAAP) — prevails in the United States. International Financial Reporting Standards (IFRS) perform a similar function in many other countries. GAAP, IFRS, and complementary regulations establish required disclosures, reporting formats and timelines, and assurance requirements for financial information. In contrast to the situation with financial reporting, there are as many as 15–20 frameworks for reporting non-financial information — a veritable alphabet soup of standards.

Common ESG reporting frameworks include the **Global Reporting Initiative** (GRI), the **Sustainability Accounting Standards Board** (SASB) and the **Task Force on Climate Related Financial Disclosures** (TCFD), amongst others. The newly created **International Sustainability Standards Board** (the "ISSB"), which recently merged in the Sustainability Accounting Standards Board (SASB) and is working collaboratively with GRI, is expecting to finalize in June its first two Sustainability reporting standards. In the European Union (EU), the **Corporate Sustainability Reporting Directive** was also recently finalized, modernizing and strengthening the rules establishing the social and environmental information that companies have to report on pursuant to the European Sustainability Reporting Standards.

Standard developers recognize the need for consistency and comparability in reporting and are working toward consolidation to achieve these goals. For the moment, however, there is considerable variability in what data and metrics companies report and how they are presented. Moreover, some companies issue comprehensive reports and discuss their performance on a range of ESG topics, while others include information on a subset of topics on their website and other locations — or avoid reporting it at all.

Companies can benefit from working with an auditor to study their reporting options and choose those frameworks that are most appropriate for their business, recognizing that these will likely evolve over time. An experienced auditor can assess the reporting that will provide the information that is most helpful to a company's stakeholders and align with industry peers.

Determining Materiality

Materiality is often a topic of extensive discussions in an ESG assurance engagement. It is applicable both in determining which topics and indicators are material for a company and should be included in their reporting, as well as in evaluating errors or omissions in each indicator within a topic. Indicators included in a company's report could be quantitative, such as metric tons of greenhouse gas emissions or cubic feet of water usage or board diversity; or qualitative, such as level of board experience or employee satisfaction. When companies fail to report material topics or omit material indicators, they risk being accused of **greenwashing** and/or **greenhushing**.

In many ways, ESG assurance requires rethinking traditional materiality. The relevant stakeholders extend far beyond investors to also include customers, vendors, regulators, and members of the community and broader society. These groups often have distinct concerns and different perspectives regarding what is material.

Additionally, qualitative and subjective factors play a broader role in Sustainability and ESG reporting than they do in financial reporting. For example, a discrimination lawsuit that is financially immaterial may be considered material to Sustainability and ESG reporting if it reveals important information about the company's culture or governance.

Finally, the concept of "double materiality" is a key element of certain reporting frameworks, such as GRI. Double materiality addresses not only the impact of outside factors on the company but also the company's impact on society and the planet. The latter concept is not present in traditional financial reporting and therefore requires a change in mindset for those who are taking their first steps into non-financial reporting.

Addressing Data Issues

ESG assurance raises novel data issues. In contrast to traditional financial reporting, where virtually all data are in a stated currency, there are numerous potential units in which ESG data may be presented. The variety of units makes it more difficult to evaluate whether errors are material to the report as a whole.

Data sourcing raises other complexities. In traditional financial reporting, data generally are collected from a discrete corporate function — finance. In ESG reporting, companies are collating new and varied data which may be held with various functions spanning operations, real estate, human capital and procurement, in addition to finance. The collation of new data along with the involvement of new functions within the organization necessitates the creation of processes and the establishment of controls that may not previously have been present to ensure data is captured properly.

Certain ESG data may also originate from external sources including vendors, customers, and suppliers. These sources may provide data such as "scope 3" emissions that occur beyond a company's organizational boundaries but within its value chain. Where external data is used, consideration needs to be given to the basis on which the company can rely on this information — for example, whether the entity providing the information has obtained assurance over its own data.

Finally, while financial data lends itself well to calculations and comparisons, ESG (non-financial data) reporting includes estimates, assumptions, and qualitative assertions — such as "ethics are integral to our decision-making" or "our board has deep industry experience" — that commonly used sampling approaches were not designed to accommodate.

For these reasons, companies and their auditors must collaborate closely to ensure data quality and integrity when issuing ESG reports.

Identifying a Qualified Assurance Firm

In the past, ESG assurance has been offered by a range of service firms, including boutique engineering or consulting firms. As the world of ESG assurance matures, companies are increasingly relying on public accounting firms to provide these services. There are several reasons for this. First, an increase in the breadth of ESG information under review is demanding the kind of specialized experience that public accounting firms offer. Additionally, more ESG reporting is being included in public filings and facing greater scrutiny from stakeholders. This may raise risks associated with issuing an opinion on the data to a level of reliance that boutique firms are not comfortable taking on. Finally, many companies are finding it more efficient for their financial auditors to also attest to their non-financial information.

Identifying an assurance firm for your Sustainability and ESG reporting is a decision that should not be taken lightly. The rapid rise in popularity and evolution of ESG assurance is creating a high demand for firms with experience in this area. Planning ahead allows companies to evaluate prospective firms for ESG assurance services and identify a team who can meet their specific needs. A proactive approach also allows time to discuss the assurance process and identify and address any matters that could create issues ahead of the project commencing.

Positive Developments in ESG Assurance

Despite the challenges and complexities described in this article, there have been positive developments in ESG assurance. Overall, the field is moving toward greater standardization and professionalism. Regulators around the world are taking steps to require a certain level of Sustainability and ESG reporting and assurance. Standard-setting organizations are working together to consolidate their frameworks, leading to greater clarity and more uniform reporting.

Public accounting firms are making meaningful investments and are bringing their experience and skillsets from traditional financial reporting to the field of ESG assurance. Younger talent in particular is showing strong interest in the field, and ESG professionals across the board are benefitting from training provided by public accounting and other consulting firms. Finally, there has been a proliferation of software platforms that collate, track and report ESG data, streamlining the process and reducing the burden on management.

Overcoming ESG Assurance Challenges

Companies can take several steps to manage the challenges and associated risks related to ESG assurance, including:

Work closely with qualified professionals: Firms that have deep experience in assurance, expertise in ESG, and familiarity with specific industries can help your company navigate ambiguity associated with reporting standards, data, processes and controls, and materiality. Engaging a firm early will allow time to plan the work appropriately in advance of the desired reporting date.

Assess your readiness for ESG assurance: High-quality data, processes, and controls are key to a smooth process. Evaluate your readiness for assurance in relevant areas and consider seeking an ESG assurance readiness assessment from an experienced firm.

Emulate best-in-class examples: Particularly while standards are still evolving, companies can model their Sustainability and ESG reports on those produced by sizeable companies that have deeper focus and experience in this type of reporting. Competitor reports can also be a good source of intelligence on which frameworks, topics, and indicators are most appropriate for your company's industry or unique situation.

Consider the needs of ecosystem partners: In many cases, a company's ESG data will be relevant to reports issued by vendors, customers, and others in the value chain. Greenhouse gas emissions from the company's products, for instance, may be incorporated in the Scope 3 reporting. As such, companies should understand these partners' needs and work with them to produce the necessary reporting.

Identify the most comprehensive reporting requirements: Different jurisdictions have different Sustainability and ESG reporting requirements. Companies that do business in a variety of jurisdictions should identify the most comprehensive reporting requirements that apply or are expected to apply to them in a particular location and consider applying this approach across all jurisdictions.

Seeking assurance over ESG data is a significant undertaking — particularly the first time through. Working with a qualified, experienced auditor can help ensure a smooth and efficient process and assist in navigating the challenges involved. We encourage companies to get professional assistance in determining which non-financial data to report, seek assurance, and get started early. By being proactive, companies can avoid a crisis situation in the future when regulators or other stakeholders impose additional Sustainability and ESG reporting and assurance requirements.

BDO publishes insights on an ongoing basis to help companies understand how to navigate the ESG assurance landscape. Executives are encouraged to follow this series for comprehensive, value-added insights on the ESG environment.

HAVE QUESTIONS OR WANT TO LEARN MORE? CONTACT US!

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