Corporate decision-making: Why choose a CPA for your ESG assurance needs?

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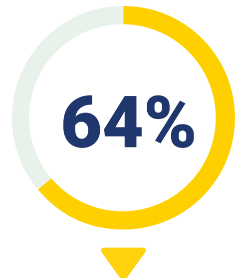
Corporate decision-making:

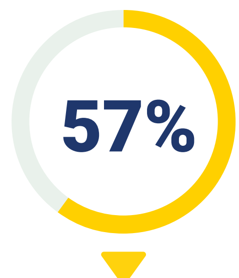
Why choose a CPA for Your ESG assurance needs?

ESG considerations have become a core part of investment analysis and a top priority for corporations and communities. There has been an acceleration in the number of companies reporting on ESG risks and opportunities; a dramatic shift in the range of stakeholders (investors, employees, customers, and others) demanding ESG prioritization; an evolution of laws and regulations on ESG matters; and massive fund flow into ESG investment strategies as the finance sector increasingly recognizes the importance of ESG factors to long-term performance and corporate value.



Companies that obtained assurance on some of their ESG reporting in 2021

As organizations increasingly report ESG, or sustainability-related information, investors, regulators, and other stakeholders are placing greater emphasis on the reliability of this information. Studies show that investors have a preference for information that is assured.[1, 2, 3] To increase stakeholders' confidence in the reliability of ESG information, corporations are engaging independent Certified Public Accountants (CPAs) to perform assurance engagements on their ESG information.



Engagements conducted by audit firms in 2021 (i.e., 516 of 913 assurance reports from 818 companies)

According to a study done with the International Federation of Accountants (IFAC): *The State of Play in Reporting and Assurance of Sustainability Information*, of the 1,350 companies studied in 21 jurisdictions covering the Americas, Europe, Middle East and Africa (EMEA), and Asia, 64% of companies that disclosed ESG information obtained assurance over some of their 2021 reporting.[4] Overall, CPAs account for a majority of all assurance reports on ESG, and 70% of the ESG assurance reports provided by audit firms were by the same firm as the statutory auditor for the same reporting entity.

PUBLIC COMPANY CONSIDERATIONS: INCREASING DEMAND FOR INDEPENDENTLY ASSURED ESG INFORMATION

Around the world, there are various regulations and proposals to require third party assurance of ESG information, primarily for exchange-listed companies.[5, 6] Mandatory assurance may initially be limited assurance or a review engagement and then, over time, transition to be reasonable

1 Ryan J. Casey and Jonathan H. Grenier, "Understanding and Contributing to the Enigma of Corporate Social Responsibility (CSR) Assurance in the United States," *Auditing: A Journal of Practice & Theory* 34, no. 1, (February 2015): 97–130.
2 "ESG and the cost of capital," *MSCI Blog,* February 2020.
3 Brian Ballou, Po-Chang Chen, Jonathan H. Grenier, and Dan L. Heitger, "Corporate Social Responsibility Assurance and Reporting Quality: Evidence from Restatements," *Journal of Accounting and Public Policy* (2019).
4 Global Benchmarking Study State of Play in Sustainability Assurance
5 On January 5, 2023, the European Union Corporate Sustainability Reporting Directive (CSRD) entered into force. Companies in scope of the CSRD will be required to report on sustainability matters in accordance with The European Sustainability Reporting Standards, including climate-related and other ESG matters along with the process used to identify these matters within a dedicated section in their management report.
6 On March 21, 2022, the SEC proposed amendments to Regulations S-X and S-K for the *Enhancement and Standardization of Climate-Related Disclosures*. The proposed rule would require a domestic or foreign registrant to include certain climate-related information in its registration statements and periodic reporting.

assurance or an examination engagement.[7, 8] However, jurisdictional regulation aside, institutional investors and voluntary reporting regimes like the CDP (formerly Carbon Disclosure Project) are expecting ESG information to be subject to assurance.

Though non-accounting firms may be an accepted service provider, in some cases, regulation or rule may only allow accounting firms to provide assurance. In addition, providers other than accounting firms may not have the skills, knowledge, expertise, and systems of quality management to issue a report at the reasonable assurance level.[9] Therefore, companies, their management and boards, should be cautious about choosing an assurance provider who is not an independent public accounting firm.

In addition, public company board members and management could find it beneficial to use the same third party assurance provider for both the financial statement audit and assurance over sustainability-related information given that the financial statement auditor already has an understanding of the company, including its processes, systems, and data through the financial statement audit. The financial statement auditor also has an existing working relationship with the company, the board and its audit committee. These factors contribute to effective and efficient execution of the assurance engagement, resulting in possible cost and time savings for the company.

Companies, their management and boards, should be cautious about choosing an assurance provider who is not an independent public accounting firm.

PRIVATE COMPANY CONSIDERATIONS: THIRD PARTY, INDEPENDENT ASSURANCE MAY BE REQUIRED OR DESIRED

Private companies, including family-owned businesses, not-for-profit organizations and companies having no intention of going public may be under increasing pressure to obtain, or may decide voluntarily to obtain third party assurance over some of their ESG information. As customers and vendors of both public companies and larger private companies expect compliance with enhanced supplier codes of conduct, they will focus on meeting their own Scope 3 emission goals related to their supply and value chains. As a result, the demand for reliable ESG information will likely increase.[10] Having independently assured ESG information would also signal to certain stakeholders such as employees and the community that this reporting is important to private companies.

Lenders and private investors may request or require third party assurance in connection with their investment and credit decision-making processes, including traditional long-term financing, sustainability-linked loans, and green bond issuance. Further, private equity-owned portfolio companies may be required to report ESG information, as private equity firms will need to meet their own requirements for mandatory reporting (e.g., in connection with the Corporate Sustainability Reporting Directive or the Sustainable Finance Disclosure Regulation).[11]

7 Office Journal of the European Union, DIRECTIVE (EU) 2022/2464 OF THE EUROPEAN PARLIAMENT AND THE COUNCIL, page 322/35
8 US Securities and Exchange Commission (SEC), *The Enhancement and Standardization of Climate-Related Disclosures*, page 44
9 Office Journal of the European Union, DIRECTIVE (EU) 2022/2464 OF THE EUROPEAN PARLIAMENT AND THE COUNCIL, page 322/36
10 In its Supplier Code of Conduct, Microsoft outlines expectations for suppliers, and their employees, personnel, agents, and subcontractors to act with integrity while conducting business with and/or on behalf of Microsoft.
11 Effective March 10, 2021, the European Commission Sustainable Finance Disclosure Regulation (SFDR) imposes mandatory sustainability disclosure requirements for asset managers and other financial markets participants.

Why a CPA for ESG Assurance?

BENEFITS OF ENGAGING A CPA FOR THIRD PARTY ASSURANCE OF ESG INFORMATION:

+ **Knowledge of a company's business and business processes:** As companies establish new processes to gather the necessary information to understand their activities, drive change across their organizations, and communicate these efforts to the outside world, they are engaging independent CPAs to perform assurance engagements on their ESG reporting. Assuring ESG information may help identify opportunities for improvement of systems and processes surrounding collection and reporting of ESG data. Assurance over ESG reporting, specifically when performed by a CPA, can enhance the ESG information's reliability because CPAs understand specific industries, market forces, and why certain ESG metrics are important financially as well as from a risk perspective. They have extensive experience in gaining an understanding of a company's business processes and assessing and responding to risk, and they have expertise in evaluating a company's internal systems and processes for collecting, measuring, analyzing, and reporting information. CPAs also have a long history of and experience with independently evaluating company prepared information that is used by investors when making capital allocation decisions.

+ **Adherence to recognized standards:** The public accounting profession has decades of experience in developing methodologies that enable them to apply the auditing and attestation standards of the AICPA, Public Company Accounting Oversight Board (PCAOB), and International Auditing and Assurance Standards Board (IAASB).[12] In a reasonable or limited assurance engagement, generally US accounting firms commonly apply the AICPA attestation standards, while dual reporting applying other relevant alternative standards is permissible. The AICPA standards have been subjected to due process procedures, a transparent, public and reasoned process. The AICPA attestation standards are also publicly available at no cost, which allows users to evaluate the practitioner's report against the requirements of the attestation standards. Members of professions other than public accounting who provide verification services are subject to their own professional requirements; those requirements may differ from those of the public accounting profession.

+ **Commitment to quality control, professional and ethical standards:** CPAs comply with rigorous and widely recognized requirements for independence, firm systems of quality control, and subject matter[13] competency. Although non-CPA firms may, in some cases, disclose that they adhere to similar ethical standards and requirements, they may not have the same rigorous credentialing, continued

Assuring ESG information may help identify opportunities for improvement of systems and processes surrounding collection and reporting of ESG data.

12 The IAASB is developing a new overarching standard for assurance on sustainability reporting. Proposed International Standard on Sustainability Assurance (ISSA) 5000, General Requirements for Sustainability Assurance Engagements (ISSA 5000).

13 The AICPA's clarified attestation standards, which are codified in *Professional Standards*, define *subject matter* as, in an examination or review engagement, the phenomenon that is measured or evaluated by applying criteria.

education, quality control, and oversight which could potentially impair independence and objectivity at the risk of public protection. Regardless of the level and scope of assurance, the independence of the assurance provider is crucial to the integrity of the reported information and to the value of that information to the marketplace.

+ **Use of specialists:** Public accounting firms have access to the specialists, if necessary, with expertise in a wide variety of ESG information, including climate-related areas such as GHG emissions, and have proven experience incorporating those specialists to deliver seamless services as they have done consistently with the specialists they use in financial statement audit engagements (e.g., actuarial services). Additionally, public accounting firms often have a network of other practitioners that can support multinational reporting requirements.

+ **Trusted and valued by users of ESG reporting, including capital market participants:** Investors are increasingly focused on ESG information because they find such information helpful in understanding the resilience of 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 confidence in ESG information by providing insight into the reliability of management's assertions, data, and disclosures. In addition, investors increasingly look to published ESG ratings and data provider reports as an input to their decision-making (for example, assurance of ESG information may impact a company's CDP score or rankings and ratings on sustainability indices, such as the Dow Jones Sustainability Index [DJSI]); external assurance on the ESG information may contribute to improved ratings.

The specific service to be applied is based on the company's objectives (e.g., assurance over ESG emissions information reported to a registry) and generally is determined by the engaging party in consultation with the service provider, although the type of service may also be determined by regulators, debt service agreements, etc. For example, assurance services provided by CPAs can range from rigorous examinations that result in reports about whether the CPA believes the information to be free from material misstatement to those assurance services employing less rigorous procedures, resulting in lower levels of assurance. There are also other services that do not provide assurance and focus instead on advice, information development and recommendations for the engaging party's decision-making. The exhibit on page 7 illustrates the range of services that can be provided by a CPA to enhance confidence in information.

Third party assurance can enhance confidence in ESG information by providing insight into the reliability of management's assertions, data, and disclosures.

NON-ATTEST[14]/ NON-ASSURANCE	**CONSULTING (OR ADVISORY)** + Generally, the work performed is only for the use and benefit of the client + The nature and scope of work is determined by agreement between the practitioner and the client + Any service that meets the definition of an assurance engagement is not a consulting engagement
ATTEST / NON-ASSURANCE	**AGREED-UPON PROCEDURES** + A practitioner performs specific procedures on subject matter and reports the findings without providing an opinion or conclusion + The procedures to be performed may be developed by the practitioner, the engaging party, another party, or a combination of these parties. Further, the procedures may be prescribed by law, regulation, or contract. + Because the needs of an engaging party may vary widely, the nature, timing, and extent of the procedures may vary, as well
ATTEST / ASSURANCE	**LIMITED ASSURANCE** + Limited assurance is a "review" and includes: • Focus on areas of increased risk • Inquiry to obtain an understanding of processes and controls • Evidence obtained primarily through inquiry and analytical procedures + The practitioner's report includes a conclusion about whether, based on the review, any material modifications should be made to the subject matter to be in accordance with the criteria, noting that a review is substantially less in extent than a reasonable assurance engagement **REASONABLE ASSURANCE** + Reasonable assurance is an "audit" or an "examination" and includes: • Identifying risks of material misstatement, including the degree of measurement uncertainty, and designing an appropriate response • Obtaining an understanding of processes and controls, evaluating their design, and determining whether they have been implemented • Evidence obtained through a combination of inquiry, analytical procedures, and substantive testing • Multi-location scoping considerations • Additional testing of third-party information + The practitioner's report includes an opinion of whether the subject matter is in accordance with the criteria, in all material respects

14 Non-attest services differ from attest engagements because CPAs don't express opinions, conclusions, or findings.

Different registries and regulatory frameworks may use different terms and definitions for similar services, including *validation*, *verification*, *certification*, or *assessment*. These terms may not be defined in the same way, which can be confusing to users of reports. It is important to understand the official definitions of such terms under the registry or regulatory framework relevant to the engagement. A reasonable or limited assurance engagement (performed by a CPA under the AICPA attestation standards as an examination or review engagement) may satisfy these requirements and are understood and accepted by capital market participants. Because a non-CPA service provider does not have the same rigorous credentialing, continuing education, quality management, and oversight required by the CPA profession, an engagement performed using a proprietary methodology that is "based on", for example, the IAASB International Standard on Assurance Engagements (ISAE) 3000, may not be performed to the same level or with the same consistency and transparency.

WHAT TO DO NEXT:

+ Start the dialogue with your CPA on your ESG related needs, including assurance
+ Determine and agree on the scope of assurance to meet the needs of key stakeholders and your organization
+ Engage and complete the work to enhance the confidence in your reporting and to satisfy key stakeholders. As you think about engaging an assurance provider, companies and their boards, audit committees, or those charged with governance will need to evaluate the assurance provider. The appendix provides consideration points to aid in your evaluation.

> Companies that seek assurance on ESG information often do so to enhance trust and confidence in disclosures, identify areas for improvement related to controls and processes surrounding the collection and reporting of data, and support more informed decision-making. The accountancy profession is well suited to provide assurance on ESG information due to its expertise, professional standards, systems of quality management, objectivity, and independence requirements. Further, the practitioner that audits the financial statements is the best-positioned to also provide assurance on ESG information in a connected way –i.e., auditors are already well-acquainted with the company, its structures, processes, and controls.

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Suggested reference materials

The Association of International Certified Professional Accountants, the unified voice of AICPA and CIMA, and the Center for Audit Quality (CAQ) have developed a number of ESG-related resources which companies may find helpful:

RESEARCH

+ AICPA-CIMA/IFAC Global Benchmarking Study State of Play in Sustainability Assurance
+ S&P 500 ESG Reporting and Assurance Analysis

VIDEOS

+ ESG update from AICPA Town Hall
+ Playback: COP26 debrief and a look ahead for ESG standards
+ Playback: Current Developments in Sustainability Standard-Setting and SEC Rulemaking
+ Playback: Sustainability Disclosure Priorities for 2023

THOUGHT LEADERSHIP

+ Key Actions for Establishing Effective Governance Over ESG Reporting
+ What boards should know about climate change and value creation
+ Achieving Effective Internal Control over Sustainability Reporting (ICSR): Building Trust and Confidence through the COSO Internal Control-Integrated Framework
+ The Role of Auditors in Company Prepared ESG Information: Present and Future
+ The Role of Auditors in Company-Prepared ESG Information: A Deeper Dive on Assurance
+ The Role of the Auditor in Climate-Related Information

TOOLS

+ ESG Assurance: CPAs are the Preferred Choice
+ AICPA Summary: SEC Proposed Rule on Climate-related Disclosures

For more information please visit https://www.aicpa-cima.com/topic/sustainability-esg and https://www.thecaq.org/collections/auditors-and-esg/.

Appendix I:

Considerations for selecting a service provider for ESG assurance

	POINTS TO CONSIDER	OBSERVATIONS
Assurance provider independence and objectivity	Is the service provider subject to principles of professional ethics, covering at least their public-interest function, their integrity and objectivity and their professional competence and due care?	
	Does the service provider demonstrate integrity and objectivity (e.g., by maintaining a respectful but questioning approach throughout the engagement, proactively raising important issues to appropriate levels of the organization until resolution is reached, and articulating a point of view on issues)?	
	Is the service provider independent of the entity and its affiliates in fact and appearance? Does the service provider have financial relationships with the entity and its affiliates? Will the service provider be in a position of providing assurance over their own work?	
	Is the service provider forthright in dealing with difficult situations (e.g., by proactively identifying, communicating, and resolving technical issues; raising important issues to appropriate levels in the organization; and handling sensitive issues constructively)?	
Quality and sufficiency of the firm	Is the service provider subject to public oversight? Is there a mechanism in place to determine that the service provider is in compliance with and consistently applies the applicable professional standards?	
	Is the service provider subject to quality assurance requirements (e.g., a system of quality control consists of policies that a firm establishes and maintains to determine that the firm and its personnel comply with professional standards, as well as applicable legal and regulatory requirements, and to provide that the reports issued by the firm are appropriate in the circumstances)?	
	Is the service provider subject to record-keeping requirements with respect to the work performed for the limited or reasonable assurance engagement and, if so, what are the record-keeping requirements and the duration of those requirements?	
	Does the service provider's approach to professional development and coaching at both the firm and the engagement team level promote engagement quality?	

	POINTS TO CONSIDER	OBSERVATIONS
Quality and sufficiency of the engagement team	Does the service provider have a license from any licensing or accreditation body to provide assurance, and if so, what is the licensing or accrediting body, and is the service provider a member in good standing of that licensing or accreditation body?	
	Does the service provider have both assurance expertise and subject matter knowledge (i.e., relevant ESG expertise, including GHG emissions)?	
	Is the service provider technically competent and able to translate knowledge into practice (e.g., by delivering quality services within the scope of the engagement, using technical knowledge and independent judgment to provide realistic analysis of issues, and providing appropriate levels of competence across the engagement team)?	
	Does the service provider understand the business and industry (e.g., demonstrating an understanding of the specific business risks, processes, systems, and operations; sharing relevant industry experience; and providing access to firm experts on industry and technical matters)?	
	Does the service provider demonstrate an understanding of the processes and internal control over identifying, measuring, capturing, aggregating, retaining, monitoring, and reporting the sustainability information?	
	Has the service provider discussed the engagement plan including the use of technology and how it addresses company- and industry-specific areas of accounting and assurance risk (including fraud risk and other significant risks)?	
	Is the service provider subject to any professional standards on performing assurance engagements? If so, are those standards publicly available at no cost and have they been established by a body or group that has followed due process, including broad distribution of the framework for public comment?	

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