



**ACCOUNTANCY
EUROPE.**

SETTING UP FOR HIGH-QUALITY NON-FINANCIAL INFORMATION ASSURANCE IN EUROPE

Position paper

VIEWS.

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HIGHLIGHTS

Non-financial information (NFI) is vital for companies and stakeholders to make sound business decisions. It makes environmental, social and governance impacts transparent to support moving to more sustainable economies.

As the importance of NFI is growing, stakeholders also need to know if the information can be trusted. Independent, external assurance enhances the reported NFI's reliability, strengthens confidence in markets and contributes to the global sustainable finance objectives.

This publication explores three conditions to develop and ensure high-quality NFI assurance:

1. EU regulatory framework mandating assurance
2. professional standards applicable to all assurance service providers
3. public oversight of assurance service providers

INTRODUCTION

The European Commission (EC) is revising¹ the Non-Financial Reporting Directive 2014/95/EU² (NFRD) to improve disclosures on non-financial information (NFI) by companies and financial institutions.

To do so, the EC is exploring different policy options to enhance NFI reporting and assurance thereon at European Union (EU) level. In this publication, we aim to inform the policy debate about how independent external assurance (hereafter ‘assurance’) on NFI could be addressed within the NFRD. We also highlight the necessary conditions to achieve high-quality assurance.

NFI is increasingly important for business decisions. It helps to inform stakeholders in the financial markets in their investment decision-making towards a sustainable economy and provides transparency on the impacts of companies’ environmental, social and governance (ESG) performance.

Such information therefore needs to be comparable among companies in terms of definitions, but also in terms of quality, reliability and relevance. As the importance of NFI is growing, assurance is necessary to enhance the information credibility and should become part of the mechanism to support the ambition to transition to a sustainable economy.

To set appropriate conditions for assurance, the reported information has to be verifiable:

- **with appropriate subject matter and suitable reporting criteria.** The reporting criteria suitability is key as it serves as a point of reference to evaluate the subject matter. This may be a commonly used reporting framework, a standard or a regulation that should provide clear definitions. Suitable criteria exhibit the following characteristics: relevance, completeness, reliability, neutrality and understandability³.
- **with effective and properly managed internal processes and controls.** That way, the reporting entity is confident about the quality of the data reported and able to provide appropriate evidence. Currently, companies do not always have mature systems and processes in place to collect and report accurate NFI data.

Effective internal processes and controls, however, are not sufficient to make NFI comparable, relevant and reliable. Assurance by an independent external assurance service provider (hereafter ‘assurance service provider’) is necessary to ensure that NFI reporting is at a high-quality level.

CONDITIONS FOR HIGH-QUALITY ASSURANCE ON NFI

For assurance to be provided at high-quality level, the following conditions need to be fulfilled:

1. EU regulatory framework mandating assurance
2. professional standards applicable to all assurance service providers⁴
3. public oversight of assurance service providers

These conditions are further explained below.

¹ European Commission (2019), the European Green Deal, see: <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1576150542719&uri=COM%3A2019%3A640%3AFIN>

² Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014, amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, see: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN>

³ The International Auditing and Assurance Standards Board (2018), Supplement to the Handbook of International Quality Control, Auditing Review, Other Assurance, and Related Services Pronouncements, see: <https://www.ifac.org/system/files/publications/files/IAASB-2018-HB-Vol-3.pdf>

⁴ Any assurance service provider, being the statutory auditor, another independent practitioner working in an accountancy firm, or another service provider.

EU REGULATORY FRAMEWORK MANDATING ASSURANCE

The NFRD has been a significant legislative initiative to promote consistent non-financial reporting in the EU. There are, however, still challenges to be addressed to enhance NFI reporting. We support the EC's current efforts to strengthen the legislative requirements to achieve European and ultimately global sustainable finance objectives. To bring NFI reporting to its full potential, it is key to deal with the following aspects on assurance.

MANDATORY INDEPENDENT EXTERNAL ASSURANCE

Given the importance of NFI to investors and other stakeholders, the EU regulatory framework should mandate assurance at EU level. If the scope of the NFRD is expanded to all public interest entities and large non-listed companies as supported in our response to the consultation on the revision of the NFRD, assurance requirements should also be applicable to these companies.

Assurance engagements provide stakeholders with confidence in the information reported. The professional standard used for assurance engagements defines an assurance engagement as *an engagement in which a practitioner aims to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence to the intended users*.⁵ Also, assurance service providers can provide insights into additional matters which are not significant to affect the assurance conclusion, but that may be useful to the management⁶.

The assurance service provider – being the statutory auditor, another independent practitioner working in an accountancy firm, or another service provider – should abide by specific principles and requirements to ensure the quality of the service provided. This is further discussed under the section on professional standards.

CLEAR LEVEL OF ASSURANCE

Two types of assurance levels: limited or reasonable

In a reasonable assurance engagement, the assurance service provider obtains sufficient appropriate evidence to reduce the risk of a material misstatement of the subject matter information to an acceptably low level. The work effort in this type of engagement entails extensive procedures that include consideration of the reporting entity's controls, and substantive testing. Reasonable assurance is the same type of assurance as the one required in an audit of financial statements where the auditor expresses a positive opinion on whether the financial statements give a true and fair view in accordance with the applicable reporting framework.

In a limited assurance engagement, the work effort is not equivalent: the assurance service provider performs different and fewer tests than those required in a reasonable assurance engagement. A limited assurance engagement primarily focuses on inquiry, observation and analytical procedures, although it also involves a level of substantive testing over metrics. Limited assurance is the type of engagement where the practitioner expresses a negative opinion on the fact that, based on the procedures performed and evidence obtained, nothing has come to their attention that the subject matter information is materially misstated.

Level of assurance within the NFRD

Ultimately, the level of assurance on NFI should not be different to that on financial information. This is not only due to the importance of NFI to stakeholders, but also because of its connectivity to financial information. That is why the EU regulatory framework should set reasonable assurance as an end-goal to be achieved, for example, over a period of three to five years.

⁵ The International Standard on Assurance Engagements (ISAE) 3000 Revised, Assurance Engagements other than audits or reviews of historical financial information, see:

<https://www.ifac.org/system/files/publications/files/ISAE%203000%20Revised%20-%20for%20IAASB.pdf>

⁶ World Business Council for Sustainable Development (WBCSD) and the Institute of Chartered Accountants in England and Wales (ICAEW) (2019), ICAEW Buyer's guide, see: <https://www.wbcSD.org/Programs/Redefining-Value/External-Disclosure/Assurance-Internal-Controls/Resources/A-buyer-s-guide-to-assurance-on-non-financial-information>

It is important to consider the development of NFI reporting by companies. While the reporting practice is rapidly evolving, it has not yet reached its desired maturity level⁷. We think that this transition period of three to five years would be useful to less mature companies included in the scope of the NFRD so that they have sufficient time to develop their NFI reporting processes. Other companies with more mature processes might already be ready for reasonable assurance so that financial and non-financial information can be trusted at the same level. Regardless of the level of the assurance provided, robust examination procedures are key features of the assurance methodology which are of greatest value to users.

The assurance report, mostly prepared in accordance with the International Standard on Assurance Engagements (ISAE) 3000⁸ Revised, has been instrumental in fostering trust between preparers and users. In some engagements, the International Standard on Assurance Engagements on Greenhouse Gas Statements (ISAE 3410) will also be applicable.

PRECISE SUBJECT MATTER OF AN ASSURANCE ENGAGEMENT

The subject matter of assurance should be clearly defined at EU level. Any assurance engagement, whether it aims at providing a reasonable or limited assurance, needs a clearly identified subject matter to be assessed. The selected subject matter for the assurance engagement should be core to the company's strategy, its business model and what drives the value created within the company. A major challenge for NFI reporting is to clearly define the intended users and their needs and then determine the assurance service accordingly.

Currently, assurance is commonly provided on the following subject matters:

- compliance with reporting criteria
- relevance of the non-financial matters and materiality of the risks that are disclosed
- reliability of the quantitative indicators and qualitative outcomes (all of them or a selection)
- fairness, balance and understandability of the reported qualitative information on strategy, governance, risk management, policies (and the reality of their deployment) and the forward-looking information
- quality and robustness of the internal controls and data collecting processes, where appropriate
- consistency of indicators published with material issues and risks identified
- effectiveness of the reporting entity's policies in relation to the matters covered by the NFRD

Precise subject matters, related assurance standards defining the work effort, and transparent reporting by the assurance provider are essential. Clear definitions in regulatory requirements on assurance will be key. The terms used in the EU legislation and their definitions should be aligned with the concepts used in professional standards. For example, terms such as 'check', and 'verify' which are used in the NFRD bring confusion in practical application as these terms are not defined in professional standards.

PROFESSIONAL STANDARDS APPLICABLE TO ALL ASSURANCE SERVICE PROVIDERS

To enhance the relevance and reliability of NFI, the assurance service provider – being the statutory auditor, another independent practitioner working in an accountancy firm, or another service provider – should be required to apply international professional standards designed to conduct assurance engagements. Applying widely accepted and recognised standards means that an assurance service provider is bound by measures designed to ensure assurance engagements of an equivalent quality.

⁷ Alliance for Corporate Transparency (2019), Report on Companies Sustainability reporting, see: [https://www.allianceforcorporatetransparency.org/assets/2019_Research_Report%20Alliance for Corporate Transparency-7d9802a0c18c9f13017d686481bd2d6c6886fea6d9e9c7a5c3cfafa8a48b1c7.pdf](https://www.allianceforcorporatetransparency.org/assets/2019_Research_Report%20Alliance%20for%20Corporate%20Transparency-7d9802a0c18c9f13017d686481bd2d6c6886fea6d9e9c7a5c3cfafa8a48b1c7.pdf)

⁸ The International Standard on Assurance Engagements (ISAE) 3000 Revised, Assurance Engagements Other than Audits or Reviews of Historical Financial Information, <https://www.ifac.org/system/files/publications/files/ISAE%203000%20Revised%20-%20for%20IASB.pdf>

The international professional standards for assurance engagements cover:

- competence
- quality management
- ethical requirements, including independence

Today, the commonly used standard for assurance engagements on NFI is the International Standard on Assurance (ISAE) 3000 Revised, Assurance Engagements Other than Audits or Reviews of Historical Financial Information. When appropriate, practitioners use national equivalent standards (which are based on ISAE 3000). ISAE 3000 is mainly used by the accountancy profession, but other assurance service providers can also apply this standard.

The International Auditing and Assurance Standards Board (IAASB) is currently developing non-authoritative guidance to assist practitioners in conducting assurance engagements on extended external reporting, including NFI. This upcoming guidance is necessary and helpful. However, we envision that subject-matter specific standards will need to be developed, when appropriate, as NFI reporting practice is still emerging.

COMPETENCE

Providing NFI assurance services requires a high level of knowledge in, and practical experience with, a broad range of matters. These include environmental and societal issues, human resources management processes and reporting, corporate governance, risk management and audit processes. Depending on the circumstances of the engagement, knowledge in the areas of IT, tax and finance may also be relevant.

Assurance service providers have to be able to assess the business as a whole. Therefore, they must have a sufficient understanding of the reporting entity's sector, its strategy and governance as well as economic conditions in its operating environment. This understanding is key to be able to integrate opinions of other experts working on the engagement team and form a comprehensive opinion. The opinion will be formed based on evaluation of the effectiveness of internal control and performing other procedures and appropriate methods of review described in professional standards.

It is important to involve experts to ensure a diverse skill base to deliver quality services and to meet business needs. The multidisciplinary model is a reliable mechanism to develop skills and expertise. The accountancy profession has a long-standing experience in involving experts with relevant expertise in engineering and scientific fields, corporate social responsibility or with other key skills.

Equally, the accountancy profession has the necessary assurance skillset due to their long-standing experience in financial audit and extensive experience in, not only evaluating the systems and processes in place, but also in providing confidence in their output. That is key given the necessity to improve the connectivity of financial and non-financial information.

High-level education is necessary for experts as they start their professional career, but assurance service providers have to continue developing their competences on an ongoing basis through continuing professional development.

QUALITY MANAGEMENT

Assurance services should be provided within the framework of a dedicated quality management system. An assurance service provider applying ISAE 3000 has to abide by the requirement to have a quality control or quality management system in place to ensure the assurance engagement is carried out with consistent high quality.⁹

⁹ IAASB ISAE 3000, see : <https://www.ifac.org/system/files/publications/files/ISAE%203000%20Revised%20-%20for%20IAASB.pdf>

ISAE 3000 specifically refers to the International Standard on Quality Control (ISQC) which sets requirements for quality systems. It is possible to abide by other quality requirements, for example, requirements that could be set out in law or regulation, but their requirements have to be as demanding as ISQC¹⁰.

ETHICAL REQUIREMENTS, INCLUDING INDEPENDENCE

It is essential that assurance service providers abide by strong ethical principles and rules, including independence. Independence safeguards the ability to form an assurance conclusion without their professional judgement being compromised, thereby allowing the service provider to act with integrity, and exercise objectivity and professional scepticism. This is achieved by ensuring assurance providers act with integrity, objectivity, confidentiality, professional competence, and due care and professional behaviour¹¹.

The essence of such requirements should be applied to all assurance service providers to ensure no threat to objectivity undermines the quality of the service.

The accountancy profession applies professional judgement and scepticism, with attitudes of mind that reflect a determination to do the right thing, having a responsibility to act in the public interest, and not simply to comply with a legal requirement. In particular, statutory auditors are subject to strict rules defined by EU law, such as the Audit Directive¹² and the Regulation¹³.

PUBLIC OVERSIGHT OF ASSURANCE SERVICE PROVIDERS

Given the growing importance of NFI to investors, but also to the public at large, public oversight of assurance service providers is necessary. It will ensure that the principles and requirements discussed above are fulfilled by the service provider. It will also add credibility to the assurance service being provided.

Such a role would better fit within the remit of existing oversight bodies by extending their current mandate. It will also help the liability regime to function properly. Given the connectivity between financial and non-financial information, it might be confusing to have different oversight mechanisms for different service providers.

CONCLUSION

We need qualitative information to assess companies' ESG performance, to foster sustainable investment, and ultimately to achieve progress towards global sustainability. Measures are needed to ensure that, from the outset, this information is reliable and fit for purpose.

Mandating assurance is one of these measures that can strengthen confidence that NFI reporting provides the full story without cherry picking, or undue emphasis or omission of certain information.

Conditions, as highlighted in this publication, have to be fulfilled to make sure assurance services are provided with high-quality and consistency across Europe. Otherwise, we run the risk of developing non-financial reporting that will not serve the demand of stakeholders.

Professional accountants are already providing assurance on NFI in many countries and companies in Europe. They have built up knowledge and experience, mainly due to their experience in financial audit. Using this experience is key given the necessity to improve the connectivity of financial and non-financial information.

¹⁰ At the date of writing, the revision of ISQC is in the process of being finalised by the IAASB enhancing the robustness of firm's systems of quality control and embedding quality risk management more clearly in the requirements. The revised standard will be International Standard on Quality Management 1 (ISQM 1).

¹¹ IESBA Code of Ethics, see: <https://www.ifac.org/system/files/publications/files/IESBA-Handbook-Code-of-Ethics-2018.pdf>

¹² Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014, amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, see: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0056&from=EN>

¹³ Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC, see: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014R0537>



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