

Financial Audit Procedures Employed in Sustainability Assurance

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Abstract

Assurance on sustainability reports is a new concept in Romania and this paper aims to enlarge the vision upon the benefits which can be obtained through involving financial auditors in providing assurance services on non-financial reports issued by companies.

Current developments related to non-financial reporting in the European Union indicate that more and more EU-based companies will soon be confronted with more detailed requirements related to sustainability reporting and stricter audit requirements, such as the mandatory assurance of non-financial reports.

Our paper explains and illustrates from a practical perspective the audit procedures performed and the content of assurance reports issued by financial auditors upon auditing non-financial reports.

Key words: sustainability assurance, financial auditors, assurance reports, non-financial reporting
J.E.L. classification: M40, M41, M42

1. Introduction

Corporate social responsibility or sustainability assurance refers to assurance engagements where providers express a conclusion to intended users about the information provided in corporate social responsibility reports against chosen criteria. Having in view the growing need of stakeholders to receive credible sustainability information of companies, the importance of obtaining external assurance on sustainability reports is stressed at the global level because both reporters and report users understand that external assurance can contribute to improving sustainability disclosure.

Sustainability reports are published according to national reporting requirements and they are drafted based on guidance provided by international frameworks developed by global organisations. According to a study performed by KPMG in 2016, the international frameworks mostly used worldwide for reporting on corporate sustainability are the following: the Global Reporting Initiative (GRI), the United Nations Global Compact (UNGC), the OECD Guidelines for Multinational Enterprises, International Organization for Standardization (ISO), UN Guiding Principles on Business and Human Rights, Carbon Disclosure Project (CDP), Greenhouse Gas Protocol (GHG Protocol) (KPMG, 2016, p. 25-27).

The main professionals that can offer assurance services on sustainability reports are accountancy and audit firms, engineering firms and other professional services firms (KPMG, 2016, p. 28). The major assurance standards used globally by assurance providers for delivering sustainability assurance are presented below in table no. 1.

Table no. 1 - International assurance standards used for providing sustainability assurance services

Standard name	Standard issuing body	Standard description
International Standard on Assurance Engagements (ISAE) 3000 - Assurance Engagements other than Audits or Reviews of Historical Financial Information	The International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC)	A standard used by accounting and audit firms to guide their assurance engagements on sustainability reports
AA1000 Assurance Standard (AA1000AS)	AccountAbility, UK-based consulting firm, a leading global sustainability framework developer and standards setter that works with businesses, investors, governments, and multi-lateral organizations	A standard developed through a multi-stakeholder process so that the reporting and assurance meet stakeholders' needs and expectations
ISO 14064-3 Specification	The International Organization for Standardization (ISO)	Specifies principles, requirements and provides guidance for those conducting or managing the validation and/or verification of greenhouse gas (GHG) statements

Source: Own processing from KPMG Study (2016)

In the European Union, starting with year 2018, the law requires large companies to publish non-financial information together with their annual financial statements in order to present corporate sustainability aspects. According to Directive 2014/95/EU known as the Non-Financial Reporting Directive (NFRD), public-interest companies employing workforce more than 500 persons have to publish information related to environmental and social matters, treatment of employees and information in respect of human rights, anti-corruption, bribery and diversity on company boards.

The Directive 2014/95/EU allows companies to use recognised international frameworks, European or national guidelines to prepare their non-financial reporting. The disclosure of non-financial information can be done either by including a non-financial statement within the management report published within the annual financial statements, or by publishing a separate non-financial or sustainability report on the company's website.

Currently, the audit of published non-financial information is not mandatory. Statutory auditors must only check that the non-financial statement or the separate report has been provided by the audited company. The requirement that the non-financial information be verified by an independent assurance services provider is left as an optional measure for Member States of the European Union to implement if they consider necessary.

In 2020 the European Commission engaged in the revision of the non-financial reporting directive (European Commission, 2021). In April 2021, a proposal for a Corporate Sustainability Reporting Directive (CSRD) was adopted for increasing the requirements related to non-financial reporting. This directive will be applicable to all large companies and all companies listed on regulated markets (except listed micro-enterprises).

One of the biggest changes is that the non-financial reporting will be prepared based on specific EU sustainability reporting standards, which will be mandatory for companies to use and are to be developed by the the European Financial Reporting Advisory Group (EFRAG). The first set of standards will be available by October 2022 and they will be linked to EU policies.

Another significant change is that the audit (assurance) of reported non-financial information is required to be performed as a compulsory measure.

As a result of these developments, upon the adoption of CSRD Directive, a great number of companies based in the EU will soon be subject to more detailed reporting requirements due to mandatory EU sustainability reporting standards and stricter audit requirements, such as the mandatory assurance of non-financial reports.

2. Theoretical background

Out of the international standards on auditing and assurance engagements issued by IAASB, the following can be used by financial auditors when providing assurance services on corporate sustainability reports: the International Standard on Assurance Engagements (ISAE) 3000 *Assurance Engagements other than Audits or Reviews of Historical Financial Information* and the International Standard on Assurance Engagements (ISAE) 3410 *Assurance Engagements on Greenhouse Gas Statements*. The latter was issued in 2013 for addressing specifically the assurance engagements in which practitioners check and report on entities’ greenhouse gas statements (GGS).

According to the 2018 edition of IAASB *Handbook of international quality control, auditing, review, other assurance, and related services pronouncements* (IAASB, 2018, pp. 123-206), an assurance engagement is an engagement in which the practitioners undertake verification procedures designed to obtain evidence needed to support the presentation of a conclusion. The aim of the practitioner’s conclusion is to increase the level of confidence of the report users that are external to an entity about the published information that has been prepared by using certain reporting criteria.

Assurance engagements performed according to ISAE 3000 and ISAE 3410 can provide different levels of assurance to report beneficiaries, depending on the financial auditor’s level of work procedures. Reasonable assurance or limited assurance are the two levels of assurance that can be provided about whether “the subject matter information is prepared, in all material respects, in accordance with the applicable criteria”. In ISAE 3000 an example is given about the engagements on sustainability involving providing assurance on sustainability performance reports of entities, in which the information is prepared by the management of entities.

In an article written by Philip Wallage and published in 2000, assurance services provided on sustainability reports was discussed, from the perspective of a new service area for financial auditors, referring specifically to the financial audit procedures performed upon sustainability reports containing affirmations regarding corporate social responsibility issues. The different elements of the definition of an assurance engagement were explained with respect to sustainability auditing. Evidence gathering techniques include a combination of the traditional financial audit methods (Wallage, 2000, p. 61):

- Inquiry: seeking information from knowledgeable persons within or external to the entity;
- Observation: verifying how a process or a procedure is being executed by employees;
- Inspection: examining records, documents, or tangible assets;
- Re-computation and re-performance: checking the arithmetical accuracy of source documents and accounting records or performing independent calculations;
- Confirmation: obtaining response to an inquiry to corroborate information included in the accounting records; and
- Analytical procedures: the analysis of significant ratios and trends including the resulting investigation of fluctuations and relationships that are not consistent with other verified information or deviate from predictable amounts.

3. Research methodology

As previous research shows, by the year 2020, in Romania financial auditors have not yet been involved in providing assurance services on sustainability reports issued by local companies. The publishing of non-financial information either as a separate sustainability report, or as a non-financial declaration included in the administrators’ report has been verified by statutory auditors and the audit reports mention that there are no material inconsistencies between these information and the financial statements or the auditor’s knowledge obtained in the statutory audit (Buică *et al*, 2020, pp. 117).

Consequently, for the purposes of this paper we have selected 6 of the most recent assurance reports issued by financial auditors for some of the EU’s major groups of companies in the automotive, consumer goods, oil, energy and banking fields. The reports are available online on the companies’ websites and the description of the non-financial reports assured by financial auditors by providing assurance reports is presented below in table no. 2.

Table no. 2 – Assurance Reports selected for research

Selected company	Non-financial report description	Financial auditor	Assurance report issued	Assurance report date
ERSTE GROUP BANK AG	Consolidated Non-Financial Report 2020 prepared according to Austrian law and GRI Standards	Deloitte	Independent Assurance Report	10-Mar-21
OMV GROUP	Non-Financial Reporting 2020 prepared according to Austrian law and GRI Standards	EY	Report about the Independent Assurance of the non-financial Reporting 2020	25-Mar-21
RAIFFEISEN BANK INTERNATIONAL AG	Consolidated Non-Financial Report 2020 prepared according to Austrian law and GRI Standards	KMPG	Independent Assurance Report on the Non-financial Reporting	02-Mar-21
ENEL GROUP	Consolidated Non-Financial Statement 2020 prepared according to Italian regulations and GRI Standards	KMPG	Independent auditors' report on the consolidated non - financial statement	19-Apr-21
VOLKSWAGEN AG	Separate Non-Financial Report 2020 prepared according to German law and GRI Standards	EY	Independent Auditors Limited Assurance Report	26-Feb-21
UNILEVER PLC	Unilever Sustainable Living Plan (USLP) and Environmental and Occupational Safety (EOS) performance measures 2020	PWC	Independent Limited Assurance Report to the Directors of Unilever PLC	03-Mar-21

Source: Own selection and processing

We have analysed the selected reports in order to ascertain the verification procedures employed in practice by financial auditors for auditing non-financial information, the content of assurance reports issued and the design of the conclusions expressed by financial auditors.

4. Findings

All the reports under study stated that they provide a limited level of assurance upon the non-financial reporting and that the assurance engagements were performed in accordance with the reporting criteria chosen, specifically the GRI Standards and the reporting requirements as stipulated by the national legislation of the respective jurisdiction.

All the engagements were completed based on ISAE 3000 *Assurance Engagements other than Audits or Reviews of Historical Financial Information*. In case of UNILEVER PLC, the assurance engagement was based both on ISAE 3000 and ISAE 3410 *Assurance Engagements on Greenhouse Gas Statements*, in respect of the company's greenhouse gas emissions.

The content of the audit reports follow the structure required by ISAE 3000 (IAASB, 2018, pp. 123-206), respectively the title mentioning that the report is an independent assurance report, the report's addressee, the specification of the level of assurance provided by the report, the description of the applicable criteria that were used, the nomination of the parties responsible for the report preparation and for the assurance services provided, the statement specifying the ISAE followed in performing the engagement, the statement that the services provider complies with professional requirements, independence and other ethical requirements, the presentation of a summary of the procedures performed, the practitioner's conclusion and signature, date of the assurance report and the location where the reports was signed.

From the assurance reports selected for research, we have analysed the specific procedures performed in practice by financial auditors in order to provide assurance on non-financial reports and classified them in several distinct areas of audit work, as follows:

1. Understanding the specific industry sector, business management and organisational model, governance processes and the sustainability strategy of the company – procedures employed:
 - Performed an analysis of the specific field in which the company operates and of the operational and organizational structure of the company;
 - Performed interviews of the company’s senior management for checking the internal control procedures applied over the preparation of the non-financial reporting;
 - Examined sustainability-related risk management and governance policies and procedures implemented by the company and performed the critical assessment of the disclosures presented in the non-financial reporting;
 - Performed interviews of the company’s employees regarding the sustainability strategy, the sustainability principles and the sustainability management operated by the company.
2. Risks identification and materiality analysis – procedures employed:
 - Inquiries of personnel at the group level, who are responsible for the materiality analysis, in order to gain an understanding of the processes for determining material sustainability topics and respective reporting thresholds of the company;
 - Performed an analysis for the identification of the likely risks of material misstatements in the non-financial report;
 - Performed a risk assessment, including a media analysis, on relevant information on the company’s sustainability performance in the reporting period.
3. Evaluation of the reporting processes, data capture and compilation methods of the non-financial information – procedures employed:
 - Interviewing employees to assess the methods of data generation, data recording, data collection, data processing and internal controls;
 - Inspection of the relevant documents describing the systems and procedures used for data gathering by extraction from the company’s records, selection of the relevant information, data verification and centralisation in the reporting period;
 - Reviewed on a sample basis the non-financial information and reporting processes employed by the company’s employees in order to assess whether the non-financial information have been obtained and consolidated correctly in the non-financial report. The auditors checked whether the non-financial data were aggregated and presented in an accurate and reliable way and that all the relevant information has been disclosed.
4. Analytical procedures and tests of detail performed for testing the non-financial information included in the reports, by applying the following procedures:
 - Performed the analysis and the evaluation of the reported data (computation of ratios, analysis of trends and comparison with reported financial information) and disclosures included in the non-financial report;
 - Reviewed the presentation of significant issues that occurred in the communication with the company’s stakeholders, in the media and in sustainability reports of similar companies;
 - Performed inquiries and examination of selected documents related to the aggregation and reporting of data;
 - Interviewed responsible persons in overseas subsidiaries to understand the key processes and controls for reporting performance data of other locations in order to obtain supporting information, for example on performance indicators;
 - Checked selected disclosures concerning subsidiaries in other locations for obtaining evidence on their completeness, reliability, accuracy and timeliness;
 - Performed the analysis and evaluation of non-financial data and disclosures included in the reports by comparing the statements presented in the non-financial reporting with the auditor’s previous knowledge of the company and with the GRI Standards principles;
 - Performed the matching the non-financial disclosures shown in the report with the calculation documents provided;

- The evaluation of selected internal and external documents, in order to determine whether qualitative and quantitative information is supported by sufficient evidence and presented in an accurate and balanced manner;
 - The evaluation of the overall presentation of the disclosures by critically reading the non-financial report;
 - Comparison of economic information presented in the non-financial report with those included in the company’s financial statements.
5. Compliance with the reporting criteria – procedures employed:
- Assessment whether the national reporting requirements have been complied with in an adequate manner;
 - Review whether the reporting standards were consistently applied;
 - Analytical evaluation of the data and trend of quantitative disclosures regarding the reporting standards.

The conclusions expressed by financial auditors specify that having in view the procedures performed and the evidence gathered, nothing came to their attention to make them consider that in all material respects the non-financial report has not been drawn by observing the legal requirements as stipulated by the national legislation and also the sustainability reporting guidelines used for the non-financial report preparation (GRI Standards).

5. Conclusions

Assurance reports on non-financial reporting issued by financial auditors are prepared in accordance with ISAE 3000 *Assurance Engagements other than Audits or Reviews of Historical Financial Information* and, in case of greenhouse gas emissions, ISAE 3410 *Assurance Engagements on Greenhouse Gas Statements* and they provide limited level of assurance on the non-financial information published by companies.

The audit procedures performed for the verification of non-financial reports refer to understanding the specific industry sector, business management and organisational model, governance processes and the sustainability strategy of the company; review materiality analysis; evaluation of the reporting processes, data capture and compilation methods of non-financial information; analytical procedures and tests of detail performed for testing the non-financial information; verification of compliance with applicable reporting requirements as established by laws and reporting frameworks.

ISAE 3000 is applicable when providing external assurance for non-financial reports, but it is not specifically developed for sustainability assurance engagements and focuses on describing assurance procedures and technical requirements in a very general manner. This standard provides a general framework for accounting professionals and it establishes procedural requirements related to practitioners’ ethics, the conditions for the acceptance and the continuance of engagements, the quality control of engagements, the planning and performing of the assurance mission, the procedures necessary for reaching the auditor’s conclusion and for the assurance report drafting. The planning and the evidence collection and evaluation procedures are very similar to the ones used in the other categories of professional auditing and assurance engagements. Procedures performed are selected by financial auditors as considered necessary in order to obtain an adequate level and quality of evidence needed as a basis for expressing their conclusion.

In our opinion, a separate assurance standard should be issued and designed specifically for performing assurance engagements on non-financial reports.

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