The Journey to ESG Assurance

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The ESG (Environmental, Social, and Governance) reporting landscape is rapidly evolving. Stakeholders and organizations see the value in aligning financial and sustainability reporting. Aligned disclosures will allow for better decision making by investors and other stakeholders. Sustainability and climate reports, the mechanisms through which sustainability information is currently communicated to stakeholders, not only allow investors to make better current state assessments, but also better understand the potential impact of ESG risks and opportunities on an organization's financial position, results and cash flows in the short, medium and longer terms.

More than 96% of the G250 – the 250 largest companies globally by revenue based on Fortune 500 rankings – report on sustainability.[1] This trend is expected to expand to include most businesses, driven by significant incoming standards and regulations.

Despite a stated objective of convergence, standard setters and regulators around the world are continually adding to the alphabet soup of ESG disclosure requirements that have been released or proposed. These include the Taskforce on Climate-related Financial Disclosures (TCFD) Recommendations, the International Sustainability Standards Board (ISSB) disclosure standards S1 and S2, the European Sustainability Reporting Standards (ESRS), the Canadian Office of the Superintendent of Financial Institutions (OSFI) Guideline B-15, the Canadian Securities Administrators' Climate Disclosure Proposal and the U.S. SEC's Climate Disclosure Proposal. These standards and regulations, many of which will have effective dates

[1] Big shifts, small steps (kpmg.com).

commencing as early as 2024, are likely to have a significant impact on a company's reporting burden, depending on its jurisdictions of operation.

The Demand Is Growing

Investors are now demanding that companies disclose consistent, comparable and verifiable ESG information. Gone are the days of marketing-oriented sustainability reports. Concerns about corporate 'greenwashing' have become so prevalent that, on November 3, 2022, the Canadian Securities Administrators published CSA Staff Notice 51-364 – *Continuous Disclosure Review Program Activities for the fiscal years ended March 31, 2022 and March 31, 2021*. In the notice the CSA stated:

> "We have observed an increase in issuers making potentially misleading, unsubstantiated or otherwise incomplete claims about business operations or the sustainability of a product or service being offered, conveying a false impression commonly referred to as 'greenwashing'."[2]

This observation is not limited to CSA-regulated companies but has also been observed globally.

To achieve the objectives of consistency, comparability and verifiability, third-party assurance over a company's sustainability reporting will often be necessary; it is already a requirement with ESRS in the EU, and is expected to be required in certain jurisdictions that adopt the ISSB disclosures standards as well as in the SEC's final regulations expected later in 2023.

To serve the public interest, assurance over sustainability reporting needs to be of the same high quality as is applied to financial reporting.

Introduction to Assurance Standards

Assurance over ESG disclosures has already been voluntarily adopted by many of the world's largest companies. The KPMG Survey of Sustainability Reporting 2022 found that 63% of the G250 companies obtained some form of independent external assurance over sustainability reporting information. Similarly, the International Federation of Accountants (IFAC)'s recent study of 1,350 companies in 15 jurisdictions found that, in 2021, 64% were obtaining assurance over at least some of their ESG information; in 57% of these cases, the assurance was obtained from an audit or audit-affiliated firm (70% of these used their statutory auditors).[3]

The era of mandatory assurance over ESG disclosures is coming, and the EU provides a live example of how assurance mandates can be applied by a phased-in approach through 2028 – moving from limited assurance to reasonable assurance. We expect that some jurisdictions and regulators that adopt the ISSB standards will require assurance over disclosures for public-interest entities (generally those listed on stock exchanges), although it remains uncertain whether that assurance will be at the limited or reasonable level. The SEC's initial 2022 proposal[4] included a requirement for assurance over Scope 1 and Scope 2 greenhouse gas (GHG) emissions disclosures.

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[2] https://www.osc.ca/sites/default/files/2022-11/csa_20221103_51-364_continuous-disclosure-review.pdf.

[3] High-quality ESG reporting depends on high-quality assu - KPMG Global.

[4] Proposed Rule: The Enhancement and Standardization of Climate-Related Disclosures for Investors (sec.gov).

To serve the public interest, assurance over sustainability reporting needs to be of the same high quality as is applied to financial reporting. Standards governing assurance engagements are in a state of evolution. Standards used today, for example, International Standard on Assurance Engagements (ISAE – Canadian equivalent "CSAE") 3000 *Attestation engagements other than audits or reviews of historical financial information*, were designed to govern all assurance engagements, not specifically those related to ESG.

In June 2023, the International Auditing and Assurance Standards Board (IAASB), recognizing this limitation in ISAE 3000, approved a draft for consultation of International Standard on Sustainability Assurance (ISSA) 5000 *General requirements for sustainability assurance engagements*. This standard is designed to be a "comprehensive, stand-alone standard suitable for limited and reasonable sustainability assurance engagements [that] will apply to sustainability information reported across any sustainability topic and prepared under multiple frameworks."[5]

Some individual jurisdictions are mirroring the IAASB's initiative, such as Canada's Auditing and Accounting Standards Board (AASB), which has approved a project to adopt ISSA 5000 concurrently in Canada as CSSA 5000.[6] Approval of the final ISSA 5000 standard is anticipated in September 2024.[7]

To ensure that assurance remains relevant to sustainability reporting in advance of adoption of ISSA 5000, guidance has been provided to bridge the gap. In 2020, IAASB and AASB released Non-Authoritative Guidance on Applying ISAE/CSAE 3000 to Sustainability and Other Extended External Reporting (EER) Assurance Engagements. According to the Internal Federation of Accountants (IFAC), the EER guidance "help[s] assurance practitioners apply the Standard in sustainability-related and integrated reporting engagements (among other extended external reporting)."[8] These developments should further increase stakeholder confidence in the relevance and reliability of assurance reports over non-financial information.

Who should be providing assurance?

There are various views on who is best placed to provide assurance, and currently there exists no uniform approach. Over time, sustainability assurance providers will need the same deep understanding of a company's business processes required for financial audits if they are to play their part in bringing sustainability-related information to the same quality as financial information. Without that, the assurance can be essentially limited to metric verification.[9]

Under the evolving reporting ecosystem, sustainability and financial information is expected to be increasingly integrated – in fact, often drawing from the same systems and processes, subject to similar internal controls, and with oversight by the same bodies charged with

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[5] Proposed International Standard on Sustainability Assurance 5000 Approved for Public Consultation by Unanimous Vote | IAASB.

[6] Sustainability Assurance (frascanada.ca).

[7] Sustainability Assurance | IAASB.

[8] https://www.ifac.org/knowledge-gateway/supporting-international-standards/publications/using-isae-3000-revised-sustainability-assurance-engagements.

[9] High-quality ESG reporting depends on high-quality assurance - KPMG Global.

governance. ESG and sustainability information will increasingly need to be managed on a formal, structured basis, in contrast to today where much of it is aggregated through informal and unstructured approaches such as spreadsheets and emails. Assurance over sustainability reporting and financial statements will ultimately need to be of the same exacting quality – something that the audit profession is well-placed to provide.[9]

Benefits for companies to use their statutory auditors for ESG assurance include avoiding duplication of testing of the controls, processes and systems used in ESG reporting that are already known to the financial statement auditor. Ensuring that an established profession is responsible for assurance over both forms of reporting, working to globally consistent standards and under a robust system of oversight and inspections, will limit the risk of greenwashing.[10]

There is no one-size-fits-all solution, as many organizations are at different stages of the journey.

Given the growing need for diverse skills to support assurance over a wide range of ESG subject matters (e.g., from climate change to human rights to supply chain risk management), there will clearly be an important role for subject matter specialists to work in conjunction with traditional auditors in applying the above assurance standards.

Getting Ready for Reporting

Given that the ESG reporting and assurance ecosystems are rapidly evolving, organizations are now addressing the changes required to be compliant with the upcoming frameworks and regulations. The extent of preparation is, however, not as far along in many cases as it could be, as reflected in the following survey results:

Results of a KPMG survey of 246 financial reporting executives from companies representing a broad cross-section of industries and revenues, including both public and private organizations[11]

[10] High-quality ESG reporting depends on high-quality assurance - KPMG Global.
[11] 22122-esg-reporting-final.pdf (kpmg.us).

Source: 22122-esg-reporting-final.pdf (kpmg.us)

The above companies were surveyed by KPMG in the United States to identify the extent to which each had an established ESG reporting strategy. The responses were widely distributed, with only 30% of the companies having a well-established strategy. Of those surveyed, 57% noted that their companies faced challenges in capacity and expertise of resources, while 48% of those surveyed noted challenges presented by the expanding range of ESG reporting frameworks and standards.

The journey to ESG reporting and assurance maturity is a multi-activity process. There is no one-size-fits-all solution, as many organizations are at different stages of the journey and each organization has its own unique challenges. KPMG has worked closely with many organizations to lead them through a structured approach to ESG reporting maturity, covering six key activities:

- **Establish** – Understand and define ESG reporting objectives and requirements, and establish ESG governance structure and leadership.
- **Assess** – Assess the current state of ESG reporting processes, controls and technology enablement.

- **Design** – Develop a target state operating model, including processes and controls, people and culture, service delivery model, technology and data to meet anticipated ESG disclosure requirements.
- **Implement** – Apply effective project and change management principles to implement the target state operating model and publish ESG disclosures in line with relevant requirements and leading practices.
- **Sustain** – Continuously monitor external ESG regulatory developments and assess ongoing operating effectiveness of controls.
  Assure – Obtain an external assessment of readiness for assurance in the year before assurance will begin, and implement the assessment's recommendations in preparation for future assurance over ESG metrics and narratives.

ESG Reporting Frameworks: A Closer Look

We take a closer look below at certain of the leading frameworks that currently exist or are planned for release later this year. While there is an element of convergence around the TCFD Recommendations in these frameworks and standards, each has its own unique requirements that need to be carefully analyzed.

TCFD

The TCFD was established to help capital markets understand the opportunities, impacts and risks associated with climate change. The TCFD released its Final Report: Recommendations of the Task Force on Climate-Related Financial Disclosures in June 2017. This report set out 11 recommendations across four pillars: (i) governance; (ii) strategy; (iii) risk management; and (iv) metrics and targets.

ISSB

The ISSB published its first two standards on June 26, 2023:

- IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*
- IFRS S2 *Climate-related Disclosures*

IFRS S1 builds on the TCFD pillars discussed above and is a general sustainability disclosure standard. IFRS S2 provides specific guidance on climate-related risks and opportunities. The ISSB is expected to release further standards for other ESG-related topics, but organizations should apply IFRS S1 concepts to report on other ESG topics in the meantime.[12] The effective date for the S1 and S2 standards is January 1, 2024, but adoption and related timelines will be influenced by local jurisdictions. Canada is in the process of establishing a Canadian Sustainability Standards Board, which will recommend national timelines. Note that these standards will become fully mandatory only if incorporated within laws and regulations.

[12] ISSB Standards are now live! - KPMG Global.

OSFI

OSFI released [Guideline B-15: Climate Risk Management] in March 2023, establishing expectations related to a federally regulated financial institution's management and related disclosures of climate-related risks.[13]

CSRD

The European Corporate Sustainability Reporting Directive (CSRD) has been effective since January 2023. Currently under development are the European Sustainability Reporting Standards (ESRS), which follow the guidelines set out in the CSRD. CSRD is planning to publish 12 ESRS. Although ESRS 2 is currently the only standard that is mandatory, organizations will be required to perform a materiality assessment to determine if they need to disclose under the other 11 standards. The ESRS are expected to be adopted by August 2023, with the effective date for the first phase of in-scope entities being January 1, 2024.[14]

CSA Climate Disclosure Proposal

The original draft CSA disclosure proposal[15] was released in October 2021. CSA staff intend to conduct further consultations to adopt disclosure standards based on the ISSB Standards, with modifications considered necessary and appropriate in the Canadian context. A further market update from the CSA will follow in the coming months.

SEC Climate Disclosure Proposal

The original draft SEC climate disclosure proposal[16] was released in March 2022, and was considerably more onerous than the original CSA proposal. A revised proposal is expected later in 2023, with the U.S. political and litigation environment likely to have an impact on the extent of modifications made to the original proposal. Canadian SEC registrants currently exempt from SEC disclosure requirements under the Multijurisdictional Disclosure System (MJDS) are monitoring the CSA and SEC developments closely, to ensure that the MJDS exemption will apply to climate disclosures.

Affected and interested parties of the standards want them to be scalable, clear and concise, relevant to current and future needs and issues, and easy to implement consistently.

GHG Emissions Reporting

The ISSB, CSRD, CSA, SEC and OSFI B-15 will all require organizations to report on some combination of Scope 1, 2, and 3 GHG emissions. Although many organizations are reporting or beginning to report on Scope 1 and 2 emissions related to their own operations, it is much more challenging for organizations to collect, aggregate and report on Scope 3 emissions, which represent indirect emissions from across an organization's value chain.[17] There are 15

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[13] https://www.osfi-bsif.gc.ca/Eng/Docs/b15-dft.pdf.
[14] https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2022/07/talkbook-get-ready-for-esrs.pdf.
[15] Canadian securities regulators seek comment on climate-related disclosure requirements - Canadian Securities Administrators (securities-administrators.ca).
[16] Proposed Rule: The Enhancement and Standardization of Climate-Related Disclosures for Investors (sec.gov).
[17] https://kpmg.com/xx/en/home/insights/2022/12/issb-ghg-scope3-emissions.html.

categories of Scope 3 emissions for various upstream and downstream activities undertaken by an organization's suppliers, customers and investees. As a result, many of the reporting standards discussed above take a phased approach to requiring Scope 3 reporting.

Assurance Standards: A Closer Look

The IAASB and AASB's development of ISSA/CSSA 5000 is a major step toward ensuring that assurance over sustainability metrics provides the same value to the capital markets that today's auditor's financial statement opinions. Specifically, ISSA 5000 is intended to be:

- Responsive to the public interest need for a timely standard that supports the consistent performance of quality sustainability assurance engagements.
- Suitable across all sustainability topics and information disclosed about those topics, under multiple reporting frameworks.
- Implementable by all assurance practitioners (i.e., professional accountants and other professionals performing assurance engagements).[18]

Affected and interested parties of the standards want them to be scalable, clear and concise, relevant to current and future needs and issues, and easy to implement consistently across the globe.[19] The ISSA 5000 scope will be comprehensive to allow for ease of adoption and execution, addressing, among other topics:

- Facets of sustainability disclosures.
- Reporting boundaries.
- Information that will be required to be assured.
- Applicable standards.

More specifically, we expect that ISSA 5000 will provide clarity on areas such as the level of work required for a limited versus reasonable assurance engagement, the applicable reporting areas, scope of work, the type of evidence needed for assurance, internal controls, and materiality. This will allow for consistency in the application of these standards when performing assurance engagements and help strengthen the credibility of ESG assurance reports.

Many organizations are already obtaining assurance over their climate and/or sustainability reports. While ISSA and CSSA 5000 are in their developmental stages, assurance providers are currently applying ISAE/CSAE 3000, *Attestation Engagements Other than Audits or Review of Historical Financial Information* when performing these types of engagements. To bridge the gap until ISSA/CSSA 5000 is adopted, the IAASB's and AASB's Non-Authoritative Guidance on Applying ISAE/CSAE 3000 to Sustainability and Other EER Assurance Engagements provides a useful resource for assurance providers, including:

- Engagement acceptance considerations (e.g., team competence and capabilities, determining preconditions).
- Assessing a company's reporting parameters (process to identify reporting topics, determining the suitability and availability of criteria).
- Processes and controls.

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[18] https://www.iaasb.org/consultations-projects/sustainability-assurance.

[19] https://www.iaasb.org/consultations-projects/sustainability-assurance.

- Assertions, audit evidence and quality of information.
- Addressing future oriented EER information.
- Completion and communication matters (materiality of misstatements, assurance reporting).[20]

Financial statement audit considerations

Separate from ESG reporting and assurance is the need for companies and auditors to consider the impact of ESG and climate-related risks in preparing and auditing the financial statements. These considerations will further increase in visibility when ESG reporting is released at the same time as the financial statements, which is a requirement of the final and proposed climate disclosure standards under the EU, ISSB and SEC.

The IAASB's Staff Audit Practice Alert, *The Consideration of Climate-related Risks in an Audit of Financial Statements,* issued in October 2020, reminds management that it is tasked with considering the importance of climate-related risks to investor decision making when preparing the financial statements, in addition to its reporting in other documents such as sustainability reports.[21] Such risks could include, for example, impairment of assets that will need to be replaced or upgraded to meet emissions legislation or ESG commitments the entity has made that rise to the level of provisions to be recorded. Similarly, auditors need to consider and ensure that the accounts under audit reflect appropriate amounts and disclosures, including appropriateness of estimates and completeness of provisions, which may be required to be made in relation to the impacts of climate risks on an organization.[22]

The Road Ahead[23]

As we have discussed throughout this article, it is clear that the evolution towards assurance over ESG reporting is in full swing. As jurisdictions and regulators increasingly require assurance over this information, companies will need to prepare. There are actions for every organization to take to get ready for mandatory assurance, from those that have yet to report on ESG information to those that have already been obtaining some form of ESG assurance voluntarily.

Where companies are only starting on their ESG reporting and assurance journey, involving your advisors and assurance providers in the six key activity areas previously highlighted will help ensure all parties are aligned on the determination of metrics to be reported, the processes and controls to measure and report these metrics, and the evidence that will be acceptable as support for assurance. Performing an assurance readiness assessment during the year before formal assurance is planned will identify potential gaps and help set up the organization for success.

Given the pace of change in ESG reporting and assurance requirements, and these requirements gaining equal importance to financial reporting, the time to take action is now.

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[20] Non-Authoritative Guidance on Applying ISAE 3000 (Revised) to Sustainability and Other Extended External Reporting Assurance Engagements | IAASB.

[21] The Consideration of Climate-Related Risks in an Audit of Financial Statements | IAASB.

[22] The Consideration of Climate-Related Risks in an Audit of Financial Statement | IAASB.

[23] 22122-esg-reporting-final.pdf (kpmg.us).