## Sustainability Assurance Services – Hot Market or Tough Sell?

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In his famous 1970 essay in the *New York Times*, influential economist Milton Friedman said the one and only social responsibility of business is to increase its profits, while operating in free and open competition without deception fraud.[1] Times have changed. A 2021 IFAC/AICPA/CIMA survey of 1400 companies globally showed 91% of respondents reported some level of information on their environmental, social and governance (ESG) responsibilities. Also, 51% obtained some level of assurance on aspects of that information.[2],[3] A draft EU Corporate Sustainability Reporting Directive (CSRD) requiring limited assurance will likely come into effect in 2023.[4] And, now, the IFRS Foundation has set up the International Sustainability Standards Board (ISSB) to become a major player in the ESG information world.

Canadian CPAs who do audits and reviews for a living might reasonably expect a lot more work to come their way. Not all ESG information sources can be trusted. Independent assurance could be vital in reducing material misstatements and related bad decision making. Unfortunately, any expectation of a hot sustainability assurance services market for CPAs is illusory. On the demand side, Canadian regulators will not likely mandate sustainability assurance services and thereby create a significant market. A surge in companies voluntarily obtaining assurance is also improbable. On the supply side, the assurance divisions of CPA firms may well find it difficult to recruit and retain personnel who have the required experience and expertise to take on highly complex, broadly-scoped sustainability assurance engagements.

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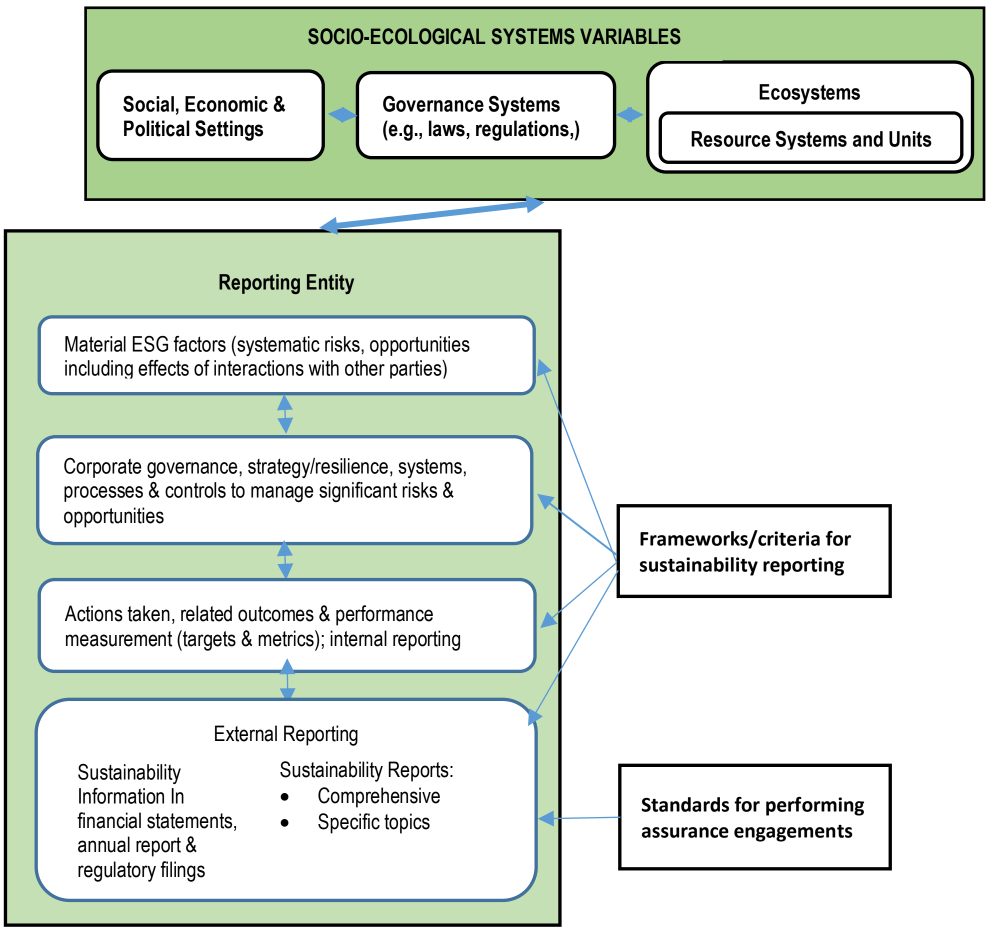
### Potential Market

Figure 1 provides a high-level overview of a sustainability information process and suggests matters for which assurance might be warranted.

At the overall society/environment level, ESG information is pervasive, complex and interconnected. One ESG model has seven socio, economic and political settings variables, three ecosystems variables, seven resource units, nine resource systems variables, eight governance systems variables, nine “actors” variables (i.e., variables-related entity operations), 10 interactions variables and three outcomes variables. Each variable has vast amounts of relevant data associated with it.[5]

**Figure 1 Overview – Sustainability Information**




Not all ESG matters at the society level will be relevant to an individual entity. As indicated by the two-directional arrow between the socio-ecological factors and an individual entity, however, what is “material” takes into account both how the entity is affected by ESG matters and how that entity affects society.

There are many frameworks/criteria against which ESG information can be evaluated. Two examples are those provided by the Global Reporting Initiative (GRI) and the Financial Stability Board’s Task Force on Climate Related Disclosures (TFCD). Material matters that may require disclosure include, for example, (1) ESG-related systematic risks and opportunities including effects of interactions with other parties (e.g., the entity’s supply chain and customers) and (2) aspects of their corporate governance, strategy/resilience, systems, processes and controls to manage significant risks and opportunities, as well as targets and performance metrics. The need to meet criteria for ESG disclosures often will affect all aspects of how an entity addresses sustainability, although this may not always be the case. Aspects of the process are iterative (as indicated by the two-directional arrows) with change continually being made as new information comes to light.

**Auditors do not normally provide assurance on ESG information in documents such as annual reports or regulatory filings, but may read this information to identify any material inconsistencies with the audited financial statements.**

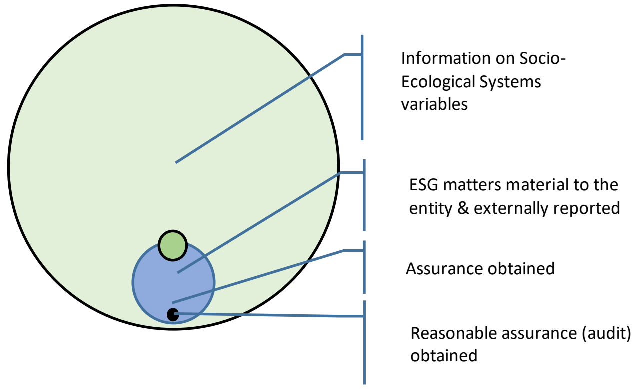
An entity might request an audit or review of a report on any aspect of its ESG process, including controls. These might include, for example, a comprehensive sustainability report, or reports on specific aspects of ESG such as allocation of Green Bond proceeds. Financial statement auditors do not normally provide assurance on ESG information in documents such as annual reports or regulatory filings, but, for example, read this information to identify any material inconsistencies with the audited financial statements.

Despite the potential indicated by Figure 1, significant growth beyond the current sustainability assurance services market is unlikely.

**Current Market**

CPA Canada's Research Guidance Support Group has started an analysis of the current Canadian landscape for sustainability assurance services. The results are not yet available. Figure 2 shows, however, the results of a limited non-rigorous web search. The amount of ESG information on which assurance is provided is likely small, and most of that is reviewed rather than audited.

**Figure 2 –Canadian Sustainability Assurance Market: Now & in Future**

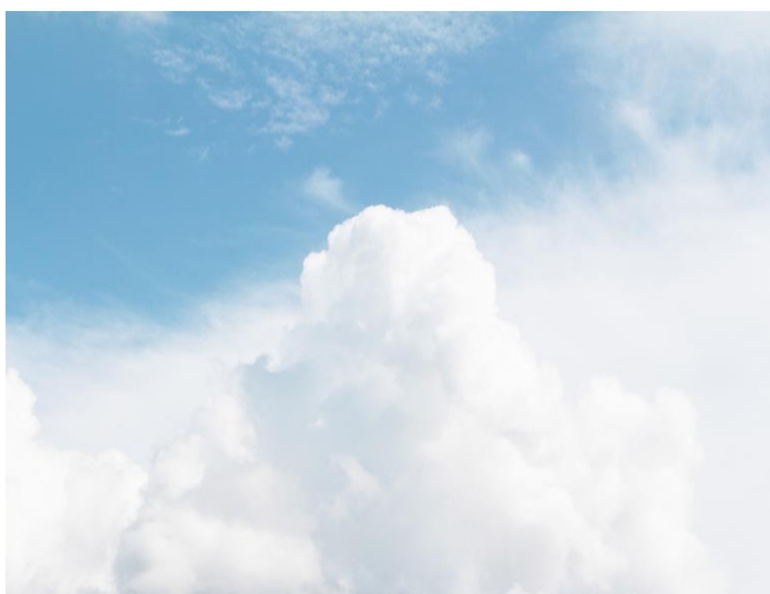


Although this may seem odd, given what various surveys say, companies making only miniscule ESG disclosures and having only a few aspects of that reviewed may positively skew some survey results. The *TCFD 2020 Status Report* injects a useful dose of realty. It notes that, despite improvements made, companies' disclosure of the potential financial impact of climate change on their businesses and strategies remains low.[6]

In the Canadian financial services sector, major banks provide comprehensive sustainability reports, but assurance is obtained on only very small amounts of specific types of information. For example, the 2020 comprehensive sustainability report by CIBC covers its governance responsibility, social responsibility (e.g., community building, stakeholder inclusion, culture), and environmental responsibility. Throughout the report, a small † symbol indicates a "key environmental and social metric" for which limited assurance was obtained. The related "letters of assurance" appear in a CIBC's ESG Document Library (a webpage separate from the sustainability report).

CIBC reported more than 30 social responsibility metrics. Its external auditor provided limited assurance on only four of them: employee engagement score and three related to executive positions approved by the Board that were filled by women, visible minorities and the Black community. An engineering firm reviewed six GHG emissions performance metrics out of the more than 80 environmental responsibility metrics reported. No assurance was obtained for any of the seven governance responsibility metrics.[7] In summary, of over 120 performance metrics reported, only a few were reviewed and none were audited.

Further, no assurance was obtained for the many significant ESG disclosures beyond performance metrics. For example, CIBC disclosed comparative data on its loans in environmentally sensitive sectors (forest products, mining, oil and gas, utilities and agriculture) as a percentage of its total loans. The report states that the bank performs an enhanced due diligence review for specific sectors and prohibits or limits certain transactions for sensitive sectors.[8]



None of this information appears to have been reviewed or audited. Information on responsible investing can be a particularly sensitive aspect of a financial institution's operations. CIBC's approach was to provide a link to the *CIBC Asset Management's United Nations Principles for Responsible Investing* (PRI) Report. [9] That report notes that no third-party assurance was obtained on the information provided and there are no plans to do so. [10] Concerns are being expressed about the reporting of so-called ESG assets. Addisu Lashitew of Brookings notes that, in the absence of detailed, verified information, asset managers can fall prey to "greenwashing" and classify securities of unsustainable companies as ESG assets.[11] Also, reactions to the January 2002 CSA Staff Notice 81334, about misleading ESG asset information, have not all been positive. The groundswell in ESG assets is viewed as being like the "wild west," with concerns expressed that the CSA guidance does not impose new obligations and is not enforceable.[12] That guidance makes no reference to any assurance being obtained.

For ESG information outside of its sustainability report, CIBC's external auditor verified that proceeds from a "Green Bond" and an Index Growth GIC were allocated to eligible projects (i.e., renewable energy or green buildings).[13]

Although CIBC's approach to obtaining assurance on sustainability information seems largely similar to that for the other largest Canadian banks, the external auditor of one bank (rather than an engineering firm) reviewed its GHG emissions. Another bank did not obtain assurance on any information in its comprehensive 2020 sustainability report

**Low Expectations for Increased Market Demand**

Questions are now being raised about the value of ESG reporting, even in the absence of assurance. In the view of a former COO of Timberland (a pioneer in ESG awareness), "evidence suggests that the impact of the measurement and reporting movement has been oversold" and "Worse yet, the focus on reporting may actually be an obstacle to progress—consuming bandwidth, exaggerating gains, and distracting from the very real need for changes in mindsets, regulation, and corporate behavior." [14]

Contrary to this view, a 2020 EY Global survey suggests that both ESG information and assurance on it may be highly valued.[15] Respondents do not appear to have been asked, however, how much they would be willing to pay out of their own pockets for assurance services. When faced with direct personal costs or losses, attitudes change. Take, for example, Unilever, a large UK conglomerate known for its pursuit of ESG goals. Faced with a poor share value performance, a major shareholder said the company has "lost the plot" by pursuing "sustainability medals" at the expense of financial performance. [16]

On the other hand, proactive pursuit of goals related to climate change may be important, for example, to shareholders of companies that depend on bank financing. European banks are beginning to drop clients who are not making significant progress in decarbonization. Banks view these companies as having uncertain futures and as being high credit risks.[17] Would banks demand more assurance from CPAs to inform their lending decisions? Likely not. Decarbonization actions in the oil and gas sector could include, for example, changing power sources, reducing fugitive emissions, electrifying equipment, reducing routine and non-routine flaring, and increasing carbon capture use and storage.[18] Companies wanting continued or additional bank financing would likely give banks access to information on their decarbonization efforts. A bank's own analysts would obtain the required data and plug it into their credit risk and capitalization models.

**There is an impasse on what those who may benefit from ESG assurance services want and what those providing it can provide.**

Are customers likely to demand assurance on ESG features of a company's products? An *EY Future Consumer Index Survey* shows that 61% of customers plan to pay more attention to the environmental impact of what they consume. Sixty-four percent, however, intend to focus more on value for money — creating a tension over who should pay for sustainability. Consumers often say they'll pay more for sustainable products and services, but then don't support that intention with action.[19] Given the recent high inflation rates and supply-chain issues resulting from the COVID pandemic, consumers are even less likely to care whether ESG claims about products have been independently reviewed or audited.

Also, wording in assurance reports is not doing the profession any favours. A 2019 survey of sustainability assurance service providers showed that a significant number of respondents recognized that technical language, including the proliferation of negative wording, such as "nothing has come to our attention," can be confusing and even misleading for stakeholders. Also, some reports contain limitation of responsibility wording (e.g., "We do not accept or assume responsibility to anyone other than to the company for our work, or for the conclusions we have reached in this assurance statement").

Such wording distances assurance providers from the content and quality of the assurance report and could be questioned by stakeholders.[20] Assurance service providers perspective would, however, be correct in saying that, without such language and in the absence of a more appropriate legal liability regime, they are exposed to an untenable risk of potential litigation from a vast range of stakeholders. There is, therefore, an impasse on what those who may benefit from assurance services want and what those providing it can provide.

**Low Likelihood of Canadian Securities Regulators Mandating Sustainability Assurance**

Canadian securities regulators may follow the EU's lead and mandate extensive ESG disclosures but not mirror the EU's proposal to require independent limited assurance on these disclosures.

The November 2021 IOSCO recommendations on asset management disclosures stated that ISSB's new standards could deliver a global baseline for sustainability reporting but that the auditability of future reporting standards will be considered at some future date.[21] The latter comment has the air of being platitudinous. The Ontario Securities Commission is an IOSCO Board member.

Regulation in Canada is more likely to be much more influenced by what happens in the US than in Europe. US senator Elizabeth Warren expressed concern about the SEC's failure to develop a mandatory climate risk disclosure rule proposal by the end of 2021. She refers to delays caused by concerns about legal challenges (from politicians who oppose the measures) and about whether the proposal should require auditor sign off on the disclosures.[22] While mandatory climate-related disclosure in the US seems imminent, mandatory assurance seems far less likely.

Even if the SEC were to mandate assurance on ESG information, Canada may not go in the same direction. Since 2002, some public companies in the United States are required have their internal control over financial reporting audited. Public accountants in Canada widely anticipated that Canadian securities regulators would take a similar step. That did not happen.

**The identification of material misstatements would be difficult because so much ESG information is qualitative.**

A 2017 study suggested not requiring such audits has contributed to possible underreporting of material control weaknesses by Canadian companies. When asked to comment on the results of this study, Ed Waitzer, former chair of the Ontario Securities Commission, stated "The consensus view was that management should attest, and requiring the auditor to attest on internal controls was an unjustified imposition of cost."[23] If regulators take the same position regarding sustainability assurance, why could companies ever decide to voluntarily incur significant costs?

**Hurdles on the Supply Side**

Providing assurance on a comprehensive sustainability report would conceivably require the engagement team to include experts in many disciplines including, for example, chemical engineering, environmental science, toxicology, public health and sociology. As indicated by a January 2022 study by Deloitte, however, ESG skills are scarce in the Canadian financial services sector.[24]

To obtain and retain experts, assurance services divisions of CPA firms would be competing not only with outside firms, but also with their own consulting services divisions. Experts might often find performing consulting services much more attractive than assurance services. They would not have to face the burdens of complying with onerous assurance and ethics standards. Also, clients might place higher value on consulting services that help them identify and respond to significant sustainability risks, design and implement systems and controls, and set appropriate targets and performance metrics.

Of course, sustainability assurance services require high level assurance skills as well as subject matter expertise. The CPA profession has the inside track there, given its extensive experience in providing assurance on financial statements. There is also a strong desire to maintain connectivity between financial reporting and sustainability reporting.[25]

There would, however, be significant technical assurance hurdles to address if assurance was to cover many aspects of a comprehensive sustainability report. These would relate, for example, to fundamental concepts such as what constitutes a material misstatement. Also, the question arises as to whether an audit of a comprehensive sustainability reported would ever be requested.

Regarding materiality, the prototype IFRS/ISSB prototype framework would make life easier for preparers and CPA assurance providers. The scope of this framework focuses only on sustainability matters that affect an enterprise's value, including the amounts, timing and certainty of future cash flows over the short, medium and long terms.[26] Materiality would be viewed from the perspective of the effects of omissions, misstatements or obscuring information that could reasonably be expected to influence decisions that *the primary users of general-purpose financial reports* (i.e., investors, lenders and other creditors) make on the basis of those reports (emphasis added). Other frameworks, such as underlying the EU CSRD, would take into account the effects on decisions of a much broader range of users (beyond investors, lenders and other creditors). The IFRS/ISSB's focus has been challenged on the basis that "an enterprise value/cash flow approach has nothing to do with the impacts of an organisation on society or the environment" and "Can a private sector body that has put itself forward to take an 'investor perspective' be trusted to have a focus on sustainable development?"[27]

The identification of material misstatements would be difficult because so much ESG information is qualitative. The IFRS/ISSB prototype framework does not provide any relief in that regard. It defines sustainability-related financial information as "information that provides insight into drivers of enterprise value, providing a sufficient basis for users to assess the resources and relationships on which the entity's business model and management's strategy for sustaining and developing that model depend, by understanding (a) how effective the entity's business model is at creating value and generating cash flows, including their timing and certainty, over the short, medium and long term; (b) how scalable and adaptable the model is, and; (c) how resilient and durable the model is. This information includes, but is not limited to, information about matters such as climate change; water use and discharge; biodiversity; and employees and human rights."[28] So, for example, if the entity maintains that its model is both resilient and durable regarding all those ESG matters, what criteria would management use to make this forward-looking determination? And how would an assurance provider identify material misstatements, omissions, or obscurities? To many, this task may understandably seem mind-boggling.

Further, stakeholders vary significantly in their ideas about what constitutes a material misstatement. For example, banks who finance entities in environmentally sensitive sectors may face allegations of greenwashing if a stakeholder group is not satisfied that the recipient of funds (who is not a related-party of the bank) operates in an environmentally sensitive way.[29] It is far from clear whether it would be practicable to take such matters into consideration within the scope of the sustainability assurance engagement of a lender.

Finally, would an assurance services provider ever be asked to audit a comprehensive sustainability report? The draft EU CSRD would mandate limited assurance on ESG information. Key reasons stated for not mandating reasonable assurance included the absence of a commonly agreed standard for assurance of sustainability reporting, especially with regard to forward looking and qualitative disclosures. Also, reasonable assurance is more costly than limited assurance.[30] Similar constraints would apply in Canada.

**Conclusion**

Milton Friedman's doctrine of virtually no corporate social responsibility likely still has some supporters. Nevertheless, comprehensive sustainability reporting may well significantly increase in Canada. That will not likely be the case for sustainability assurance services for several reasons, but mostly because regulators and others perceive costs as exceeding related benefits. These services will continue to be a tough sell, largely restricted to a few performance metrics and specific ESG topics.

**Comprehensive sustainability reporting may well significantly increase in Canada. That will not likely be the case for sustainability assurance services.**

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**End Notes:**

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2 In this article, the term "sustainability assurance" is used to refer to engagements by independent external professionals to provide some level of assurance on one or more aspects of ESG information made available to external stakeholders of an entity. The terms "sustainability-related information" and "ESG information" are used interchangeably.

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10 CIBC, *Sustainability Report 2020*, pg. 32.

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17 Schwartzkopf, Frances, "Banks Start Dropping Clients to Dodge Costs Tied to ESG Risk," *Bloomberg News* (October 4, 2021), Bloomberg - Banks Dodge Costs (accessed 2022-03-05).

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