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Article SERIES

SUSTAINABILITY ASSURANCE: HOW ASSURERS OVERCOME BARRIERS TO ADOPTION OF NON-FINANCIAL INFORMATION ASSURANCE

The disclosure of non-financial information in the form of sustainability reports and integrated reports is now a globally established practice. Most jurisdictions across the world encourage, either through stock exchange listing requirements or through legislation, the need for companies to provide information on their non-financial performance. However, these disclosures are often criticised for failing to offer a credible account of the reporter's sustainability performance. To address this criticism many reporters voluntarily secure third-party assurance over their disclosures.

The ADGM Academy Research Centre is pleased to publish a series of articles by Associate Professor Muhammad Bilal Farooq on the key issues related to the assurance of non-financial reports, such as sustainability and integrated reports, also referred to as sustainability assurance. This second article examines some of the tactic's assurers use to overcome barriers to stimulate the demand for external assurance of non-financial information. These tactics are organised into those undertaken before, during and after the assurance engagement itself.

BEFORE THE ASSURANCE ENGAGEMENT

Assurance providers offer potential clients the option of pre-assurance (also referred to as a dry run, readiness review or simply internal assurance). The aim is to assess the reporter's readiness for external assurance. Essentially the assurer takes the reporter through the assurance process without publishing an assurance statement/report at the end of the engagement. The benefit is that it overcomes managers fears of receiving an adverse opinion and the resulting legal and reputation damage this would entail. Pre-assurance allows practitioners an opportunity to educate inexperienced managers on what changes they need to undertake, e.g., improving systems and ensuring that evidence is available to backup claims made by the reporter. However, not all clients will transition from pre-assurance to the real thing. Reporters that drop out cite the high cost and time involved. This suggests that not all boards are committed to spending time and money on improving their systems and processes to support credible reporting. This approach filters out high risk/uncommitted reporters who may end up receiving a qualified assurance opinion. Given the voluntary nature of this new assurance market, assurers are weary of issuing qualified opinions which may scare off potential clients. The challenge, however, with pre-assurance is the potential impact it may have on the assurer's independence. Assurance practitioners must avoid offering advisory services during pre-assurance engagements if they wish to offer assurance to the same reporter in subsequent years.

Financial audits are mandatory and the scope of the engagement heavily regulated. This is not the case with non-financial information assurance, where engagement scopes are decided through mutual agreement between assurers and assurees. For example, the scope of an engagement can be set to cover the entire set of disclosures (broad scope engagements) or alternatively some disclosures and not others (narrow scope engagements). There are three reasons why narrow scope engagements are preferred. First, broad scope engagements are costly and therefore less attractive to clients with smaller budgets. Second, narrow scope engagements are attractive to clients who are less committed to sustainability reporting. For example, some managers argue that if readers/stakeholders cannot distinguish between narrow and broad scoped engagements then it is more cost effective to secure narrow scope engagements. Third, assurers themselves recommend narrow scope engagements to ambitious inexperienced reporters who risk receiving a qualified opinion if they opt for a broad scope engagement. Instead the advice is to gradually increase the engagement scope over several years. However, this flexibility can be exploited to exclude contentious material from engagement scopes by mature reporters.

DURING THE ASSURANCE ENGAGEMENT

During the engagement assurers engage with managers focusing on educating them on the requirements of non-financial information assurance engagements. This guidance is designed to assist managers in introducing systems and processes that can support external assurance. Further, assurers may provide some guidance on sustainability reporting by sharing samples of high-quality sustainability reporters, weblinks, documents (articles and reports) and details of workshops and seminars on non-financial reporting. Assurers will also share their experiences from other assurance engagements as well as offering to connect reporting managers based in different organisations.

Assurance practitioners also encourage managers to use non-financial information to support broader corporate processes related to risk management, strategic planning and decision making. This will serve to raise the profile of non-financial reporting as well as the assurance of that information. The aim is to change corporate norms around non-financial reporting which is typically viewed as nothing more than an external reporting tool designed to benefit stakeholders.

END OF THE ENGAGEMENT

Similar to financial audits, non-financial information assurance engagements generate two key outputs. The first is the assurer's opinion which is published alongside the sustainability or integrated report and is designed to enhance disclosure credibility. The second is a management letter/report which identifies weaknesses in underlying systems and offers broad recommendations on improvement. This second document is prepared for senior managers and boards and is kept confidential. Inexperienced reporting managers value the management report as the recommendations assist them in improving the quality of their disclosures. Experienced reporting managers value the management report as it allows them to build a case for investing time and resourcing in their non-financial disclosures. Such managers will often point out issues for the assurer to investigate and will request the assurer to use clear and strong language in their management report so that boards act. The report serves as a wake-up call for senior managers and boards who are confident (or overconfident) in their sustainability reporting. Those reporters that are committed to non-financial reporting may be encouraged to transition from narrow to broad scoped engagements. However, the challenge is that as reporters gradually address issues raised in earlier engagements the management letter gradually becomes thinner and as a result the perceived value addition from assurance engagements lessens. Consequently, the relative cost of assurance becomes greater than the perceived benefits, creating a risk of reporters transitioning back to narrow scope engagements. It is also important to mention that the focus on value addition may threaten the assurer's independence and objectivity. However, practitioners and managers explain that the recommendations contained within management reports are broad and do not constitute advisory services. Rather practitioners are simply attempting to throw the spotlight on issues which are important but do not adversely influence the assurance opinion.

CONCLUSION

To conclude, in the absence of regulation, assurance practitioners must deploy a range of strategies to overcome managers hesitations to external assurance. The success of these strategies will be revealed in due course. However, in the long run regulators will need to introduce tougher guidelines in this area. The next article in this series will answer the question "Does external assurance actually improve the credibility of sustainability reports?"

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For more information on sustainability assurance please read:

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