Ceres

Closing the Gap

Investor Insights into Decision-Useful Climate Data Assurance

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Introduction

After every financial crisis, we ask ourselves "How can we prevent this from happening again?" In many cases, the reforms are under our noses. After the Wall Steet Crash of 1929, Congress responded with rigorous disclosure requirements, mandatory audits, and the establishment of a strong securities regulator to restore the confidence of the investing public in U.S. capital markets. After the Enron and Worldcom collapses in 2002, Congress again acted to protect U.S. capital markets with audit, accounting and governance reforms, all geared toward making corporate disclosure more reliable.

In a world rapidly moving to a clean energy future and facing increased risk from climate-driven extreme weather events, investors are asking hard questions about whether the businesses they invest in are fit for the future. How can we avoid a collapse in asset values, as in 1929, or a crisis in trust in reporting, as in 2002?

For this report, we set out to understand what investors think about the quality of climate data and where the most critical credibility gaps lie. This report is the product of a listening tour with leaders in the investment community who use climate-related information to make investment decisions. We wanted to understand which data sets present the most challenges for investors, and where better-quality climate data would enhance investment decision-making. We also interviewed experienced executives across the investment analysis, data and audit fields who provided numerous insights for where improvements in data quality would help fill the current gap.

The message from the more than 20 investors we spoke with was unanimous: the current state of climate-related information is insufficient. Investment decisions often rely on data that is based on inconsistent methodologies and that lacks a systematic check on management biases.

> *"When I look at bond documents, most key performance indicators are linked to emissions-reduction goals, but it is all based on self-reporting data with limited assurance. Therefore, I have to make a bet without knowing anything. This should be a legal requirement; to put rules in the covenants, to mandate issuers to have reasonable assurance. To me that's an easy ask," one investor interviewed said.*

The tools to protect our capital markets are available to investors and companies today—processes and controls, transparency, and high-quality independent assurance. Fortunately, the model of reasonable assurance that is standard for financial reporting can be applied to climate data to support markets that operate on quality decision-useful information.

This report provides a path to incorporate assurance over climate data to protect and reinforce our capital markets as companies meet the challenges of the energy transition and a warming planet. The report also discusses several types of disclosures that investors said would benefit from independent, third-party assurance. Based on this input, we identified several opportunities to design protocols to apply assurance using existing principles and practices to improve the quality of key information used by investors.

Context

As with other material risks, climate risk and the energy transition can impose changes in companies' access to resources or changes in consumer demand for companies' products, prompting changes to companies' business models and financial estimates. Investors want reliable data to back up management claims in the face of these disruptions and opportunities. These market demands reflect responsible investment stewardship to protect investment portfolios from the downside of disruption and capture the benefits of preparing for the future. For capital markets to function efficiently and at the lowest cost to participants, they need reliable information to facilitate capital allocation that will promote long-term shareholder value.

Disclosure about companies' risks, position, and strategies is critical to inform investment decision-making. Governments, regulators, and standard setters worldwide are working rapidly to meet market needs for consistent, rigorous disclosure to wisely navigate investment risks and opportunities in an uncertain world. But disclosure is useful only if it is reliable. Both investors and market regulators have complained about greenwashing in the corporate sustainability reports that investors use to judge companies' long-term prospects in the face of climate risk and the energy transition. The solution has been hiding in plain sight: independent, third-party assurance is a highly effective market tool to validate and discipline manager claims. It is also an efficient monitoring mechanism, in that it reduces the redundancy of investors' own, expensive and less effective, monitoring mechanisms.

Assurance has long played a critical role in establishing a basis for trust in capital markets and in supporting the broad participation in capital formation that drives and sustains economic prosperity. Yet this robust investor protection tool currently is not being applied sufficiently or appropriately to address greenwashing. The annual financial statements of companies that issue securities in public capital markets must be audited, by professionals who are themselves subject to robust regulation and professional standards, such as independence rules and quality control. This is not so when it comes to important disclosures outside the traditional financial statements. While some companies voluntarily obtain some form of assurance over metrics disclosed outside the financial statements, that assurance varies widely in scope, depth, and quality, typically has no connection to the financial statement audit, and often results in reports that do little to inform investors (or worse, provide a false sense of comfort in management claims). Implementing assurance protocols on a broader scale can effectively elevate the standard of these disclosures across entire sectors. This approach not only ensures more reliable and accurate reporting but also contributes to reducing systemic risks in the long run.

This is a problem not just for investors, but it is a broader economic problem that holds back prosperity. As investors learned after revelations of fraudulent misreporting, such as those by Enron and Worldcom, capital allocated based on misinformation is capital misapplied. While much attention has been focused on the availability of disclosure and new disclosure standards and requirements, what markets and investors need now is a mechanism for companies to demonstrate they are good for their claims: a basis for trust.

Regulators have begun to require expanding assurance to enhance investor protection and more systematically improve the rigor and reliability of disclosure, but those efforts face political headwinds and may not advance as rapidly or broadly as capital markets need. Investors have an important role to play to work with other market participants to develop assurance as a timely and effective tool to meet market needs.

The Role of Assurance

Independent, third-party assurance is a long-standing mechanism to protect investors as well as the stability of capital markets. Mandatory assurance over annual financial statements was an important reform to address the loss of investor confidence in corporate reports after the stock market crash of 1929. Assurance is perceived to be so critical to fair and efficient capital markets that governments worldwide enacted further reforms to improve it in the wake of the accounting scandals involving Enron, Worldcom, and numerous other companies in the U.S. and elsewhere.

The reason assurance is critical to the functioning of efficient capital markets is that it reduces the risk of material misstatement to a level that is acceptable to the user of the information. In economic terms, when investors have confidence in companies' disclosures, those companies enjoy a lower cost of capital. In practical terms, it also is a basis for market participants to give boards and managements more leeway to embark on major, transformative but inherently risky endeavors. There is a common misconception that rigorous disclosure with assurance constrains boards and managements from risk-taking, whereas the opposite is the case. For investors, assurance can address concerns about the reliability of corporate disclosures, and it is just as applicable to sustainability disclosures as to the traditional financial statements. **Assurance is a key process to give investors the confidence that the estimates that management uses to prepare disclosures are not influenced by hidden changes in methodology, bias, or unrealistic assumptions.**

Internal policies and procedures

When high quality assurance is in place, it does not just give investors confidence that a specific number is reliable; it gives investors confidence in the quality of management's processes to prepare the disclosure, as well as confidence that management has a deep understanding of the matter disclosed and related impacts on the business and the assumptions and estimates that go into the financial results and position. Investors consistently reported that they believe that companies should have in place rigorous internal measurement policies, processes, monitoring, and governance to produce reliable sustainability information. These processes, when tested by the external assurance provider, provide a foundation for the external assurance provider to communicate a basis for confidence to users of the information. Conversely, the absence of assurance—or weak assurance—can signal there are risks that material information may be misstated, with knock-on capital market effects to account for that risk.

Assurance standards

Most assurance reports on voluntary disclosures cite one or more of a number of assurance standards, often with caveats, such as claiming only that the provider's work was "based on" a standard, begging a question whether the provider *complied* with the standard. There are numerous assurance standards to choose from, which contributes to investor confusion. Moreover, each of those standards presents assurance providers with numerous choices, many of which are negotiated with the company's board or management as part of the assurance engagement. Those choices can determine the scope of the engagement, the level of assurance, the skillsets of the assurance team, procedures performed, and the form and content of reporting. While investors use the assurance to make investment decisions, they have no voice in those choices. **For investors, *who* carries out the assurance and *which* standard they apply is critical for confidence building.** Assurance providers should have a code of ethics that requires independence. The provider should also have policies and procedures in place to ensure effective quality control. Assurance that fails to have these attributes is unlikely to be useful for investors.

Current Landscape: Challenges

Investors seek reliable and rigorous climate-related information, rooted in strong governance. Investors want to know how companies are managing the headwinds that the current environment presents, including effects of climate change and the energy transition. For example, companies with business models or practices linked to high GHG emissions, either directly or in their value chain, should be clear how those emission profiles could impact the business, and what steps management may take to adapt.

Investors are interested not just in seeing companies announce commitments to net zero emissions strategies, but also in demonstrated and verified actions to evolve the business model for resiliency in the future, through climate and energy transition plans including long- medium- and short-term targets. Water security is also gaining attention as impacts of climate risk make sourcing water a critical consideration in industries that rely on freshwater, including power generation. Investors also explained that a company's disclosure of its scope 3 emissions, which cover its entire value chain from source to end-use, is a sign that the company has a mature climate strategy and a solid grasp of the risks facing its business model.

However, investors do not currently have access to consistent, comparable, decision-useful climate data. During our discussions, investors highlighted several challenges related to using climate data. We identified five key themes from our conversations:

Poor data quality

High quality data requires accuracy, completeness, reliability, relevance, and timeliness. During the interviews, investors voiced concerns about inadequate data quality, often citing at least one of these characteristics as lacking. Investors believed that data quality would be enhanced by conformity with a stated, suitable framework for measurement and the appropriate, transparent disclosure of measurement methods using reasonable and consistent assumptions. For example, one investor who uses third-party databases that estimate corporate GHG emissions to understand how companies' business models will be affected by the energy transition said,

> ***"We found errors in those databases. The analyst side of me is never comfortable. I'm worried about comparability, whether it's equity or operating method on GHG emissions. I do not have the nuances that differentiate one company's coverage from another," one investor interviewed said.***

Limited disclosure

There are significant gaps in the information that is available for investors. Risks that can crystallize into business issues are not clearly being disclosed, nor are the strategic ways businesses are capitalizing on related opportunities, leaving investors in the dark. This leads investors to turn to external estimates of the missing information, introducing the risk that investors may make decisions based on sub-optimal information that companies could have provided more accurately.

Companies may not have consistent measurement policies or controls to be able to disclose sustainability information. This may enhance the risk of greenwashing, further perpetuating mistrust in company-reported information. Investors shared their belief that meaningful and credible reporting serves as a stewardship mechanism to signal that a company holds itself accountable for establishing and meeting strategic corporate goals.

> ***"There's a huge disconnect. I've been studying the carbon market, carbon offsets, carbon allowance trading, and I often wonder why aren't companies disclosing that in their statements? Especially for companies who have committed to net zero. What is the impact of these carbon offsets to your CAPEX?" one investor interviewed said.***

A lack of connectivity between sustainability reporting and financial reporting

Investors often cannot see a clear through line between companies' sustainability and climate disclosures, on the one hand, and their financial position and results, on the other. This is explored in-depth in three reports: Ceres' Lifting the Veil: Investor Expectations for Paris-aligned Financial Reporting at Oil and Gas Companies and CarbonTrackers' Flying Blind: the glaring absence of climate risks in financial reporting, and Still Flying Blind: The Absence of Climate Risk in Financial Reporting.

For example, when companies discuss initiatives for addressing climate, water, or nature-related risks, but provide no evidence of their financial costs or impacts, investors question the legitimacy of the initiatives or whether they are based on the same set of assumptions. Investors are left to use guesswork to reconcile the two types of reports on their own. This can also be an indication that corporate reporting may not be decision-useful. Investors want to see evolution from performance reporting related to sustainability (for instance, tons of emissions or liters of freshwater used) to reporting on the value created or eroded (for instance, impacts and dependences on ecosystems).

> ***"If the CSR report is not covered by the same amount of control and oversight as the financial statements are, you at least need the same people doing it—the financial controllers, not the marketing department. Shift the reporting owner—that makes a huge difference. Is it material? These are questions the financial department will answer and will naturally think about," one investor interviewed said.***

Inconsistent assurance quality

While some companies obtain third-party assurance over certain disclosures, such as GHG emissions, the inconsistencies in approaches to assurance make it difficult for investors to compare and use assurance reports. That is, the variation in the level of assurance, extent of procedures, and form of reporting on results of those procedures is an impediment to meeting capital market needs.

Investors believe that companies need to be encouraged to obtain high-quality assurance over data that is important to investor decision-making in a way that is consistently useful for investors. As an example, numerous different types of assurance engagements can be conducted on climate risk data, including both limited or reasonable assurance on a specific metric or on an entire climate disclosure report, by a variety of providers with various skillsets and credentials operating under professional norms that range in rigor. Investors find it challenging to discern and weigh these variations, making it more challenging to interpret and compare the assured data across companies.

> ***"Where are your protocols on testing the inactive oil wells and methane sites? Have they reached out externally to experts? There is no sense of the rigor of the limited assurance," one investor interviewed said.***

Weak corporate governance

Investors expressed concerns that inadequate governance lies at the root of these challenges. Good governance plays a foundational role in the development and disclosure of meaningful and credible disclosure. Investors indicated that they see a lack of disclosure on scope 1, 2, and 3 emissions as indicative of poor board governance and inadequate risk oversight (including transition risks, physical risks, regulatory risks, and reputation risks).

Investors are calling for transparent climate governance, clear disclosures, and sound risk management. When they can clearly see these three elements working in tandem, they believe the market will be able to price securities accurately. Although companies' approaches to strategic governance over sustainability matters may differ, investors believe audit committees nevertheless play an important role in establishing and maintaining investor trust in company disclosures. Investors want to see that the audit committee has a strong working relationship with the compensation committee and understands management compensation incentives. Investors also want comfort that the auditors understand how the board sees incentives and how those incentives translate into risk. Investors want board-level disclosures to "connect the dots" between strategy, incentives and sustainability and financial reporting in a more comprehensive way.

> ***"The lack of disclosure for scope 1, 2, and 3 indicates poor board governance and poor risk oversight—transition, physical, regulatory, and reputation risk, depending on the sector and business model of the company. This risk needs to be mitigated. Climate disclosures are an indicator of good risk management. Understanding GHG emissions, such as the intensity per unit of revenue, will also help us create performance metrics for a company," one investor interviewed said.***

Assurance as a tool to build trust and reduce cost of capital

According to a recent survey of senior executives and board members, the benefits of third-party assurance include credibility with investors, increased customer satisfaction, greater innovation and decreased cost of capital. During our discussions, investors identified ways that data preparers and assurers can give them greater confidence in the disclosed climate data, reducing capital cost premiums that may be incurred when market participants do not have faith in company disclosures.

Steps companies can take

1. **Highlight considerations of energy transition plans and GHG accounting guidelines in the accounting policy note to the financial statements** to make it clear how energy transition plans have been considered in the development of accounting policies. This will provide greater transparency and create a through line for investors to understand how the company's sustainability reporting relates to its financial statements. Investors would like to see financial management more involved in the development of controls and processes to produce sustainability reports. Further, preparers should demonstrate how their energy transition plans, climate targets, and risk mitigation strategies flow through the financial statements, including how plans to reduce emissions are reflected in accounting estimates and capital budgeting.

2. **Disclose climate and sustainability data methodologies, key assumptions, and calculations** to provide investors with transparency on how the data was developed. As with the preparation of financial statements, sustainability measurement policies need to be disclosed.

3. **Implement effective governance over climate and sustainability data,** including broader board engagement and sign-off on emissions data.

4. **Ensure the audit committee oversees all assurance providers** and is involved in determining the type, scope, and procedures of assurance engagements necessary to support investor trust in the company's reporting. Investors noted that many companies use unregulated assurance providers for their sustainability information. In such cases, it is important that the provider demonstrate that they have a robust and transparent ethics framework, particularly to demonstrate independence, and a system of quality control over the assurance engagement to ensure procedures and judgments are applied consistently.

   Investors reported concern that, in many cases, very little information about providers' independence, processes, and quality control is available to judge the reliability of the assurance. Also, when companies engage different assurance providers for different disclosures, it is unclear whether or how those assurance providers communicate. Investors expect audit committees to ensure there is open and relevant communication among assurance providers.

5. **Create and document a clear data flow and an ownership structure of climate and sustainability data** across each element of disclosure to improve data quality. For example, as one investor described, the operations team is typically responsible for reporting scope 1 and scope 2 emissions to the chief operating officer. However, if the company has a larger upstream presence, this may be the responsibility of the procurement team. If the company has a larger downstream value chain, then it may fall to the sales team. A sustainability reporting controller can coordinate all these teams to ensure consistency in controls and processes.

6. **Engage the financial reporting team in the collection and reporting of sustainability-related information** to develop sustainability reporting with the same level of rigor that is applied to financial information.

7. **Ensure that third-party assurance providers consider component assertions underlying sustainability disclosures including climate data**, similar to the financial statement assertions of accuracy and valuation, existence, completeness, and rights and obligations to create stronger accountability for the quality of reported data and the estimates and assumptions that underlie that data.

Steps assurance providers can take

1. **Create lines of communication and avenues to collaborate across financial and sustainability data assurance teams.** Investors believe assurance is critical to establishing a discernible through line connecting important disclosures in different company reports. Investors also expect financial audit teams and sustainability assurance teams to take the results and insights from one another's work into account in their consideration of appropriate procedures, evidence, and assumptions.

2. **Build in conditions that enable big picture thinking and reflection.** This will support the development of procedures that consider the connectivity between financial performance and social or environmental impacts and dependencies.

3. **Obtain training and build capacity on sustainability and climate risks** to scale up assurance resources to meet the growing demand for credible, reliable climate data.

4. **Engage subject matter experts to be part of the audit team** to help bridge the short-term knowledge gap on climate and sustainability matters. Both skill sets—assurance know-how and sustainability expertise—are important to developing and performing meaningful procedures to form the basis for an opinion that a disclosure is fairly presented in conformity with a suitable framework. For example, there is a common misconception that financial results are more precise because they are historical, or backward-looking, whereas GHG emissions involve factoring in numerous estimates. To the contrary, both financial reporting and climate data involve estimates, which are based on reporting criteria, measurement policies and processes, and controls.

   Bias is an inherent risk in any estimation process, which is why independent external assurance is so important to investor confidence. Just as the policies, estimates and assumptions used to develop financial statements (for example, accounts receivable and estimates on whether customers will be able to pay back their debts, or if they should be written off) can be affected by management bias, so too can emissions data. Assurance providers need to have sufficient subject matter knowledge to ask appropriate questions to challenge estimates, calculations, and processes.

5. **Allow investors' needs to influence the scope and depth of procedures** to support their confidence in the information used for their decision-making. Assurance is provided to support investor trust, so assurance providers should engage with investors to understand what type of data is most important for their purposes and develop procedures that meet their needs.

6. **Explicitly address the suitability of the company's reporting criteria.** One important need consistently expressed by investors is more explicit discussion in the auditor's opinion as to the appropriateness of the metrics that companies use to report sustainability matters. Investors

reported observing that even where there are publicly available reporting standards for a topic, some companies adjust those measures or develop their own measures. They are concerned about whether such measures are fair or inherently skewed to support a positive story.

This risk, related to the suitability of criteria used to report, is important in all types of assurance, including audits of financial statements. Given the existence of well-established, publicly available financial reporting frameworks, such as Generally Accepted Accounting Principles or International Financial Reporting Standards, market participants often take the auditor's work to ensure the suitability of reporting framework for granted. In such cases, the suitability of the framework referenced in the audit report is implied in the auditor's report on the fairness of the presentation of the financial statements. When it comes to sustainability reporting, however, there is little consistency in measures used across companies. In this context, the auditor's work to assess the suitability of the reporting criteria that a company uses is a significant check on greenwashing. Investors see the value of this work, and they would like to see it explicitly addressed in the assurance report.

7. **Evolve assurance reports to meet the needs of investors, including adding critical assurance matters to the standard format of assurance reports on sustainability disclosures.** In recent years there have been many improvements to financial statement audit reports, which investors use and value. This same evolution needs to be applied to the assurance of disclosures outside the financial statements. There has clearly been good progress made with critical audit matters in audits of financial statements, but there is also more that can and should be done, for example in the way the auditor expresses a point of view, identifying risk areas, and explaining related audit responses, assessments, and conclusions, to underpin the confidence that the audit function is providing on information.

If you haven't looked at an audit report lately, you may be surprised at how informative it is. Audit reports are no longer boilerplate. U.S. and international standards on auditing financial statements require that auditors discuss critical or key audit matters in their audit reports. The precise definition of a critical or key audit matter differs under U.S. and international standards. In the U.S., a critical audit matter is defined as any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that:

- Relates to accounts or disclosures that are material to the financial statements; and
- Involved especially challenging, subjective, or complex auditor judgment.

Critical or key audit matters are rarely included in assurance reports on sustainability disclosures, but we think including them should be a best practice. For example, KPMG Accountants N.V.'s audit reports on sustainability information included in Royal DSM's integrated annual report includes a key assurance matter in its assurance report on key metrics in Royal DSM's sustainability report, related to the percentage of sales attributable to a line of sustainable products and services. The assurance provider considered this metric to be a key assurance matter because it is a material indicator for the company to report on the environmental and social impact of its products and services and because the assessment of products and services to qualify as sustainable is inherently subject to assumptions and judgment.

New applications for assurance

Investors are using and relying upon key climate and other information for decision-making and are now demanding more robust and reliable data. We asked investors what additional data, topics, or subjects they would be interested in having assured to support their investment decision-making processes.

Table 1: Examples of subject matter investors are interested to have assured

GHG emissions and targets

Investors have called for mandatory assurance over GHG emissions disclosures, based in part on the poor quality of disclosures to date. The European Union's new Corporate Sustainability Reporting Directive requires member states to implement mandatory assurance over GHG emissions (starting with limited assurance and soon thereafter moving to reasonable assurance), and the U.S. Securities and Exchange Commission has proposed a similar requirement. California has also mandated audited reports on GHG emissions, also starting with limited assurance and over time moving to reasonable assurance. To support these requirements, the International Audit and Assurance Standards Board has embarked on development of a new series of assurance standards for sustainability disclosures. These developments were welcome to the investors we spoke with, and indeed they reiterated the importance of obtaining reasonable assurance as soon as possible to protect investors from unreliable disclosure. But these broad mandates still leave many important details to future negotiation and development, such as the form of the assurance report, the qualifications, independence and quality control of providers, and coordination amongst a company's assurance providers.

ESG information used in executive compensation

Metrics that impact executive compensation indicate what the company truly values and is working toward. Investors want to make sure the related data is accurate, as it is an increasingly significant component of their own analysis of a company's performance. Investors called for greater transparency and assurance over the process that is used to determine if management should be rewarded when their targets have been met, as well as allowing them to see when management is falling short. [For more information on ESG-linked compensation, see this Ceres' article: A Board's Guide to ESG and Incentives: Focusing the Company Around ESG Priorities.]

Sustainability-linked bonds

Investors are calling for reasonable assurance over triggers and covenant metrics in sustainability-linked bonds and investment products to provide greater confidence that the covenant is in fact being met.

Green bond allocation reports

Allocation reports for green bonds provide an overview of how the funds from the bond were spent, along with the related impact. Investors are interested in whether the impact that is being claimed by the bond funds is in fact being created and if that impact is being apportioned appropriately in the company's allocation report.

Carbon credits

Carbon credits are a key part of many companies' net zero strategies. Investors are interested in knowing if the credits companies are including in their transition plans represent real climate change mitigation. Carbon crediting programs have rules and requirements to ensure that carbon credits are additional, permanent, and conservatively measured, and that leakage is accounted for. They also require that credits are independently verified by an accredited body and exclusively claimed by one entity. Companies that rely on carbon credits to offset a portion of their emissions or to make claims about achieving climate goals should purchase credits that are certified by a carbon crediting program. Assurance of the carbon credit provides investors comfort that companies are relying carbon credits that represent credible climate mitigation.

Natural capital assessments

Nature conservation and restoration are critical global goals that are closely tied to stabilizing our climate and resource availability. Companies are beginning to conduct natural capital assessments to, among other things, communicate to their stakeholders the impacts and dependencies they have on natural capital. The data landscape for nature is immature compared to that of climate, and while greater uptake of nature reporting will take companies time, like with other data, companies should keep in mind the value of third-party assurance to investors in assessing their claims.

Scenario analysis

Companies are using and publishing scenario analyses to support their energy transition strategies. Investors are interested in the reliability of the underlying assumptions used in these scenarios and whether they are consistently applied and aligned with climate science. Scenario analysis gives investors an understanding of the financial results and position under a different set of assumptions than those management has chosen, useful information given the uncertainty of the rate of climate change and the energy transition. Assurance should help ensure that the inputs and methodology for the scenario analysis are appropriate, and there is no hidden bias.

Climate Transition Action Plans

A climate transition action plan is a forward-looking document outlining a company's near-term actions to reduce its GHG emissions in line with a 1.5 pathway. By creating and sharing climate transition action plans, companies aim to strengthen investor confidence in their progress towards their stated long-term goals. Incorporating third-party assurance in climate transition action plan's progress reports would significantly enhance its credibility. This external validation confirms the company's active implementation of the reported measures.

With new applications of assurance, investors also want to see improvements in the quality and usefulness of the assurance reports they receive. Many of the reforms investors would like to see are grounded in the quality they have come to expect and rely on in audits of corporate financial statements, for example:

- **Companies should phase out or reduce the use of limited assurance.**
  Procedures used in limited assurance can be quite limited. Because of this, it does not result in an opinion by a third-party expert provider that the disclosure is accurate, fairly presented, or free of material misstatement. Rather, it results in a statement that the assurance provider performed certain procedures, during which nothing came to the provider's attention that would indicate the disclosure is inaccurate. Those procedures may or may not be disclosed, and even if they are disclosed they may not be clear to a reader of the report. The World Business Council for Sustainable Development has described this type of assurance as a statement that the disclosure is "plausible" in its Buyer's guide to assurance on non-financial information. This is of little value to investors, and worse, it may convey a false sense of comfort. Financial statements have long been subject to reasonable assurance, which results in an opinion by the expert third-party as to whether the disclosure is fairly presented in conformity with the relevant disclosure framework and is free of material misstatement. Only such an opinion is a true attestation to the reliability of the disclosure.

- **In the absence of regulatory oversight, robust disclosure about providers' qualifications, team lead and characteristics, quality controls, independence, and compliance with standards is needed.**
  Many companies choose to retain assurance providers that are not subject to regulatory oversight to protect investors who may rely on their work. This is especially the case in the United States. Moreover, many assurance reports by unregulated providers assert the provider's independence from the audited company in significantly narrower terms than would be permissible under regulatory independence standards. Many assurance statements also include circumspect descriptions of the assurance standards used (for example, that the provider's procedures were "informed by" or "based on" a set (or partial set) of assurance standards), again in ways that would not be permissible in regulatory filings.

- **If a company retains different assurance providers to audit different aspects of its disclosures, investors should be able to expect that the assurance providers communicate with each other on key risks, the status of key controls, and findings.**
  Some companies use the same assurance provider to audit both the financial statements and important sustainability disclosures. When this is not the case, or even if the same provider uses different teams for different engagements for a company, there is a risk that one or another provider or team will be unaware of key risks, weaknesses in controls over the production of information or development of assumptions and estimates, and even the other assurer's findings. Coordination of assurance is important to strengthening the through line between sustainability disclosures and financial disclosures.

- **Assurance providers will enhance the value of assurance to investors if their reports explicitly address the suitability of measures used in voluntary disclosures.**
  Much reporting on climate and other sustainability matters is voluntary and based on bespoke measures (or adjustments to standardized frameworks). An important part of any assurance engagement is the auditor's determination that the company has used suitable criteria for reporting. Public companies use mandatory financial reporting frameworks to develop their financial statements; thus there is little need for auditors to comment on the suitability of those frameworks. Not so when it comes to sustainability: investors told us they would find considerable value in the auditor of sustainability disclosures discussing the results of its evaluation of the reporting criteria the company used (or perhaps developed itself). Bespoke metrics can be useful to measure a company's progress on a company-specific plan, but they may also be an opportunity for greenwashing.

- **Assurance providers should also include key, or critical, assurance matters in their reports.**
  It is common today for reports on audits of financial statements to include a discussion of key or critical audit matters, including a description of the matter and the auditor's approach to risks related to it. Such discussions provide investors valuable insights about the audit. Discussion of such matters in reports on assurance over sustainability disclosures are rare. This should be a best practice.

- **Audit committees should explain the company's choices about the scope, level, and approach to obtaining assurance to enhance investor trust and confidence in the company's disclosures, as well as its selection of assurance providers.**
  If it has chosen not to use the same assurance provider for financial statement assurance and sustainability assurance, the audit committee should explain in its annual report to shareholders how it has ensured fluid communication amongst providers in a way that supports audit quality.

Next Steps

Many governments, regulators, and standard setters worldwide are working rapidly to meet market needs for consistent, rigorous disclosure to wisely navigate investment risks and opportunities in an uncertain world. This work is extremely important to all the investors we spoke with, and many expressed concerns about political debates and delays in updating or establishing critical standards, particularly in the United States, that could impede market functioning.

Companies too seek ways to mitigate risks related to the absence of requirements and standards, and the heightened regulatory scrutiny of corporate claims about environmental, social and governance matters. In early 2023, the multi-national law firm, Norton Rose Fulbright, found that 28% of more than 430 general counsel and in-house litigation leaders said their so-called ESG dispute exposure increased in 2022, and 24% expect it to deepen over the next 12 months. High-quality, third-party assurance can be an important tool to help foster trust by markets and regulators, reducing litigation and regulatory risk, as well as establishing a foundation for market support for the company's long-term strategy and initiatives.

There are actions that can be taken immediately to accelerate the development of robust and reliable sustainability disclosures to enhance investor trust in sustainability reporting. Investor needs can be met right now through protocols that articulate a new way to apply a long-standing tool. Moreover, while regulators have begun to consider expanding assurance to enhance investor protection and more systematically improve the rigor and reliability of disclosure, those efforts face political headwinds and may not advance as rapidly or broadly as capital markets need. Investors have an important role to play to work with other market participants to develop assurance as a timely and effective tool to meet market needs.

Explore the development of necessary protocols

Investor-grade protocols will give investors a "seat at the table" in setting the scope, level, and characteristics of assurance over climate-related information used in investment decision-making. These protocols should outline appropriate choices for assurance that meets investor needs leveraging existing assurance standards. Where existing standards afford choices, the protocols should set forth where investor-grade assurance stands amongst those choices. Based on our discussions with investors and assurance providers, the content of these protocols may include:

- Guidance on investor preferences on critical choices relating to the scope and level of assurance, the nature and extent of procedures performed, and the characteristics and skillsets of providers. Collaboration with assurance firms and standard-setters will be critical to create consistency across the market.
- Guidance on investor needs for reporting that is accessible, understandable, relevant and informative. Reporting should also clearly address the standards used and clearly state that the assurance provider is independent of the company in all potentially relevant ways.
- Guidance on appropriate mechanisms to make assurance accessible to and usable by investors and analysts.

This report
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