Which Level of Assurance is Best for Your ESG Reporting?

The decision has meaningful implications for budget, time commitment, and confidence in your reporting.

Obtaining assurance on environmental, social and governance (ESG) reporting is a critical competitive differentiator, as we explained previously. Once a company commits to engaging with an audit firm, key decision makers must determine what level of assurance to seek. BDO shares insight and provides an overview to help guide readers through the decision-making process.

There are two levels of ESG assurance that align with established financial reporting terminology. The higher levels are referred to as reasonable assurance in Europe and examination in the United States. The lesser levels of assurance are limited assurance in Europe and review in the United States.

Regardless of the terminology differences, the factors driving decisions on the type of assurance to obtain are similar across jurisdictions. For the sake of simplicity, we use the European terminology in this article.

MORE ON BDO'S ESG ASSURANCE ARTICLE SERIES:

Learn more about the competitive importance of ESG assurance and considerations for companies seeking attestation on their ESG data through BDO's seven-part series of insights, which will cover the following topics:

- The Path to ESG Reporting and Attestation Readiness
- ESG Assurance: A Competitive Differentiator
- Which Level of Assurance is Best for Your ESG Reporting?
- Challenges in the ESG Assurance Environment
- Preparing Your Control Environment for ESG Reporting and Attestation
- Managing your ESG Data Towards Third-party Assurance
- Sustainable Finance and ESG Assurance

What distinguishes limited from reasonable assurance?

Reasonable assurance is a high but not absolute level of assurance, in which the auditor affirms that the information reported is materially correct. In contrast, limited assurance states that the auditor is not aware of any material modifications that should be made.

Reasonable ESG assurance demands a greater understanding of internal processes and controls. It requires the auditor to check metrics and disclosures, tracing them to their source to confirm accuracy. It also involves a closer examination of the elements that are material to users, to ensure that the company presents a balanced report that is relevant to stakeholders. It limits greenwashing and ensures the company is not unfairly focusing on areas where it performs well.

Limited assurance relies more heavily on representations made by the company's management team as an information source. It entails less verification to source documents as compared to a reasonable assurance engagement, a less detailed understanding of processes and controls and a lower level of scrutiny of source data and topics to include in the report.

Which level of assurance do most companies seek?

Currently, a majority of companies that engage an audit firm to review their ESG reporting seek limited assurance. There are advantages and disadvantages to each type of assurance, and companies are not required to apply a single standard to all of their ESG reporting. For instance, they may choose reasonable assurance for an area of stakeholder focus, such as climate performance, and limited assurance for indicators that may be of lesser importance to stakeholders.

While either level of assurance is generally acceptable based on EU or US regulations proposed or finalized as of early 2023, the European Union recently passed the **Corporate Sustainability Reporting Directive** (CSRD) and the U.S. Security and Exchange Commission (SEC) **proposed ESG regulations** indicating requirements for reasonable assurance to be phased in over time.

What are the advantages of limited assurance?

Limited assurance is typically lower in cost and requires less work from the auditor and management. Limited assurance may serve as an appropriate first step, enabling a company to become accustomed to the intricacies of high-quality ESG reporting before it faces more rigorous requirements. This approach may be appealing given that ESG assurance is a new and rapidly-evolving practice. In contrast to financial reporting, where GAAP provides a uniform standard, there are currently more than a dozen ESG-reporting standards. Moreover, the relevant information included in an ESG report is diverse — ranging from greenhouse gas emissions to talent demographic metrics. Also, the quality of information and availability of supporting documents may not be immediately adequate for a reasonable assurance engagement.

What are the advantages of reasonable assurance?

Reasonable assurance offers advantages that make it attractive, even though it typically requires a higher cost, takes longer and places a greater burden on the company. A primary benefit is that reasonable assurance is more likely to discover errors in ESG information before it is reported publicly, providing management with a higher level of confidence in the disclosures made. This is particularly important for companies that face scrutiny or that may have had errors in their reporting in the past. It is also important for companies seeking to position themselves as ESG leaders or those that rely on favorable sustainability ratings from investors or other stakeholders.

Reasonable assurance presents additional benefits. The close scrutiny of ESG information and its sources by auditors provides management the opportunity to better understand and evaluate its ESG data. A reasonable assurance engagement provides insights into the company's processes, controls and general oversight associated with collation of ESG information. This may be particularly valuable for a company that presently lacks confidence in its ESG reporting. Overall, a reasonable assurance engagement will better prepare the company for future expectations and demands of regulators, investors, rating agencies, and other stakeholders.

Which auditing standards apply?

In the United States, the AICPA standards that apply include AT-C 105 Concepts Common to All Attestation Engagements, AT-C 210 Review Engagements and AT-C 205 Assertion-Based Examination Engagements. In Europe, the relevant standards are the International Auditing and Assurance Standards Board's International Standard on Assurance Engagements (ISAE) 3000.

How should a company decide whether to seek reasonable or limited assurance?

Regulatory requirements and stakeholder expectations for reasonable versus limited assurance are evolving. For now, the decision is a strategic one. Companies can evaluate the factors below to decide what is best for them.

Stakeholder focus
To what extent does the company face scrutiny from stakeholders?

Regulatory requirements
How soon will the company be compelled to seek reasonable assurance based on its size, industry and jurisdiction?

Internal processes and controls
How confident is the company that its reporting procedures are sufficient to meet current and future needs?

Data quality
Is the company's data reliable enough to ensure reporting is accurate?

Management team capacity
Is the management team able to handle a more rigorous reasonable assurance engagement, or would it make sense to start with limited assurance and build on the lessons learned?

Competitive landscape
Are peers seeking ESG assurance, and if so, at which level?

Deciding which level of ESG reporting assurance is right for your organization can be complex. In either case, a trial run with auditors may be a worthwhile option. BDO's experienced auditors are available to guide companies through the ESG attestation process. Contact BDO's ESG Center of Excellence or ESG Assurance team for a conversation about what may be right for your organization.

BDO publishes insights on an ongoing basis to help companies understand how to navigate the ESG assurance landscape. Executives are encouraged to follow this series for comprehensive, value-added insights to navigate the ESG landscape.

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