

By email: competition@frc.org.uk

10th June 2024

Dear Sir / Madam,

Assurance of Sustainability Reporting Market Study: Invitation to comment

We welcome the opportunity to comment on the FRC's market study on the assurance of sustainability reporting.

The Chartered Governance Institute UK & Ireland is the professional body for governance and the qualifying and membership body for governance professionals across all sectors. Its purpose under Royal Charter is to lead 'effective governance and efficient administration of commerce, industry and public affairs', working with regulators and policy makers to champion high standards of governance and providing qualifications, training and guidance. As a lifelong learning partner, the Institute helps governance professionals to achieve their professional goals, providing recognition, community and the voice of its membership.

One of nine divisions of the global Chartered Governance Institute, which was established 130 years ago, The Chartered Governance Institute UK & Ireland represents members working and studying in the UK and Ireland and in many other countries and regions including the Caribbean, parts of Africa and the Middle East.

As the professional body that qualifies Chartered Secretaries and Chartered Governance Professionals, our members have a uniquely privileged role in companies' governance arrangements. They are therefore well placed to understand the issues relating to the assurance of sustainability reporting. In preparing our response we have consulted, amongst others, with our members. However, the views expressed in this response are not necessarily those of any individual members, nor of the companies they represent.

Our responses to the consultation questions are set out below.

Consultation questions

- 1) *How well is the UK sustainability assurance market currently functioning? To what extent does it help support economic growth or create burdens and costs on business?*

From the perspective of UK plc, there is no doubt that the expectation to procure assurance on sustainability reporting has risen drastically in the past five years. This trend is largely confined to larger companies – who are also more likely to fall into scope for an increasing number of sustainability-related reporting requirements. Assurance, whilst not mandatory, is one piece of the puzzle of producing sustainability disclosures and can represent a significant cost for businesses. Of course, there is a monetary cost associated with paying the assurance provider, but there is also an internal time and resource cost of producing disclosures in such a way that they become assurable in the first place. This is not always straightforward, particularly as the mechanisms for sourcing, collecting and analysing many types of sustainability data and information are still immature.

From an investor and stakeholder perspective, there are some benefits to assurance. It can help to mitigate the risk of greenwashing, and – in conjunction with consistent reporting standards – to improve the degree of comparability between different companies' sustainability reporting. A company may gain more legitimacy by having its sustainability reporting assured. Companies may also choose to have sustainability information assured even when this information is only intended for internal use – such as when creating or refreshing an overarching sustainability strategy. This can reassure directors and senior management that they are basing their decisions on reliable information. Ultimately, assurance can improve the reliability of sustainability information and build confidence in companies' sustainability activity. For these benefits of assurance to be felt (by investors, stakeholders or, indeed, companies), the independence of the assurance provider is of utmost importance.

- 2) *What, if any, interplays exist between the UK sustainability assurance and UK audit markets?*

There are significant interplays, as many audit firms provide sustainability assurance, meaning that the pressures on one market will impact the other. Many audit firms are looking to strengthen and build out their sustainability assurance offerings, which has implications for the firms' wider capacity, resource and revenue generation.

However, the markets cannot be equated; there are many non-audit sustainability assurance providers too. The UK is unusual compared with other countries in Europe, in that many providers are non-audit firms, including consultancies and engineering firms. According to the IFAC report *State of Play*, audit providers assured 42% of the UK companies surveyed, with 58% of companies using non-audit providers. The rest of Europe relies far more heavily on audit firms to provide this assurance, with between 85% and 100% of assurance coming from audit firms. However, companies in Asia-Pacific use more non-audit providers, roughly in line with the UK, and in the USA, audit assurance providers are in the minority, at only 23%.¹

¹ International Federation of Accountants. 22nd February 2024. *The State of Play: Sustainability Disclosure & Assurance 2019-2022, Trends & Analysis*. <https://www.ifac.org/knowledge-gateway/audit-assurance/publications/state-play-sustainability-disclosure-assurance-2019-2022-trends-analysis>

This indicates that the UK market potentially has more flexibility than certain other markets, in terms of choice and competition between different types of providers. It means that the interplays between the sustainability assurance and audit markets are smaller than the interplays between them in the EU – although larger than the interplays in the USA. As such, the UK should exercise caution when looking to draw examples from other jurisdictions as to how the market for sustainability assurance can be improved, because the landscape here is different.

There is a further similarity between the audit and sustainability assurance markets, and that is the potential for an ‘expectation gap’. There can be a big difference between the public or stakeholder expectation of what audit achieves, and what an auditor perceives it to be. This is a question as to whether it is audit’s role to demonstrate that a company is not in imminent danger of failure, or to check the accuracy of its financial accounts. In the same way, this expectation gap can appear in the sustainability assurance market. Is the role of sustainability assurance to demonstrate that a company is behaving in an environmentally responsible manner, or is it to check the accuracy of its sustainability reporting? In addition, sustainability reporting often lends itself to be more qualitative – and potentially more subjective – than a set of financial accounts, which can make the assurance provider’s role even more complex, and further reinforces the importance of sound judgement.

Choice and competition

- 3) *To what extent do UK companies have sufficient choice of sustainability assurance provider? What factors, such as quality, influence their choice? How might this change?*

As mentioned, the UK has a relatively varied pool of sustainability assurance providers – particularly when compared with other European countries. However, amongst the UK’s largest companies, there does seem to be a tendency to choose accountancy firms, and particularly the Big 4. There are several factors which influence companies’ choice of provider. These include:

- Subject matter knowledge and competency of assurance providers. Accounting and audit firms are widely seen as having highly credible and robust assurance processes, methodologies and standards. However, their understanding of sustainability issues is sometimes perceived to be less in depth than that of non-audit providers. Non-audit - providers, and particularly the larger engineering firms, are seen as having higher levels of technical expertise and understanding of complex sustainability processes, and so can potentially offer better recommendations and opinions. Sustainability assurance consultancies, whilst often far smaller than either audit or engineering firms, may offer more knowledge of a company’s local stakeholders. Companies may also choose an assurance provider based on their expertise within a particular sector-specific subject matter, or based on their use of and familiarity with a particular assurance standard.
- Operating environment (from a regulatory, investor and reputational perspective) of the company seeking assurance. Companies based in geographies and sectors with higher levels of scrutiny over their sustainability disclosures are more likely to turn to higher-quality assurance providers with more established reputations, such as a Big 4 firm or a

large engineering firm. Such providers are seen as giving more legitimacy to the company's disclosures. Notably, this does not necessarily equate to audit or non-audit providers.

- Governance structures within companies seeking assurance. Overall, companies with higher 'board monitoring quality' are more likely to choose a Big 4 accounting firm for their sustainability assurance.² There is a correlation between the independence of the audit committee, as well as higher numbers of women on the board, with the choice of a Big 4 provider. Companies with a board-level sustainability committee are more likely to appoint an engineering firm. There are several other governance factors which play a role in choice of provider, including board size, frequency of board meetings and separation between the Chair and the CEO.
- Size of the assurance provider. In much the same way as within the audit market, the size of the assurance provider is an important factor. The Big 4, as well as large engineering firms, are seen as capable of undertaking assurance on even the largest and most complex sustainability disclosures. Consultancies tend to be smaller and operate more locally.
- Degree of assurance sought. Audit firms are far more likely to provide limited assurance than reasonable assurance on sustainability assurance. If a company is looking for reasonable assurance (which is currently still relatively rare), it is likely to turn to a non-audit provider. As more companies move towards reasonable assurance (which is an impact of the EU's CSRD), it is likely that audit firms could increase their ability to provide reasonable assurance, and that non-audit providers will continue to offer this and build out their capacity too.

4) *How does competition work in the UK sustainability assurance market? How might this change?*

We do not have specific views on this question.

Market capacity, opportunities and barriers to entry / expansion

5) *What, if any, capacity issues exist in the UK sustainability assurance market? How might these change?*

The demand for assurance is going to continue to rise – particularly as the EU's CSRD comes into force, impacting many UK companies which fall into scope. Currently, UK assurance providers are much more likely (to be able) to provide limited assurance. It is likely that they will need to increasingly move towards reasonable assurance.

The capacity of the market to respond to this demand ultimately depends on the number of assurance providers, as well as on the capacity of those providers to deliver their work in a timely and appropriate manner. One of the current challenges of this is the lack of

² Accounting & Business Research. 27th March 2023. *Board attributes and companies' choice of sustainability assurance providers*. <https://doi.org/10.1080/00014788.2023.2181141>

standardisation across companies' reporting methods. Much of the sustainability information that companies report is not consistent or comparable, and companies may develop their own criteria which may not be granular enough for assurability. Sustainability information often also contains a lot of qualitative reporting, which can, depending on its content, be subjective and untestable.

As companies across sectors increasingly adopt more standardised and consistent reporting frameworks, this challenge may become less significant – particularly as the UK moves towards endorsing and implementing the ISSB's standards. However, such standards, and their accompanying guidance, must be detailed enough to provide companies with recommendations on not just what to report, but also how to report, if the benefits of this are to be felt. In the meantime, assurance providers should, where appropriate, be empowered to provide a modified opinion, in cases where a company has been unable to source key data.

6) What are the opportunities for firms in the UK sustainability assurance market? To what extent are there any barriers to entry / expansion?

We do not have specific views on this question.

Regulatory framework and future developments

7) How might international regulatory developments affect the UK sustainability assurance market?

It is clear that there will be increasing numbers of companies looking for assurance across a wider array of sustainability information, and eventually to a higher level of assurance as well. The global standards from the ISSB, once endorsed, will be undergoing further consultation as to their implementation in the UK. This will include a decision as to the level of assurance which it is appropriate for companies to procure, and will have a significant impact on the sustainability assurance market. Many UK companies also fall into scope under the EU's CSRD, and whilst some of these companies were already procuring assurance, others will be new buyers to the market.

8) What, if anything, would you like to see change in the UK market? (For example, any regulatory / policy changes and/or any specific actions taken by the FRC, Government, firms, companies or others).

Currently in the UK, procuring sustainability assurance is not mandatory, and there are no restrictions as to who can provide sustainability assurance. It seems likely that, in the long term, both of these may change.

As a first step, the Institute would like to see a UK-based Code of Conduct for sustainability assurance providers be developed, ideally by the FRC and applied on a voluntary basis. In the same way that the FRC has established a task group to form a voluntary Code of Conduct for ESG Ratings and Data Providers, the Institute believes that this would improve the quality of assurance across the market and enable assurance providers to differentiate themselves by adhering to the Code. In particular, this Code should focus on guarding against managerial

capture (the pressure that a client might exert over a provider) and professional capture (the providers' desire to win and retain clients, in order to bill). The IESBA's proposed framework for the ethics and behaviours of sustainability assurance providers could form a useful starting point for this work.³

In time, the Institute would like to see increased uniformity in the type and quality of assurance provided, particularly with regards to limited assurance. Currently, there is significant variation in both the methodologies and rigour of different providers. This variation has the potential to undermine the benefits – and ultimate goals – of assurance, which include reducing the risk of greenwashing and improving the comparability of different companies' reporting. Standardising the ways in which assurance is provided could be achieved through more systematic (or mandatory) adherence to established standards (such as the ISAE3000 or ISSA 5000) and / or through further regulation – although this would require significant further consultation. In the meanwhile, the Institute recommends that all assurance providers include a detailed and thorough report of their own (within the assured reports of their clients), so that investors and stakeholders can fully understand what process was followed, which criteria were used, and to what extent the information has been assured.

If you would like to discuss any of the above comments in further detail, please do feel free to contact me.

Yours faithfully,

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³ IESBA. 29th January 2024. *Proposed International Ethics Standards For Sustainability Assurance (Including International Independence Standards) (Iessa) And Other Revisions To The Code Relating To Sustainability Assurance And Reporting*. <https://www.ethicsboard.org/publications/proposed-international-ethics-standards-sustainability-assurance-including-international>