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Non-financial Disclosure and Integrated Reporting

Theoretical Framework and Empirical Evidence

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Limited or Reasonable Assurance for NFI?: Effectiveness and Criticalities

Patrizia Riva and Francesco Bavagnoli

1 An Overview of How Member States Have Implemented the EU Directive on Non-financial Information Regarding the Auditor's Involvement

The Directive 2014/95/EU (NFRD) represents a milestone in the process of promoting firms' reporting of NFI, which is increasingly observed by investors and governments to allocate capital and grant legitimacy and licence to operate to businesses.

As far as assurance is concerned, the Directive has just obliged Member States to ensure that the statutory auditor or audit firm check whether the NFI has been provided by the entity and left to Member States to decide whether NFI should be verified by an independent assurance services provider (art. 19a, par. 5–6, of the Directive 2013/34/EU as amended by Directive 2014/95/EU).

As shown in Table 1, the large majority of countries which transposed the NFRD into their legal system (19 out of 30) have exactly replicated the requirements of the NFRD providing for the simple check by the auditors of the presence of the NFI statement in the reporting package.

Zooming in on some of the most relevant economies of the Union, it is possible to appreciate more in detail how the auditor's activity has been regulated where the independent verification of NFI has been made mandatory (Table 2).

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Table 1 Auditor's involvement in countries that adopted the NFRD

Country	Comparison vs NFRD	Object of auditor's verification
Austria	=	
Belgium	O	Presence of statement and consistency check of disclosures as part of the review of the management report
Bulgaria	O	Presence of statement and consistency check of disclosures as part of the review of the management report
Croatia	=	
Cyprus	=	
Czech Republic	=	
Denmark	O	Presence of statement and consistency check of disclosures as part of the review of the management report
Estonia	=	
Finland	=	
France	O	Presence of statement and content is required if company has 500+ employees and has a turnover over EUR 100 million or balance sheet over EUR 100 million
Germany	=	
Greece	=	
Hungary	=	
Iceland	O	Presence of statement and consistency check of disclosures as part of the review of the management report
Ireland	=	
Italy	O	Presence and content of statement
Latvia	O	Presence of statement and consistency check of disclosures as part of the review of the management report
Lithuania	=	
Luxembourg	=	
Malta	=	
The Netherlands	O	Presence of statement and consistency check of disclosures and identification of material misstatements are part of the review of the management report
Norway	=	
Poland	=	
Portugal	=	
Romania	O	Presence of statement and consistency check of disclosures as part of the review of the management report
Slovakia	=	
Slovenia	=	
Spain	O	Presence and content of statement
Sweden	=	
United Kingdom	O	Presence of statement and consistency check of disclosures as part of the review of the management report
= Requirements are the same as in the Directive		
X Requirements have been omitted		
O Requirements have been adapted		

Source: Adapted from CSR Europe and GRI (2017)

Table 2 Verification of NFI in France, Italy, Spain and the United Kingdom

France	Information must be verified for those companies with 500 employees or more and a turnover of 100 million Euros or more. The audit must confirm that the non-financial information statement complies with the requirements of the legislation and must state what due diligence was carried out as part of its audit. The report must be circulated to shareholders.
Italy	Must be audited for compliance with the relevant requirements, and the report must be attached to the non-financial information statement and jointly published with it. An internal audit of the non-financial information statement must also be carried out and must be reported on to the general shareholders' meeting and in the company's annual report.
Spain	The NFI must be verified by an independent provider of assurance services.
United Kingdom	Must be audited for compliance with legal requirements and any material misstatements.

2 Limited or Reasonable Assurance

Even if there is not yet an officially recognised standard covering the verification of NFI, the IAASB's ISAE 3000 (revised 2013), Assurance Engagements Other than Audits or Reviews of Historical Financial Information, is the principle most widely used by professionals engaged to audit NFI. ISAE 3400 sets out two different levels of assurance: reasonable and limited. The two types of assurance share some key elements: in both cases, the assurance providers must clearly define the criteria against which the subject matter will be evaluated, including levels of materiality to use in assessing the outcome of tests; they will adopt the same risk basis for planning their work and deliver a written opinion (Riva and Dallai 2020). However, there are some significant differences as illustrated in Table 3.

It is widely recognized that the main purpose of assurance is to enhance the credibility of the NFI delivered to the stakeholders (Reimsbach et al., 2018) and that assurance of better quality, other things being equal, grants actual benefits to the entities under verification. For example, García-Sánchez et al. (2019) found evidence that the presence and the quality of external assurance of CSR disclosure (one proxy of better quality of assurance being the reasonable and not limited level of it) strengthen the positive relationship between CSR disclosure quality and access to finance.

Despite this background that presumably promotes a complete verification procedure (which is standard practice required by EU regulation for financial statements) for NFI, even in those countries where the assurance of NFI is mandatory, it takes typically the form of limited assurance. As documented by the European Commission in a survey conducted in 2020 to gather evidence to review the NFRD, a large proportion of respondents' non-financial reports that are assured undergo a limited assurance procedure (74%), compared to 14% reasonable assurance, and 11% a mix of limited and reasonable assurance procedures. Regarding the type of information that is verified, it is most common to assure the complete

Table 3 Main differences between reasonable assurance and limited assurance

	Reasonable assurance	Limited assurance
Type of assurance obtained	This type of assurance is achieved when the risk of a material misstatement of the subject matter has been reduced to a low level To achieve this, the assurance provider must conduct extensive procedures The assurance provider obtains sufficient evidence to confirm whether the subject conforms to the criteria This is essentially the same type of assurance as is required in an audit of financial statements where the auditor confirms if the financial statements are fairly presented	This type of assurance is achieved when the risk of a material misstatement of the subject matter has been reduced through the collection of evidence, but not to the low level required by reasonable assurance To achieve this, the assurance provider performs different or fewer tests than those required for reasonable assurance or uses smaller sample sizes for the tests performed. The assurance provider's conclusion provides comfort over whether the subject is plausible against the criteria. The opinion provided on a half-year review of financial statements is an example of a limited assurance conclusion albeit over financial information and under a specific assurance standard for reviews over financial information
Conclusion	Reasonable assurance conclusions are framed in a positive manner For example, 'based on the procedures performed, in our opinion, the management assertion on [subject matter] is properly prepared'	Limited assurance conclusions are framed in a negative manner For example, 'based on the testing performed, nothing has come to our attention to indicate that the management assertion on [subject matter] was not properly prepared' This form of reporting requires a double negative which is intended to alert the reader to the lower level of assurance being provided

Source: Adapted from WBCSD and ICAEW (2019)

non-financial reports (i.e. sustainability reports, non-financial information consolidated statement or disclosure, published non-financial information etc.) and some KPIs, especially around GHG emissions, energy and waste, employee matters and the materiality process.

The reasons why reasonable assurance is still seldom performed are the same that explain why it was not possible in the first place to make the assurance of NFI mandatory all over Europe.

First, there is not a common sustainability accounting standard. NFI preparers saw a proliferation of different sets of rules, 'a soup' of 360 standards (*The Economist*, 2020), even if there are some signs of consolidation, and the principles endorsed by the following institutions are gaining wider acceptance: the Global Reporting Initiative (GRI), which focuses on metrics that show the impact of firms on society and the planet; the Sustainability Accounting Standards Board (SASB), which includes only ESG factors that have a material effect on a firm's performance;

the International Integrated Reporting Council (IIRC), which promotes integrated communication about value creation covering economic, social and environmental aspects as the next step in the evolution of corporate reporting; the Task Force on Climate-Related Financial Disclosures (TCFD); and the Carbon Disclosure Project (CDP), which is chiefly concerned with climate change—specifically companies' exposure to its physical effects and to potential regulations to curb carbon emissions.

Second, undergoing a thorough verification of NFI costs more than a limited check. According to the responses to the public consultation of the EC (2020), the median cost for the respondents undergoing any kind of assurance (limited, reasonable or a mix) is of EUR 50.000. The median costs of reasonable assurance are of EUR 60.000, EUR 50.000 for limited assurance and EUR 40.000 for a mix of reasonable and limited assurance.

Third, the nature of NFI is complex, including among others forward-looking and narrative-qualitative information, physical measures and highly judgemental statements involving human rights. These pieces of information may be hard and costly to collect and elaborate for the firms (Riva et al., 2015) and in some cases not verifiable in the same sense that is understood for financial information.

3 A Possible Way Forward Through Mixed Assurance

The EC survey (2020) on the review of the NFRD gives interesting insights about the possible future trends in NFI assurance.

First, there is an increasing demand for assurance of NFI, and most respondents (56%) think that the differences between the assurance requirements for NFI and financial information are not at all justifiable or only to a small extent (Fig. 1).

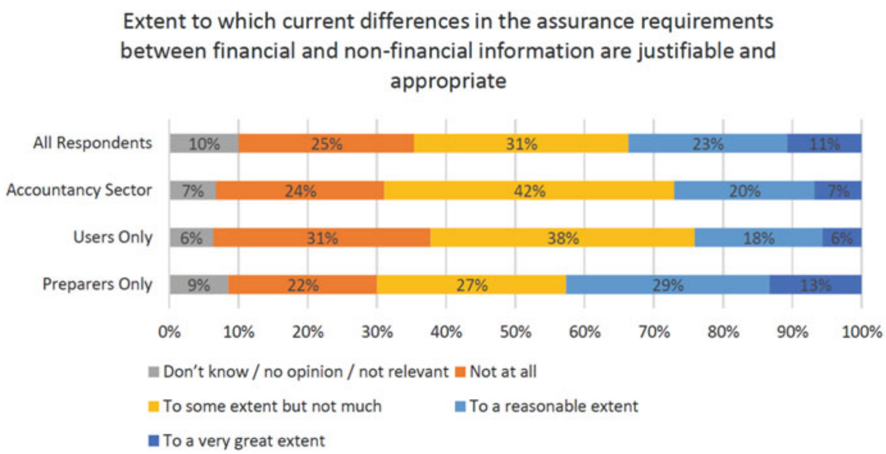

Fig. 1 Question from EC (2020) regarding different assurance requirements for NFI and financial information

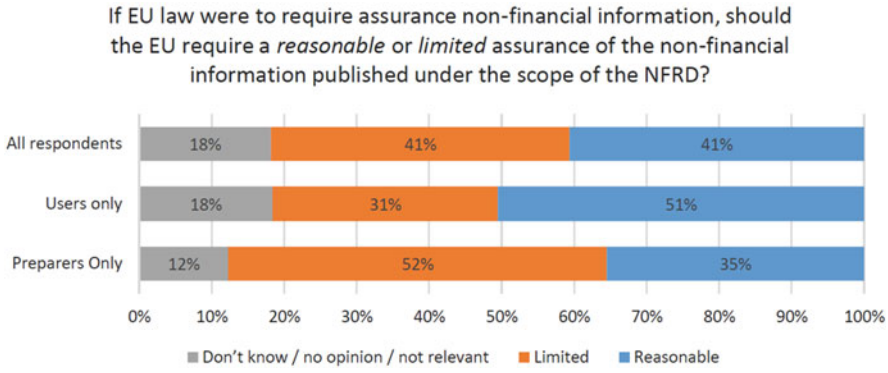

Fig. 2 Question from EC (2020) regarding different levels of assurance

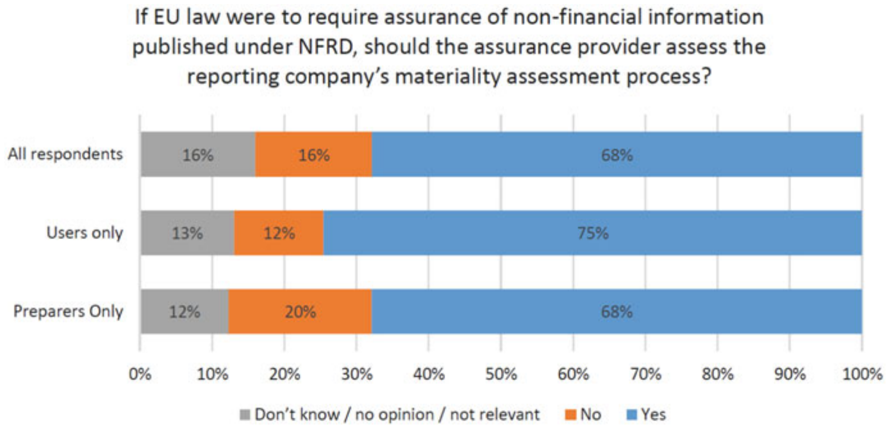

Fig. 3 Question from EC (2020) regarding the assurance of the materiality assessment process

Second, regarding the level of verification, the consultation asked whether it should require reasonable or limited assurance of NFI if EU law were to make it mandatory. Understandably, users who collect the benefits prefer reasonable (51% compared to 31% for limited), while preparers who bear the costs prefer limited (52% compared to 35% for reasonable) (Fig. 2).

Third, to a specific question concerning the assurance of the materiality process of NFI (Gelmini et al., 2015), 68% of respondents agree that it should be included as part of the auditors' verification (Fig. 3).

In the comments of the respondents, we find some interesting remarks: first, a widespread perception that it may be too early or not feasible to impose a mandatory reasonable assurance on NFI; second, a common understanding that in the medium term the differences between the assurance requirements on financial and non-financial information will probably vanish; third, a shared expectation that in the coming years the transition will take place with firms submitting to a full review the most sensitive—especially environmental and climate change related—KPIs to enhance their legitimacy, credibility and trust granted by the public.

In the near future, while we wait for a common sustainability accounting and auditing standard, we may expect:

(i) On one hand, that the materiality process will maintain its relevance, with the additional double—financial and environmental and social—materiality concept gaining momentum after the publication of the supplement guidelines of the EC on NFI (2019)

(ii) On the other hand, that the most conscious—and marketing oriented—companies will enlarge the scope of the reasonable assurance to sensible items, such as GHG emissions, energy and water consumption or the materiality process itself (here it could be interesting to perform as a substantive test independent interviews of the stakeholders by the auditors).

In other terms, expect in the coming years to see more mixed (than reasonable) assurance.

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