The road to reliable nonfinancial reporting
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Introduction: the road to reliable nonfinancial reporting

The term “nonfinancial information” is often used to refer to data on environmental issues, but in reality it covers a much broader area. Accountants consider “Nonfinancial information to be the additional items in an annual report beyond the financial statements.” But, in the marketplace outside of accounting, the term nonfinancial information is used more broadly. Nonfinancial information involves issues related to: sustainability; corporate responsibility; environmental, social and governance (ESG); ethics; human capital; and environment, health and safety (EH&S).

Although described as “nonfinancial,” the information involved is typically indirectly correlated with an organization’s financial performance and outlook, especially when assessed over time. Moreover, nonfinancial performance also impacts tangible asset value and can be tied to intangible assets, including brand reputation, intellectual capital and an organization’s market value. By 2015, the implied intangible asset market value of the S&P 500 was an average of 84% of total market value, leaving a mere 16% attributable to the physical assets of an organization, according to Ocean Tomo’s updated “Components of S&P 500 Market Value” study.

Internal management and external stakeholders (including investors and customers) increasingly consider nonfinancial information in their decision-making as the link between tangible and intangible asset value continues to strengthen. In EY’s Tomorrow’s investment rules report from 2014 – our second yearly study on institutional investors’ views regarding nonfinancial reporting (NFR) by issuers – we found that: (1) most investors factor ESG information into their decision-making; (2) only a minority use structured, systematic methods to evaluate ESG; and (3) many investors who do not use ESG information question whether companies’ disclosures are adequate to determine if ESG is material to investment decisions.

Tomorrow’s investment rules concluded that companies need to improve the nonfinancial information they report to meet the needs of investors. The 2015 survey, involving more than 200 institutional investors around the world, showed a dramatic increase in respondents who consider corporate social responsibility (CSR) or sustainability reports as essential or important when making investment decisions – from 35% in 2014 to nearly 60% in 2015. It also found growing support for mandatory board oversight of NFR and evaluations of environmental and social disclosures (see infographics opposite).

Management and stakeholders rely on nonfinancial data when deciding on a course of action, driving the need for reliable data management, reporting and disclosure of nonfinancial information. Organizations are realizing that reporting sustainability information is not enough – decision-makers using that information must have confidence that it is reliable. As evidenced through the 55% increase in assurance of nonfinancial reports since 2008, more companies now want to increase stakeholder confidence in their reporting of nonfinancial information.

The journey that companies are undertaking can be difficult, complex and time-consuming, as data is coming from numerous sources within and outside the organization and traditionally has not been produced using robust data management systems. Additionally, some of the information presented in NFR is anecdotal and contains uncertainties that can be attributed to different measurement criteria and estimates. But the benefits of moving toward robust and reliable NFR are numerous and can include increased recognition, trust and credibility; reduced risk and increased value; improved board and C-suite engagement; strengthened internal reporting and management systems; and increased stakeholder confidence.4

Barriers to overcome include formalizing and automating data management and internal audit processes with an aim to create strong lines of defense against inaccuracy, incompleteness and subjectivity that can undermine the value of nonfinancial information. By using the principles and standards that are common in financial management and reporting, NFR can become a vital contributor to overall reporting practice and has the potential to deliver benefits more often associated with traditional financial disclosure. Measuring and incorporating nonfinancial information is a proven tool for improved management and operations at many companies. The benefits include better overall business performance across a wide range of business functions, which could lead to improved access to capital.

**Towards a new value paradigm**

Growing reliance on nonfinancial information

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>2014</td>
<td>64%</td>
</tr>
<tr>
<td>2015</td>
<td>80%</td>
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Percentage of respondents who consider mandatory board oversight of nonfinancial performance reporting “essential” or “important.”

Source: *Tomorrow’s investment rules 2.0*, EY, 2015

**Towards new measures of performance**

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<th>Year</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>2014</td>
<td>64%</td>
</tr>
<tr>
<td>2015</td>
<td>79%</td>
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Percentage of respondents who conduct evaluations of environmental and social disclosures.

Source: *Tomorrow’s investment rules 2.0*, EY, 2015

It has been about 30 years since early adopters started to release external social and environmental reports. Since then, several reporting frameworks have been developed, such as the Global Reporting Initiative (GRI) guidelines in 2000, the Greenhouse Gas (GHG) Protocol in 2001 and the International Integrated Reporting Council’s Framework in 2013. Although most of these frameworks primarily have an external reporting focus, they also enable companies to standardize management accounting systems by providing common definitions and comparable criteria.

When these frameworks became available, organizations made a strong push to adopt their guidance to demonstrate leadership in this arena. With origins tied to the chemicals, energy and mining sectors, NFR has now become widespread. The number of organizations that have released a sustainability report reflects the progress: according to the US-based Governance & Accountability Institute, the number of S&P 500 companies reporting their performance on ESG issues more than tripled from 2010 to 2013. Only 20% of the S&P 500 reported on ESG in 2010, but this had grown to 72% in 2013.5

More companies are adopting external reporting standards while improving their internal management accounting systems for nonfinancial information. According to EY research on the Fortune Global 500, the number of reporters using the Global Reporting Initiative as a guide for consistency and comparable NFR rose 8% from 2010 to 2013. In Verdantix’s “Understanding the EH&S Software Market” report from July 2013, over 23% of the 106 survey respondents stated that they had implemented a software solution for EH&S data in the previous two years, demonstrating the growing importance of internal management accounting systems for nonfinancial information. At that time, 43% of respondents stated that their spending on EH&S software was anticipated to increase in 2013, with 56% expecting expenditure increases in 2014.6

In 2013, the Association of Chartered Certified Accountants examined the current trends in reporting and the audit relationship from the perspective of the chief financial officer through a survey of 200 CFOs in the UK and Ireland. The research indicates that nearly half the companies surveyed expected to move to an Integrated Reporting (<IR>) model within three years. Furthermore, 37% of the companies surveyed were taking active steps to move toward an <IR> model, and 5% had already implemented one. Of the remaining companies


surveyed, 48% were adopting a “wait and see” approach, and 10% had no intention of making the move unless it became compulsory.7

Requests for external assurance of nonfinancial reports have also increased significantly. According to the GRI, the number of companies globally that have published an externally assured GRI report rose from 29% in 2008 to 45% in 2013. We are also seeing a trend in assurance reports. The GRI performed additional analysis about trends in the US market, noting that the number of reports expressing limited or reasonable assurance has increased since 2011, although still at a low level. The number of reports expressing limited assurance increased from 16 to 32 companies, while the number of companies obtaining a report expressing reasonable assurance grew from 3 to 10 from 2011 to 2013. This trend has gone hand in hand with nonfinancial disclosures becoming more reliable.

Similarly, governments are increasingly requesting that companies report on their nonfinancial information. Governments and stock exchanges in more than 40 countries now require or encourage some level of sustainability reporting, according to one estimate.8 For example, in April 2014, the European Commission released its directive on required disclosures of nonfinancial information that will take effect in 2016 for companies with more than 500 employees. Organizations will have to provide insight into how they deal with matters concerning the environment, social and employee impacts, respect for human rights, and anti-corruption and bribery. In relation to these aspects, the directive expressly addresses the following elements:

- The business model
- The policy pursued (including due diligence processes)
- The results of the policy pursued
- The principal risks and the management of these risks
- Nonfinancial key performance indicators

The impact will also affect companies other than the ones directly in the scope of the EU directive as organizations are encouraged to report on their supply chain impacts through the GRI’s G4 Implementation Guidance.


A voyage of discovery: nonfinancial information pioneers

Evidence from stakeholder surveys, CFO interviews and the quantitative data on reporting reflect how nonfinancial information is becoming increasingly important in managing an organization’s value. As such, organizations need detailed insight into their financial, social and environmental impacts, both externally and internally. These could include human rights impacts within their supply chain, carbon emissions from the company’s operations or environmental impacts as a consequence of the downstream use of their products. As companies get more detailed insights into these impacts, they also start to manage them, driven by the fact that “what gets measured gets managed.”

Companies are also carefully measuring and managing their supply chain externalities. Unilever’s sustainable-living plan defines a clear ambition for the consumer goods company to improve health and well-being while reducing negative environmental impacts by 50% by 2020 (e.g., greenhouse gas emissions). Furniture retailer IKEA, for instance, has implemented strong controls for its suppliers to reduce negative social and environmental impacts. Similarly, paints and chemical maker AkzoNobel put a target in place in 2014 concerning its Scope 3 carbon emissions (i.e., those of its suppliers).

In 2009, the Walmart Sustainability Index initiative — in which the US retailer requested environmental and social policy data from suppliers — led thousands of companies to increase their awareness of and investment in sustainability reporting. Such data included measurement and reporting of GHG emissions, waste, water usage, and target/policy information for sustainable purchasing and social compliance. Although these impacts go beyond internal boundaries, companies recognize that they are a part of their value chain and therefore have responsibility for the associated impacts and potential risks.
Such plans, however, cannot be executed without appropriate management information. Analogous to financial management, performance metrics are required to provide management with support for decisions on defining impacts, performing analyses and taking corrective actions. Nonfinancial information has therefore entered the arena of management accounts and financial managers. But management of nonfinancial information – in comparison to financial information – is still in its infancy for most organizations, which typically rely on manual processes and controls and spreadsheets for reporting.

However, as companies place emphasis on sustainability impacts, they are also adopting the principles and good practices common in financial reporting and management, using technology and internal audit. Leading companies have invested in making their reporting processes more robust and are now seeking external assurance over those processes. They appreciate that nonfinancial information is strongly linked with the company’s intangible assets, such as brand reputation and intellectual capital. And as reporting practices mature, businesses recognize the growing impact nonfinancial information can have on managing an organization’s tangible assets as well. External assurance, with involvement from the finance function, enables shortened timelines, improved accuracy and more complete sustainability disclosures each year.
Potential roadblocks

The challenges of NFR, and performance management generally, depend on the maturity of the organization:

- **Starters** are just commencing with nonfinancial performance management, typically facing challenges related to definitions, data collection, governance and organizational competence.

- **Front-runners** are advanced users of nonfinancial information, typically facing challenges related to reporting complex supply chain disclosures (e.g., Scope 3 supply chain emissions) and developing the systems and information necessary to enable a practitioner to perform a reasonable assurance engagement.

- In between the two are those in the **middle-of-the-pack**, who are striving to further hone their NFR capabilities.

Companies face a number of common pitfalls that can impact their ability to develop reliable NFR, including:

- Limited formal governance structure over reporting oversight and approvals
- Reliance on one individual
- Undocumented processes/controls
- Making commitments without clearly defining how they will be measured
- Internal control environments
- Lack of generally accepted estimation methodologies
- Lack of baselines and baseline management
- Use of unexplained jargon
- Boundaries that are unclear and/or inconsistent with financial reporting
- Undisclosed uncertainties in data (i.e., the degree of estimation uncertainty in the estimates being made)

Looking at the journeys that companies are undertaking, it is useful to examine the role of the finance function in general and of the group finance function in particular. In the Starters group, most companies treat NFR as a separate discipline from a process and technology perspective. While maturing, they realize that using group finance function’s discipline, systems and experience with data gathering for internal and external reporting purposes benefits the entire organization. The growing demand from external stakeholders for different, more frequent and more detailed information drives the process toward integrated reporting. Also, from a nonfinancial information assurance perspective, the need for segregation of duties (i.e., that data preparation and data approval/monitoring should be separated), internal controls, audit trails and transparency perfectly fits the expertise of the group finance function.

Organizations need to consider more than just reporting effectiveness alone. The efficiency of data management and reporting is also important. Organizations need to strike a balance to prevent being over- or under-controlled as they are putting controls in place to make their nonfinancial information more reliable. Technology is increasingly being adopted to
The road to reliable nonfinancial reporting

Scope 3 reporting and data management

The GHG Protocol defines Scope 3 emissions as “indirect emissions that occur in the value chain of the reporting company, including both upstream and downstream emissions.” Although these emissions do not occur within the boundaries of the company, they certainly can be influenced. For instance, companies can develop their products to reduce the environmental or social footprint for consumers. In addition, the upstream supply chain emissions can be influenced as companies manage their source of supply. However, Scope 3 emissions are complex and time-consuming to report, as data must be collected from a variety of sources. Below are typical examples of Scope 3 emissions and their data sources:

- Emissions as a consequence of transporting goods (supply chain management department)
- Business travel resulting in emissions from car or airplane travel (business travel department)
- Emissions during the “use phase” of products manufactured by the company (innovation department)
- Emissions of suppliers to produce incoming materials (procurement department)

improve nonfinancial information data management, and this raises the question of what information communications and technologies (ICT) and process architecture delivers most value. Manual reporting processes, enabled by spreadsheets, are error-prone and labor-intensive. Technology is critical to implement controls and to consolidate and disclose the reported information to the users. Automation can make use of reporting templates and calculation parameters made in accordance with various reporting protocols, such as the GRI and the GHG Protocol.

For example, pre-built conversion calculation rules allow companies to report on calculated nonfinancial information such as greenhouse gas emissions that are derived from direct emissions and energy consumption from electricity, coal, heat or other sources. Systems also typically enable complete audit trails (e.g., utility invoices) to build confidence and accuracy in how nonfinancial information is collected and consolidated, potentially followed by an external audit that utilizes this information as supporting evidence. Over the past few years, niche software vendors have brought applications to the market that are focused purely on nonfinancial information. However, more recently, large enterprise resource planning (ERP) vendors have also entered the market with nonfinancial information modules that have similar functionality. This allows companies to embed nonfinancial information reporting and data management within their existing ERP infrastructure and processes.

Finally, there is the complexity of external nonfinancial information disclosures. For instance, reporting on Scope 3 emissions is a struggle for many organizations. The reason is that Scope 3 emissions data comes from a variety of (external) sources, including the company’s suppliers and the users of its products.
Potential roadblocks
continued ...

An overview of the challenges is provided in the table below

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<th>Phase</th>
<th>Description</th>
<th>Typical challenges</th>
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| Starter          | Organizations that commence with nonfinancial information performance management and external reporting | • Setting uniform definitions, boundaries and scope, and aligning these to available standards, such as GRI, GHG and <IR>  
• Defining governance and controls  
• Mobilizing nonfinancial information competence within remote operations  
• Setting SMART management targets\(^9\)  
• Obtaining senior management buy-in |
| Middle-of-the-pack | Organizations that have the ambition to take further steps in monitoring nonfinancial information performance and external reporting, including adopting the GRI reporting standard (GRI G4) | • Involving the finance function and refining internal control functions  
• Building an effective third line of defense (internal audit) through enabling terms of reference for audits of material operations and disclosures  
• Enabling technology for nonfinancial information data management, including performance dashboard and smart data analytics  
• Driving organizational change management and “integrated thinking” |
| Front-runner     | Leaders in sustainability and advanced users of nonfinancial information with the ambition to achieve maturity at the same level as their financial information | • Managing audit trails, effective processes and IT general controls  
• Managing (complex) supply chain impacts and developing data collection and aggregation controls  
• Assessing the correlations between financial and nonfinancial information over time and integrating financial information and nonfinancial information to enable collaborative thinking and decision making |

\(^9\) SMART is specific, measurable, achievable, relevant, time-based.
Most journeys toward reliable nonfinancial reporting start with developing a strong governance structure to oversee reporting that management and external stakeholders can use for effective business decisions. Thereafter, the materiality of nonfinancial matters is typically assessed, metrics are explored to manage performance and mitigate risk associated with those material matters, and a repeatable and efficient data collection process is developed. To be successful, companies need to develop lines of defense against inaccurate, incomplete or misleading nonfinancial information.
Over the next few years, we expect more companies to be focusing their efforts on developing measurable, objective, relevant and complete nonfinancial reporting by defining criteria and measurement requirements for their nonfinancial information indicators, establishing robust data management processes and making the transition to external assurance.

This journey requires preparation by companies to strengthen their lines of defense by developing their people, processes and technology. As a result, internal controls will be created that are as reliable as financial controls. Expanding on a model described in the Institute of Internal Auditors position paper, we contend that in order to develop reliable nonfinancial reporting, companies should, ultimately, build four lines of defense; adding as we do, a final consideration of the role external assurance should play.

Nonfinancial information: considering four lines of defense

LoD1: operational functions
- Segregation of duties in delivery of sustainability performance data
- Management approvals of reported sustainability data
- Plan-do-check approach using performance dashboards

LoD2: control functions
- Standards and definitions
- Data management and reporting processes and controls
- Smart data analytics
- Data consolidation, including supporting ICT

LoD3: internal audit
- Risk-based testing of data trail
- Check conformance to standards and definitions

LoD4: external audit
- Independent external assurance (limited/reasonable)
- External conclusion/opinion on the conformance of the NFI with their criteria

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As the lines of defense are specific to each organization, there are a number of pathways that can be followed. Front-runners in sustainability and NFR are adopting many good practices, highlighted below.

**A. First line of defense: operational management**

Operational management functions serve as the first line of defense for nonfinancial information performance management: operations typically executes nonfinancial information-related controls, and management oversees and approves them. Additionally, adequate managerial and supervisory reviews should be in place to ensure compliance with standards and appropriate process execution. Two main concepts emerge when discussing internal controls and how they apply to nonfinancial information: the control environment and control activities.

According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO):

“The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the entity’s people; management’s philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided by the board of directors.

Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity’s objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.”

For nonfinancial information data management, typically controls include segregation of duties in reporting and management review analytics (through performance dashboards and automated data validations).

The value of nonfinancial information cannot be unlocked unless the data is made available to the users, who can then analyze it and support performance improvements. Today, front-runners in sustainability often create performance dashboards to provide transparency to the internal users of the information – including operations and management. Such performance dashboards allow users to benchmark the performance of their manufacturing site to the company’s comparable operations and identify correlations between production and consumption (e.g., energy usage, water usage and materials efficiency). In addition, data can be tailored and analyzed for comparability and to identify errors or inaccurate estimations in the data.

These dashboards enable management to make interventions similar to practices common in the finance discipline. They also provide high-level insights into trends and correlations that help identify the reasonableness of reported value accuracy and completeness. Simplified trend analysis, via the performance dashboards, offers a way to address completeness and accuracy issues.

Data analytics is an increasingly prominent discipline. Smart analytics can reveal reporting errors, thereby supporting the continuous improvements in a company’s journey to reliable nonfinancial information. Smart analytics is based on business rules that have been set to perform the analysis. Consider a company with global operations that reports on energy consumption and greenhouse gas and other emissions (i.e., NOx, organic emissions and SO2). The energy consumption types involved range from oils and coals to gas and electricity. The combustion of coal results in NOx content as a consequence of the chemical content of coal. Therefore, sites that use coal as an energy source also emit NOx. Smart data analytics (e.g., automated data validation controls) can be built to reveal sites that use coal as an energy source but do not report on NOx emissions, resulting in an error message. This is an example of using automated data validation controls through smart analytics to identify errors before they go up the chain of command for review and/or external assurance. This is especially powerful, as it provides full coverage of the data rather than a simple data sample.

This approach is typically supported by data managers, operations managers, technology and data management systems.

**Emerging technology**

Imagine a world where you would have all company data at your fingertips in an integrated dashboard, including both financial and nonfinancial information. It would enable you to intervene in your supply chain to overcome human rights risks with one of your suppliers. In addition, as you changed the design of your product, you could get real-time insight into how its environmental impact has improved when it is used. The insights provide a powerful tool to make balanced and integrated decisions with the fastest response time possible as you are able to “slice and dice” economic, social and environmental data to obtain different perspectives.

This type of big-data-enabled technology is emerging that can make such scenarios a reality, creating readily available and easy-to-access data to enable better management decision-making.
B. Second line of defense: risk management and compliance functions

These groups monitor reporting issues. In many cases, this line of defense is responsible for supporting management policies (e.g., definitions for nonfinancial information key performance indicators or external disclosures) and defining roles and responsibilities for nonfinancial information data management. Success in these areas means appropriately identifying and managing risks and issues related to reporting unreliable information internally or publicly. According to COSO:

“Every entity faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economic, industry, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

Internal control systems need to be monitored – a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management and the board.”

The risk management and compliance functions of an organization can help check conformance with local, regional and global regulations for a range of nonfinancial metrics (e.g., waste management, water management, air quality) that may be material to the organization or risk profile. They can also help develop suitable criteria for measurement, management and reporting of performance metrics – thereby eliminating subjectivity and mitigating uncertainty. This line of defense is often supported internally by disclosure committees, general legal counsel, the chief ethics officer and a global compliance officer.

C. Third line of defense: the role of internal audit

The Institute of Internal Auditors (IIA) defines “internal auditing” as “an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations” that “helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.” In practice, internal auditors perform audits to test the effectiveness of nonfinancial information data management, compliance with internal and external standards and definitions, and the accuracy and completeness of the reported information – all in an effort to manage key risks to the organization.

The IIA’s implementation guidance suggests: “The internal audit activity must evaluate the adequacy and effectiveness of controls in responding to risks within the organization’s governance, operations, and information systems regarding the:

- Achievement of the organization’s strategic objectives
- Reliability and integrity of financial and operational information
- Effectiveness and efficiency of operations and programs
- Safeguarding of assets
- Compliance with laws, regulations, policies, procedures, and contracts”

12. Ibid.
This implies that if nonfinancial matters are material to an organization’s risk portfolio and its ability to achieve strategic objectives, then internal audit must evaluate the adequacy and effectiveness of controls related to those risks. In practice, we have seen that internal audit has assumed a growing role in assessing nonfinancial information within most companies. Traditionally, internal audit departments have an established role in areas such as EH&S compliance. In reality, however, internal audit is rarely involved in testing the accuracy and completeness of reported nonfinancial information, even though this information can be linked to brand reputation and operational risks. Internal audit can play a critical role in the nonfinancial information reporting and data management by:

1. Recommending improvements to controls for assuring the accuracy and completeness of nonfinancial information.
2. Focusing on the disclosures.
3. Offering recommendations to expedite how nonfinancial information is collected, aggregated and managed.
4. Providing recommendations regarding the types of disclosures made (in external and internal reporting) and whether the information is material to the organization.
5. Evaluating the information to ensure it is consistent with the criteria defined by companies and with external reporting standards.
6. Ensuring that the data management processes, controls and data flows are documented appropriately.

D. The fourth line of defense: external assurance

External auditors provide independent assurance over the nonfinancial disclosures reported in companies’ sustainability or integrated reports. At present, most sustainability/nonfinancial information external assurance engagements provide limited assurance but, as discussed in Section 3, some organizations are voluntarily engaging assurance practitioners to perform reasonable assurance engagements of the nonfinancial information. The predominant standard for assurance globally, with various regional adaptations for local standards and regulations is The International Standard on Assurance Engagements Other Than Audits or Reviews of Historical Financial Information (ISAE 3000) issued by the International Auditing and Assurance Standards Board (IAASB).

Predominant assurance standard

Developed by the IAASB of the International Federation of Accountants (IFAC), ISAE 3000 is a generic standard for any assurance engagement other than audits or reviews of historical financial information. Only professional accountants can issue an assurance report “in accordance with ISAE 3000,” as the assurance provider must also comply with the Code of Ethics for Professional Accountants from the International Ethics Standards Board for Accountants (IESBA). It covers professional competence, independence and objectivity, and the International Standard on Quality Control.

In the United States, the American Institute of Certified Public Accountants’ AT101 is the prevailing standard for assurance engagements performed by accountants. It mirrors ISAE 3000 with some differences relating to terminology, independence considerations, suitability of criteria and requirements of its practitioners.
Suitability of criteria

Assertions by organizations often lack suitable measurement, management and assurance criteria in their sustainability and integrated reports, and this is one of the most common difficulties in providing assurance on nonfinancial information — and one that is critical to address. Suitable criteria, as identified by ISAE 3000, exhibit the following characteristics:

- “Relevance: relevant criteria result in subject matter information that assists decision-making by the intended users.
- Completeness: criteria are complete when subject matter information prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made on the basis of that subject matter information. Complete criteria include, where relevant, benchmarks for presentation and disclosure.
- Reliability: reliable criteria allow reasonably consistent measurement or evaluation of the underlying subject matter including, where relevant, presentation and disclosure, when used in similar circumstances by different practitioners.
- Neutrality: neutral criteria result in subject matter information that is free from bias.
- Understandability: understandable criteria result in subject matter information that can be understood by the intended users.

Suitable criteria are required for reasonably consistent measurement or evaluation of an underlying subject matter within the context of professional judgment. Without the frame of reference provided by suitable criteria, any conclusion is open to individual interpretation and misunderstanding.”

Levels of assurance

A reasonable assurance engagement aims to reduce the practitioner’s assurance engagement risk to an acceptably low level in the circumstances of the engagement, providing the basis for a positive form of expression of the practitioner’s conclusion. In contrast, a limited assurance engagement aims to reduce assurance engagement risk to an acceptable level within the circumstances, but where that risk is greater than for a reasonable assurance engagement, and provides the basis for a negative form of expression of the practitioner’s conclusion.

A limited assurance engagement (review) therefore results in a conclusion that states “nothing came to the assurance provider’s attention that caused them to believe that the subject matter was not presented, in all material respects, in accordance with the criteria.” A reasonable assurance engagement (audit), however, enables the auditor to express an opinion that the “nonfinancial information is, in all material respects, presented in accordance with the applicable criteria.”
The extent to which assurance procedures will be performed should be based on the level of assurance to be provided and the practitioner’s consideration of the following:

- The nature and materiality of the information to be tested to the subject matter or the assertion taken as a whole
- The likelihood of misstatements
- Knowledge obtained during current and previous engagements
- The responsible party’s competence in the subject matter
- The extent to which the asserter’s judgment affects the information
- Inadequacies in the responsible party’s underlying data.

Both reasonable assurance and limited assurance engagements require assurance skills and techniques to be applied and sufficient appropriate evidence to be gathered as part of an iterative, systematic engagement process that includes obtaining an understanding of the subject matter and other engagement circumstances. The nature, timing and extent of procedures for gathering sufficient appropriate evidence in a limited assurance engagement are, however, deliberately limited relative to a reasonable assurance engagement.

According to IFAC, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the subject matter information “to a degree that is clearly more than inconsequential.” At the same time, the enhanced coverage provides organizations with more in-depth feedback on issues or possible process improvements through a detailed management letter, enabling them to develop internal systems and controls.

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14. Ibid.
The journey in practice

In this section, we present a real-life case study of a company that is on a journey to improve the reliability of its nonfinancial information. The company laid the foundation in 2008 by developing a governance structure that included an oversight committee from cross-functional groups and defining ambitions for nonfinancial performance. In that same year, KPI definitions (i.e., criteria) were established, resources were mobilized and a manual reporting process was installed with some basic operational controls, including segregation of duties between data collection and management review/approval. Two years later, the reporting and data management was further developed – for example, by getting the finance function involved and enabling ICT for reporting. In that same year, an external auditor was engaged to perform a limited assurance engagement on the reported nonfinancial information.

Over the years that followed, internal audit was mobilized as a third line of defense for nonfinancial information, and more advanced controls were installed, such as smart data analytics. Performance dashboards for operations were developed that assessed trends in the data and correlations with other metrics to check completeness and accuracy, enabling the function to further analyze and benchmark their performance. This was an important step to enhance the awareness of nonfinancial information.

At the moment, the company is performing internal procedures designed to enhance the effectiveness of internal controls, realize further compliance with criteria, and document the full audit trail of social and environmental performance. When this is complete, the company plans to engage a practitioner to undertake a reasonable assurance engagement on the nonfinancial information.
An overview of how the process could work now is shown in the infographic below.

**Criteria assessment**
- Initial consolidation and review process implemented with segregation of duties
- Assurance-readiness assessment
- Assurance engagement performed on reported KPIs

**Initial consolidation and review process**
- Data collection and spreadsheet-based data management
- Uniform KPI criteria developed
- Finance function involved in nonfinancial information reporting
- Biannual nonfinancial information performance review
- Reporting strategy defined and articulated
- Governance infrastructure developed

**Data collection and spreadsheet-based data management**
- Assurance-readiness assessment
- Internal audit training
- Internal audit program and procedures

**Uniform KPI criteria developed**
- Controls formalized over data collection and aggregation
- Internal audit training
- Assurance engagement performed on reported KPIs

**Material matters and associated metrics developed**
- Board remuneration on nonfinancial information performance
- Smart data analytics enabled
- Sharing of good practices between sites and businesses
- New supply chain disclosures (e.g., Scope 3)
- Continuous improvement of processes and definitions

**Reporting boundary and scope defined**
- Assurance engagement performed on reported KPIs
- Internal audit scope and effectiveness improvements
- Release of quarterly management reporting and review cycle

**Reporting strategy defined and articulated**
- Internal audit effectiveness review
- Enhanced automation of consolidation and review process

**Reporting infrastructure developed**
- Workflow-enabled ICT solution for nonfinancial information reporting implemented
- Nonfinancial information performance dashboards released to business and sites

**Each step in the process requires appropriate governance oversight and change management activities to engage, train and empower data managers in the design of the reporting processes to optimize resources and value**.
When companies transform nonfinancial information to create reliable performance measurement, they are making an investment that can unlock significant business value. Like finance and ERP transformations, this journey is not a stand-alone project but rather several initiatives, including organizational change management. EY has supported a number of organizations in their journey to enable more reliable nonfinancial information.

EY’s Climate Change and Sustainability Services (CCaSS) group can help you optimize the value of your efforts, whether you are developing governance structures to support a strong control environment, embedding nonfinancial information management into business functions, or assessing whether your criteria are suitable for managing and measuring performance.

In the drive toward preparing credible data, we typically advise our clients along four major work streams: information collection and Q&A, criteria assessments, assurance readiness and, finally, assurance:

### Four work streams

**Information collection and Q&A** – informing management decision making. An essential review across organization departments and functions is conducted to ensure appropriate measures are identified and establish proper sets of data for ongoing assessment.

**Criteria assessment** – supporting consistent definitions. An assessment of the criteria used to provide context and clarity for specific terms included in publicly disclosed nonfinancial assertions.

**Assurance readiness** – increasing confidence in processes, systems and data. An assessment of the data, processes, systems, controls and evidence available to support nonfinancial assertions publicly disclosed to report sustainability indicators and progress against commitments. This will also highlight any potential process and control gaps that could cause material misstatements.

**Assurance** – demonstrating data quality. An independent assurance engagement (at the desired level of assurance) in accordance with the internationally accepted standards.
A limited overview of how we can help is provided below:

<table>
<thead>
<tr>
<th>EY support as your assurance provider</th>
<th>EY support as your advisor</th>
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<tbody>
<tr>
<td><strong>Starter</strong></td>
<td><strong>Middle-of-the-pack</strong></td>
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<tr>
<td>• Perform a criteria assessment to identify any potential gaps against internal and/or external reporting standards</td>
<td>• Provide advice on how to draft definitions for the nonfinancial information disclosures that are available and suitable</td>
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<tr>
<td>• Perform assurance-readiness on selected material nonfinancial information disclosures</td>
<td>• Provide support on governance setup</td>
</tr>
<tr>
<td>• Assess efficacy of process/control and data flow documentation</td>
<td>• Help identify and define the scope and boundaries for nonfinancial information disclosures following the different reporting frameworks</td>
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<table>
<thead>
<tr>
<th><strong>EY support as your advisor</strong></th>
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<tbody>
<tr>
<td><strong>Middle-of-the-pack</strong></td>
<td><strong>Front-runner</strong></td>
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<tr>
<td>• Create a road map to prepare for assurance engagement</td>
<td>• Provide advice on the reporting process and controls for Scope 3 or other complex disclosures</td>
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<tr>
<td>• Assess technology for nonfinancial information reporting, including data conversion and definition of process and controls</td>
<td>• Help prepare the organization for the journey toward integrated reporting</td>
</tr>
<tr>
<td>• Support data gathering (and audit trail) for nonfinancial information disclosures to prepare for an assurance engagement not performed by EY</td>
<td>• Provide advice and support on impact measurement and reporting</td>
</tr>
<tr>
<td>• Assist internal audit through procedures or co-sourcing of internal audit activities</td>
<td>• Provide advice and support on measuring and valuing stock of capitals\textsuperscript{15}</td>
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<tr>
<td>• Provide internal audit training on nonfinancial information</td>
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Key questions to ask

Organizations need to assess whether their management of nonfinancial information is optimized to reliably and efficiently deliver the right information. Here are several key questions to help organizations on their journey to optimize how they manage nonfinancial information:

1. Are you concerned about brand reputation, stranded assets, business resiliency or license to operate?
2. Do you get sufficient business value from NFR?
3. What is the current state of nonfinancial information management in your organization?
4. What information matters most and who is most likely to use the business information that is reported publicly?
5. Do investors use nonfinancial information to assess risk and the outlook for your organization?
6. Are you confident that nonfinancial information governance, processes and definitions are sufficiently reliable?
7. Is the finance function involved in nonfinancial information management?
8. Do you use technology effectively to support credible reporting and optimize resources?
9. To what extent do you plan to integrate sustainability reporting and annual (financial) reporting?
10. Can you gain efficiencies by obtaining sustainability report assurance and financial auditing from the same provider?
Let’s continue the conversation

EY’s Climate Change and Sustainability Services team can help you reach peak performance in nonfinancial measurement, management and reporting.

Contact the professionals below for more information

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