Valoris
Stewardship Catalysts

Investor Alert

A concise treatment of an emergent topic of special interest to our institutional investor clients.

Assurance of Sustainability Data in the US and Europe

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Assurance of Sustainability Data under the European and (Proposed) U.S. Regulatory Frameworks

The recent steps taken by policymakers and regulators in the realm of sustainability foreshadow increasing demand for corporate sustainability data disclosures. This increase in disclosure of sustainability information, along with evolving investor expectations, will drive (or rather enhance) another trend: the securing of third-party assurance of such information. Like assurance of financial disclosures, assurance of sustainability data contributes to its credibility, facilitates progress-tracking and decision-making processes for investors and other actors, and supports regulator supervision.[i] For these reasons, more and more firms report sustainability information, with some voluntarily securing a certain level of assurance from major audit firms and other assurance service providers.[ii] However, the speed and duration of the trend toward greater provision of assurance of sustainability data will vary across jurisdictions. An important illustration of this is the difference in approaches in the U.S. and Europe. To assist our clients in better understanding what the future holds regarding assurance of sustainability information and how investor expectations may influence regulations and market practices, this Investor Alert provides a concise comparative overview of how U.S. and European policymakers are currently approaching sustainability assurance and how these approaches may evolve going forward.

Sustainability Assurance under the Current European and Proposed U.S. Approaches

The EU's Corporate Sustainability Reporting Directive (CSRD) is expected to alter the scope of current EU non-financial disclosure requirements and ultimately influence the shape of assurance of sustainability disclosures in member countries. Its American counterpart, while not equivalent in terms of breadth of scope, is the US SEC proposed rules on the Enhancement and Standardization of Climate-Related Disclosures for Investors.[iii] These two sets of rules share the same aim of regulating disclosure and assurance of certain sustainability (and in particular climate) information, yet they differ in many important aspects. The following table is a basic comparison between the two.

	The European Approach	The (Proposed) U.S. Approach
Timeline and entities subject to the rules	The CSRD applies to EU and non-EU companies with EU presence that meet certain thresholds (balance sheet, turnover and workforce). The entities subject to these rules vary depending on the timeline they are required to abide by, as follows: (1) Fiscal year 2024: EU undertakings already subject to the current Non-Financial Reporting Directive (NFRD).[iv] (2) Fiscal year 2025: Large EU undertakings (including subsidiaries of non-EU companies) listed or not if they meet certain thresholds and EU parent undertakings of a large group that on a consolidated basis satisfy at least two of these thresholds.[v] (3) Fiscal year 2026: Listed SMEs (except for micro-undertakings), small and non-complex credit institutions and captive insurance undertakings. [vi] (4) Fiscal year 2028: Non-EU undertakings that meet two thresholds. [vii]	The entities subject to these rules vary depending on the timeline they are required to comply with, as follows: (1) Fiscal year 2023: Large accelerated filers[viii] for all proposed disclosures except Scope 3. (2) Fiscal year 2024: Accelerated filers and non-accelerated filers for all proposed disclosures except Scope 3 and large accelerated filers for Scope 3. (3) Fiscal year 2025: Accelerated filers and non-accelerated filers will disclose Scope 3 information while smaller reporting companies will remain exempt from Scope 3 disclosures.[ix]
Level of Assurance	There is an initial requirement for limited assurance, with the aim of transitioning to reasonable assurance around 2028.	Limited assurance until the third year after the final rule goes into effect. After that (Fiscal year 2026), the level of assurance would be reasonable.

Scope of Coverage (Topics and information to be assured)	All topics, including reporting on environmental and social issues.	As its name implies, the U.S. regulation focuses on climate-related disclosures, in particular Scope 1, 2 and 3 information.
Standards to be used	Limited assurance standards that will be adopted by the EC before October 2026. Until then, Member States can opt to apply national assurance standards.	No specific standards, but certain standards are recommended: the PCAOB, the AICPA, and the International Auditing and Assurance Standards Board (IAASB).

Modest Predictions and Recommendations

We anticipate that the whole process of developing accepted assurance standards that meet regulatory requirements and investor expectations will take an extended period of time. The agreement on regulatory requirements and the evolution of market expectations will require numerous iterations of interactions among companies, investors, other stakeholders and policymakers. Specifically, investor engagement in the development of assurance practices will intensify, both through existing forums and through direct communications between large institutional investors and companies. Throughout these interactions, important practical challenges will arise and subsequently will need to be resolved. As a result, the specifics of assurance will remain at least for a while unclear. This ambiguity will be deciphered and clarified gradually with new developments (*e.g.*, investor engagement) and tools (*e.g.*, European Financial Reporting Advisory Group (EFRAG) reporting standards).

Notwithstanding our view that it will be some time before regulators and markets come to a consensus on what assurance of sustainability data should look like, we believe it is important for our investor clients to start incorporating in their due diligence and portfolio supervision processes some form of evaluation of the scope of sustainability information covered by assurance, the level of assurance provided, the standards applied to arrive at such assurance, and the assurance service providers' capabilities. Especially in the case of concentrated portfolios and high-conviction strategies, investors may benefit from developing some form of scorecard that tracks companies' progress over time in terms of the breadth and quality of sustainability disclosure and the level of assurance provided. Investors who keep abreast of sustainability information disclosure patterns and who thoughtfully incorporate consideration of assurance quality in the investment process should find themselves well-placed to take fullest advantage of the improving disclosure and assurance practices in both the EU and the US.

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Notes

[i] For a discussion of the current state of sustainability information assurance, see "Assurance of ESG and Sustainability Reporting" in Dallas and Lubrano, Governance, Stewardship and Sustainability (2022), pp. 168-170. https://routledge.pub/Governance-Stewardship-and-Sustainability

[ii] There are pronounced differences across sectors and markets in the extent to which firms report and obtain assurance over sustainability disclosures, the assurance standards used and the assurance service provider types chosen. In their 2021 report, IFAC and the AICPA & CIMA, in partnership with Audit Analytics, reviewed 1,400 companies across 22 jurisdictions, finding that 1,269 disclosed ESG data (91%), of which 51% (44% excluding EU) obtained some level of assurance.

[iii] The CSRD entered into force on January 5, 2023. However, the U.S. Proposed rules have not been finalized as originally expected (Last quarter of 2022) due in part to a "technical glitch". Since the new target date has now been moved to April 2023, the compliance dates in our table are likely to shift forward.

[iv] In EU Case law, an 'undertaking' is a concept that covers "*any entity engaged in an economic activity, regardless of its legal status and the way in which it is financed*".

[v] (1) A balance sheet total of more than EUR 20 million; (2) A net turnover exceeding EUR 40 million; (3) An average of more than 250 employees over the financial year.

[vi] The CSRD will apply to SMEs that are "*governed by the law of a Member State and whose transferable securities are admitted to trading on a regulated market of any Member State*". In EU law, the category of micro, small and medium-sized enterprises (SMEs) consists of enterprises "*which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million*". If you are more curious about the concept of listed SMEs in the EU, please check the text of the SME Listing Act via the following link: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019R2115

[vii] (1) A net turnover of more than EUR 150 million in the EU for each of the last two consecutive years at the consolidated level or otherwise the individual one; (2) have at least one subsidiary or branch in the EU within the scope of the CSRD.

[viii] According to the Securities and Exchange Commission (SEC) Rule 12b-2, a company must satisfy the following conditions to qualify as a large accelerated filer: "*(i) The issuer had an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of $700 million or more, as of the last business day of the issuer's most recently completed second fiscal quarter; (ii) The issuer has been subject to the requirements of section 13(a) or 15(d) of the Act for a period of at least twelve calendar months; and (iii) The issuer has filed at least one annual report pursuant to section 13(a) or 15(d) of the Act; and (iv) The issuer is not eligible to use the requirements for smaller reporting companies under the revenue test in paragraph (2) or (3)(iii)(B) of the "smaller reporting company" definition in this section, as applicable.*"

[ix] The SEC defines a smaller reporting company as "*an issuer that is not an investment company, an asset-backed issuer, or a majority-owned subsidiary of a parent that is not a smaller reporting company and that: (1) had a public float of less than $250 million; or (2) had annual revenues of less than $100 million and either: (i) no public float; or (ii) a public float of less than $700 million.*"

Contact Us

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