A Comparison of Limited and Reasonable Assurance Engagements in the context of Sustainability Reporting.

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The International Auditing and Assurance Standards Board (2021) establishes that an assurance engagement requires the practitioner to expresses 'a conclusion in the form that conveys the practitioner's opinion on the outcome of the measurement or evaluation of the underlying subject matter against criteria.' The Institute of Chartered Accountants in England and Wales (2023) provide the widely accepted description of a reasonable assurance engagement as one in which the practitioner needs to reduce the assurance engagement risk to an acceptably low level as the basis for a positive form of expression of the practitioner's conclusion. A limited assurance engagement differs to the extent that the practitioner collects less evidence than for a reasonable assurance engagement but sufficient for a negative form of expression of the practitioner's conclusion. The practitioner achieves this ordinarily by performing different or fewer tests than those required for reasonable assurance or using smaller sample sizes for the tests performed.

The distinction between a reasonable and a limited assurance engagement has become increasingly important to the audit profession in recent years as businesses and organisations have opted to engage in sustainability reporting and integrated reporting in order to meet the expectations of investors and other stakeholders, as well as to be prepared for inevitable mandatory reporting requirements. Indeed, the introduction of mandatory reporting has already begun. In the UK, large businesses[1] are required to report their climate related risks and opportunities under the Task Force on Climate Related Disclosures. Concurrently, the Corporate Sustainability Reporting Directive (the CSRD) was adopted into the legislation of EU member states in December 2022. Consequent to the Directive, the first set of EU sustainability reporting standards are currently being released. By 2025, all large EU firms[2] will be legally required to report under these standards with respect to the 2024 financial year, and the reports will be subject to limited assurance.

Against this background, one quickly realises the significance of understanding how a limited assurance engagement differs to a reasonable assurance engagement which would typically be conducted in the case of the audit of annual financial statements. In the context of the CSRD, the reported sustainability information should form part of the management report. However, it is essential to ensure integration between financial and sustainability reporting such that all stakeholders can assess how financial performance is achieved in an environmentally and socially sustainable manner, on which the company's long-term viability depends.

[1] UK registered companies that have more than 500 employees and turnover of more than £500 million; banking and insurance companies; and limited liability partnerships (LLPs) which have more than 500 employees and turnover of more than £500 million

[2] Companies with more than 250 employees and/or more than €40M turnover and/or more than €20M total assets; listed companies; Large companies currently incorporates companies not established in the EU that are listed on EU regulated markets and EU subsidiaries of non-EU companies.

Independent assurance will need to assess whether the information is accurate in all material aspects. It should also consider whether the reporting provides the complete story in a neutral manner. Accordingly, the assurance provider must be alert to the potential for 'greenwashing'. Under the CSRD, assurance of sustainability information can be provided by an independent service provider who is not necessarily the statutory auditors. This might be, for example an ESG consultant or expert. An entity's choice to engage a non-statutory auditor may be driven out of necessity as evidence indicates that the supply of suitably qualified accountants is exceeded by the demand for their services (Alsahali & Malagueño, 2022).

The CSRD will require the provider to provide limited assurance over compliance with the reporting standards, and the process carried out by the undertaking to identify the information reported. Assurance will also need to be provided of compliance with the requirement to mark-up sustainability reporting in accordance with Article 19d of the Directive (digitalisation) as well as compliance with the reporting requirements of Article 8 of the EU Green Taxonomy Regulation (Regulation (EU) 2020/852).

The use of the word 'limited' should not mislead one into complacency. Accountancy Europe (2022) points out that the practitioner must obtain a sufficient understanding of the entity in order to be able to assess the risk of material misstatement. Since sustainability reporting aggregates data from different sites, subsidiaries, or countries at corporate level, obtaining such an understanding in an often scientifically technical area with which the audit and accounting profession may well be unfamiliar may be a complex task. It is also crucial to be aware that the internal controls over sustainability information may be less robust than for financial information. Accordingly, in the audit of larger entities, consideration should be given to whether the audit work should be performed only at corporate level or also at subsidiary level and if detailed testing is required and to what extent. While an appropriate standard to apply in the case of a limited assurance engagement has yet to be specified, the International Standard on Assurance Engagements (ISAE) 3000 (Revised) Assurance Engagements Other than Audits or Reviews of Historical Financial Information is considered to be a suitable standard for the CSRD.

In practice, limited assurance on sustainability information, for example climate information, should aim to enhance the assurance provider's understanding of climate-related risk so as to enable effective consideration of this risk throughout the financial statement audit. In contrast, were the provider to provide reasonable assurance, the climate information would be used to inform their risk assessment and related financial statement audit considerations, to deliver transparency and assure faithful representation.

In line with ISA 500, the provider should design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. For example, an auditor engaged by a pharmaceutical company to provide limited assurance for the purposes of CSRD or otherwise might be required to devote some consideration to reported water withdrawal, consumption and discharge of effluents. Tests to be performed in this case could begin at the level of the financial statements. This would include a review of any environmental fines in the financial statements (issued for example by the Environmental Protection Agency). This will identify whether the company has engaged in any environmental breaches with respect to water. Associated legal documentation and that on legal expenses would be enquired and reviewed to assess whether legal advice was sought. The financial impacts of changes in water treatment expenses or from availing of any governmental incentives to manage water more efficiently, for instance the use of grants to adapt taps or flushing systems, may also be reflected in the financial statements. Performing analytical reviews of water treatment costs may aid in detecting material misstatements. Non-financial and third-party sources may also provide appropriate evidence- significant issues may be reflected in records of complaints or in media reports. The provider should use professional judgement in reviewing any evidence, and management responses should be viewed with a degree of professional scepticism, considered in the context of the substantive work undertaken.

In accordance with ISA 700 and the Companies Act 2014, the report resulting from a reasonable assurance engagement will include the auditor's opinion, the basis for the opinion, conclusions relating to going concern, key audit matters, other information, opinions on other matters, matters on which the auditor required to report by exception, respective responsibilities of those charged with governance and auditors, other reporting responsibilities, and closing elements. In contrast, the elements of the report resulting from a limited assurance engagement will be fewer. While the guidance on the contents of the limited assurance report in the context of sustainability reporting continues to emerge, those produced thus far tend to include a conclusion and/or recommendations, an explanation of the inherent limitations of the engagement, respective responsibilities of those charged with governance and assurance providers, and a detailed explanation of the assurance work performed.

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