The Role of the Auditor in Climate-Related Information

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CAQ

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Overview

As companies increasingly report climate-related information, investors, regulators, and other stakeholders are placing greater emphasis on the reliability of this information. The purpose of this publication is to provide public company auditors with insight into the significant growing demand for reliable climate-related information and to highlight the critical role that auditors can play in a US Securities and Exchange Commission (SEC) registrant's reporting of climate-related information, not only as it affects the audit of the financial statements and internal control over financial reporting (ICFR) but also separate, standalone reporting of climate-related information.[1] The publication also provides insights into the current climate-related reporting landscape and the types of climate-related information auditors may encounter.[2]

What is driving demand for climate-related information?

Demand for climate-related information is being driven by a large variety of evolving stakeholder preferences.

+ Large institutional and private equity investors are seeking climate-related information to help them manage their investment risk.
+ Retail investors have increased and plan to further increase their investments in environmentally (and socially) responsible companies and are calling for climate-related information to inform their decisions.[3]
+ Creditors and lenders are basing lending terms on companies' performance against their climate-related strategies and targets (e.g., meeting targets or improving performance may be rewarded by lower interest rates.)
+ Insurance companies are requiring this information as they manage the climate-related risk in their portfolios and as they develop required reporting to the National Association of Insurance Commissioners (NAIC).[4]

Large institutional and private equity investors are seeking climate-related information to help them manage their investment risk.

1 While this publication has been written with a focus on public companies, much of the information is universal and could be applicable in a private company context. For purposes of this publication, the word "auditor" encompasses both the financial statement auditor and the practitioner performing the assurance work on the climate-related information. In some cases, they might be the same and in other cases, they might differ.
2 This publication focuses specifically on climate-related information (and primarily greenhouse gas-related information) as opposed to broader environmental, social and governance (ESG) information.
3 GlobeScan Radar, *Retail Investors Views of ESG*, 2021.
4 NAIC Adopts New Climate Risk Disclosure Standard for its Survey - Insurance & Reinsurance.

- Many customers and local communities are interested in doing business with companies that focus on climate-related matters.
- Many business-to-business customers are making their own climate-related commitments that encompass their supply chains leading them to develop climate-related expectations for their suppliers and to enhance monitoring of climate-related risks and performance across their suppliers.
- Employees are increasingly interested in transparency from companies about climate-related goals to assess how those goals align with their personal values.
- Greater stakeholder attention to rating agencies' scoring and benchmarking of companies' climate-related activities is driving companies to be increasingly transparent about those activities.
- Through both formal and informal policies, governments are increasingly focused on how companies communicate climate-related risks and opportunities.

More than ninety percent of S&P 500 companies have voluntarily decided to publish ESG reports containing climate-related information.

Given the increasing attention on these disclosures, more than ninety percent of S&P 500 companies have voluntarily decided to publish ESG reports containing climate-related information.[5]

The increase in demand for company-prepared climate-related information has prompted governments and regulators around the world to take a closer look at climate-related reporting requirements to understand whether changes are needed to meet stakeholders' evolving information needs. For example, in March 2022, the SEC issued a request for public comment on its proposed rules: *The Enhancement and Standardization of Climate-Related Disclosures for Investors*. The SEC received an unprecedented number of responses to its proposed rules (over 4,000 unique comment letters). The SEC staff are in the process of finalizing the rules. All SEC registrants would be in scope of the proposed SEC rules, with specific reporting and assurance requirements that may differ depending on filing status. (For greater insight into the SEC's proposed climate rules, see Appendix A.) In addition, certain federal agencies (e.g., the Environmental Protection Agency, the Federal Acquisition Regulatory Council) require disclosures of select climate-related information and are increasingly requiring some form of third-party assurance or attestation over that information.[6]

In November 2022, the European Union adopted a Corporate Sustainability Reporting Directive (CSRD), which introduces more detailed climate-related and other ESG reporting requirements including assurance for many entities. These requirements affect European listed companies and certain US and other non-EU companies and their EU subsidiaries.[7] (For greater insight into the EU CSRD, see Appendix A.)

These regulatory developments and broader stakeholder demand make clear that climate-related reporting is here to stay. Consistent with the role auditors play in reliable financial reporting, auditors have a critical role to play within this evolving reporting landscape.

5 Center for Audit Quality (CAQ), *S&P 500 ESG Reporting.*
6 Code of Federal Regulations, Title 40, *Part 98 -- Mandatory Greenhouse Gas Reporting,* https://www.ecfr.gov/current/title-40/chapter-I/subchapter-C/part-84/subpart-A/section-84.33 §84.33(e)(1), and The White House, FACT SHEET: Biden-Harris Administration Proposes Plan to Protect Federal Supply Chain from Climate-Related Risks, Nov 2022.
7 Official Journal of the European Union, *DIRECTIVE (EU) 2022/2464 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL.*

What types of climate-related information are companies disclosing?

Climate-related disclosures vary depending on each company's unique facts and circumstances. While much of this information is currently reported within standalone ESG reports, due to investor demand and growing regulatory pressure, some of this information is also appearing in SEC filings (e.g., Form 10-K). Some of the more common climate-related disclosures that auditors could encounter, either in separate ESG reports or in SEC filings, could include (but are not limited to):

The TCFD recommendations are structured around four thematic areas representing core elements of how organizations operate: governance, strategy, risk management, and metrics and targets.

TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (TCFD) INFORMATION[8]

The Task Force on Climate-related Financial Disclosures was created by the Financial Stability Board (FSB) in 2015 to develop recommendations on the types of information that companies should disclose to support investors, lenders, and insurance underwriters in appropriately assessing and pricing risks related to climate change.[9] The TCFD recommendations are structured around four thematic areas representing core elements of how organizations operate: governance, strategy, risk management, and metrics and targets. The four thematic areas are supported by recommended disclosures that build out the framework with information aimed at helping investors understand how companies assess climate-related risks and opportunities.

+ Governance, strategy, risk management, and metrics and targets associated with climate-related risks and opportunities

The TCFD indicates that climate-related risks that could potentially impact an entity (and its financial statements) typically fall into one of the following categories: (1) physical risks or (2) transition risks. Physical risks may include damage to businesses and their assets arising from acute climate-related events such as wildfires, floods, hurricanes, tornadoes, and heatwaves. Companies may also face chronic risks and more gradual impacts from long-term temperature increases, drought, and sea level rise.[10] Transition risks are the risks associated with required changes to a company's business due to the transition to a low carbon economy. These risks may arise from potential adoption of climate-related regulatory policies including those that may be necessary to achieve national climate goals that may be or have been adopted by various countries; climate-related litigation; changing consumer, investor, and employee behavior and

8 Link to the TCFD Recommendations: FINAL-2017-TCFD-Report.
9 The FSB is an international body that monitors and makes recommendations about the global financial system to promote international stability.
10 US Securities and Exchange Commission (SEC), *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, Mar 2022, p 55 and TCFD, *Recommendations of the Task Force on Climate-related Financial Disclosures*, 2017, p 6.

choices; changing demands of business partners; long-term shifts in market prices; technological challenges and opportunities, and other transitional impacts.[11]

The TCFD also indicates that company efforts to mitigate or adapt to climate-related risks can produce climate-related opportunities (e.g., through resource efficiency and cost savings, the adoption of low-emission energy sources, the development of new products and services, access to new markets, and building resilience in the supply chain).[12]

While the TCFD recommendations represent a voluntary reporting framework, various regulators (including the SEC in its proposed climate rules) have based their requirements or proposed requirements on the TCFD recommendations.[13]

+ Scenario analysis

The TCFD believes that organizations should use scenario analysis to assess potential business, strategic, and financial implications of climate-related risks and opportunities and to disclose them.[14] The TCFD technical supplement indicates that companies should be prepared to disclose key inputs, assumptions, analytical methods, outputs, and potential management responses associated with their scenario analyses.[15]

According to the *Recommendations of the Task Force on Climate-related Financial Disclosures – Final Report*, "scenario analysis is a process for identifying and assessing the potential implications of a range of plausible future states under conditions of uncertainty. Scenarios are hypothetical constructs and not designed to deliver precise outcomes or forecasts. Instead, scenarios provide a way for organizations to consider how the future might look if certain trends continue or certain conditions exist. In the case of climate change, for example, scenarios allow an organization to explore and develop an understanding of how various combinations of climate-related risks, both transition and physical risks, may affect its businesses, strategies, and financial performance over time.

Scenario analysis can be qualitative, relying on descriptive, written narratives, or quantitative, relying on numerical data and models, or some combination of both. Qualitative scenario analysis explores relationships and trends for which little or no numerical data is available, while quantitative scenario analysis can be used to assess measurable trends and relationships using models and other analytical techniques. Both rely on scenarios that are internally consistent, logical, and based on explicit assumptions and constraints that result in plausible future development paths."[16]

Scenario analysis can be qualitative, relying on descriptive, written narratives, or quantitative, relying on numerical data and models, or some combination of both.

11 Ibid.
12 Task Force on Climate-related Financial Disclosures, *Recommendations of the Task Force on Climate-related Financial Disclosures*, 2017, p 62.
13 According to a Center for Audit Quality (CAQ) analysis of stand-alone ESG reports for periods ending in 2020, more than 60% of the S&P 500 (302 of the 500 companies) reference the TCFD Recommendations. See *S&P 500 ESG Reporting.*
14 Task Force on Climate-related Financial Disclosures, *Recommendations of the Task Force on Climate-related Financial Disclosures*, 2017, p 25.
15 Task Force on Climate-related Financial Disclosures (TCFD), *Technical Supplement - The Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities*, p 7.
16 Task Force on Climate-related Financial Disclosures, *Recommendations of the Task Force on Climate-related Financial Disclosures*, 2017, p 25.

FINANCIAL STATEMENT IMPACTS

Although US GAAP currently doesn't include explicit references to climate-related risks, companies are implicitly required to consider them in applying the standards when the effect could reasonably be material to the financial statements.[17] Whether or not physical and transition risks will have an impact on a company's financial reporting will vary from company to company and depend on several factors, like the nature of the company's business, its industry, geographic footprint, types of underlying transactions and the significance of the climate-related risk to the entity's business, among other things.

Climate-related risks and opportunities can impact the financial statements in a variety of ways. For example, if a company decides to replace existing assets with more energy efficient assets earlier than expected this could result in possible impairment of those assets due to changes in the assumptions used to assess recoverable amounts; any replacement assets purchased could result in higher depreciation expense; certain climate-related commitments could result in liabilities; shifting consumer demand for products could result in inventory obsolescence; or changing sales terms could influence revenue recognition. Those are just some examples of financial statement areas that might be affected.

The time horizon over which climate-related risks come to fruition also will vary by company and industry; thus, while risks may exist, the impact on the current-period financial statements may not be material. Ultimately some climate-related risks may directly affect amounts or disclosures in the financial statements, while others may only indirectly affect the financial statements, and others may have no impact at all.

The time horizon over which climate-related risks come to fruition also will vary by company and industry.

GREENHOUSE GAS (GHG) EMISSIONS

Many companies report their GHG emissions considering the standards developed by the Greenhouse Gas (GHG) Protocol.[18] The Corporate Accounting and Reporting Standard, developed by the GHG Protocol, is the primary guidance for businesses and other organizations preparing to disclose their GHG emissions. The standard focuses specifically on accounting and reporting on seven specific greenhouse gases.[19] The standard classifies a company's GHG emissions into three scopes: Scope 1, Scope 2 and Scope 3 GHG emissions (see Appendix A for definitions).

CLIMATE-RELATED COMMITMENTS

As the focus on climate risks intensifies, companies are setting various targets and making commitments to achieve those targets. Companies are disclosing commitments to achieve net zero emissions, or to be carbon neutral by a specified date in the future by reducing their emissions (e.g., a company may announce a commitment to achieve net zero emissions by 2050). For the purpose of this publication, we refer

17 See *FASB Staff Educational Paper - Intersection of Environmental, Social, and Governance Matters with Financial Accounting Standards.*
18 The World Resources Institute (WRI) and the World Business Council for Sustainable Development (WBCSD) created the Greenhouse Gas (GHG) Protocol in 2001 to streamline emissions measurement and help organizations identify opportunities to reduce emissions. The GHG Protocol, provides extensive and standardized frameworks for measuring, managing and disclosing GHG emissions for companies, organizations, cities and countries.
19 The seven greenhouse gases are sulfur hexafluoride (SF_6), methane (CH_4), carbon dioxide (CO_2), nitrous oxide (N_2O), perfluorocarbons (PFCs), hydrofluorocarbons (HFCs), and nitrogen trifluoride (NF_3).

to these and other types of similar commitments as climate-related commitments. This practice of making climate-related commitments spans across many industries, such as (1) energy companies that historically relied on fossil fuels committing to substantially reduce their carbon emissions, (2) food and beverage companies committing to reduce GHG emissions in their supply chains, (3) banks committing to transition the GHG emissions from their lending and investment portfolios to align with pathways to net zero, and (4) automotive manufacturing entities committing to phase out production of traditional vehicles that are powered by fossil fuels.

'Going net zero' refers to reducing GHG emissions and/ or ensuring that any ongoing emissions are balanced by removals.

Terminology that auditors may encounter in relation to GHG emissions is explored in greater detail below. There are many sources that define each of these terms slightly differently and each company may define their specific climate-related commitments differently too.

+ *What does net zero emissions mean?*

A state in which the greenhouse gases going into the atmosphere are balanced by removal of greenhouse gases out of the atmosphere. 'Going net zero' refers to reducing GHG emissions and/or ensuring that any ongoing emissions are balanced by removals.[20]

GHG emissions throughout the entire value chain

Reducing or removing GHG emissions from the atmosphere

+ *What does carbon neutral mean?*

Any CO_2 emissions attributable to a company's activities are fully reduced or removed. While similar to net zero emissions, carbon neutral only refers to carbon and not all GHG emissions.[21]

+ *What are GHG reductions?*

Actions that reduce the quantity of GHG emissions attributable to a company relative to a baseline (e.g., avoided emissions from deployment of renewable energy).[22]

+ *What are GHG removals?*

Actions that remove GHG emissions from the atmosphere in relation to a baseline are referred to as GHG removals. (e.g., reforestation).[23]

20 Oxford Net Zero, What is Net Zero?
21 Ibid.
22 Ibid.
23 Ibid.

+ *What are offsets?*

Offsets are discrete GHG reductions used to compensate for (i.e., offset) GHG emissions elsewhere. Offsets are calculated relative to a baseline that represents a hypothetical scenario for what emissions would have been in the absence of the project.[24] Offsets can be used to reduce or "offset" an organization's scope 1, 2 or 3 emissions. They are measured in metric tons of CO_2 or CO_2 equivalent.[25]

How do carbon offsets work?

Carbon offsets allow companies to help build projects around the world that reduce GHG emissions beyond what one company could achieve individually. Carbon offsets are purchased to finance these projects and decrease the impact of a company's own GHG emissions, even though the projects are located elsewhere. Carbon offsets are useful for emissions that are impossible to reduce given that funds can be used to help reduce emissions elsewhere.[26]

+ *What are renewable energy certificates (also known as renewable energy credits or RECs)?*

A REC is a tradeable, market-based instrument that represents the legal property rights to the "renewable" or clean energy aspects-of renewable electricity generation. A REC is created for every megawatt-hour (MWh) of electricity generated and delivered to the grid from a renewable energy resource. Electricity cannot be considered renewable without a REC to substantiate it. RECs are measured in megawatt hours (MWh) and can lower an organization's gross market-based scope 2 emissions from purchased electricity.[27]

How do renewable energy certificates work?

Given that electricity enters the grid from a variety of sources (e.g., from solar power and wind to natural gas and nuclear power), it's not possible to know exactly what energy source electricity comes from. To help companies solve this problem, they can purchase RECs along with their electricity. RECs are certificates that transfer the "renewable" or clean energy aspects of renewable energy to the owner. Ultimately, RECs paired with electricity from the grid are renewable energy that is being generated on a company's behalf.[28]

Carbon offsets are useful for emissions that are impossible to reduce given that funds can be used to help reduce emissions elsewhere.

24 ghg-protocol-revised.pdf – p 59.
25 Green Power Partnership, US Environmental Protection Agency, *Offsets and RECs: What's the Difference?*, p1.
26 Terrapass, *Carbon Offsets Explained.*
27 Green Power Partnership, US Environmental Protection Agency, *Offsets and RECs: What's the Difference?*, p1.
28 EnergySage, Renewable Energy Credits (RECs): What You Need To Know.

+ ***What are science-based targets?***
GHG emissions reduction targets are considered "science-based" if they are in line with what the latest climate science says is necessary to meet the goals of the Paris Agreement.[29]

+ ***What is the Paris Agreement?***
The Paris Agreement is an international treaty on climate change. "It was adopted by 196 Parties at COP 21 in Paris, on 12 December 2015 and entered into force on 4 November 2016. Its goal is to limit global warming to well below 2, preferably to 1.5 degrees Celsius, compared to pre-industrial levels. To achieve this long-term temperature goal, countries aim to reach global peaking of GHG emissions as soon as possible to achieve a climate neutral world by mid-century."[30]

Is the US party to the Paris Agreement?
The US initially became a party to the Paris Agreement in 2016, withdrew in November 2020 and rejoined again in January 2021. While the US is currently party to the Paris Agreement it is important to remember that registrant operations in foreign countries who are party to the agreement may be impacted regardless of US participation in the Agreement.

GHG emissions reduction targets are considered "science-based" if they are in line with what the latest climate science says is necessary to meet the goals of the Paris Agreement.

Why do companies seek assurance over climate-related information?

There are many reasons why a company and its stakeholders may find third-party assurance on its climate-related information useful. For example:

+ Boards of directors may want to assess whether their company's public facing climate-related disclosures are of a high quality, as these issues are increasingly seen by investors as a window into business viability and the future of company performance.

+ Investors are increasingly focused on climate-related information because they find such information helpful in understanding a company's long-term value creation strategy, and the information

29 Science Based Targets, *Science-Based Target Setting Manual*, Version 4.1 April 2020, p9.
30 United Nations Framework Convention on Climate Change, *The Paris Agreement.*

enables them to manage their investments based on the related risks and opportunities. Third-party assurance can enhance the reliability of climate-related information.

+ Management may want to seek assurance from a third-party to obtain another perspective on its climate-related information and associated processes. Assurance from a third-party over climate-related information can enhance management's confidence in the integrity of the company's disclosed climate-related information.

+ Other stakeholders including customers, suppliers and prospective employees also may rely on a company's climate-related information to make decisions and assurance by a third-party could enhance the reliability of such information. For example, information on a company's climate-related practices may determine whether a customer purchases a product or chooses to purchase it from a competitor.

+ Assurance of climate-related information may impact a company's CDP score or rankings and ratings on sustainability indices (e.g., Dow Jones Sustainability Index).[31]

As a result of these factors, roughly fifty-five percent of S&P 500 companies already voluntarily obtain assurance or verification over certain of their climate-related disclosures.[32] The majority of those companies engaged a third party to obtain limited assurance on that information.[33] Most S&P 500 companies obtain this assurance or verification from engineering or boutique consulting firms,[34] whereas globally over 60% of companies obtain assurance from accounting firms.[35] Research findings suggest that the benefits of climate-related assurance are greater when the assurance engagement is performed by public company auditors versus other providers.[36] US public company auditors currently perform assurance engagements in accordance with the AICPA attestation standards while other assurance or verification providers perform their services in accordance with a variety of other standards or approaches.[37] Current and proposed regulatory requirements like those in the EU and the US underscore the importance of assurance.

Third-party assurance can enhance the reliability of climate-related information. Roughly fifty-five percent of S&P 500 companies already voluntarily obtain assurance or verification over certain of their climate-related disclosures.

31 The CDP was formerly known as the Carbon Disclosure Project.
32 As part of our analysis of S&P 500 companies' reporting of ESG information for 2020, we observed that 274 companies assured certain of their GHG emissions metrics.
33 Center for Audit Quality (CAQ), *S&P 500 ESG Reporting.*
34 Ibid.
35 IFAC and AICPA & CIMA, *State of Play in Sustainability Reporting and Assurance of Sustainability Information: Update 2019-2020 Data & Analysis.*
36 Understanding and Contributing to the Enigma of Corporate Social Responsibility (CSR) Assurance in the United States," Auditing: A Journal of Practice & Theory, Vol. 34, No. 1, pages 97–130 (February 2015) and Journal of Accountancy, *Save money by having your sustainability report assured.*
37 Our *S&P 500 ESG Reporting* analysis revealed that the most common assurance standard referenced by other assurance/verification providers was International Organization for Standardization 14064-3 Greenhouse gases — Part 3: Specification with guidance for the verification and validation of greenhouse gas statements (ISO 14064-3). Other providers also referenced AccountAbility's AA1000 Series of Standards as well as their own assurance methodology which they commonly stated was based on the International Standard on Assurance Engagements (ISAE 3000).

What is the role of public company auditors in climate-related information?

As part of serving the public interest, US public company auditors support the flow of reliable information for decision making. As such, auditors have a role to play in an SEC registrant's reporting of climate-related information – not only in the context of the audit of the financial statements and ICFR – but also in attestation engagements to report on standalone climate-related information (e.g., GHG emissions).

Auditors have a role to play in an SEC registrant's reporting of climate-related information.

Below we explore the auditor's role in climate-related information reported in a document that contains the audited financial statements (e.g., Form 10-K) as well as climate-related information disclosed in a separate ESG report (i.e., outside of a document that contains the audited financial statements).

AUDITOR'S RESPONSIBILITY FOR ASSESSING CLIMATE-RELATED INFORMATION AS IT RELATES TO THE AUDIT OF THE FINANCIAL STATEMENTS AND ICFR

Climate-related information disclosed in Form 10-K within the audited financial statements

The auditor's overall objective of a financial statement audit—as set forth by existing PCAOB auditing standards—is to obtain reasonable assurance about whether the financial statements are free of material misstatement whether due to error or fraud and to assess whether the financial statements were prepared in accordance with US GAAP in all material respects. Financial statement auditors are responsible for considering the appropriateness of management's consideration of the financial statement implications of potential risks of material misstatement, which encompasses climate-related risks.

When assessing the potential impact of climate-related risks, the auditor might consider it necessary to conduct inquiries of management, including personnel outside the finance department (e.g., chief sustainability officer, office of general counsel, risk and compliance or sustainability committees) to understand how and when management expects climate-related risks could impact the entity and how management plans to consider such risks in the preparation of the financial statements.[38]

PCAOB auditing standards require the financial statement auditor to perform a risk assessment, which includes the auditor obtaining an

38 Such inquiries could be conducted in conjunction with the inquiries required under PCAOB AS 2110.54, *Identifying and Assessing Risks of Material Misstatement.*

understanding of the company and its environment. The auditor's risk assessment includes consideration of relevant industry, regulatory, other external factors and the company's objectives, strategies, and business risks that might reasonably be expected to result in risks of material misstatement.[39] The risk assessment encompasses climate-related risks and their potential impact on an entity's financial statements. If the auditor identifies a risk of material misstatement related to climate, the auditor is required to develop an audit response that addresses this risk within the impacted financial statement accounts and disclosures.

The auditor's risk assessment encompasses climate-related risks and their potential impact on an entity's financial statements.

Throughout the audit, the auditor also evaluates any contradictory information that comes to the auditor's attention in evaluating the sufficiency and appropriateness of audit evidence obtained in response to risks of material misstatement, which encompass those related to climate.

To the extent climate-related risks manifest themselves into risks of material misstatement such that there could be accounting or disclosure impacts, management would be responsible for establishing its ICFR to properly identify and consider such risks. In situations where the auditor is engaged to perform an ICFR audit, the auditor also would consider the company's ICFR in relation to the climate-related information included or disclosed in the financial statements and assess whether the company's controls are designed and operating effectively to help prevent or detect a material misstatement in the company's financial statements.

For greater insight into climate-related considerations as part of the audit of the financial statements see: *Audited Financial Statements and Climate-Related Risk Considerations*.[40] To help inform the audit approach, it may be helpful to have a deeper understanding of how registrants should be thinking about climate risk. The following may be a helpful resource: *FASB Staff Educational Paper - Intersection of Environmental, Social, and Governance Matters with Financial Accounting Standards*.

What can public company auditors expect going forward?
The proposed SEC climate rules would require disclosure of the impact of climate-related events and transition activities on the line items of the consolidated financial statements if the absolute value of those amounts is 1 percent or more of the related line item. As currently proposed, these disclosures would be required in a note to the financial statements and would be subject to the financial statement audit.

Climate-related information disclosed in Form 10-K outside of the audited financial statements

While auditors do not obtain assurance or opine on "other information" when conducting an audit of the financial statements, auditors do have a responsibility under PCAOB standards to read other information included in documents that contain audited financial statements,

39 PCAOB AS 2110.07-.09, *Identifying and Assessing Risks of Material Misstatement*, also includes other matters that the auditor is required to consider when performing risk assessment.
40 While the following publications do not address US public company audits, they may be useful: AICPA Practice Aid, *Considerations of ESG-related matters in an audit of financial statements*; IAASB Staff Audit Practice Alert, *The Consideration of Climate-Related Risks in an Audit of Financial Statement.*

such as climate-related information included in the description of the business, discussion of legal proceedings, risk factors, and MD&A, and consider whether such information, or the manner of its presentation, is materially inconsistent with information appearing in the audited financial statements.[41] For example, if a company discloses climate-related emissions targets and any progress in achieving them in its Form 10-K, current PCAOB standards require the financial statement auditor to read the presented climate-related information for material inconsistency with the financial statements.[42] While the auditor would take action if there are any such inconsistencies or misstatements, the auditor has no obligation to perform any procedures to corroborate this other information.[43]

Like the audit of the financial statements and ICFR, third-party assurance from a public company audit firm can enhance the reliability of climate-related information presented by companies to investors and other stakeholders.

What can public company auditors expect going forward?
Per the SEC's proposed climate rules, the proposed disclosures (besides the proposed financial statement note disclosures) would be required within the Form 10-K outside of the audited financial statements. While that information would be considered "other information" in the context of the financial statement audit, the Scope 1 and Scope 2 GHG emissions disclosures for certain registrants would be required to be subject to a separate attestation engagement. The auditor's role in these attestation engagements is described below.

AUDITOR'S RESPONSIBILITY FOR ASSESSING CLIMATE-RELATED INFORMATION AS PART OF AN ENGAGEMENT SEPARATE AND APART FROM THE FINANCIAL STATEMENT AUDIT

Companies often include climate-related information in standalone ESG reports that do not include the audited financial statements. In these instances, the auditor has no responsibility for this climate or other ESG information as part of the audit of the financial statements or ICFR. However, companies can and do engage auditors to perform a separate attest examination or review engagement to obtain assurance over climate-related information in standalone ESG reports. This is where auditors have another role to play. Like the audit of the financial statements and ICFR, third-party assurance from a public company audit firm can enhance the reliability of climate-related information presented by companies to investors and other stakeholders. US public company auditors currently perform attestation engagements in accordance with the AICPA attestation standards, as follows:

+ Examination engagements (i.e., reasonable assurance engagements): The practitioner expresses an independent opinion about whether the climate-related information is in accordance with the criteria, in all material respects. An examination engagement is the closest equivalent to the reasonable assurance obtained in an audit of financial statements and is more thorough than a review engagement. An examination engagement includes obtaining an understanding of the

41 PCAOB AS 2710.04, *Other Information in Documents Containing Audited Financial Statements.*
42 A material misstatement of fact is a high threshold, and given the nature of climate-related information, it may be unlikely the auditor would be aware of a misstatement of fact since such information is outside the scope of an audit of financial statements and internal control over financial reporting.
43 PCAOB AS 2710.04, *Other Information in Documents Containing Audited Financial Statements.*

subject matter and other engagement circumstances sufficient to identify and assess risks of material misstatement and provide a basis for designing and performing procedures to respond to the assessed risks. This includes obtaining an understanding of internal controls, evaluating the design of relevant controls, and determining whether they have been implemented. The auditor is required to design and perform tests of the operating effectiveness of relevant controls if the auditor intends to rely on their operating effectiveness in determining the nature, timing, and extent of other procedures and in certain other circumstances.

+ Review engagements (i.e., limited assurance engagements): The practitioner expresses a conclusion about whether any material modifications should be made to the climate-related information in order for it to be in accordance with the criteria. In a review engagement the limited assurance obtained by the practitioner is equivalent to the assurance obtained by an auditor in an interim review of the financial statements; however, for an attest review engagement (unlike an interim review of financial statements), a written report is always issued. The procedures performed in a review engagement are substantially less in extent than in an examination engagement. A review engagement includes identifying and focusing on areas in which there is increased risk that the subject matter may be materially misstated. Review evidence obtained through inquiry and analytic procedures will ordinarily provide the practitioner with a reasonable basis for obtaining limited assurance; however, the practitioner may determine that other procedures are more effective or efficient to obtain limited assurance. Controls testing is less common in review engagements.

What can public company auditors expect going forward?
For certain registrants, the SEC's proposed climate rules would require that Scope 1 and Scope 2 GHG emissions disclosures be subject to limited assurance (i.e., a review engagement) during a phase-in period, followed by reasonable assurance (i.e., an examination engagement). The assurance report would be required to be filed with the 10-K.

A review engagement includes identifying and focusing on areas in which there is increased risk that the subject matter may be materially misstated.

What factors and skillsets enable auditors to perform attestation engagements over climate-related information?

Obtaining any level of assurance by a public company auditor involves obtaining an understanding of the processes, systems, and data, as appropriate, and then assessing the findings in order to support an opinion or conclusion. Further, public company auditors:

+ Have a long history of and are highly experienced at independently gathering evidence to assess the reliability and accuracy of data and information that is used to make decisions and reported externally.
+ Are skilled in gaining an understanding of a company, its business cycles, processes and how the company creates value through experience gained from financial statement and ICFR audits.
+ Have access to specialists that encompass various areas of ESG information, including climate-related areas such as GHG emissions.
+ Are required to be independent of the companies they audit, in accordance with applicable independence standards for such attest services.
+ Are required by the applicable standards to plan and perform assurance engagements with professional skepticism.
+ Are experienced in reporting on compliance with various established standards and frameworks.
+ Are required to maintain a system of quality control that is designed to provide the public company audit firm with confidence that its auditors complied with applicable standards and the reports issued by the public company auditor are appropriate.
+ Are required to adhere to continuing professional education, ethics and experience requirements, including specialized training.

Public company auditors have access to specialists that encompass various areas of ESG information, including climate-related areas such as GHG emissions.

Can a public company use the same independent accounting firm for its financial statement audit and attestation over its climate-related information?

Yes, performing an attest examination or review engagement of climate-related information is a permissible service for the independent accounting firm performing the financial statement audit, subject to pre-approval from the audit committee. The performance of an attest examination or review engagement by an independent accounting firm requires applicable independence requirements to be met. These independence requirements are consistent with the requirements for the financial statement audit and as a result, the services are compatible.

Companies could find it beneficial to use the same independent accounting firm for both the financial statement audit and attestation over climate-related information given that the financial statement auditor already has an understanding of the company, including its cycles, processes, systems, and data through the financial statement and ICFR audits. The financial statement auditor also has as an existing working relationship with the company. These factors contribute to more effective and efficient execution of the attestation engagement, resulting in possible cost and time savings for the company. Further, using an existing service provider helps support companies who are often working to streamline their year-end reporting processes and reduce the number of third parties involved.

Synergies between the financial statement audit and the attest examination or review engagement specific to climate:
Like the manner in which attestation engagements may benefit from the auditor's knowledge obtained during the financial statement audit, the financial statement audit may benefit from the auditor's performance of an attest examination or review engagement given that it may assist with the identification of risks of material misstatement for the audit of the financial statements.[44]

Performing an attest examination or review engagement of climate-related information is a permissible service for the independent accounting firm performing the financial statement audit, subject to pre-approval from the audit committee.

44 PCAOB, AS 2110: Identifying and Assessing Risks of Material Misstatement, par .45.

Conclusion

With significant growing demand for reliable climate-related information set to continue, regardless of how the various regulatory developments proceed, it is important for auditors to understand and embrace the role they can play in an SEC registrant's reporting of climate-related information not only as it affects the financial statements and ICFR but also the separate, standalone reporting of climate-related information. Future publications in this series will highlight key actions auditors can take to prepare for these evolving roles.

It is important for auditors to understand and embrace the role they can play in an SEC registrant's reporting of climate-related information.

Appendix A: Regulatory Developments

SEC PROPOSED CLIMATE RULES: *THE ENHANCEMENT AND STANDARDIZATION OF CLIMATE-RELATED DISCLOSURES FOR INVESTORS*

The SEC's proposed climate rules would require a domestic or foreign registrant to include certain climate-related information in its registration statements and periodic reports, like Form 10-K. The proposed rules would require a registrant to disclose information that would include the following, among other disclosures: [45]

+ Climate-related risks and their actual or likely material impacts on the registrant's business, strategy, and outlook.
+ Information about the oversight and governance of climate-related risks by the board and management.
+ The processes for identifying, assessing, and managing climate-related risks and whether those processes are integrated into the overall risk management system.
+ The impact of climate-related events and transition activities on the line items of the consolidated financial statements if the absolute value of the amounts are 1 percent or more of the related line item.
+ Scopes 1 and 2 GHG emissions (emissions from the company's own operations and indirect emissions from energy consumption). For certain filers the Scope 1 and Scope 2 GHG emission disclosures

45 US Securities and Exchange Commission (SEC), *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, Mar 2022, p 40 – 46.

would also be subject to limited assurance (i.e., a review engagement) during a phase-in period, followed by reasonable assurance (i.e., an examination engagement).

+ Scope 3 GHG emissions (all indirect emissions (not included in scope 2) that occur in the value chain of the company, including both upstream and downstream emissions), either if material or if the registrant has set a GHG emissions reduction target that includes its Scope 3 emissions.

+ Climate-related targets or goals. If the registrant has climate-related targets or goals (for example, if a company has made a commitment to be net zero by 2040), the registrant would disclose the scope of those activities, the planned time horizon, any interim targets and how the registrant plans to achieve its targets along with updates on progress.

Registrants would be required to electronically tag both narrative and quantitative climate-related disclosures in Inline XBRL. The proposed rules would include a phase-in for all registrants, with the compliance date dependent on the registrant's filer status.

EU CORPORATE SUSTAINABILITY REPORTING DIRECTIVE (CSRD)

The CSRD amends and significantly expands the existing EU requirements for sustainability reporting – both in terms of the number of companies in scope and the nature of the sustainability reporting. In addition to EU companies, the directive also applies to non-EU companies that generate net revenue of more than EUR 150 million and have a subsidiary in the EU that meets the criteria applicable to EU companies (i.e., are listed on an EU regulated market (except micro-undertakings) or are large companies, as defined)[46] or a branch in the EU generating more than EUR 40 million net revenue.[47]

Among other requirements, the directive calls for:[48]

+ reporting based on the double materiality principle (considering the impact the company has on sustainability matters and how sustainability matters affect a company's business development, performance, and position)

+ more detailed reporting requirements, and a requirement to report in accordance with mandatory European Sustainability Reporting Standards (ESRS), which include the following sections for each sustainability topic, including climate:

  - Governance
  - Strategy
  - Impact, risk and opportunity management
  - Metrics and targets

46 Large companies meet 2 of the following 3 criteria (per the Accounting Directive 2013/34/EU):
Greater than 250 employees during the financial year
Total assets exceed EUR 20 million
Net revenue exceeds EUR 40 million.

47 Official Journal of the European Union, *DIRECTIVE (EU) 2022/2464 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL* and Accountancy Europe, *FAQs: all you need to know about the Corporate Sustainability Reporting Directive*, Nov 23, 2022.

48 Ibid.

- disclosures to be included within a dedicated section of the management report (similar to the US annual report)
- limited assurance of reported information initially and later reasonable assurance of the reported information (after assessing whether reasonable assurance is feasible).
- companies to digitally ‘tag’ the reported information, so that the information is machine readable.

Reporting for the first companies in scope comes into effect from January 1, 2024 and additional reporting for non-EU companies with branches/subsidiaries come into effect from January 1, 2028.

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