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Dear Olivier

How to respond to assurance needs on non-financial information

We[1] welcome this opportunity to comment on your discussion paper and to share our experience of services to build confidence in non-financial information (NFI), including assurance in the context of ISAE 3000. Our response reflects on the mandatory assurance of non-financial statements resulting from the implementation of the EU directive on non-financial reporting in Germany as well as the voluntary assurance and other related services we provide on NFI, across Europe.

NFI is used in this letter to describe information sets that sit outside of the financial statements (both metrics and statements). These often have a financial impact (in the short, medium and/or long term) and include environmental, social, governance, as well as operational (including non-GAAP) information.

While, there has been significant progress in the development of NFI reporting frameworks and practice, it is still a nascent form of reporting. Therefore, it is important that as a profession, we are innovative and can respond to the need for confidence in NFI even where this is based on immature systems and processes and assurance is not possible. We discuss in an attached document how we do this with our reporting insights model (see 'Detailed Comments on *How to respond to needs for assurance on non-financial information*').

Given the evolving nature of NFI reporting, it is critical that companies are supported to explore how best to tell their own, holistic story without assurance becoming a restricting factor. So, care is needed to avoid creating the expectation that all NFI can or should be assured as that risks companies reporting what is easy rather than what matters.

[1] This response is being filed on behalf of the network of member firms of PricewaterhouseCoopers International Limited and references to "PwC", "we" and "our" refer to the PwC network of member firms.

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For example, we have heard from clients about a misalignment between management information and reported NFI that can occur, because of this assurance expectation, and this does not serve users well. Where assurance can be given, the relevance and balance of the NFI selected for assurance are key.

In our view there will be significant technological advances in the medium term that will facilitate more meaningful NFI metrics (while also raising new challenges for building confidence in it). A growing number of organisations – technology companies, investment groups, data aggregators – are driving a move towards a more diverse and fluid information environment. New solutions to building confidence will also emerge from these technological advances, including the use of the increased processing and analytical power to collate and analyse huge volumes of data from multiple sources to corroborate data.

The attached document has been prepared by experts from PwC member firms across Europe. It contains detailed comments on the current practical challenge our teams face with the key steps for NFI assurance engagements highlighted in your paper. Experts from our network would be pleased to meet with you and elaborate on our responses. If a conversation would be useful, then do not hesitate to contact Superna Khosla (superna.khosla@pwc.com) or Alan McGill (alan.mcgill@pwc.com).

Yours sincerely

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Detailed Comments on ‘How to respond to needs for assurance on non-financial information’

1. Defining the scope: challenges and solutions

We are currently performing more limited assurance engagements than reasonable assurance engagements. This is largely due to the relative cost of reasonable assurance against the benefit perceived by the market today. As underlying NFI reporting systems mature, the quantum of work required for reasonable assurance may reduce resulting in increased demand. Additionally, as NFI becomes more embedded in the decision making of management, investors and other stakeholders, there will be a shift in needs, towards more reasonable assurance. At the same time, as we note above, rapid technological advances might open up alternative sources of confidence.

1a) Before external assurance

As a precursor, given the developmental stage of much NFI, other services include assurance readiness, maturity assessments, and insight reports (which we discuss further at no 5 below). This enables the selection of limited or reasonable assurance (or something else).

Where companies have previously worked with firms who are not professional assurance firms (‘boutique firms’) there can be an expectation gap. They may previously have received reasonable assurance reports. In our view, this is not always required – the objective being to provide assurance on material information and not the whole report, necessarily. Also, our readiness assessments might show that assurance itself is not possible or that if reasonable assurance is given the costs will outweigh the perceived benefits (e.g. due to the need for high testing samples because of lack of automated systems).

Before external assurance is feasible, we might advise management:

- to perform their own due diligence (through internal audit, management review etc.), or
- to consider how their NFI is corroborated through reporting with others/relevant NGOs they are working with or
- to obtain private assurance (independent reporting to management or agreed upon procedures) to help them develop their systems, processes and controls before considering external assurance.

We often provide assurance over processes and management’s adherence to relevant industry protocols in the first instance to enable some confidence for users. However, the challenge over the quality of data may remain (i.e. what is input into the process impacts the integrity of data).

1b) Reporting boundaries

Current practices vary and we see that where the NFI sits can have a bearing. For example in a number of territories where NFI is contained within annual reports, it often mirrors the reporting boundaries of the financial statements (based on control etc.). While we are seeing more reports using the international integrated reporting framework that extends reporting boundaries beyond traditional financial boundaries, practice here is still at a nascent stage.

However, the focus on outcomes reporting will only increase and we believe the trend for NFI is towards the expansion of reporting boundaries along the supply chain. The assurance challenges that arise from this include assessing the reasonable extent of the reporting boundaries – at what point the outcome (and not the output) can be measured and still be attributed to the company. The extent of the reporting boundaries will not always be comparable between companies, as this will depend on individual value creation models as well as practical considerations regarding the availability of information. A further challenge lies in understanding the different criteria sets for data along the supply chain – where in some cases the company itself will not be controlling/generating that information.

This opens up a number of big questions for the profession: as we consider the reporting of the supply chain performance, at what points will confidence be needed and who will be responsible for enabling it?

2. Assessing the subject matter for assurance: challenges and solutions

We provide assurance on a range of subject matters including activities, processes and on metrics and statements that may be contained in the following:

1. The non-financial statement introduced by the EU directive for NFI (separate or incorporated in existing annual/sustainability/integrated reports), assurance on which is mandatory in some of our territories.
2. Multi-issue reports (voluntary or part mandatory) - sustainability reports/corporate responsibility reports, integrated reports.
3. Single-issue reports (voluntary or part mandatory) such as human rights, gender pay gap, GhG statement, prompt payments, and taxes paid etc.

There is also an increasing demand for building confidence in non-GAAP and other data sets that influence markets. For example with platform businesses, the focus shifts away from goods and services and the typical units of analysis (revenues, profits, inventory), to metrics focused on interaction failure, engagement and network effects etc.

2a) Relevance and balance: connected to the core

Fundamental to our assessment of the subject matter, is its relevance to and the balance within an overall report/statement. To foster trust in NFI, it is key that the subject matters selected for assurance, are core to company strategy, the business model and what drives value creation, and take into account the expectations of key stakeholders. Understanding the rationale for what is left out is as important as understanding what is to be included. This avoids perceptions of 'cherry-picking' and requires professional scepticism to challenge companies' views. We often take the materiality analysis as a starting point to identify the subject matter and assess the rationality of the engagement.

While we are beginning to see greater integration of management information, in a majority of cases this is not the case. This creates further challenges in assessing the relevance of the subject matter.

In any new assurance guidance, consideration should be given to embedding the rationality for NFI selection.

Other related challenges include a lack of clarity in the definition of the indicator and the sufficiency of supporting evidence. In many cases, indicators are based on manual ad hoc processes and excel spreadsheets, rather than being generated by the company's core accounting/reporting systems, impacting our materiality assessments (as discussed below).

2b) Completeness

A key challenge for NFI assurance is the 'single-entry' nature of the accounting, which creates inherent limitations in respect of how we test the completeness of a number of data sets.

2c) Forward looking information

There is an increasing focus on forward looking information in reporting, driven by stakeholder expectations to understand leading rather than lagging indicators and supported by frameworks such as that for integrated reporting. Currently, this information is typically not part of our ISAE 3000 assurance engagements but, as a profession, we do need to innovate to provide confidence in these areas. It will require greater emphasis on the expertise brought to bear in management's estimates and on understanding the company's culture, values and behaviours.

2d) Assurance and meeting stakeholders' information expectations

We believe there is a balance to be struck so that comprehensive reporting on relevant issues is not compromised. The very nature of many of the subject matters in NFI means that underlying judgements are subjective and the systems and processes may still be in a nascent stage. We, as a profession, have to be careful not to create the expectation that everything can be or should be assured.

We think it is critical that there is innovation by assurance providers in other ways of enhancing the credibility of such information. Otherwise, there is a risk that the greater expectation for assurance halts progress in reporting as key indicators stop being reported (if they can't be assured). We already know from our engagement with investors, that there is a wide gap between what investors think is important in this area (understanding the business model and what drives value creation) and the effectiveness of current reporting on these matters.

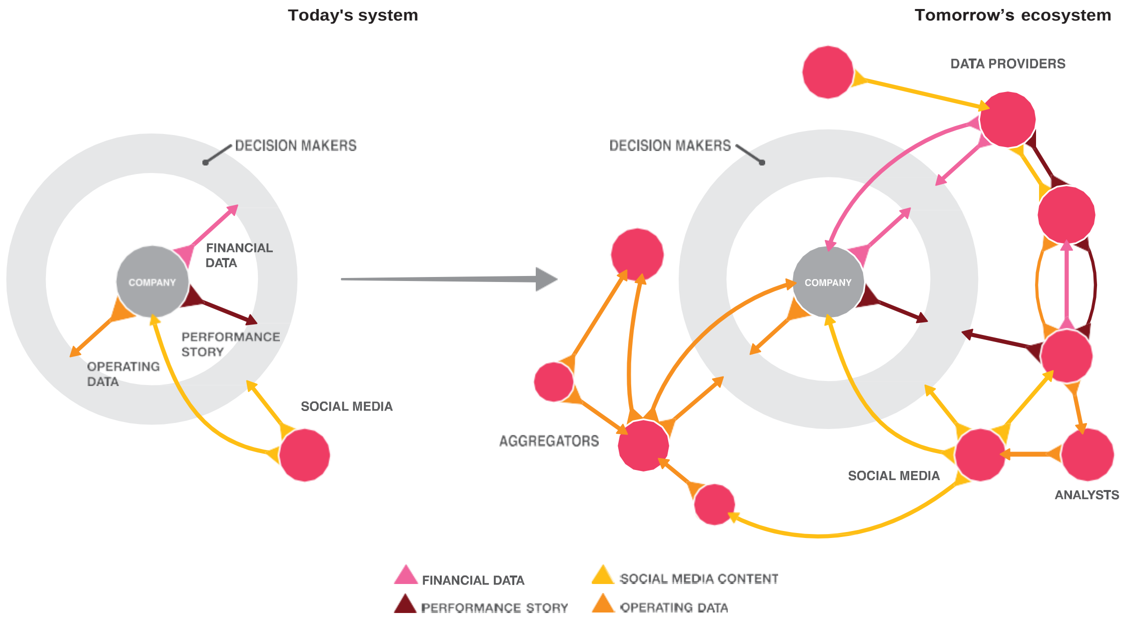
Below (at no. 5), we discuss how our insights model can enable investors and other stakeholders (both external and internal) to have confidence in more holistic reporting that may be in an embryonic/ maturing stage (i.e. not suitable for assurance).

2e) An eye to the future: Assessing subject matter in tomorrow's world of technological advancement

Notwithstanding that in a number of cases, there are immature NFI reporting systems today, companies are facing technological advances that are unprecedented in their speed and impact.

This is enabling their management teams to access data from an expanding array of internal and external sources (see figure below). Significantly, the subject matters that we, as a profession, will be asked to assess, may not relate to data controlled or generated by the company. These developments will require new approaches to enabling confidence alongside more established methods such as independent assurance.

Today's company generated data will be supplemented by data from multiple sources



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We think what will be markedly different to today's assurance model is how, when, by whom and for whom confidence is enabled. Artificial intelligence, for example, will help to highlight unexpected or outlying data and provide reassurance to users, while machine learning will process data to make better decisions. However, technology will also raise questions about trust. For example, as the use of algorithms grows, people will want confidence in how these work. Is there bias in the formulation? Is it aligned with the values, ethics and expectations of the decision-maker, be it the company or the customer? How reliable is the information feeding the machine learning – and how do we know? Thus, we will see a much broader spectrum of subject matters. We discuss this further in our publication, Tomorrow's World [2].

3. Reporting criteria: challenges and solutions

There is little standardisation here. While there are some national codes to support criteria development, these are typically at a very high level. Most frequently, GRI definitions for specific indicators are used as reporting criteria. This is often supplemented by company designed criteria.

While transparency is critical, this has to be balanced with understandability. The challenge is how much of these criteria should be made publicly available. There is a range of practice from simple statements of reference to GRI to more comprehensive disclosure that can run to two pages per indicator within the report or referenced to a website. The quality of language also can vary from very specific criteria to broad-brush statements that can restrict what can be assured.

For instance, the choices that clients make within GRI criteria provide a flavour of the subject matter that can be material to the user so disclosure of the rationale for the selection is important. We see deeper disclosure, however, where criteria are self-designed and not GRI based.

Overall, the criteria is not as mature as with financial statements and while there needs to be greater alignment in the available protocols, we do think that it is key that management tell their own NFI story. In our response to the IAASB consultation on EER assurance (February 2017) we noted that investors worry about the assurance model in and of itself inhibiting corporate reporting by restricting companies to report within defined constructs (criteria). We believe that there is a real risk that a more defined assurance standard –with its need for defined criteria – may inadvertently stifle the experimentation and innovation needed in both companies' reporting and the assurance, that might best meet companies' and users' needs in the evolution of it.

4. Our experience in performing materiality assessments on NFI

GRI guidance is often the basis for companies' own assessment of materiality. With the implementation of the EU directive for NFI we are seeing companies in some countries increasingly considering the impact on society and making assessments in that light. This is still quite a new area for many and practices are slowly developing which we are supporting with internal cross management/board level workshops etc. The factors we consider include:

- The relevance of the indicators for a specific company/sector, based on different sources (materiality study of the company, SASB and GRI indicators for the sector, etc.).
- The output of companies' stakeholder dialogue. The quality can vary significantly here. A further challenge is judging what the frequency of extensive stakeholder dialogue should be (e.g. is a 3 year cycle with media and peer group updates in between sufficient?).
- Risk of error – see comments above under no 2, in respect of manual processes.

This leads to interesting conversations at board and supervisory board level to put the selected NFI in the context of corporate strategy, linked sustainable development goals etc. and raises questions of the depth of integration and relevance.

As with financial information, materiality is considered individually for each data set, to understand the impact on the intended user. Unlike financial information where investor primacy is more firmly grounded, there will be a number of different users and, in the short-term, their needs may not be aligned. Materiality will also vary by sector (for example, carbon emissions – a 10% sway will be more significant for the energy sector receiving subsidies than a professional services company).

5. Considering the maturity of the company's reporting systems

We have talked above about the challenges of immature systems in identifying suitable subject matter and of the need to build confidence, nonetheless. Our response is the insights model that provides investors and other stakeholders with transparency on the maturity (embryonic, maturing, mature) of the information they are using and its sources.

It gives users the choice of what to rely on and what to question further, focusing on the following aspects:

- Measurement certainty – whether the metric is clearly defined, how it is calculated (noting the rationale for the starting point for any reconciliations) and the strength of assumptions used.
- Reporting frameworks – whether a reporting framework has been used (and if so, which components of the metric are derived from it and which are not) and the process and governance behind the development of the framework.
- Integrity – the integrity of any systems, processes or controls used to generate, manage or report the information.
- Consistency – consistency in derivation and reporting over time, with peers and in both internal and external reporting (noting the rationale for any changes in calculation or the introduction or removal of a metric).
- Transparency – the extent to which the performance metrics are reported internally to the board and disclosed externally, noting the rationale for using the metric (e.g. rather than an accounting metric).
- External validation – whether the metrics were subject to any form of independent assurance.

These reports are prepared for management and can be used internally or made publicly available [3].

Our investor interviews have highlighted the following as key concerns on non-GAAP measures that assurance and other ways of building confidence need to respond to:

- Perceived positive bias: if a company excludes a cost, it should also exclude the revenue or benefit associated with that cost (e.g. exclude the benefits of restructuring when backing out restructuring charges).
- Lack of transparency about how they are calculated: Descriptions of adjustments are often too broad to understand what they relate to and are not granular enough to allow analysts to create equivalent earnings measures. Non-GAAP adjustments can therefore distort earnings comparability across companies and over time.
- Inconsistencies over time, lack of comparability across companies: there is sometimes a lack of logic about the items selected for adjustment (e.g. a pharmaceutical or technology company that acquires in-process R&D as part of its business model should explain why management considers it to be 'non-core').
- Lack of understandable and granular reconciliations to accounting numbers (for accounting-based metrics): analysts perceive non-GAAP data to be more reliable when companies provide a quantitative reconciliation – but the fact that reconciliations are quantified does not mean that the adjustments made are appropriate.

While NFI is less mature than financial information, we find that NFI linked to financial information is often better controlled and companies that embed NFI in financial reporting have better controlled NFI. Reporting solutions include embedding NFI in ERP-systems, consolidation-systems, monthly and quarterly reporting and dashboards, linking NFI to remuneration.

Technology however is moving at a fast pace and while we still see a lot of information sitting outside of ERP systems, we anticipate that information both generated by the company and by others down the supply chain will result in much more free flowing information. This will provide new confidence challenges. We have considered this in our piece on Tomorrow's World, referred to above (no. 2).

6. Form of the assurance report

Our experience varies between territories and is guided by ISAE 3000, national level accounting bodies' templates as well as our own risk management protocols. Often, there is a preference from companies for short form but this is not always appropriate especially where there is a greater presence of inherent limitations. We consider that there is interest from users for insights in the report, arising from our work. The direction that audit reports have taken with the Key Matters section, may be useful in the context of NFI also. Currently, there is some scope for greater insights with limited assurance (e.g. the work done descriptions can give added colour and context for users). Occasionally we will issue reports covering both reasonable and limited assurance.

We engage frequently with investors and believe there are still misconceptions over assurance reports that require us as a profession to do more to explain what is audited, what assured, the differences between limited and reasonable assurances as well as providing sufficient insight for users.

References:

1. Over 60% of investors cannot say that 'I have enough trust in the information companies report on strategic goals, risks and key performance indicators for me to be confident in my analysis and decision making.' PwC Global investor survey on corporate reporting, Nov 2017. https://www.pwc.com/gx/en/services/audit-assurance/corporate-reporting/investor-view/global-investor-survey-on-corporate-reporting.html
2. Tomorrow's World, July 2017 https://www.pwc.com/tomorrows-world
3. Example of PwC insights report – The Crown Estate https://www.thecrownestate.co.uk/our-business/total-contribution/pwc-insight/