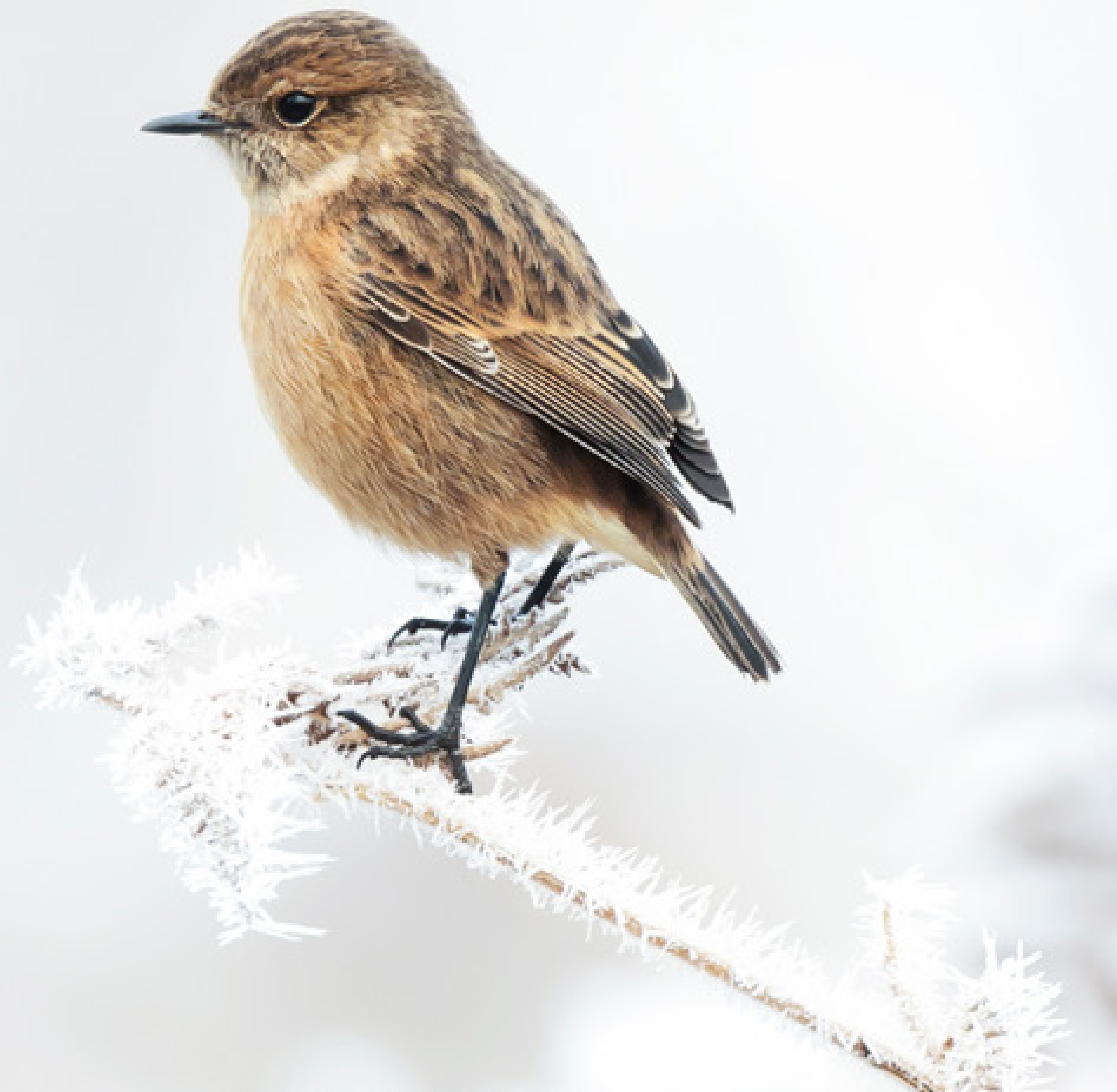
CHAPTER 2

Ethics consideration in sustainability reporting

This article aims to:

- Provide guidance on the challenges with respect to consideration of professional ethics in sustainability reporting.



Background

Stakeholders are now focussing on information that provides a better understanding of an entity's long-term value creation goals. This helps them to allocate capital to businesses that are striving for sustainable rather than just focussing on financial metrics. This has led to an increase in demand for timely, accurate and relevant sustainability information[1]. Many countries across the globe are adopting mandatory reporting and disclosure of sustainability related information.

The accountancy profession plays a major role in sustainability reporting from the perspective of technical competency in preparing, presenting, and assurance. While global sustainability reporting standards will be essential to meet the information needs of investors and other stakeholders, it is critical to recognise the role of ethics in supporting public trust in sustainability reporting and assurance. The International Ethics Board of Accountants (IESBA) develops and promotes the International Code of Ethics for Professional Accountants (the Code) by setting high-quality ethics standards for professional accountants.

In October 2022, IESBA issued a non-authoritative publication in the form of Questions and Answers (Q&A) which highlights the key principles in the Code that apply in preparing and presenting sustainability information. The publication highlights professional accountants' obligations and assists them in navigating situations relating to ethics or challenges that might lead to reporting misleading or false sustainability information. This document is also useful for other professionals involved in preparing sustainability reports or disclosures including regulators and audit oversight bodies, policy makers, investors, Those Charged with Governance (TCWG), national standard setters, professional accountancy organisations, and others working towards sustainability reporting and assurance.

1. The term 'sustainability' refers to Environmental, Social and Governance (ESG) matters and related considerations associated with the achievement of the United Nations Sustainable Development Goals (SDGs)

Key concepts

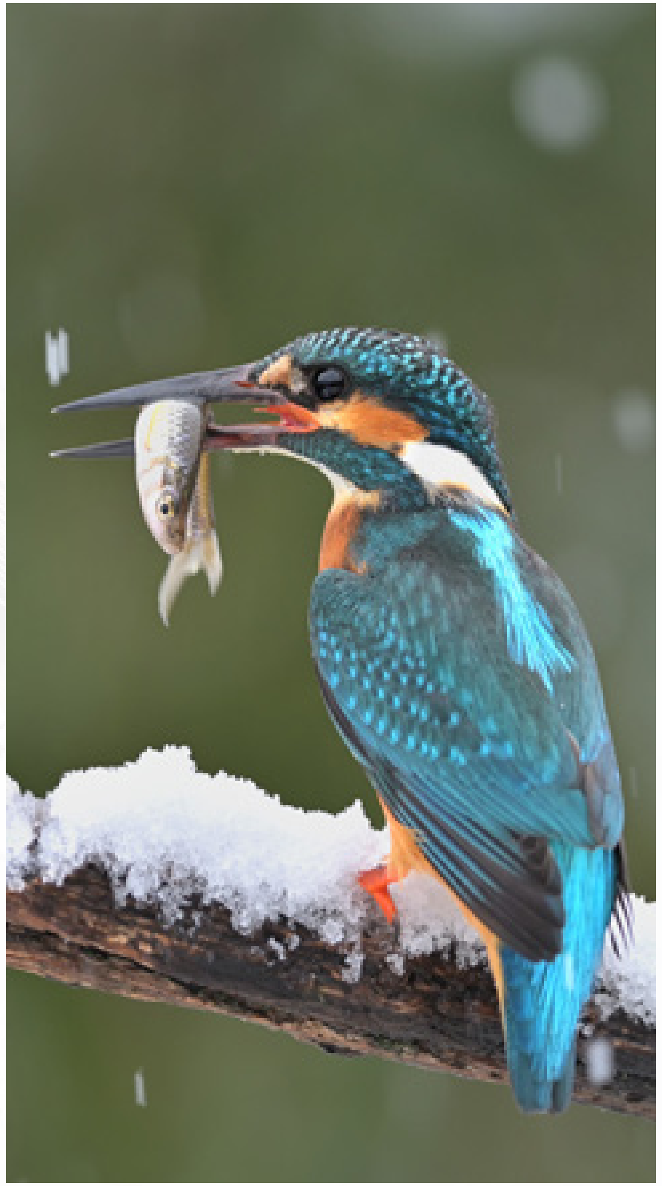
The key concepts highlighted in the publication are as follows:

Application of the code to financial and non-financial information

The Code provides that a professional accountant must act in public interest while accepting any engagement. Professional accountants should adhere to the ethical principles and professional standards, use business acumen, apply expertise on technical and related matters and should exercise professional judgment in order to provide advice or other output that meets the purpose of the intended users of such output.

The financial and non-financial information including sustainability information, may assist stakeholders in understanding and evaluating an organisation's state of affairs and in making decisions concerning an organisation. The professional accountants must comply with the fundamental principles[2] of the Code while preparing and presenting sustainability information.

2. Section 110 of the Code describes the five fundamental principles of ethics for professional accountants. These include:
   a) Integrity
   b) Objectivity
   c) Professional competence and due care
   d) Confidentiality
   e) Professional behaviour



Preparation, presentation and reporting of sustainability information

In the recent years, a number of sustainability reporting frameworks and standards have been developed, majority of which deal with disclosures on ESG matters. The multitude of voluntary reporting standards and the fact that these can have different target users and scope as well as different definitions, formats and metrics, could create challenges with regard to comparability across different voluntary frameworks.

The Code specifically requires professional accountants to prepare and present sustainability information in accordance with the relevant reporting framework, where applicable. In cases where a sustainability reporting framework is not applicable or when the reporting framework does not include specific industry-related guidance, there is a possibility that some companies may choose to disclose certain ESG-related matters (e.g., carbon emissions) while omitting others (e.g., human-rights-related issues or information about diversity, equity and inclusion) or selectively disclose the risks. Therefore, the Code states that, when disclosure of particular aspects of sustainability performance is not required or is not standardised, professional accountants should exercise discretion in making professional judgement to prepare and present sustainability information. A professional accountant should consider following key points from the Code[3]:

a. Understand the purpose for which the information is to be used and the context within which it is given

b. Aware of its intended audience

c. Relevant background, assumptions and other disclosures should be provided to enable the intended users to make their assessments.

d. Industry specific information should be considered

e. Not to omit anything with the intention of misleading the intended users

f. Represent the facts accurately and completely in all material respects, describe the true nature of business transactions or activities and classify and record information in a timely and proper manner

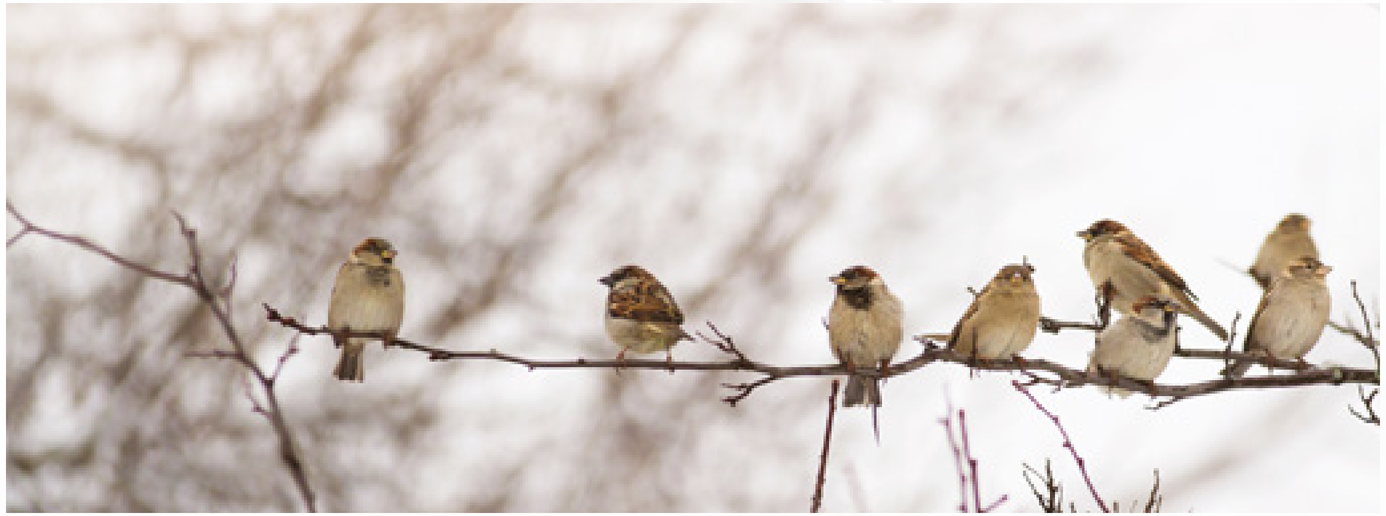
g. Discretion in making judgement should not be exercised with the intention of misleading others or influencing contractual or regulatory outcomes inappropriately.

Challenges and safeguards with regard to ‘greenwashing’

The term ‘greenwashing’ has not been defined in the Code. The International Organisation of Securities Commissions’ (IOSCO) publication on Sustainable Finance and the Role of Securities Regulators[4], defines greenwashing as practices that involve disclosing information which would result in misleading the intended users or intentionally giving them a false impression about how well an organisation or an investment is aligned with its sustainability goals. Greenwashing covers more specifically a range of behaviours, from omitting information to misrepresenting or falsifying it with an intent to mislead investors and other users. In some cases, greenwashing might result in non-compliance with laws and regulations.

The entities should develop well-functioning systems, processes and internal controls to accurately collect and report sustainability information. It is pertinent to note that, although obtaining an external assurance can reduce the risk of reporting misleading information, considering the nascent state of ESG (Environmental Social and Governance) reporting and assurance standards, assurance alone cannot prevent greenwashing or act as a safeguard against greenwashing.

The Code highlights that the professional accountants should disassociate themselves from misleading information as threats to compliance with the fundamental principles of objectivity, professional competence and due care and professional behaviour can be created.



3. As per paragraph R220.4 (b) and (c), R220.5, R220.6 and R220.6 A1 of the Code.
4. IOSCO publication no. FR04/2020 issued in April 2020

Other matters

Professional competence, expertise and experience

A professional accountant should be professionally competent and should have the relevant expertise and experience when dealing with sustainability reporting requirements, measurements and evaluations. A professional accountant should comply with the fundamental principles of professional competence and due care.

However, if a professional accountant does not have the relevant sufficient expertise, it would result in creation of self-interest threat. Obtaining assistance or training from someone with the necessary expertise might be an appropriate safeguard to address the self-interest threat. However, if the self-threat cannot be addressed, the Code requires a professional accountant to consider declining the performance of his/her duties in question. If the accountant determines that declining is appropriate, the reasons for such decline should be communicated.

Verification of sustainability information

Certain companies may make misleading or inaccurate claims about their sustainability performance without providing evidence for such claims. Professional accountants must not accept the sustainability information at face-value. The Code requires an accountant to have an inquiring mind to obtain an understanding of the known facts and circumstances. The professional accountant should take note of the following principles:

- Consider the source, relevance and sufficiency of information obtained
- Be alert and open for further investigation or other action, where required

The Code provides guidance to assist professional accountants in considering the source, relevance and sufficiency of information obtained. The matters to consider include new information that has emerged or any changes in the facts and circumstances, information or source should not be biased or possibility that potentially relevant information might be missing from the facts and circumstances, etc.

Communication with TCWG

TCWG, including audit committees, play a vital role in enhancing the quality of corporate reporting, and determining the strategy, risks and opportunities relating to sustainability. Effective communication with TCWG provides enhanced transparency and contributes to promoting an ethical culture in an organisation, especially when leaders within the organisation hold themselves and others accountable for demonstrating ethical values. When communicating with TCWG, a professional accountant should determine the appropriate individual(s) within the entity's governance structure with whom to communicate considering the nature and importance of the circumstance and the matter to be communicated. The Code states that, communication with TCWG would help in evaluating threats to compliance with the fundamental principles or in resolving specific issues pertaining to greenwashing risks, such as:

i. Pressures on individual involved in sustainability reporting to meet internal or external ESG targets, goals and expectations and the consequential risks

ii. Misleading information about sustainability should be communicated to the TCWG and they should be requested to take appropriate action to resolve the matter

iii. Non-Compliance with Law or Regulations (NOCLAR) related matters, including actual and suspected matters should be communicated to TCWG.

Bottom line

As sustainability reporting is an emerging area, there are many challenges regarding the quality of information being reported and information being reliable. This occurs because such information is often based on forward-looking data instead of historical trends and is subject to higher levels of estimation uncertainty and volatility. Further, organisations may lack mature systems, processes and internal controls to accurately collect and report the required information. Considering this, the IESBA Code sets out the fundamental principles of ethics, provides a robust ethical framework for sustainability reporting and assurance engagements. IESBA is now working towards a project plan for a timely delivery of profession agnostic ethics (and independence) standards so as to create an infrastructure for sustainability assurance engagements. In India, the Code of Ethics issued by Institute of Chartered Accountants of India (ICAI) is applicable, which is largely aligned with the provisions of IESBA's Code of Ethics