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ESG REPORTING WITH MANDATORY AUDIT

Companies required to provide an ESG report from 2025 will have to have it audited by an independent auditor. This is stipulated by the European CSRD on Sustainability Reporting, which is being transposed into Slovak legislation through an amendment to the Accounting Act. What does this mean for companies?

IDEAL COMBINATION: AUDITOR FOR BOTH FINANCIAL AND NON-FINANCIAL AUDIT

If a Slovak subsidiary has a parent company in the EU and the latter prepares a consolidated sustainability report according to CSRD directive, the Slovak company does not have to. This exemption does not apply to Slovak companies with a parent company in the U.S. or an Asian country. If such companies meet at least two of the three criteria, i.e. assets worth over EUR 20 million, net turnover over EUR 40 million, number of employees over 250, they will have to prepare and audit their sustainability report separately.

For companies that are required to undergo both financial and non-financial audits, it is ideal, and probably the best financial solution, to have both audits performed by the same company because of synergies. Crucial is to have the audit company ready as early as possible, as the audit process requires intensive work over several months during this year. What is prohibited is, the same firm or two firms from the same network provide compiling and then auditing an ESG report.

ESG DATA COLLECTION: COMPANIES MUST REPLACE MARKETING REPORT WITH HARD DATA

Whereas until recently, reporting on environmental, employee relations and governance activities was essentially a “loose discipline”, the introduction of the CSRD has brought about a fundamental change in the quality of ESG reporting.

> **Whether a company operating in Slovakia will compile an ESG report or not, the ESG data collection itself cannot be avoided.**

The ESG Reporting Standards strictly define what companies must track and report. Like financial statements, reporting on sustainability information will have to follow reporting standards that define the rules, procedures, areas and method of reporting data. This is undoubtedly good news for companies’ customers and business partners, as the standardized criteria confirmed by an external auditor have significantly higher informational value and credibility.

Whether a company operating in Slovakia will compile an ESG report or not, the ESG data collection itself cannot be avoided. It will either need the data itself or it will be required by its parent company, which will take over reporting at the group level. Firms should have been collecting data for several months. If they haven’t started yet, it is high time, as they will be needed for the first report in 2025.

THE AUDIT OF AN ESG REPORT RESEMBLES A TRADITIONAL FINANCIAL AUDIT IN MANY WAYS

How will such audits be conducted? The auditing standards for verifying sustainability information are not yet finalized. Only a draft of the ISSA 5000 standard has been published, which is still subject to change. However, it is already evident that ESG report audits will resemble traditional financial audits in some ways. The risk assessment procedures that are usually carried out in pre-audits, the discussion with management, the assessment of the internal control system, all this will also be carried out in ESG report audits. As with financial audits, companies will submit a prepared ESG report to the auditor together with relevant supporting documents, i.e. calculations, certificates, measurements and records, external confirmations, etc.

Some companies mistakenly believe that the auditor will measure or calculate, for example, CO_2 emissions instead of the company. This is not the case, in the same way that the auditor does not calculate provisions or reserves instead of the audited entity.

DIFFERENCES FROM A FINANCIAL AUDIT

The types of information to be verified in a sustainability audit will be radically different from a traditional financial audit. These will include various indicators from different ESG areas, information on the company’s processes, strategy and objectives in ESG areas. Auditors will also assess whether sustainability information is misleadingly reported, whether important information has been omitted, etc. It will therefore be very much an entirely new discipline for auditors. It will also depend on how the concept is put into practice, as the processes and methodology of sustainability audits will certainly evolve in the early years. The audit of ESG reports will not aim to assess the impact of measures on company performance. On the contrary, it will be a very precise snapshot of the quantitative fulfilment of specific parameters, such as the ratio of men and women among employees. These areas of reporting are precisely enumerated in the ESRS standard. At the same time, the audit will also include qualitative information that describes the company’s strategy and objectives for changing the parameters mentioned above, for example, achieving the specified emission reductions by a specific year.

HOW WILL THE NON-FINANCIAL AUDIT BE CONDUCTED?

The auditor will analyze the sustainability information presented in the ESG report and examine whether it provides a true and fair view of the company. They will check selected samples to ensure the information reported is correct and based on real and true information. For example, in the case of the calculated carbon footprint, the auditor, with the assistance of a competent expert, will review all the company’s calculations and measurements. For reported information related to pay equity, the auditor will verify the calculations using employee lists and pay slips. In the case of reported energy consumption data, verification will be done at the level of the relevant meter records, and so on. The auditing principles are therefore the same in a non-financial audit as in a financial audit, but the information to be verified is quite different and very varied.