Agenda Item 1-D

CREDIBILITY AND TRUST IN RELATION TO EXTENDED EXTERNAL REPORTING (EER)
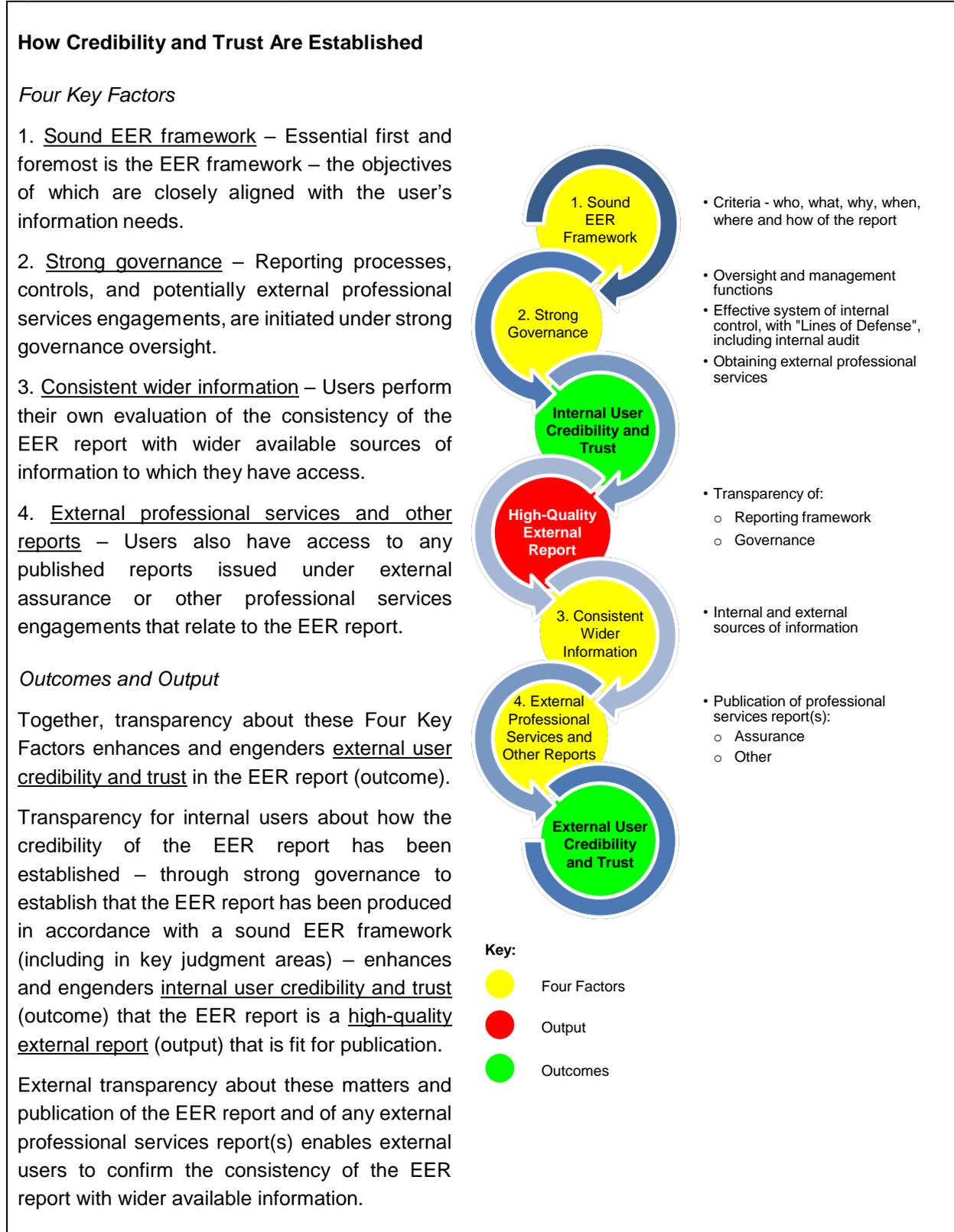
Introduction

1. This paper explores the concept of credibility and trust in relation to EER reports and introduces four factors which may enhance their credibility. It aims to show how external assurance may have a role as part of a wider context of factors which can support credibility, and therefore the users' trust in EER information.

2. The paper may be of relevance to assurance practitioners, preparers of EER, and users of EER.

3. Credibility is a user-perceived attribute of information that engenders in the mind of the user an attitude of trust in the information. Factors other than credibility can also affect user trust in information. For example, a strong track record of an entity delivering on its promises can increase trust, but a perception of self-interest – or conflicts of interest – by the entity can diminish trust.

4. In the context of EER reports, credibility is likely to be enhanced if there is:

    - A Sound EER Framework—which is transparent and in which the user has confidence that the output of applying the EER framework (the EER report) provides a sound basis for meeting their needs.

    - Strong Governance over the Reporting Process—which satisfies the user that robust processes and controls were applied with appropriate oversight, and that the people involved were competent and not influenced by conflicts of interest.

    - Consistent Wider Information—which satisfies the user that the EER report is internally consistent and consistent with the user's wider knowledge.

    - External Professional Services and Other Reports—independent external professional services reports and other external inputs relating to the EER report to which the user has access.

5. As these factors show, external assurance is only one means of enhancing the credibility of EER reports, and its benefit is greatest when the other factors are present too.

Four Key Factors

6. The four factors identified above that may enhance the credibility of EER reports are illustrated in Figure 1 and discussed below. We refer to these as the "Four Key Factors".

Figure 1: Overview of Credibility and Trust

How Credibility and Trust Are Established

Four Key Factors

1. Sound EER framework – Essential first and foremost is the EER framework – the objectives of which are closely aligned with the user's information needs.

2. Strong governance – Reporting processes, controls, and potentially external professional services engagements, are initiated under strong governance oversight.

3. Consistent wider information – Users perform their own evaluation of the consistency of the EER report with wider available sources of information to which they have access.

4. External professional services and other reports – Users also have access to any published reports issued under external assurance or other professional services engagements that relate to the EER report.

Outcomes and Output

Together, transparency about these Four Key Factors enhances and engenders external user credibility and trust in the EER report (outcome).

Transparency for internal users about how the credibility of the EER report has been established – through strong governance to establish that the EER report has been produced in accordance with a sound EER framework (including in key judgment areas) – enhances and engenders internal user credibility and trust (outcome) that the EER report is a high-quality external report (output) that is fit for publication.

External transparency about these matters and publication of the EER report and of any external professional services report(s) enables external users to confirm the consistency of the EER report with wider available information.

- Criteria - who, what, why, when, where and how of the report

- Oversight and management functions
- Effective system of internal control, with "Lines of Defense", including internal audit
- Obtaining external professional services

- Transparency of:
  - Reporting framework
  - Governance

- Internal and external sources of information

- Publication of professional services report(s):
  - Assurance
  - Other

Diagram elements:
- 1. Sound EER Framework
- 2. Strong Governance
- Internal User Credibility and Trust
- High-Quality External Report
- 3. Consistent Wider Information
- 4. External Professional Services and Other Reports
- External User Credibility and Trust

Key:
- Four Factors
- Output
- Outcomes

Factor 1: Sound EER Framework

7. Management is responsible for ensuring that the external report complies with an applicable EER framework. The user's perception of the credibility of an EER report can be influenced by the qualities and transparency of the EER framework used for its preparation.

8. A sound EER framework guides preparers in ensuring that the EER report is an effective communication and gives users confidence that the EER report will meet their needs. EER frameworks therefore typically address:

    - *Reporting Objectives*: intended users, scope and use (the who; the high level what, when and where; and the why of the EER report);

    - *Content Elements* to be included in the EER report (the more detailed what, when, and where of the EER report); and

    - *Qualitative Characteristics of the Information*, including:

        o   *Depiction Methods* for the content elements (measurements, quantitative or qualitative evaluation or assessment techniques, and descriptions) (the technical aspects of the "how"); and

        o   *Principles for Communicating* effectively in the EER report (the communication aspects of the "how").

9. The table below summarizes the characteristics of the features of an EER framework that are likely to engender credible reporting, and their relationship to the characteristics of suitable criteria set out in paragraph A45 of ISAE 3000 (Revised)[1].

Characteristics of an EER Framework that are Likely to Engender Credible Reporting	IAASB's Characteristics of Suitable Criteria
Has an objective that reflects the users' expectations as to the scope, intended users and intended use of the EER report	Relevance
Consistently includes and reliably depicts all relevant reportable content elements that are material to the intended users in the context of the intended purpose of the EER report	Relevance, completeness, reliability
Recognizes areas of uncertainty, ambiguity and judgment that give rise to inherently greater susceptibility to preparer bias risk and establishes adequate disclosure and neutrality principles to counter this	Neutrality, completeness
Promotes transparent (open), clear (unambiguous) and concise (readily understandable) reporting of these matters, and enables effective comparability both with other pertinent entities and over time	Relevance, reliability, understandability

---

[1]   International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

10. The credibility of EER reports can also be enhanced when there is user confidence in the quality of the EER framework applied because:

- The due process for developing the EER framework involves interaction with stakeholders to ensure that the interests of the intended users and other stakeholders are appropriately reflected;

- There is effective governance over the development of the EER framework that addresses potential conflicts of interest; and

- The EER framework is well-known, commonly understood, and has broad stakeholder acceptance.

11. The objectives of different EER frameworks can vary significantly. The closeness of fit between the objectives of the EER framework and the user's needs is an important credibility factor. Transparency about the reporting objectives is therefore important.

12. Where EER frameworks specify content elements and depiction methods, this can drive consistency in reporting but may also limit the ability of the preparer to tailor the EER report to the entity's specific circumstances. Where such tailoring is important in meeting the reporting objective, EER frameworks may specify principles-based requirements for judgments by preparers to determine relevant content elements or depiction methods.

13. Where applicable, the need for such judgments and the potential for ambiguity in those criteria may make the EER framework inherently more susceptible to the risk of preparer bias. For example, under a principles-based requirement:

- Identifying content elements and depiction methods can involve significant judgments about what to report and the appropriate depiction methods to use. Clear principles for determining these matters (such as a strong materiality principle and a requirement for stakeholder engagement to enable it to be applied effectively), and transparency about these matters and about the processes to implement them, can be important credibility factors for an EER report.

- Applying depiction methods can involve addressing significant uncertainties in making estimates and qualitative evaluations or assessments and can therefore require significant judgments by preparers. EER frameworks may address such uncertainties and judgments by requiring related disclosures and by establishing a neutrality principle to be applied in making such judgments to counter the inherently greater susceptibility to preparer bias risk.

14. The existence of a multiplicity of EER frameworks covering similar areas may lead to confusion amongst users of EER reports, and may also reduce the ability of users to compare entities effectively.

Factor 2: Strong Governance

15. Strong governance includes sound governance structures that oversee a strong internal control system, including effective risk management and high-quality reporting processes. Management and, in some jurisdictions, those charged with governance (TCWG)[2] are responsible for establishing internal control as necessary to ensure that the information in the EER report is reliable and available

---

[2] See the *Glossary of Terms* in the IAASB Handbook. For some entities in some jurisdictions, TCWG may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

on a timely basis. Management or TCWG may be required to, or may voluntarily make, an explicit assertion in the external report on their responsibility.

16. The competence and accountability of management and TCWG is therefore an important element of the strong governance which is required to enhance credibility and trust. Underpinning this is a need for preparers to behave in a way that is consistent with the spirit of the objectives of the relevant EER framework to present EER information faithfully and without bias. In some circumstances, the use of external specialists may be appropriate, and may enhance credibility further.

17. Oversight by TCWG, who are responsible for overseeing the strategic direction of the entity and its obligations related to accountability, includes overseeing the entity's external reporting process, which may historically have been primarily focused on the financial statements. The responsibilities of TCWG may become broader as EER continues to evolve. In listed companies and other large entities, much of the work related to overseeing the entity's external reporting process is often undertaken by an audit committee. A transparent and constructive relationship between management and TCWG will enhance credibility of the external report. In executing their responsibilities, TCWG (including audit committees where they exist) may engage with intended users to obtain their perceptions of the usefulness and quality of external reporting.

18. Some entities also have as part of their governance process a separate disclosure committee that assists the Board of Directors and the audit committee in preparing the required disclosures and helps ensure that an entity's disclosure controls and procedures are properly implemented. These activities help to support the quality of external reporting.

19. A strong internal control system is founded on:

- A control environment in which the oversight function (TCWG) and management actively support high-quality external reporting, and embed a culture in the entity that engenders effective internal control;

- An effective information system for obtaining and processing relevant data and information of sufficient quality to support decision-making to enable the depiction of content elements;

- Identification and assessment of risks that may threaten the quality of external reporting and the design, implementation and effective operation of appropriate responses in the form of control activities;

- Regular overall monitoring of controls to determine that such controls are effective; and

- Adequate information and communication, including more broadly on the business processes.

20. Many entities use internal audit for their operational audits or to assist in the audit of the external reporting process or the external report itself. Internal auditors are also exploring how their role may evolve along with the maturity of the EER processes within the entity.[3] Professional services providers may also be engaged to perform assurance engagements or other external professional services, reporting to TCWG, to support internal credibility and trust in the EER reporting process or in the resulting EER report.

21. Stakeholder engagement also forms an important part of governance processes, informing an entity's strategy and identification of material issues for disclosure.

---

[3]   Institute of Internal Auditors (2013) in Integrated Reporting and the Emerging Role of Internal Auditing.

22. Management routinely communicates and engages with intended users, particularly investors, in a number of ways. Visible, active engagement with users may provide an added motivation for management to achieve high-quality external reporting and may also enhance credibility.

23. Stakeholder dialogue is an important part of the process for defining an entity's strategy, identifying the most material issues to address, and disclosing them in external reports. The importance of such engagement is reflected in many EER frameworks as part of the entity's EER materiality process. Entities may also include stakeholder representatives in their governance structures, such as in their non-executive board, or may have a separate expert advisory group to advise the board on such matters.

24. For external users, the credibility of external reports may increase if the different elements of the governance system (structures, processes and people) that support the EER process are made transparent. This includes transparency about the individuals involved in the reporting process within an entity and those that govern these processes, as well as information pertinent to users' perception of those individuals' integrity and competence.

Factor 3: Consistent Wider Information

25. Inconsistencies between the various sources of information about the entity and its environment available to users may impact the credibility of the EER report. EER reports also need to describe all relevant issues and be complete if they are to be consistent with other information available about the entity.

26. Ensuring the consistency of information in the EER report with other sources of information likely to be available to users of the EER report, or explaining apparent inconsistencies, may enhance the credibility of the EER report.

27. Factors affecting the credibility of that wider information – such as the perceived independence and objectivity of the ultimate source of the information, the medium through which it is communicated (for example, a respected news agency), or the fact that the information was obtained in the past and was already perceived as credible - may influence whether the EER report or the wider information is determined to be most credible by users when there are inconsistencies between them.

Factor 4: External Professional Services and Other External Inputs

28. Entities seek to enhance the credibility of their external reports not only through strong governance, but also through obtaining professional services or other external inputs. Credibility can come from a variety of professional services and other external inputs obtained from various types of providers, not just professional accountants (such as engineers). Such professional services may result in reports under assurance or other professional services engagements or other external inputs that are either made publicly available or restricted to internal parties involved in the engagement (see paragraph 20).

29. The type of professional service that is most appropriate in the circumstances and most relevant to users will depend on users' needs (which may be quite different between internal and external users), the nature of the external input and the maturity of the entity's EER processes.

30. The way such professional services and other external inputs may enhance the credibility of the EER report is dependent on the particular characteristics of such inputs and the personal traits of those providing them, for example:

- Competence that is demonstrated or generally well known;

- Objectivity and independence;

- Professional skepticism and professional judgment;

- Quality in the performance of the engagement;

- Quality control, where applicable, at the engagement and firm level by the practitioner and firm that perform the engagement;

- Professional standards applicable to the practitioner;

- Regulatory oversight and supervision of professional services, where applicable; and

- Clarity of reporting, and transparency about the work performed.

31. Although the necessary competence may be different depending on the particular form of professional services or other external input and the complexity of the entity, in general competence likely needs to include:

- Knowledge of the relevant EER framework;

- Knowledge of the underlying subject matter; and

- Knowledge of any engagement standards that apply.

32. Transparency about the competence of those performing the professional service or other external input may add to the credibility of the EER report. Particular types of engagements (for example, assurance engagements) also require the practitioner to meet independence and other relevant ethical requirements.

33. The manner in which the outcome of the external professional services or other external input is reported can influence the degree to which the external service or input adds credibility to the EER report. Key characteristics of a communication that may add such credibility include that such communication is understandable and clearly structured, well balanced, not biased and, where applicable, comparable between reporting periods and with other entities that prepare EER reports.

34. An explicit reference to national or international standards for quality control of the practitioner's firm and for the performance of the engagement, as well as to relevant ethical requirements, may also enhance the degree to which the external input adds credibility to the EER report.

35. Whether the credibility of information is enhanced may be affected by the users' understanding of the external professional services, including assurance. There may be a need to educate users about the nature of such services and the levels of assurance that can be obtained from them.

36. Without experience of how to read assurance reports to understand the scope and level of assurance being provided, there is a danger of user confusion and misunderstanding, particularly given the range of services which practitioners can provide and the differing professional standards which assurance providers work to.