

FAR Masterclass
Seeing Beyond the Numbers:
ESG Risks in Financial Audits



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Focus of Today

Sustainability assurance



Is the sustainability information
fairly stated?

Focus: sustainability statement and
sustainability assurance
engagement

Financial audit

Does ESG-related information change
our understanding of client risk or risk
of material misstatement? and What
are the consequences for audit
quality?

Focus: client risk assessment in the
financial audit

WE ARE
HERE.

The audit risk lens is expanding

The financial auditor is being asked to understand the broader business environment. – Not NEW!!!!

- Issue #1: *The range and complexity of signals*
- Issue #2: Missing or underweighting those signals can lead to an incomplete risk assessment
- Issue #3: An incomplete risk assessment can weaken the quality of the audit

THE WALL STREET JOURNAL.

BUSINESS • MEDIA

Disney Agrees to \$43.3 Million Settlement in Suit Alleging It Paid Women Less Than Men

The deal would conclude a case first filed in 2019

By Robbie Whelan

Nov. 25, 2024 10:03 pm ET

Disney - gender-pay dispute: workforce issue becomes a direct financial cost

At what point should a workforce or pay-equity issue move from HR or ESG reporting into the financial auditor's risk assessment?



Foundation for
Auditing Research

The New York Times

BUSINESS

How PG&E Ignored Fire Risks in Favor of Profits

By IVAN PENN, PETER EAVIS and JAMES GLANZ

Graphics by KEITH COLLINS and JUGAL K. PATEL

MARCH 18, 2019

On the morning of Nov. 8, a live wire broke free of its grip. A power failure occurred on the line, affecting a single customer. But 15 minutes later, a fire was observed nearby.

PG&E - California wildfires: physical risk becomes a viability risk

At what point does an environmental risk stop being an 'ESG issue' and become a going-concern issue for the financial auditor?



Shein reveals child labour cases at suppliers

23 August 2024

João da Silva
Business reporter

SHEIN - child labour in the supply chain: a social signal with strategic financial consequences

If the financial impact cannot yet be quantified, how much weight should a financial auditor give a confirmed child-labour finding in the supply chain?

The audit risk lens is expanding



Are these really two separate information worlds?

Professional Tension: Integration and Reconciliation

Expanding the lens means evolving financial audit logic, not abandoning it!



ESG in the financial audit: boon or bane?

- a. Boon – an opportunity
- b. Bane – a burden



What did we identify from the interviews?



A process view of ESG in client risk assessment

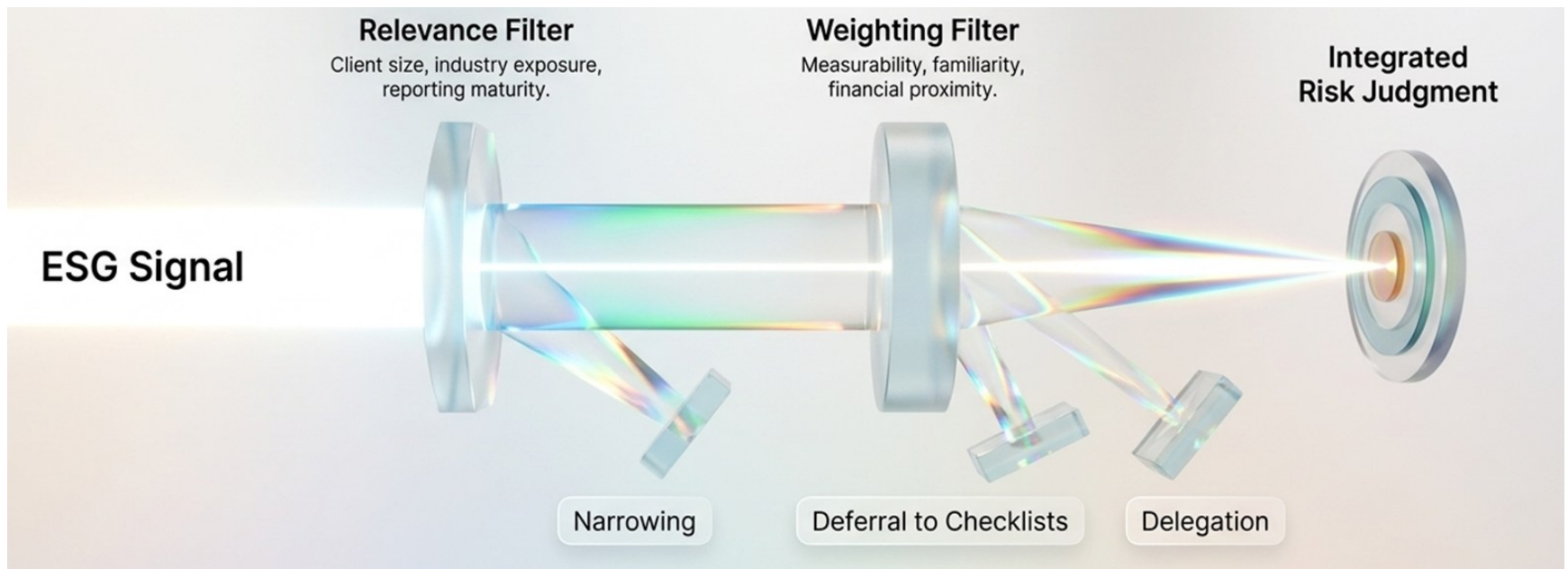


Insight #1: Recognition ≠ integration

- ESG is increasingly seen as relevant in risk assessment, but relevance is filtered by:
 - client context
 - industry exposure
 - size and visibility
 - reporting maturity
 - **perceived financial connection** - Financial proximity made some signals easier to act on

“When we look at environmental aspects, I review it from the litigation and claims perspective...”

Insight #2: Integration and reconciliation is a conditional weighting process



Auditors discount signals they feel ill-equipped to measure, prioritize financial proximate cues.

Insight #3: When uncertainty increased, structure becomes attractive

Unclear
standards

Limited
knowledge

Time pressure

CHECKLISTS

“If you tick the boxes, it feels like everything is fine....”

“The checklists are more in form than substance...”



Insight #4: E, S and G create different judgment problems

E-Environmental

Technical
Forward-looking
Specialist knowledge
Emissions,
pollution,
biodiversity



S-Social

Hard to observe
Narrative evidence
Labour, human rights,
Communities.

"The things you don't see"



G-Governance

Controls,
oversight
Tone at the top
Management
behavior



Uncertainty and Accountability

Trigger 1

Conceptual uncertainty

*"I don't know how to translate
this...."*

Trigger 2

Personal accountability

"I have to sign...."

Uncertainty + accountability → specialist consultation

Insight #5: Specialists help translate uncertainty into action



Does specialist consultation build audit-team capability?

BRIDGE

knowledge
translation
confidence
defensibility

BOUNDARY

ownership shifts
responsibility fragments
competence remains outside
the audit team

Specialist input should strengthen—not displace—the audit team's judgment capability.

Work with the evidence

Case study: Ardenvi Group N.V

Case stage 1: Basics and Financials

You are part of the financial statement audit team of Ardenvi Group N.V.

Client snapshot	2025	2024
Net sales (€m)	31,860	32,420
Gross margin	53.9%	53.3%
Operating margin	8.6%	7.2%
Profit for the year (€m)	1,813	1,536
Cash flow from operations (€m)	4,586	4,360
Inventory (€m)	4,890	5,520
ROE	28.8%	23.3%

Question 1: How concerned are you about the sustainability of Ardenvi's future earnings?
Score 1 = very low concern to 5 = very high concern.

Case stage 2: Governance risk signals

- A familiar ISA 315 territory: governance, control environment, management bias and tone at the top

- Ten-member board and four-member audit committee
- Founder-related investment vehicle remains largest shareholder, with enhanced voting influence
- New three-year LTIP for senior management:
- 45% cumulative operating-profit performance
- 35% absolute total shareholder return
- 20% ESG-related measures
- Short-term variable pay mainly linked to sales and operating profit, subject to minimum profitability threshold
- No evidence of inappropriate behaviour
- Audit team has identified forecasting, inventory valuation, and store impairment as judgmental areas

Question 2:

Does this governance information change your risk assessment? If yes, what would you reconsider?

Case stage 3: Environment risk signals

- More than 90% of Ardenvi's climate footprint arises in the wider value chain
- 2030 transition targets depend heavily on suppliers changing: energy sources, production processes, material inputs,
- Reported progress by end-2025:
- Scope 1 & 2 emissions ~40% below base year and Scope 3 emissions ~33% below base year
- 90% of product materials recycled or sustainably sourced
- recycled materials >30%
- Next transition phase may require additional investment by Ardenvi and suppliers
- Financial impact remains uncertain and depends on: regulation, energy prices, material availability, supplier investment, speed of technology adoption
- Management expects buying improvements, inventory efficiency, and stronger supplier relationships to offset part of the transition costs

Question 3:

How much weight should environmental information receive relative to current financial performance and governance?

Case stage 4: Social risk signals

- More than 1 million workers across Ardenvi's first-tier production network
- Policies and monitoring processes cover: working hours, health and safety, wages, forced labour, discrimination, freedom of association, grievance mechanisms
- During 2025, Ardenvi reported 7 severe human-rights cases: 6 resolved by year-end, 1 remained under remediation
- Additional social risks identified by the company: labour unrest, wage-related disputes, restrictions on worker representation,
- Potential consequences include: operational disruption, legal exposure, reputational damage, additional costs

Question 4:

How much weight should auditors give to social risks when the potential consequences are clear, but the probability and financial magnitude are difficult to quantify?

Case stage 5: Specialist input and final tension

- **Specialist input and financial counter-signals**
- Environmental specialist clarifies transition risks, but cannot give one correct forecast adjustment
- Human-rights specialist assesses exposure, but cannot reliably quantify 12-month financial impact
- Audit manager: **“We are better informed, but I am not sure we are more confident.”**
- Financial evidence remains strong:
 - higher margins
 - better inventory efficiency
 - strong cash generation
 - stable demand
 - no material supply disruption

Question 5:

Does specialist input improve the quality of judgment,
or mainly make the uncertainty more visible?

More informed — or less confident?

More information can make the risk picture more complete while
also increasing uncertainty.

Implications for regulators and standard setters

Less: “Consider
ESG.”

More: “How should ESG information enter
financial audit reasoning?”

Implications for audit firms

Actionable methodologies
Risk taxonomies
Worked examples
Specialist access
Consultation culture
Role clarity
Cross-team learning

*“Everyone would like it to be
more structured and
organized... but not more
checklists....”*

Implications for client organizations

Reporting Maturity

Is ESG a boon or bane for the financial audit?

- Unprecedented ambiguity, but dramatically richer, more forward looking understanding of client reality.
- The future of the profession relies on our capacity to expand the professional risk lens – welcoming diverse signals, without forcing rigid boxes.



Six points to take back to your next audit

- ① Recognition is ahead of integration and reconciliation
- ② E, S, and G create different judgment challenges for auditors
- ③ When ESG does not fit, the risk of simplification arises
- ④ Specialists can bridge the gap — but the quality of the bridge matters
- ⑤ Meaningful integration requires more than new rules
- ⑥ Change the mindset – greater need for flexibility and adaptation

See It. Connect It. **TRACE** It.

TAKE NOTICE: Could this signal alter our understanding of the entity?

RELATE: Which risk, account, estimate, assertion or disclosure could it affect?

ASSESS: How much weight should we give it, considering reliability, measurability, timing, and financial proximity?

CONSULT: What expertise is needed—and why?

ENSURE OWNERSHIP: Who integrates the advice and retains the judgment?



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Questions, Feedback and Further Discussions?

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