



Financial Reporting Council

07 December 2022

Dear Head of Audit

*Role of the auditor in considering climate related risk*

We reported in our [2020 thematic review](#) that auditors have a key role to play in the global challenge that is climate change. Ultimately all audited entities are affected by climate related factors, either directly, or indirectly through their supply chain, customer base, financing, insurance and laws and regulations. The extent of impact on entities varies, and can change - driven by entity specific circumstances, such as industry, but also geographic and political location and developments.

Given the auditor's objective is to obtain reasonable assurance about whether the financial statements of an entity, as a whole, are free from material misstatement and report on whether the financial statements are prepared, in all material respects, in accordance with the financial reporting framework, it is key that auditors consider whether any material impact of climate change is appropriately reflected. Doing so can be challenging for audit teams given the technical complexity but also breadth of climate related considerations that might impact an entity. It is therefore key that audit firms provide their audit teams with sufficient and appropriate support, such as training and guidance, to respond to this evolving challenge.

*Background to our work*

In early 2022, the FRC considered it appropriate to perform a follow-up review of the climate related firmwide work performed in the 2020 thematic, where we had reported that the quality of support, training and resources provided to the audit practice varied considerably across the seven largest audit firms<sup>1</sup> and had asked firms to do more to ensure that their internal monitoring had appropriate regard for climate change considerations.

With this in mind, the objective of the 2022 follow-up review was to compare and contrast practices at the seven largest audit firms, primarily to identify better practices and areas for improvement.

*Key findings and observations*

In the 2022 review, we found that since the FRC Climate Thematic in 2020, all firms have shown progress in developing processes and procedures to support audit teams in identifying and responding to climate change risks, with most firms showing significant enhancements since 2020. All firms have, at a minimum, updated methodology to reflect climate change issues, provided climate related training, and issued specific climate change related communications to staff.

We recognise that there are various approaches that firms can take to support audit teams in sufficiently incorporating the risk of climate change into their audit. As such firms should carefully review our observations of common and better practice and ascertain how they might use these to optimise their processes such that they best meet the need of their particular circumstances and subsequently assess whether any changes made have had the desired effect.

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<sup>1</sup> BDO LLP, Deloitte LLP, Ernst & Young LLP, Grant Thornton UK LLP, KPMG LLP, Mazars LLP, PricewaterhouseCoopers LLP

We also remind firms that the effectiveness of climate change related tools and resources that a firm deploys depends heavily on the quality of application by the user. Specifically designed templates for example, are only effective if populated to a sufficiently high level and can risk providing false assurance if populated in a perfunctory manner. Firms therefore need to monitor that tools are being appropriately utilised by staff and ensure they meet the expected outcome. Further, given the speed and complexity with which change can occur in this area, firms must ensure timely updates are made to their guidance and resources for key developments.

### Detailed findings and better practice

The following table outlines our finding across each of the areas reviewed:

	Area or process	Why is it important?	Areas of common and better practice
1	<p><b>Central risk assessment</b></p> <p>Is the firm centrally identifying audited entities which are considered to have a high risk related to climate change? How is risk monitored? How is risk responded to?</p>	<p>Assessing risk centrally helps ensure that all entities facing heightened climate risk are identified by a firm, especially if due to rapid or lesser-known developments. It also facilitates a consistent response across all such audits identified.</p>	<p><b>Common practice</b></p> <ul style="list-style-type: none"> <li>All firms consider climate related factors within their central risk assessment procedures. The number of risk factors considered, and depth of the assessment is varied by firm.</li> <li>Risk assessment was typically driven by the industry in which the audited entity operates.</li> <li>Risk is typically considered as part of take on procedures and reassessed annually. Two firms reassess climate risk on a more frequent basis across their full portfolio of audited entities.</li> </ul> <p><b>Better practice</b></p> <ul style="list-style-type: none"> <li>Three firms use climate change specialists to assist in the identification of high-risk entities.</li> <li>Four firms identify and mandate additional climate change related procedures for entities identified as high risk. This includes for some firms, a mandatory review of the risk assessment and disclosures by a specialist.</li> </ul>
2	<p><b>Risk assessment guidance and resources</b></p> <p>What resources are available to assist teams in ensuring they pay sufficient regard to climate change considerations when performing their audit</p>	<p>The FRC's <a href="#">What makes a Good Audit Publication</a> highlights the importance of a robust risk assessment to ensure the audit is focused on the right audit risks. Identifying risks in a complex and evolving area such as climate change can be challenging, so it is important that audit teams are</p>	<p><b>Common practice</b></p> <ul style="list-style-type: none"> <li>All firms have published risk assessment guidance and issued specific templates to help teams evidence their climate related risk assessment consideration. The form of both the guidance and templates is varied across the firms. Quality of template completion is generally monitored</li> </ul>

	Area or process	Why is it important?	Areas of common and better practice
	risk assessment procedures? Are resources industry specific?	sufficiently supported to do so through guidance and templates.	<p>through the firms' standard quality control review processes.</p> <ul style="list-style-type: none"> <li>All firms have introduced mandatory training covering the requirement for audit teams to consider climate related factors within their risk assessment. Training absorption is typically monitored through online assessments.</li> <li>Six of the seven firms have provided industry specific climate training or included industry specific considerations within published guidance. Firms typically focused on industries such as banking, building and materials and energy.</li> </ul> <p><b>Better practice</b></p> <ul style="list-style-type: none"> <li>Three firms have published industry specific climate risk assessment templates for industries assessed as high risk by the firm such as banking and insurance. These are designed to be used in addition to the standard risk assessment procedures for other balances.</li> <li>One firm has built specific risk factors by industry into their standard risk assessment template to aid audit teams when performing their assessment.</li> <li>Two firms included a specific focus on performing a financial statement line-item level risk assessment to identify potential impacts within their mandatory training. At both firms this included walking through an example of best practice and case studies of potential impacts by industry.</li> </ul>
3	<p><b>Substantive testing guidance and resources</b></p> <p>What guidance/resources are available to assist teams in auditing the impact of climate change on key balances?</p>	Substantive testing guidance and resources help ensure audit procedures respond sufficiently and specifically to any climate change risks relevant to an audited entity.	<p><b>Common practice</b></p> <ul style="list-style-type: none"> <li>Six of the seven firms have released guidance which specifically covers the potential impact of climate change on individual financial statement line items.</li> <li>Guidance is typically shared with teams through training sessions or</li> </ul>

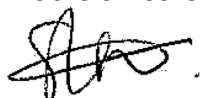
	Area or process	Why is it important?	Areas of common and better practice
			<p>via email and is embedded into audit software.</p> <ul style="list-style-type: none"> <li>Guidance generally focuses on key areas such as impairment, provisioning, useful economic life determination, investment valuation etc.</li> </ul> <p><b>Better practice</b></p> <ul style="list-style-type: none"> <li>Two firms have enhanced existing substantive working paper templates to include climate change considerations. This included adding additional procedures to the templates for testing impairment, expected credit loss provisions and pensions.</li> </ul>
4	<p><b>Disclosure testing guidance and resources</b> What guidance/resources are available to assist teams in their work over climate related disclosures?</p>	<p>Disclosure testing is a key part of an audit but can be challenging when relating to complex areas such as climate change. Guidance can assist teams in ensuring this work is performed appropriately.</p>	<p><b>Common practice</b></p> <ul style="list-style-type: none"> <li>All firms have released guidance which covers audit considerations around climate change disclosures. Generally, firms have specific guidance around annual report versus financial statements requirements which includes consideration of FSLI disclosures.</li> <li>Six of the firms have embedded climate change considerations into disclosure workpaper templates.</li> </ul> <p><b>Better practice</b></p> <ul style="list-style-type: none"> <li>Four firms provide examples of good practice disclosures within their training material. This included examples of annual report, audit report and financial statement disclosures.</li> <li>One firm has embedded example disclosures into their model financial statements for listed groups.</li> </ul>
5	<p><b>Use of specialists</b> Who typically performs the role of specialist? How do firms ensure specialists have the appropriate skillset to perform their roles? Do firms mandate the use of specialists?</p>	<p>Given the complex, evolving and far-reaching nature of climate change considerations, it is likely that many audit teams will need the help of specialists to perform high-quality procedures. It is therefore important that appropriate specialists are available and that audit teams know when to use them.</p>	<p><b>Common practice</b></p> <ul style="list-style-type: none"> <li>Three firms have a designated resource for climate change issues whose primary role is climate related e.g. climate assurance providers. For the other firms specialists are typically professionals with an audit</li> </ul>

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			<p>background who are embedded within existing quality review teams</p> <ul style="list-style-type: none"> <li>Specialists who are embedded into existing review teams are typically participating in specific climate risk training consistent with that provided to audit staff.</li> <li>Specialists are generally used to assist audit teams with identifying and responding to climate risks, which is typically performed through planning calls with the specialist, and with reviewing climate change disclosures.</li> <li>Audit teams are not typically being mandated to use climate change specialists however all firms have a specialist resource which is available if required.</li> </ul> <p><b>Better practice</b></p> <ul style="list-style-type: none"> <li>Four firms either mandate or strongly encourage the use of specialists for engagements centrally identified as being at higher risk of climate change impacts. Typically, where mandated, audit teams are required to hold a planning call with the specialist to ensure a robust risk assessment is performed.</li> <li>One firm requires the audit team of high-risk entities to hold a planning discussion with the climate specialist and the specialist is required to review the risk assessment. The same firm also has a climate change specialist review template in which the specialist must document their challenge.</li> </ul>
6	<p><b>Requirement for consultation</b> Do firms mandate consultation for any climate related areas?</p>	<p>Consultations can be a powerful means of resolving a complex audit matter, such as, for example, judgments and estimates resulting from climate change considerations. It should be clear to audit teams when consultation is recommended and when it is required by the firm.</p>	<p><b>Common practice</b></p> <ul style="list-style-type: none"> <li>Typically there is not a mandated requirement to consult on climate change issues.</li> </ul> <p><b>Better practice</b></p> <ul style="list-style-type: none"> <li>One firm has a requirement to consult with their quality team where a premium listed company</li> </ul>

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			does not disclose any climate change impact within the financial statements.
7	<p><b>Reporting and communications</b> Do firms issue tailored guidance on climate change risks either externally or to audit committees? Do firms mandate climate related audit report disclosure? Do firms provide guidance on the inclusion of climate change as a KAM?</p>	Clarity of reporting both in the audit report, but also in reporting to the audit committee is key to ensuring readers understand the climate related risks identified during the audit, the audit response and conclusions reached. Specific guidance can enhance the quality, including completeness, of this reporting.	<p><b>Common practice</b></p> <ul style="list-style-type: none"> <li>All firms include climate related issues within the templates used for their reporting to the audit committee. The extent this needs to be tailored is varied by firm. We remind firms that wording should not be boilerplate but should be tailored to the specific facts and circumstances of the audited entity.</li> <li>All firms have released external publications detailing climate change risks and considerations for entities.</li> </ul> <p><b>Better practice</b></p> <ul style="list-style-type: none"> <li>Two firms require the audit team to specifically describe their approach to auditing climate risk and their overall assessment of risk at the entity within the audit committee reporting.</li> <li>One firm clearly set out the audit committees' role in understanding climate change risk within the audit committee reporting.</li> <li>Three firms have mandated audit teams of entities meeting certain criteria to refer to climate change within the audit report.</li> <li>Four firms have released specific guidance for teams on how climate change may impact on the reporting of KAMs within the audit report.</li> <li>One firm has added a specific climate change representation into their template management representation letter.</li> </ul>
8	<p><b>Firm monitoring</b> Are specific reviews performed to ensure audit teams are paying sufficient regard to climate change? Was good practice identified? What key issues were identified?</p>	Quality monitoring (both hot and cold reviews) is a key part of a firm's ability to identify audit quality issues, including any related to climate change considerations. Firms should therefore ensure that climate change factors are embedded within these processes.	<p><b>Common practice</b></p> <ul style="list-style-type: none"> <li>Typically the review of audit teams' consideration of climate change factors has been embedded into existing hot and cold review programs.</li> <li>Reviewers at all firms either received training or guidance on climate change to ensure they are</li> </ul>

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			<p>aware of key issues when performing reviews.</p> <p><b>Better practice</b></p> <ul style="list-style-type: none"> <li>• Four firms perform specific hot reviews on entities identified as high climate risk whereby they assess the quality of the work performed as well as review the proposed disclosures. Three of those firms use climate specialists to perform reviews.</li> <li>• One firm provides reviewers with a climate checklist which must be completed to ensure key issues are considered, including completeness of risk assessment and disclosures. Two firms provide climate change aides to be used for guidance during review.</li> </ul>
9	<p><b>Climate change related developments</b>            What policies or procedures does the firm have in place for keeping abreast of relevant developments? Is there a designated person or team within the firm responsible for this? How are developments acted upon on a timely basis?</p>	<p>Climate change is an evolving area, with developments potentially crystallizing very rapidly. Firms therefore need to be equipped to identify and respond to these developments.</p>	<p><b>Common practice</b></p> <ul style="list-style-type: none"> <li>• Typically firms will use individuals from multiple departments to ensure that climate change related developments are identified and addressed.</li> <li>• Firms are generally working with their global networks on the response to climate change developments.</li> </ul> <p><b>Better practice</b></p> <ul style="list-style-type: none"> <li>• None noted</li> </ul>

Yours sincerely



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