Submission to the Consultation Paper by Auditing and Assurance Standards Board Assurance over Climate and Other Sustainability Information

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About the authors

Assoc. Prof Mukesh Garg joined Monash University in 2006 and is currently Chair of the Academic Progress Committee and a member of the University Academic Board. He has teaching and interest in financial reporting, financial and valuation impact of climate change and its reporting, auditing, forensic accounting, financial statement analysis, and valuation. His research publications in 'A*' and 'A' ranked national and international journals are reporting regulations, financial reporting quality, auditing, climate change, sustainability, cost of capital, and valuation of listed companies. Mukesh holds a PhD in Accounting and Finance from Monash University and is a qualified member of CPA Australia. Besides, he has industry and accounting standard-setting experience with the Australian Accounting Standards Board as the Research and Education Principal.

Dr Luisa Langer completed PhD in Accounting at La Trobe University, Australia, in 2016. After completing PhD, she joined Monash University, Australia, as an Assistant Professor. She is currently working as a Postdoctoral Researcher at the Chair of Corporate Governance and Chair of Corporate Finance at the University of Mannheim, Germany. She has more than twelve years of dedicated and committed teaching experience, including delivering lectures and tutorials for undergraduate and postgraduate students. Her research interests include corporate governance; board diversity; financial reporting quality; gender differences in financial decision-making; and accounting and finance education.

Summary

The authors strongly support the assurance of climate and other sustainability information proposed by the AUASB. Assurance of these disclosures will play an important role in improving reliability and transparency around climate and other sustainability risks and the management of these risks by Australian companies, and, in turn, the use of this information by market stakeholders to help improve the climate resilience of the financial system and the broader economy. The results of our recent research paper on Australian listed companies' climate-related financial disclosures (CRFD) underline the importance of imminent mandatory disclosure reforms and audit requirements. Our empirical results suggest that CRFD by Australian listed companies that have been provided in the period leading up to the introduction of mandatory reporting, are relevant and reliable where financial implications are disclosed by companies. We expect these reforms will support ongoing improvements to climate risk and other sustainability disclosures in Australia.

Responses to ***Consultation Paper by Auditing and Assurance Standards Board***

Assurance over Climate and Other Sustainability Information

Question 1.

Consideration should be given to the relative importance of each type of disclosure and the cost of assurance over that information. In that context, do you believe that limited assurance or reasonable assurance should be required earlier or later for any disclosures in the possible assurance phasing model in Attachment 1? Please provide reasons.

Response:

Limited assurance or reasonable assurance should be required later, and not earlier, for any disclosures in the possible assurance phasing model as per Attachment 1. However, entities could be allowed to adopt assurance voluntarily earlier. A phased approach that considers entity size could be reasonable. Medium-sized and smaller entities (Group 2 and 3) may need more time to develop the necessary infrastructure and capabilities for robust reporting, whereas larger entities (Group 1) might be better positioned to implement assurance measures earlier. However, it's essential to ensure that any phasing model is flexible enough to accommodate variations in industry, regulatory requirements, and entity-specific circumstances and situations that may change between now and over the next few years. Additionally, ongoing evaluation and adjustment of the phasing model based on feedback and evolving best practices would be necessary to ensure its effectiveness. In our empirical study of Australian listed companies' CRFDs, we find that those entities that provide CRFD, on average, pay at least $5,000 in higher audit fees. The amount exceeds $500,000 for very large entities depending on the level of disclosures and the complexity of the business. Our study also suggests the need for auditors to exhibit caution in their audit of clients' assets considering the impact of climate change and sustainability risks on client's long-term asset values. Disclosing firms also pay higher audit fees suggesting auditors charge higher audit fees from clients that make CRFDs relative to other clients, contributing to the quality of financial reports prepared by the disclosing entities. Auditors are already considering CRFDs during audits and pricing the information provided by their clients which is consistent with the auditors' requirement of more extensive audit procedures to ensure accuracy and compliance with reporting standards. These disclosures are also value-relevant. The audit of climate and other sustainability information is more complex than the audit of financial information. The audit profession requires more time to develop the capacity and resources for high-quality assurance, irrespective of whether it is limited or reasonable assurance. Overall, we believe that assurance is important to support investors' confidence regarding the accuracy and reliability of climate and sustainability reporting.

Question 2.

We are seeking information on the expected ability of audit firms to resource assurance engagements using partners and staff with appropriate competence, skills expertise, as well as their own internal or external experts. If you are an auditor, do you consider the possible assurance phasing in Attachment 1 could be adequately resourced by your audit firm for entities whose financial reports are audited by your firm? If not, please identify any pressure points in the model and reasons.

Response:

While we are from the audit profession, our research on disclosures related to climate and sustainability-related disclosures suggests that the audit profession requires more time to develop capacity and resources for high-quality assurance, irrespective of whether it is limited or reasonable assurance. Certainly, the audit of climate and sustainability-related disclosures presents several unique challenges and pressure points for audit firms. Climate and sustainability disclosures often involve complex data sets, projections, and assumptions. Assessing the reliability and accuracy of this information can be challenging due to the inherent uncertainties surrounding climate change and sustainability issues. Unlike financial reporting, there is currently no universally accepted framework for climate and sustainability reporting. The recent standards from IFRS S1 and S2 could become a globally accepted guideline in the future. Understanding and implementing such a framework would require time and training as has been the case with the financial audit profession, which itself developed over several decades. This lack of standardization can lead to inconsistencies in disclosures across different entities, making it difficult for auditors to establish benchmarks and assess comparability.

Auditors may lack the necessary technical expertise in areas such as environmental science, carbon accounting, and sustainability reporting standards. Without a deep understanding of these subject matters, auditors may struggle to effectively evaluate the completeness and accuracy of disclosures. Auditors will also face resource constraints. These engagements may require additional time and expertise, which could strain audit teams already facing capacity constraints, and can impair audit quality or increase the cost of such audits significantly. Obtaining reliable data on environmental performance and sustainability initiatives, and on Scope, 1, 2, and 3 can be difficult, particularly for entities operating in multiple jurisdictions or industries. Auditors may encounter challenges in verifying the accuracy and completeness of the data provided by management.

Due to heightened pressure from multiple stakeholders, there is a risk that some entities may engage in "greenwashing" by overstating their environmental or sustainability achievements in their disclosures. Auditors need to remain vigilant and exercise professional skepticism to ensure that disclosures accurately reflect the entity's performance and commitments. Addressing these pressure points will require audit firms to invest in training and development programs to enhance the technical expertise of their audit teams, establish robust quality control processes tailored to climate and sustainability engagements, and collaborate with external experts where necessary to supplement internal resources. Hence, we advocate for auditors to obtain a thorough understanding of how climate change and sustainability disclosures affect the entity, and to use their professional judgment to determine appropriate materiality levels.

Question 3.

Do you consider that the systems and processes of entities in Groups 1, 2, and 3 will be developed, implemented, and sufficiently reliable to facilitate the assurance processes as outlined in the possible assurance phasing model in Attachment 1?

Response:

We do not believe that the systems and processes of entities in Groups 1, 2, and 3 will be developed, implemented, and sufficiently reliable to facilitate the assurance processes as outlined in the possible assurance phasing model in Attachment 1. Group 1 entities may face significant challenges in implementing systems and processes to facilitate reasonable assurance of Scope 1 and 2 emissions by 2025. Achieving this level of assurance requires robust systems for data collection, monitoring, and reporting, which may require substantial investment in technology and infrastructure. Group 2 and 3 entities may also face challenges, depending on their current capabilities and resources. However, advancements in technology and increasing awareness of environmental issues may facilitate the development and implementation of these systems over time. We propose voluntary assurance from 2025 for two years for Group 1 entities, before making it mandatory from 2027 onwards. This means a delay of at least 2 years from the assurance phasing model in Attachment 1. For entities in Groups 2 and 3, we suggest voluntary assurance from 2027. We do not propose earlier voluntary assurance for Group 2 entities, as even voluntary assurance would imply mandatory requirements and put undue pressure on entities and the assurance profession. Our empirical results from the study of Australian listed companies suggest that CRFD by Australian listed companies that have been provided in the period leading up to the introduction of mandatory reporting, are relevant and reliable where financial implications are disclosed by companies.

Question 4.

Do you agree that subject to seeing the final standard, ISSA 5000 should apply to assurance over:

a) For climate disclosures under the Australian reporting framework;

i. Assurance mandated by the final phasing model developed by the AUASB; and

ii. Any earlier voluntary assurance or adoption of reasonable assurance than mandated by the AUASB's assurance phasing; and

b) Voluntary assurance over any other sustainability information in annual or other periodic reports, including climate disclosures that are not required by the final AASB reporting framework.

Response:

We agree that subject to seeing the final standard, ISSA 5000 should apply to assurance over climate disclosures under the Australian reporting framework, and voluntary assurance over any other sustainability information in annual or other periodic reports, including climate disclosures that are not required by the final AASB reporting framework. Adopting ISSA 5000 for assurance over climate disclosures under the Australian reporting framework, whether mandated or voluntary, could offer consistency and credibility to such disclosures. It might enhance stakeholders' trust in the information provided, aligning with global standards for sustainability reporting and assurance. However, the effectiveness would depend on various factors, including the specific requirements of the final standard and the level of adherence by reporting entities. Ultimately, the decision would involve weighing the benefits of adopting ISSA 5000 against any potential challenges or complexities it might introduce.

Question 5.

Should any parts of ISSA 5000 that may not be relevant to assurance of disclosures under the mandatory climate reporting framework in Australia be identified in guidance in a local pronouncement?

Response:

We do not believe that any parts of ISSA 5000 that may not be relevant to assurance of disclosures under the mandatory climate reporting framework in Australia be identified in guidance in a local pronouncement. However, it is essential to identify and tailor relevant parts of the International Standard on Assurance Engagements (ISAE) 5000 to the specific requirements of the mandatory climate reporting framework in Australia. Not all aspects of ISAE 5000 may directly apply or be necessary for ensuring compliance with the reporting framework's disclosure requirements related to climate. Guidance in a local pronouncement, specific to some industries (e.g., mining industry) can help practitioners navigate through ISAE 5000 and focus on the aspects that are most pertinent to assurance of disclosures under the Australian climate reporting framework for industries of importance to the Australian economy. Certain industries may have specific regulations governing auditing practices. This ensures efficiency and clarity in the assurance process while maintaining compliance with international standards and local regulations.

Question 6.

Are there any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed equivalent of ISSA 5000?

Response:

We do not believe there are any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed equivalent of ISSA 5000. While specific practices may vary, there are generally recognized principles and practices that aim to maintain or improve assurance quality. These principles often include independence, objectivity, professional skepticism, and adherence to relevant standards and regulations.

Question 7.

Are there principles and practices considered appropriate in maintaining or improving assurance quality in Australia that may, or do, prevent or impede the application of the proposed equivalent of ISSA 5000, or may conflict with the proposed standard?

Response:

We do not believe there are any principles and practices considered appropriate in maintaining or improving assurance quality in Australia that may, or do, prevent or impede the application of the proposed equivalent of ISSA 5000, or may conflict with the proposed standard.

Question 8.

Should the AUASB develop and issue a local pronouncement to supplement the final ISSA 5000 dealing with assurance matters under the Australian climate and sustainability reporting framework? Please provide your reasons. Do you agree with the reasons for developing a local pronouncement in paragraph 45?

Response:

While we do not believe there are any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed equivalent of ISSA 5000, it could be beneficial to develop local pronouncement to supplement the final ISSA 5000 for assurance matters under the Australian climate and sustainability reporting framework. Specificity to Local Context: While ISSA 5000 provides a broad framework for assurance, a local pronouncement can tailor these guidelines to the unique aspects of the Australian climate and sustainability reporting landscape. This could include addressing specific regulatory requirements, industry practices, and stakeholder expectations within Australia. Developing a local pronouncement for Australia can enhance its applicability, effectiveness, and credibility within the Australian context. It ensures that assurance practices are tailored to address the unique challenges and requirements of the Australian climate and sustainability reporting framework, ultimately benefiting both assurance providers and stakeholders. Developing a local pronouncement can align assurance practices with Australia's national priorities, facilitating more meaningful contributions to environmental sustainability efforts. Besides, local pronouncement can address the specific needs and expectations of stakeholders, including investors, regulators, and the public thereby increasing the relevance and usefulness of assurance engagements.

Question 9.

Should the AUASB consider covering the matters identified in Attachment 2 in a possible local pronouncement?

Response:

Yes, we believe the AUASB should consider covering the matters identified in Attachment 2 in a possible local pronouncement. Some considerations might include the significance and relevance of the matters identified, whether they align with the AUASB's mandate and objectives, and the potential impact on stakeholders. AUASB should also consider international standards and practices to ensure consistency and comparability since the goal is to enhance the quality and relevance of auditing standards to meet the needs of users and stakeholders in the global context to enhance comparability.

Question 10.

Are there any matters identified in Attachment 2 that should not be addressed in a possible local pronouncement? Please provide reasons.

Response:

We do not believe there are any matters identified in Attachment 2 that should not be addressed in a possible local pronouncement.

Question 11.

Are there any matters that should be addressed in a possible local pronouncement in addition to those identified in Attachment 2?

Response:

Attachment 2 is very comprehensive. We do not believe any matters need to be added to Attachment 2 in a possible local pronouncement. We agree with the information in Attachment 2 on matters that may or may not be covered in a local pronouncement and their possible priority.

Question 12.

To assist the auditor in considering the adequacy of disclosures, should any local pronouncement include material on applying aspects of the reporting framework in addition to that available in sustainability standards and material from other standard setters or regulators? For example, should the auditor be reminded about their obligations under ASA 720 to consider omissions of material non-climate sustainability risks and opportunities in the Operating and Financial Review? If so, should guidance be provided on reporting frameworks that could be referred to in that regard?

Response:

Yes, local pronouncements should include material on applying aspects of the reporting framework beyond sustainability standards and should remind auditors of their obligations under ASA 720. Reminding auditors of their obligations under ASA 720 to consider omissions of material non-climate sustainability risks and opportunities in the Operating and Financial Review (OFR) is a pertinent point. This ensures that auditors are thorough in their assessment of disclosures related to sustainability and cannot use it as an excuse if there is audit failure or if the audit client provides misleading/fraudulent information.

Question 13.

Should guidance be provided on materials that might be referred to by the auditor in assessing disclosures (e.g. standards on Financed Emissions, Facilitated Emissions, and Insurance-Associated Emissions at The Global GHG Accounting and Reporting Standard for the Financial Industry)?

Response:

We believe that guidance on materials for assessing disclosures can be useful for ensuring information on areas as complex and evolving as emissions accounting. Guidance can help auditors understand these standards better and apply them effectively during their assessments. Standards such as the Global GHG Accounting and Reporting Standard for the Financial Industry can offer valuable frameworks for organisations and auditors to follow.

Question 14.

Should any local pronouncement cover considerations about the impact of climate and sustainability risks and opportunities on recognition, measurement, and disclosure in the financial report (e.g. impairment of assets, provisions)?

Response:

Climate change and sustainability issues can directly affect the value of an organisation's assets. For example, physical assets like property, infrastructure, and equipment could be at risk due to extreme weather events or changing environmental regulations. Intangible assets like brand reputation can also be impacted by sustainability-related factors. Impairment of assets and provisions is increasingly important in the context of climate and sustainability risks and opportunities in financial reporting. These risks can significantly impact a client's assets, operations, and financial performance over the short and long term. Therefore, it will be beneficial to have local pronouncements to cover considerations related to climate and sustainability risks and opportunities in the recognition, measurement, and disclosure of matters specific to asset impairments and provisions. Reporting impairment of assets and provisions involves a degree of judgment and interpretation by entities, and therefore, can be easily manipulated by audit clients.

Question 15.

The Clean Energy Regulator (CER) has assurance requirements for some of the entities that will be covered by the climate reporting requirements under the Corporations Act. These include obtaining external assurance on Scope 1 and 2 emission intensity determination pursuant to section 17 of the Safeguard Mechanism Rule. Are there any aspects of the CER's current reporting and assurance regime that the AUASB should consider when developing pronouncements on assurance over climate-related financial disclosures and other sustainability information?

Response:

The Clean Energy Regulator's (CER) assurance requirements, particularly concerning Scope 1 and 2 emission intensity determination under the Safeguard Mechanism Rule, offer valuable insights for the AUASB. When developing pronouncements, the AUASB should ensure that they are aligned with existing regulatory frameworks established by the CER. Understanding how the CER defines the scope of assurance and determines materiality can inform the AUASB's approach. This includes clarifying which emissions (e.g., Scope 1, Scope 2) are subject to assurance and establishing thresholds for materiality in the context of climate-related disclosures.

Question 16.

Some entities that will be subject to the mandatory proposed climate reporting requirements have cross-border activities or operations. Are there any international factors that the AUASB should consider when developing its proposed pronouncements relating to assurance over climate-related financial disclosures and other sustainability information?

Response:

The AUASB should indeed consider various international factors, especially given that some entities subject to these requirements have cross-border activities or operations. The AUASB should align its proposed pronouncements with internationally recognized reporting frameworks such as GRI, TCFD, IFRS S1, and S2, that provide guidelines for sustainability reporting. AUASB could also consider other jurisdiction directives examples such as the Corporate Sustainability Reporting Directive and the European Sustainability Reporting Standards. Ensuring compatibility can facilitate comparability and consistency across jurisdictions. The AUASB should also monitor emerging best practices in climate-related reporting and assurance globally as it can inform the development of robust and relevant standards. This would involve regular engagement with international standard-setting bodies, industry groups, and stakeholders to stay abreast of evolving trends and expectations. Many changes are expected due to the transition to low-emissions energy.

Question 17.

Do you have suggestions on any other matters that the AUASB should consider in relation to assurance over climate-related financial disclosures and sustainability reports?

Response:

While an audit of climate and sustainability disclosures is highly desirable, there are capacity issues within the assurance profession. Therefore, a staggered approach would be appropriate, excluding small and medium-sized companies from mandatory disclosures and audits at least initially as stated in Attachment 1. Organizations' consideration of climate and sustainability risks has grown in tandem with the importance of climate change as a topic of public concern in recent years. Another important aspect to carefully consider is the role of governance in assurance oversight. Specifically, an entity's board of directors will need to consider whether the entire board or the audit committee itself should be responsible for the oversight of climate-related and other sustainability risks and disclosures and related internal controls and procedures. Board audit committees may need to have discussions on climate-related disclosures with the entity's internal audit team as well as with external auditors.

In the Australian context, we support the current development of mandatory climate and sustainability reporting standards and guidelines on the assurance of such information to make them reliable.