ISSA 5000 Sub 5

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Australian Institute of Company Directors

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Mr Douglas Niven
Chair, Auditing and Assurance Standards Board (AUASB)
PO Box 204
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Via email: enquiries@auasb.gov.au

Dear Doug,

**AUASB Consultation: IAASB's Proposed ISSA 5000**

Thank you for the opportunity to make a submission to the Auditing and Assurance Standards Board (AUASB)'s Consultation on the International Auditing and Assurance Standards Boad (IAASB)'s proposed International Standard on Sustainability Assurance, Draft ISSA 5000.

The Australian Institute of Company Directors (AICD)'s mission is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. The AICD's membership of more than 50,000 includes directors and governance leaders of not-for-profits, large and small businesses and the public sector.

The AICD supports the making of high quality, useful and comparable climate disclosures. Assurance by a suitably qualified and independent external practitioner increases market confidence in the quality and reliability of climate disclosures. Although directors must always exercise independent diligence in overseeing and signing off on disclosures (including climate disclosures), external assurance also acts as an additional support. This is particularly important where many climate disclosures are forward-looking, such that companies and directors are subject to heightened liability risks.

Given the technical accounting focus of many of the AUASB and IAASB consultation questions, we are not proposing to respond to the designated questions. Instead, our submission will provide some overarching comments on the Draft ISSA 5000 and its potential application to Australia (noting the forthcoming introduction of mandatory climate reporting based on the International Sustainability Standards Board (ISSB) standards), focusing on how Australian directors engage with assurance.

## 1. Executive Summary

In summary, our key points are:

a. High quality assurance engagements require regular and effective communication between directors and assurance practitioners, principally through the Audit Committee. Guidance on how to facilitate this communication in the specific context of sustainability assurance would be welcome.

b. In light of the directors' role in recommending/appointing assurance practitioners and in reviewing and maintaining audit quality, more consideration needs to be given as to which quality management, ethics and independence standards apply to non-accounting sustainability assurance practitioners. Specifically, there needs to be clarification as to how to assess whether a non-accounting standard is "at least as demanding" as the relevant accounting standards,[1] by whom this assessment can be made, and how compliance will be monitored and enforced.

c. We recommend that the AUASB provide support and Australian-specific guidance to companies and directors outlining the steps they need to take to satisfy the preconditions for assurance.

d. Given the qualitative and assumption/judgement/contingency-laden nature of the majority of sustainability disclosures, consideration should be given to the suitability of the proposed "appropriateness of sustainability matters" test set out in paragraph 70 of the Draft ISSA 5000.

e. In the event that Treasury does not impose a requirement that the financial statement auditor must lead the climate assurance engagement, we recommend that the Draft ISSA 5000 clarify the nature and scope of the communication expected between the sustainability assurance provider and the financial statement auditor. We note this is not currently addressed in the Draft ISSA 5000.

f. There remains significant market uncertainty as to how to undertake, and therefore assure, materiality assessments of sustainability information. To assist, we highly recommend that the AUASB and AASB update their 2019 guidance, including to take into account significant developments since April 2019 such as the issue of the ISSB Standards and the draft Australian Climate Standard (ED SR1).

g. The Draft ISSA 5000 and Explanatory Memorandum appears to equate all greenwashing with fraud, which does not reflect the majority of greenwashing cases which may involve unintentional misleading disclosures. Consideration needs to be given as to how incidents of non-fraud greenwashing will be addressed, including how and when such cases should be raised with directors and/or management. The AUASB may need to amend the standard and/or issue Australian-specific guidance to align with Australian law.

## 2. The importance of assurance to Australian directors

One of directors' primary obligations is to oversee the preparation of the financial statements and notes and the Directors' Report in compliance with the *Corporations Act*. Specifically, directors are required to sign a declaration stating that financial statements and notes present a true and fair view of the financial performance and position of the company. They are also required to pass a Directors' Declaration approving the Directors' Report. Any representations as to future matters must be based on "reasonable grounds."

Assurance is critical to directors as it provides independent verification of information. Whilst we are not suggesting that directors rely solely on assurance practitioners when signing-off on disclosures, in practice, the dialogue between assurance practitioners and directors is an important part of directors fulfilling their financial reporting oversight function. As such, high quality assurance engagements, informed by regular and effective communication between directors and assurance practitioners, is paramount.

[1] Namely the International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants and the International Standard on Quality Management (ISQM 1).

## 3. Specific comments on the Draft ISSA 5000 and its application to Australia

We make comments on the Draft ISSA 5000 and its application to Australia on the following key topics:

- quality, competency and independence requirements of sustainability assurance practitioners;
- preconditions for assurance;
- "appropriate sustainability matters";
- materiality;
- approach to greenwashing;
- communication with those charged with governance; and
- accessibility and understandability issues.

a. Quality and independence requirements of sustainability assurance practitioners

Directors, particularly Audit Committee members, have a key role to play in the selection and periodic review of assurance providers. Key to this role is to consider the independence and competence of the assurance practitioner. Whilst current practice sees the majority of sustainability assurance engagements undertaken by the same firm as the financial audit,[2] this may change given the scope and requirements of the proposed Australian mandatory reporting framework (and depending on Treasury's final position on whether the financial auditor must conduct or lead the sustainability assurance engagement).

These requirements may see some entities, most likely smaller entities which may have price sensitivities, look beyond financial assurance providers.

As such, it is important that non-accountant sustainability assurance practitioners are subject to vigorous quality management, ethical and independence standards. A failure to do so will impact the trust that investors and other information users have in the quality of sustainability disclosures.

Whilst we appreciate that sustainability assurance is an emerging field, we consider that more needs to be done to identify quality management, ethical and independence standards which non-accounting assurance practitioners could apply. In particular, there needs to be clarification as to how to assess whether a standard is "at least as demanding" as accounting standards and requirements, such as the International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants or the International Standard on Quality Management (ISQM 1).

We note that financial auditors in Australia are subject to a registration system managed by ASIC, with competency and skill requirements stipulated under the *Corporations Act*[3] and administered by the professional accounting bodies.[4] To ensure that sustainability assurance practitioners are subject to competency and ethical requirements "at least as demanding" as those required for financial auditors, consideration should be given to the development of similar competency standards for sustainability assurance providers. Of course, the approach should reflect the emerging nature of sustainably assurance, and be appropriately phased in.

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[2] The Auditing Competency Standard for Registered Company Auditors (2016 competency standard) produced by CPA Australia (CPAA), the Chartered Accountants of Australia and New Zealand (CA ANZ), and the Institute of Public Accountants (IPA).

[3] Sections 1280 and 1280A Corporations Act.

[4] A December AUASB and AASB 2022 report found that only around 5% of listed companies' have climate-related data disclosed in their Annual Report audited: See AASB and AUASB (December 2022), Research Report: Climate-related disclosure and assurance in the Annual Reports of ASX-listed companies.

b. Preconditions for assurance

Given the threshold nature of preconditions of assurance, we highly recommend that support and guidance is provided to companies and directors to meet the preconditions for assurance.

It is also unclear what will happen to organisations which fail to meet preconditions for assurance where there is a legal requirement to obtain sustainability assurance (as is being proposed by Treasury). For instance, consideration should be given to whether the carveout in paragraph 74 of the Draft ISSA 5000, which allows the acceptance of an assurance engagement even where conditions of preconditions for assurance have not been met where it is "required by law or regulation," would apply in these circumstances.

c. Assessing the appropriateness of sustainability matters

Paragraph 70 of the Draft ISSA 5000 requires that the sustainability assurance practitioner evaluate the appropriateness of sustainability matters by considering whether those sustainability matters are *"identifiable and capable of consistent measurement or evaluation against the applicable criteria, such that the resulting sustainability information can be subjected to procedures for obtaining sufficient appropriate evidence."* Whilst the Application Guidance provides some guidance as to how this may be assessed, it fails to recognise that some, if not a significant portion, of sustainability disclosures are incapable of consistent measurement or evaluation because of the inherent uncertainties of climate disclosures.

These uncertainties arise because sustainability disclosures are often dependent on technological, regulatory, market and scientific assumptions which are subject to regular, and often significant, change. Many disclosures are also forward-looking in nature, and require estimation of the impact of inherently unknowable outcomes or events 5, 10 or 20+ years into the future (e.g. as part of transition plan disclosure). Given these inherent uncertainties, there is often debate between experts as to the reasonableness of disclosures. Key examples include the reasonableness of relying on emerging technologies, carbon offsets and/or particular decarbonisation pathways or strategies.

In light of these complexities, more consideration needs to be given as to how assurance practitioners can assess the appropriateness of qualitative and uncertain sustainability matters, and how this assessment is recorded and communicated, including to directors and management.

d. Materiality

As you are aware, materiality is a threshold issue for sustainability reporting. Crucially, the AASB is proposing to deviate from the ISSB standards by requiring that entities which conclude that there are no material climate-related risks and opportunities that could reasonably be expected to affect its prospects, disclose this fact, and explain how it came to that conclusion. In light of this, we foresee that there will be considerable scrutiny by regulators, investors and other stakeholders (including those seeking to bring private litigation), as to the veracity of materiality assessments.

Whilst the Draft ISSA 5000's Application Guidance on materiality at A270 to A285 provides useful guidance to assurance practitioners, significant market uncertainty persists (including at the director and report preparer level), as to how to make a materiality assessment on sustainability issues. To assist market understanding, we recommend that the AUASB and AASB update their 2019 guidance on the making of materiality assessments in respect of climate-related risk to take into account subsequent significant developments, such as the issue of the ISSB Standards and the draft Australian Climate Standard.

e. Approach to greenwashing

The Explanatory Memorandum for Draft ISSA 5000 states that its policy intent is to encourage assurance practitioners to identify potential cases of greenwashing. However, we do not consider that the current wording of Draft ISSA 5000 reflects the policy intent. Most significantly, the draft standard seems to equate greenwashing with fraud, which is not entirely accurate.

While there is currently no legally binding definition of 'greenwashing,' it is generally understood to mean any overstatement of environmental or sustainability benefits, or understatement of environmental or sustainability risks. As such, it canvasses a broad range of misleading conduct, only a small proportion of which amounts to fraud. The vast majority of greenwashing is unintentional, often as a result of overzealous marketing or a failure to clearly set out, or vigorously test, the assumptions, judgements or contingencies underpinning a climate disclosure. We consider further consideration needs to be given as to how incidents of non-fraudulent greenwashing will be addressed, including appropriate escalation procedures, including how and when such cases should be raised with management.

Further, it should be recognised that jurisdictions will have differing legal tests governing 'greenwashing' conduct. In Australia, entities are held liable under misleading or deceptive conduct and disclosure laws, with a "reasonable grounds" test applying to forward-looking representations. For the reasons set out in section 3c, establishing reasonable grounds can be fraught with difficulty. In light of these Australian-specific nuances, we recommend that the AUASB issue guidance and/or make specific modifications to the standard to ensure consistency with Australian law.

f. Communication with those charged with governance

High-quality communication between directors and the assurance practitioner is critical to promoting audit quality. In respect of financial report audit, ASIC states that this communication should include concerns and risks affecting the processes that support the information in the financial report, and how these concerns and risks are being addressed by directors and management, and responded to in the audit.

Given the qualitative and subjective nature of many (if not the majority) of sustainability disclosures, regular and high-quality engagement between directors and assurance practitioners will be crucial to attaining appropriate audit quality standards. We recommend that guidance on sustainability assurance address how directors and assurance practitioners should communicate to enhance assurance quality.

g. Accessibility and understandability issues

Given the intent is for Draft ISSA 5000 to improve comparability and trust in sustainability disclosures and be 'profession agnostic' (i.e. be applied by those outside of the accounting profession), we consider that more work could be done to improve the accessibility and understandability of Draft ISSA 5000.

Whilst we appreciate that the standard needs to be technical, we recommend that guidance/outreach/education be undertaken aimed at variety of stakeholders, including report preparers, directors, financial auditors and sustainability assurance practitioners, to address areas of confusion or uncertainty. Topics for engagement (some of which we discuss above) may include:

- materiality;
- working with qualitative information, estimates and forward-looking information;

- engagement with directors;
- engagement with other experts; and
- the difference between limited and reasonable assurance from the perspective of non-assurance practitioners, such as directors and investors.

## 4. Next steps

We hope our submission will be of assistance to you. If you would like to discuss these matters further, please contact Christian Gergis, Head of Policy at cgergis@aicd.com.au or Anna Gudkov, Senior Policy Adviser at agudkov@aicd.com.au.

Yours sincerely,

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General Manager, Education & Policy Leadership