Submission to the Consultation Paper by Auditing and Assurance Standards Board Proposed Australian Standard on Sustainability Assurance ASSA 5010 Timeline for Audits and Reviews of Information in Sustainability Reports under the Corporations Act 2001

Prepared by

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About the authors

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Dr Luisa Und 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 Professor at the Department of Business Economics at the University of the Balearic Islands in 2024. Previously she was 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 climate change disclosures, corporate governance, board diversity, financial reporting quality, gender differences in financial decision-making, and accounting and finance education.

Summary

The assurance of climate and sustainability information, as proposed by the AUASB, is essential for enhancing the reliability and transparency of disclosures related to climate and sustainability risks. Such assurance will significantly bolster the availability of credible information on these risks and the ways Australian companies manage them. This, in turn, will empower stakeholders to strengthen the climate resilience of both the financial system and the broader economy. We anticipate that these reforms will drive continuous improvements in climate risk and sustainability reporting across Australia. While the demand for assurance of climate report is growing, it is costly and requires specialist expertise. Scientific research and anecdotal evidence suggest that the audit profession currently lacks sufficient skills and capacity in this area. Therefore, we support the AUASB's proposed timeline for the application of ASA 5010 as it will allow staged application of the standard and development of the capacity in the audit profession.

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

Proposed Australian Standard on Sustainability Assurance ASSA 5010 Timeline for Audits and Reviews of Information in Sustainability Reports under the Corporations Act 2001

Question 1.

Do you agree that the audit and review requirements for disclosure topics in the proposed AASB S2 are appropriate, taking into account:
a. Their relative importance of assurance to users of the information;
b. Their interconnectivity;
c. The likely cost of assurance; and
d. The readiness of Group 1, 2 and 3 entities' systems and processes.

Response:
We agree that assurance requirements for disclosures within the potential assurance phasing model, should initially focus on later stages rather than early adoption. However, entities should have the option to voluntarily implement assurance measures at an earlier stage. A phased approach, considering entity size, appears reasonable; larger entities (Group 1) may be better positioned to adopt assurance measures sooner, while medium-sized and smaller entities (Groups 2 and 3) may require additional time to develop the necessary infrastructure and capabilities for comprehensive reporting. It is essential to ensure the phasing model remains adaptable to accommodate variations in industry practices, regulatory demands, and the specific circumstances of individual entities, including potential changes over the coming years.
The audit of climate and sustainability data is inherently more complex than financial audits, necessitating more time for the profession to develop adequate capacity, skills and resources for high-quality assurance—whether limited or reasonable. Assurance plays a pivotal role in strengthening investor confidence in the accuracy and reliability of climate and sustainability reporting.
We have conducted research in this area. Table 1 shows a small increase in voluntary climate assurance by auditors over the period from 2018 to 2024 among Australian listed companies from a group of S&P/ASX300 companies. The mention of "climate change" by auditors in the independent audit reports is very low with only 50 companies out of 1,819 companies over the period from 2018 to 2024.

Disclosure of term "climate change" in independent audit reports by financial year

	Machine-readable financial statements and notes	Disclosure in independent audit reports	
Year	N	N	%
2018	237	1	0.42
2019	242	1	0.41
2020	253	3	1.19
2021	274	3	1.09
2022	281	16	5.69
2023	293	16	5.46
2024	239	10	4.18
Total	1,819	50	2.75

Our above findings suggest that even larger companies are struggling to get their auditors to consider climate change in their independent audit reports during the voluntary period. Hence, questions the readiness of Group 1 entities' systems and processes.

Question 2.

If you are an auditor, do you consider that your firm could adequately resource the audit and review requirements over sustainability information for entities whose financial reports are audited by your firm?

Response:

While we are not 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. We do not believe that the educational sector has been able to impart sufficient amount of knowledge and expertise among accounting graduates to be able to meet the requirements of high-quality climate assurance. Given the increasing demand for sustainability reporting and assurance, audit firms would need to ensure they have specialized skills in areas such as environmental science, ESG (Environmental, Social, and Governance) metrics and regulation, and industry-specific knowledge to meet these requirements. 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. Reports from organizations like the International Federation of Accountants (IFAC) and various professional accounting bodies have highlighted these readiness challenges and emphasized the need for upskilling, the development of robust assurance frameworks, and collaboration among stakeholders to build auditors' capacity and skills for credible climate assurance.

Question 3.

Do you consider that governance disclosures and disclosures of risks and opportunities should be subject to review in year 1?

Response:

We support that governance disclosures should be subject to review in year 1 of the implementation of climate change assurance standards. These areas are critical as they set the foundation for how companies approach climate-related issues, including strategic oversight, risk management, and decision-making processes. Besides, governance mechanisms and disclosure requirements have been in place for close to two decades in Australia, especially for Australia-listed companies under the ASX Corporate Governances Council Best Practice Recommendations. However, the disclosures of risks and opportunities also include climate risk and many other risks such as geopolitical risks. These risks are complex. The introduction of ASSA 5010 standard involving a phased approach will allow Group 1 entities to adapt gradually. In the first year, the focus should generally be on achieving compliance with foundational elements, giving preparers and auditors the opportunity to familiarize themselves with new requirements before expanding to complex areas such as other risk disclosures and their audit. Climate risk and geopolitical risks are inherently complex, making their identification, assessment, and disclosure challenging. Companies may lack mature processes for gathering and validating data, particularly in the early stages. Providing time for refinement reduces the likelihood of incomplete or inaccurate disclosures. The initial year of new assurance standard should serve as a period to build capacity among auditors, who must develop the necessary skills to review nuanced disclosures effectively. Immediate review of other types of risks could lead to inconsistencies and undermine confidence in the assurance process.

Question 4.

Do you agree that any statements that there are no material risks or opportunities should be subject to the same level of assurance as identified risks and opportunities for any given financial year?

Response:

An entity's statement that it does not possess any material risks or opportunities should be subject to the same level of assurance as identified risks and opportunities for several reasons. First, stating that an entity does not possess any climate risk or opportunity should be based on credibility and transparency. Investors, regulators, and other stakeholders rely on accurate risk disclosures to make informed decisions. A statement claiming an absence of material risks or opportunities may indicate a clean bill of health but, if inaccurate or unsupported, could lead to serious repercussions, including a loss of credibility, reputational damage, or litigation and regulatory scrutiny. By stating that there is no material risk, there is a risk of misstatements or omissions. Therefore, we believe it is just as important to ensure the absence of risks or opportunities as it is to disclose their presence. Without sufficient assurance, an entity might inadvertently or deliberately omit information that could materially affect stakeholders' perceptions or decisions. Subjecting this claim to the same level of assurance would ensure the accuracy and completeness of disclosures. We also believe that every type of entity and every industry possesses climate change and sustainability risks, only the degree and intensity may vary. Besides, material risks and opportunities can evolve rapidly due to economic, environmental, regulatory, or market shifts. By subjecting statements of no material risk or opportunity to the same level of assurance, there is greater confidence that the company has thoroughly considered current conditions and potential future impacts, reducing the risk of complacency in risk assessments.

Question 5.

Do you agree that assurance phasing requirements for Group 1, 2 and 3 entities should commence with the same settings and progress at the same pace?

Response:

Continuous evaluation and adjustment based on stakeholder feedback and evolving best practices will be critical for the assurance standard’s success. The assurance phasing requirements for Group 1, 2, and 3 entities should not commence with the same settings or progress at the same pace because these groups are likely to have significantly different characteristics, needs, and levels of complexity in their financial reporting and auditing processes. It is highly likely that after the Group 1 entities start reporting and get their climate reports audited, the standard-setters (i.e. AUASB), management and the audit firms would have a much better understanding of the success of the ASSA 5010 standard. There should be some flexibility in terms of settings and progress for Group 2 and group 3 entities. The profession should experience the outcome from Group 1 entities and then decide the commencement for Group 2 and 3 instead of rushing into this decision at this stage.

Question 6.

Do you agree that entities that enter a Group after the first reporting year for that Group (e.g. due to an increase in their size) should be subject to the same assurance requirements as other entities in the Group for the relevant reporting year (i.e. they would not be subject to the assurance levels for the first reporting year for the group)?

Response:

Entities that join a group after the first reporting year should be subject to the same assurance requirements as other entities in the group for the relevant reporting period. This is essential to ensure consistency in financial reporting, providing transparency and comparability across the entire group. Applying the same assurance standards to the new entity ensures the accuracy and integrity of the consolidated financial reporting, reflecting the true impact of climate change of the group as a whole. Allowing different levels of scrutiny within the group could result in non-compliance with climate change reporting and auditing regulations, exposing the group to potential legal and regulatory risks. Treating newly integrated entities equally ensures fairness and consistency in the application of group-wide assurance standards, upholding integrity and ensuring that all entities within the group are held to the same high assurance standards.

Question 7.

Do you agree with the approach to assurance over comparative information?

Response:

We agree with the approach to assurance over comparative information in the current year. When ASSA 5010 is implemented, entities will have limited time to fully adopt the new requirements, especially in the first year. This could result in challenges in gathering and reporting comparative information in line with the new standard. Requiring assurance over comparative information in this context may place undue pressure on Group 1 entities to meet the new standard within a short timeframe. The adoption of new assurance standard involves changes in measurement, recognition, or disclosure practices. These changes can impact prior-year figures, requiring adjustments or restatements. It may be difficult to apply assurance to these figures as they might not fully reflect the impacts of the new standard or have been subject to the previous standard's requirements, which might not align with the current year's methodology. However, if entities are not confident about their comparative information then it should not be provided otherwise, in the absence of assurance of comparative information, the credibility and informativeness of such information can be very low.

Question 8.

Have applicable laws and regulations been appropriately addressed in the proposed Standard?

Response:

The AUASB is known for developing new auditing standards through a consultative process, which includes several key stages such as identifying the need for a new standard based on emerging issues, developing a draft for public consultation, gathering feedback from stakeholders like auditors, firms, and regulators and considers the feedback. We believe that the proposed Australian Standard on Sustainability Assurance, ASSA 5010, has considered several key aspects of applicable laws and regulations, particularly with regard to the mandatory climate disclosures outlined in the Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024. The standard addresses the timeline for audits and reviews of sustainability reports under the Corporations Act 2001, specifically setting out phased assurance requirements for various disclosures related to climate risks and sustainability performance. One key regulatory consideration is the incorporation of these mandatory disclosures for entities subject to the Corporations Act, which requires them to produce sustainability reports alongside their financial reports. The AUASB has designed a phased assurance model in response to the new framework. This model aligns with the expected maturity of reporting systems and the capacity of auditors, progressively increasing the level of assurance, from limited assurance to reasonable assurance, over several years. The assurance model also reflects the urgency of climate reporting and the complexities associated with it. For example, scope 1 and 2 emissions will require limited assurance from the first year, with the scope expanding to include other areas such as climate-related metrics and targets in subsequent years. The overall framework is consistent with the broader global movement toward standardizing sustainability assurance, with ongoing consultations aiming to finalize these regulatory measures by December 2024.

Question 9.

What are the costs and benefits of the proposals, whether quantitative or qualitative and whether financial or non-financial? The AUASB is particularly seeking information on the nature and, where possible, estimated amount of any expected incremental costs of the proposals.

Response:

Our empirical study of Australian listed companies' voluntary climate related financial disclosures (CRFD) reveal that disclosing entities, on average, incur at least $5,000 in higher audit fees, with costs exceeding $500,000 for large entities depending on disclosure complexity and business operations. This indicates the need for auditors to exercise due diligence when evaluating clients' assets, especially in light of climate change and sustainability risks affecting long-term asset values. Audit clients making CRFDs typically pay higher audit fees, suggesting that auditors charge more due to the increased requirements for extensive procedures to ensure accuracy and compliance with reporting standards, thereby enhancing the quality of financial reports. We believe that the compliance with ASSA 5010 will be a lot costlier for audit clients in the first few years of audit. Our textual analysis of disclosures also suggests that large listed companies in Australia, for example, BHP, Rio Tinto, Woolworths etc., disclose a lot more on climate change and there are efforts by the auditors in ensuring the disclosures are credible.

The disclosures by smaller entities continue to remain poor without providing much details about the climate and sustainability risks. The interconnectivity remains poor even among large companies, therefore, even Group 1 companies will require time to ensure high quality disclosures and therefore, high quality climate assurance.

Question 10.

Are there any other significant public interest matters that you wish to raise on the proposals in this exposure draft?

Response:

Most organizations cannot afford to or do not employ climate scientists who can assess the probabilities of events occurring, nor do they employ economists trained to assess the macroeconomic impacts of events once they occur. We propose that one potential solution is to create a central independent agency by each country/jurisdiction comprised of climate scientists and macroeconomists to provide such data as inputs to firms. This will reduce the cost of providing valuable information, providing managers with a starting point from which to adjust to their firm-level impacts. The quantitative scenario disclosures can be borrowed from the quantitative and qualitative risk disclosure framework from the US (i.e., Item 7A for Form 10-K). An independent agency could provide macroeconomic forecasts based on different climate and sustainability-related scenarios.

We conducted an in-depth analysis of climate disclosures of large Australian companies. We find that for large companies like BHP, the disclosures on climate change in their operating and financial review (OFR) are very complex and would require very specialist expertise for the financial auditors to offer even limited assurance. The interconnectivity is also very poor. We propose disclosures on climate change risk by Group 1 entities similar to the SEC Item 7A (BHP Billiton Ltd) based on risks to improve interconnectivity. Below is an example of such disclosures that we propose for Australian Group 1 entities:

Illustration: Equivalent of Item 7A (Wine producer – operating in UNSW): Connecting financial and climate change information

Approximate impact on the following items based on scenarios	Scenario 1 – increase in bush fires by 5% (Short-term)	Scenario 2 – increase in bush fires by 10% (Short-term)	Scenario 1 – increase in bush fires by 5% (Medium-term)	Scenario 2 – increase in bush fires by 10% (Medium-term)
Income statement				
Revenue	1% lower	5% lower	2% lower	5% lower
EBITDA	5% lower	10% lower	5% lower	15% lower
Balance sheet				
Current assets	2% lower	5% lower	2% lower	5% lower
Non current assets	5% lower	10% lower	5% lower	15% lower