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Via email: enquiries@auasb.gov.au

Dear Doug,

AUASB Consultation: Assurance over climate and other sustainability information

Thank you for the opportunity to make a submission to the Auditing and Assurance Standards Board (AUASB)'s Consultation on Assurance over climate and other sustainability information.

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 52,000 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. This once-in-a-generation change to corporate reporting will require significant investment and upskilling for both report preparers and assurance providers. Even those currently disclosing under the Taskforce for Climate-related Financial Disclosures (TCFD) framework will be required to make disclosures that are more detailed and granular than what is currently standard practice.¹

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 provides 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, our submission will focus on areas of greatest impact on directors.

¹ Whilst we know that there has been a steady increase in the number of ASX100 and ASX200 companies referring to, or disclosing, against the TCFD framework, the quality and comprehensiveness of this disclosure is patchy and inconsistent. A [June 2023 KPMG report](#) revealed that of the 88% of ASX100 companies that acknowledge climate change as a business risk, only 8% model potential impacts using scenario analysis and only 1% provide financial quantification of potential impacts. In its [August 2023 ACSI report into ASX200 reporting practices](#), ACSI states that "While the positive trends in TCFD reporting are welcome, the quality of analysis, transparency of methodologies and depth of disclosure varies considerably across companies. Too many companies are only at the stage of 'partial' alignment to the TCFD framework for their disclosures" (page 6) and that even "full alignment to the TCFD framework does not always correlate with sufficient disclosure" (page 7). For a comparison of TCFD v ISSB requirements see [Fact Sheet 2](#) of AICD, Deloitte and MinterEllison's [Director's Guide to Mandatory Climate Reporting](#).

1. Executive Summary

In summary, our key points are:

1. There needs to be alignment between the phase-in of mandatory assurance over forward-looking disclosures and the expiry of the Modified Liability² and Qualified Director regimes³ under the climate reporting legislation.⁴
2. We support Australia's adoption of the International Auditing and Assurance Standards Board (IASB) Standard for Sustainability Assurance Engagements, ISSA 5000, subject to amendments and/or clarification where the draft standard potentially conflicts with Australian law, including audit requirements under the finalised climate reporting legislation.
3. Local pronouncements and/or guidance which could assist lift the quality of, and confidence in, sustainability disclosures and assurance engagements include: quality and competency requirements; the extent of permitted reliance by the financial auditor on sustainability experts; Group 3 audit over a statement of no material climate-related risks or opportunities; materiality; preconditions of assurance; limited v. reasonable assurance; approaches to greenwashing; and communication between auditors and those responsible for governance.

2. Part 1: Potential assurance timetable

Assurance provides information users with confidence in the quality and reliability of disclosures. To achieve this objective, reasonable assurance should be mandated as soon as practicable. Of course, this need should be balanced with the resolution of technical feasibility challenges arising from the assurance of sustainability disclosures (namely forward-looking disclosures), particularly in light of data gaps, as well as capacity and skills constraints within the assurance industry. We also expect that during the phase-in of the reporting requirements, there will be instances where entities voluntarily seek to obtain a higher level of assurance than that mandated by the government to provide a greater level of confidence to the market (and directors, see below) in the accuracy of these complex new disclosures.

Scrutiny over internal systems and processes of verification is an important part of directors fulfilling their financial reporting oversight function. Such systems and processes are also necessary to satisfy pre-conditions for assurance and ultimately form the basis for audit. We reiterate and support the recent statement of the Law Council on the inter-relationship between directors' oversight functions and external assurance:

“While directors do not and cannot rely solely on auditor’s reports to form a view, they do rely on the same underlying systems and processes in an entity that auditors and assurance providers use to produce their reports.” (Law Council [submission](#) to the Senate Inquiry into the Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024 (Senate Inquiry)).

It is wholly appropriate that any climate disclosures made in the absence of mandatory reasonable assurance should be subject to a modified liability regime and qualified director declarations. It is critical that the phase-in of mandatory assurance over the most uncertain and higher liability risk disclosures, especially forward-looking statements such as scenario analysis and transition plan disclosures, aligns with the end of the Modified Liability and Qualified Director regimes.

² Section 1707D of Schedule 4 of the [Treasury Laws Amendment \(Financial Market Infrastructure and Other Measures\) Bill 2024 \(Climate Reporting Bill\)](#).

³ Section 1707C of the Climate Reporting Bill.

⁴ Climate Reporting Bill.

External assurance is also likely to support an entity or director demonstrating that they have “reasonable grounds” for forward-looking statements mandated by the sustainability standards.⁵

3. Part 2: ISSA 5000

To maintain international alignment, we generally support the adoption of ISSA 5000 by Australia.

However, in our [submission](#) to the AUASB on Draft ISSA 5000 we identified areas where the draft standard could be in conflict with Australian law. Most notably, this includes its approach to greenwashing.

As noted in our submission, consideration needs to be given as to how incidents of non-fraudulent greenwashing should be addressed by auditors. This includes how and when auditors should raise suspected greenwashing with directors and/or management. We do not consider that the current drafting of ISSA 5000, which appears to equate all greenwashing with fraud, accurately reflects the complexity of the issue.

There are likely to be many cases where a statement could be alleged to be misleading (and therefore an instance of greenwashing) due to, for example, differing understandings of reasonable reliance on carbon offsets or emerging technology and the disclosure of said reliance. It is overly simplistic to equate all greenwashing with intentional misleading conduct.

Further, given the different legal tests that apply to current v. future state disclosures, the AUASB may need to amend the standard and/or issue Australian-specific guidance to align ISSA 5000 with Australian law (see response to Part 3 **below**).

Finally, it is important that the AUASB addresses any deviations between draft ISSA 5000 and the final climate reporting legislation (if/when passed). For instance, the Climate Reporting Bill presently requires that the sustainability disclosure audit be led by the financial statement auditor, which is not required under the draft ISSA 5000.

4. Part 3: Possible Local Pronouncement

There are several areas which may warrant the AUASB to make a local pronouncement or issue implementation guidance. It is critical for business certainty that the AUASB make clear whether such pronouncements are mandatory or voluntary.

Areas for guidance which could assist lift the quality of, and confidence in, sustainability disclosures and assurance engagements include:

- **Quality and competency requirements:** Sustainability assurance is still an emerging field in Australia, with a limited number and scope of assurance engagements.⁶ Further, as we understand it, the Climate Reporting Bill requires sustainability assurance to be led by the financial statement auditor, who may have limited or no sustainability assurance skills and capability. To ensure public confidence in the robustness of sustainability assurance, it is critical that the AUASB, in consultation with the auditing profession and Professional Accounting Bodies (PABs) carefully consider quality and competency requirements, including the need for a formal certification program.

⁵ See page 8 of the KWM Advice at page 26 of the AICD [submission](#) dated 9 February 2024 to Treasury on the Exposure Draft Climate Reporting Legislation which states that “while directors must make an independent assessment of the matters the subject of the declaration, they do derive assistance from external assurance or audit, especially in relation to matters requiring reasonable grounds.”

⁶ An [AUASB December 2023 Research Report](#) found that only 40 ASX listed entities mentioned the provision of external assurance of climate-related information in their 2022 Annual Report and that only 22 attached these assurance reports to their 2022 Annual Report.

- **The extent of permitted reliance by the financial auditor on sustainability experts:** Whilst we understand the intention of the Climate Reporting Bill is to require that the sustainability audit be undertaken by the financial statement auditor, the Explanatory Memorandum acknowledges that the auditor will be supported by technical climate and sustainability experts, where appropriate.⁷ Such experts may include existing sustainability auditors including Registered Greenhouse and Energy Auditors (RGEAs). The permitted extent of this reliance and its legal ramifications are not currently clear. We recommend this be clarified by the appropriate government body by way of local pronouncement/ guidance. Coordination across key standard-setting and regulatory bodies will be critical to promoting consistency and certainty for report preparers and users.
- **Group 3 audit over a statement of no material climate risks or opportunities:** We are concerned as to the compliance burden of a mandatory *audit* of a Group 3 entity statement of no material climate risks or opportunities.⁸ Given the requirements for a formal audit, we understand from our discussions with auditing professionals that the cost of such a requirement will be significant, and ultimately unjustified, given Treasury estimates that the vast majority (95%) of Group 3 entities will face no material risks or opportunities.⁹ Accordingly, we recommend that the audit requirement be substituted for a review or limited assurance engagement or similar mechanism that provides some external assurance over the directors' statement without requiring significant unnecessary expense to be incurred. The negative consequences of requiring an audited statement of no material climate risk or opportunity would also be reduced if the thresholds for Group 3 entities were lifted to reduce the number of entities caught by these disclosures (see our [submission](#) to the Senate Inquiry in this regard).
- **Materiality:** There remains significant confusion in the market as to the application of materiality, including whether it applies at the entity and/or individual disclosure level. This confusion has been confounded by the introduction of an additional materiality test for Group 3 entities, which some in the market have interpreted as 'deeming' materiality for Group 1 and 2 entities. We highly recommend that the AUASB work with the AASB to issue clear guidance (with illustrative examples) on materiality. An update to its [2019 guidance](#) may be a prudent first step.
- **Preconditions for assurance:** Given the threshold nature of preconditions of assurance, we recommend that support and guidance is provided to companies and directors to meet the preconditions for assurance. This is particularly critical for highly uncertain and complex forward-looking disclosures which presents significant challenges for both disclosure and assurance. Ideally, such guidance would be issued in advance of the introduction of mandatory assurance requirements, given entities will be preparing their internal systems and processes in preparation for mandatory assurance phase-in.
- **Limited v. reasonable assurance:** There remains confusion at the report preparer and user levels regarding the differences in the robustness and level of auditor scrutiny of proposed disclosures for limited v. reasonable assurance. Guidance and education for these stakeholders will be key to promoting confidence in sustainability assurance and disclosures more broadly.
- **Approach to greenwashing:** For the reasons set out above, we do not consider that Draft ISSA 5000 addresses non-fraudulent greenwashing. If the policy intent of Draft ISSA 5000 and its Australian equivalent remains to encourage assurance providers to identify potential cases of greenwashing, the AUASB should issue a local pronouncement and/or guidance which reflects

⁷ Page 159 [Explanatory Memorandum](#).

⁸ Section 301A of the Bill; Paragraph 4.131 of the [Explanatory Memorandum](#).

⁹ Page 26 of the [Treasury Policy Impact Analysis](#) (September 2023, published January 2024).

Australian law. Given the lack of precedent and significant debate over what “reasonable grounds” looks like in the context of climate-related forward-looking disclosures, such guidance should be subject to significant consultation with stakeholders and relevant government agencies.

- **Communication between auditors and those responsible for governance:** Given the qualitative and subjective nature of many 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 addresses how directors and assurance practitioners should communicate to enhance assurance quality.

5. 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,



Louise Petschler GAICD

General Manager,
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