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Mr Douglas Niven
Chair, Auditing and Assurance Standards Board (AUASB)
PO Box 204
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Via online portal

Dear Doug,

Proposed Australian Standard on Sustainability Assurance, ASSA 5010 (Timeline)

Thank you for the opportunity to make a submission to the Auditing and Assurance Standards Board (AUASB)'s Consultation on Proposed Australian Standard on Sustainability Assurance ASSA 5010 *Timeline for Audits and Reviews of Information in Sustainability Reports under the Corporations Act 2001* (**ED 02/24**).

The Australian Institute of Company Directors (AICD) 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 53,000 includes directors and governance leaders of not-for-profits, large and small businesses and the public sector.

Assurance by a suitably qualified and independent external practitioner is critical to an effective mandatory climate reporting regime. First and foremost it increases market confidence in the quality and reliability of climate disclosures. Further, although directors must always exercise independent diligence in overseeing and signing off on disclosures (including climate disclosures), external assurance and engagement with the auditor is a further safeguard. This is particularly important where many climate disclosures are forward-looking, such that companies and directors are subject to heightened liability risks.

1. Executive Summary

In summary, our key points are:

1. **We broadly support the proposed timetable set out in ED 02/24** and consider it strikes an appropriate balance between meeting the demand for sustainability assurance and ensuring preparer and auditor readiness to meet these new requirements.
2. **Alignment with expiry of Modified Liability and Qualified Director regimes:** We are pleased to see, and support, the alignment between the phase-in of reasonable assurance with the expiry of the Modified Liability and Qualified Director regimes under the mandatory climate reporting regime.

3. **Phase-in from limited to reasonable supported:** We support a regime which starts with limited assurance and progresses to reasonable assurance after the fourth reporting year. This should give the assurance market the time to develop the relevant capabilities, and for standard-setters to provide guidance on the implementation of reasonable assurance over more challenging and nascent disclosures, such as scenario analysis and transition plan disclosures.
4. **Addressing market constraints and competition issues:** We note that the requirement that the Sustainability Report audit be conducted by the Financial Report auditor (or by different lead partners of the same Financial Report audit firm) may exacerbate existing audit market concentration issues. Allowing for lead auditor reliance on other (non-financial audit) sustainability assurance providers may, to some extent, alleviate this. AUAUSB guidance on the parameters of permitted reliance on other assurance providers and experts would be useful.
5. **Focus on auditor independence and quality:** Consideration should be given as to how to ensure that the quality of sustainability report audits aligns with the high standards currently seen in financial report audits.
6. **Guidance, education and capacity-building critical:** With Australia being one of the first jurisdictions to introduce mandatory reasonable assurance over ISSB-aligned disclosures, there is significant work in ensuring that directors, report preparers, and auditors are able to comply with these new obligations. The AICD is committed to lifting board and director awareness, education, competency and readiness of the new assurance requirements.
7. **Cost burden for Group 3 entities:** Group 3 entities, some of whom will be Not-for-Profits (NFPs), are likely to struggle with the cost and compliance burden of both mandatory climate reporting and assurance. Whilst it is hoped that creating a competitive mandatory assurance market will drive down fees, consideration should be given as to how to address the compliance and cost burden to these smaller entities.

2. Broad support for the proposed timetable

Overall, we support the proposed timetable. We consider it strikes an appropriate balance between meeting the demand for sustainability assurance and ensuring preparer and auditor readiness to service these new requirements. In particular, we are pleased to see, and support:

- the alignment between the phase-in of mandatory assurance over forward-looking disclosures and the expiry of the Modified Liability[1] and Qualified Director regimes[2] under the mandatory climate reporting regime; and
- a phased approach which commences with limited assurance and progresses to reasonable assurance from the fourth reporting year.[3] This should give the assurance market the appropriate time to develop the relevant capabilities, and for standard-setters to provide guidance on the implementation of reasonable assurance over more challenging and nascent disclosures, such as scenario analysis and transition plan disclosures.

3. Addressing market constraints and competition issues

The legislation requires that the Sustainability Report audit be led by the Financial Report Auditor. We understand that the AUASB is proposing that a different audit partner (i.e. a sustainability audit partner) can sign-off on the Sustainability Report provided they are a registered company auditor and both the Sustainability Report and Financial Report are partners at the same audit firm.[4] We also understand that the AUASB is developing guidance (which is welcome) on how this will work in

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[1] Section 1707D of the Corporations Act.
[2] Section 1707C of the Corporations Act.
[3] For all disclosures other than Scope 1 and 2 emissions, which progresses to reasonable in the second reporting year.
[4] AUASB August Meeting Public Paper Pack at page 26.

practice, including the degree of engagement between the two audit partners. Given the liability risks arising from inconsistencies between the component aspects of the Annual Report (Financial Report, Directors Report and now the Sustainability Report), we welcome guidance on the engagement between the Financial Report and Sustainability Report partners, including any requirements to identify material inconsistencies and misstatements.

A potential consequence of the legislated requirement that the Financial Report auditor lead the Sustainability Report audit is increased market concentration. We note that Treasury's May 2024 consultation on the regulation of accounting, auditing and consulting firms in Australia considered the question of whether there is sufficient competition in the Australian audit industry, and whether audit market concentration may reduce the sector's resilience. The UK experience reveals that, even in the absence of a specific legislative requirement that the sustainability assurance engagement be led by the financial report auditor, market perceptions[5] lead to increased market concentration within the 'Big 4.'[6]

One mechanism to address market concentration may be to set clear parameters as to the extent to which, and how, the lead auditor can rely on other sustainability assurance providers (such as National Greenhouse and Energy Reporting Act auditors).

4. Focus on auditor independence and quality

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 carefully consider quality and competency requirements, including the need for a formal certification program.

Given the maturing nature of climate reporting and assurance, current capability gaps and market concentration issues, auditor independence requirements, such as the approach to auditor provision of non-audit services (such as sustainability consulting services) should also be carefully considered.

5. Guidance, education and capacity-building critical

With Australia being one of the first jurisdictions to introduce mandatory reasonable assurance over ISSB-based disclosures, there is significant work to be done to ensure that directors, report preparers, and auditors can comply with these new obligations. The AICD is committed to lifting board and director awareness, competency and readiness of the new assurance requirements.

Issues relevant to directors which may warrant the AUASB to issue guidance (noting that AUASB has already flagged some of these issues in its August 2024 board papers[7]).

- **Limited v. reasonable assurance:** There remains confusion at the report preparer and user levels regarding the differences in the scope 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 disclosures and assurance.
- **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 commencement of

[5] Specifically that "*All non-audit assurance providers felt that choice was being limited by a perception that the Big Four audit firms (or audit firms more generally) were best placed to provide assurance*" and that "*some stakeholders noted that there are smaller non-audit firms that are unable to provide assurance over a growing range of sustainability metrics, so may be unable to compete for some larger engagements.*"

[6] FRC (October 2024) Assurance of Sustainability Reporting Market Study – Emerging Findings at page 13.

[7] Pages 26 to 30 of the AUASB August public meeting papers.

mandatory assurance requirements, given entities will be preparing their internal systems and processes in preparation for mandatory assurance phase-in.

- **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 Australian Accounting Standards Board (AASB) to issue clear guidance (with illustrative examples) on materiality. An update to its 2019 guidance may be a prudent first step.
- **Group 3 audit over a statement of no material climate risks or opportunities:** Further guidance on what an audit over a statement of no material climate risks and opportunities will entail. This should align with the final regulatory guidance arising from the current Australian Securities and Investments Commission (ASIC) consultation on sustainability reporting.[8]
- **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.

6. Cost burden for Group 3 entities

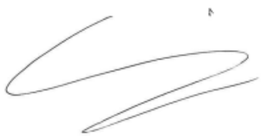
Estimating the cost of climate assurance has proved challenging (and is not information within the remit of the AICD), with current approximations ranging from $15,000 to $50,000 for audits of a Group 3 statement of no material climate risks and opportunities alone.[9] The UK experience may be instructive,[10] with the recent Financial Reporting Council (FRC) Report finding that the price of sustainability assurance can range from 5% to 30% of the financial audit fee.

In light of this, we are concerned that smaller entities within Group 3, which will include Not-for-Profit (NFP) entities, are likely to struggle with the cost and compliance burden of concurrent mandatory climate reporting and assurance. While it is hoped that creating a competitive mandatory assurance market will discourage inflationary fees, consideration should be given as to how to address the compliance and cost burden for these smaller entities.

7. Next steps

We hope our submission will be of assistance to you. If you would like to discuss these matters further, please contact Sean Dondas, Policy Adviser, at sdondas@aicd.com.au or myself at cgergis@aicd.com.au.

Yours sincerely,



[8] ASIC Consultation Paper 380: Sustainability reporting, November 2024.
[9] Nexia Australia and Chartered Accountants Australia and NZ submissions to the Senate Standing Committees on Economics Inquiry into the *Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024*.
[10] Noting, however, that assurance over climate disclosures is not mandatory in the UK. Further, the UK only requires disclosure under the TCFD framework, rather than the more detailed and granular ISSB standards.

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