



Project:	Climate-related Financial Disclosures	Meeting:	19 and 22 July 2024 (M206)
Topic:	Audit and Assurance challenges in relation to ED SR1 (GMC 32)	Agenda Item:	4.3.3
		Date:	12 July 2024
Contact(s):	Patricia Au pau@asb.gov.au Charis Halliday challiday@asb.gov.au	Project Priority:	High
		Decision-Making:	High
		Project Status:	Consider ED Feedback

Objective of this paper

- 1 The objectives of this paper are for the AASB to:
 - (a) consider feedback from stakeholders on whether the proposals in ED SR1 present any auditing or assurance challenges (GMC 32); and
 - (b) decide on any further work that might be needed in respect of GMC 32 before finalising ASRS 1 and ASRS 2.

Summary of stakeholder feedback and analysis

- 2 GMC 32 asked stakeholders: “Do the proposals create any auditing or assurance challenges and, if so, please explain those challenges?”
- 3 Of the 117 comment letters and 289 survey responses received, 44 and 49 stakeholders, respectively, provided a specific response to GMC 32.
- 4 The following table provides an overview of the responses received on GMC 32 (rounded to the nearest %).

	There are challenges	There are no challenges	Cannot form a view at present
Out of the 44 comment letters that commented on GMC 32 ¹	96%	2%	2%
Out of the 49 survey responses that commented on GMC 32 ²	84%	16%	-

¹ An overview of stakeholder feedback expressed in the comment letters is presented in Agenda Paper 4.3.6 for the Board’s reference. Staff applied judgement to categorise the overall comments expressed in the letters. Regardless of how staff categorised the feedback, the reasons provided by the respondents for supporting their position were considered as a part of the staff analysis.

² The survey responses have been provided separately for the Board’s reference.

- 5 The majority of stakeholders responded to GMC 32 identified some kinds of auditing or assurance challenges.
- 6 Staff observed that some stakeholders responded broadly on a range of assurance-related issues beyond the proposals in ED SR1, the majority of which are not within the control of the AASB. They include:
- (a) the requirement for mandatory assurance, and the scope of entities required to obtain assurance;
 - (b) the extent and timeline of phasing-in limited and reasonable assurance;
 - (c) the lack of a final international sustainability assurance standard; and
 - (d) the competency and capacity of auditors to assure sustainability information, including whether the auditor should be the same as the financial statement auditor.
- 7 Stakeholders noted several areas in ED SR1 that may present assurance challenges, including:
- (a) assurance of areas involving significant preparer judgement, including:
 - (i) the identification of climate-related risks and opportunities, or the conclusion that no material climate-related risks or opportunities were identified;
 - (ii) the application of materiality;
 - (iii) the application of “all reasonable and supportable information available to the entity at the reporting date without undue cost or effort”; and
 - (iv) assurance of climate-related scenario analysis, particularly in relation to the degree of subjectivity of inputs and assumptions used in the scenario analysis;
 - (b) assurance of Scope 3 GHG emissions, particularly concerns around lack of accessibility to primary data; and
 - (c) the impact of a lack of international alignment in disclosure requirements creating additional challenges for the upskilling and available capacity of assurance practitioners.
- 8 A spread of these issues is shown below (rounded to nearest %):

	Areas of significant judgement	Scope 3 emissions	Lack of international alignment
Comment letters	42%	29%	29%
Surveys	60%	40%	-

- 9 Staff consider that point (c) in paragraph 7 above regarding the impact of international alignment for assurance resourcing has been addressed by the Board’s decisions in M204 and M205 to develop ASRS 2 to be more closely aligned with IFRS S2; therefore this point is not discussed further in this paper.
- 10 The expected cost of compliance in preparation and mandatory assurance was also a significant recurring issue raised. Associated with commentary around the cost of compliance was the relative immaturity of systems to gather data for the required disclosures. This was also commonly tied to the issues of the available capacity of assurance providers, the areas of significant preparer judgement, and lack of guidance available.

- 11 Other matters raised by stakeholders included matters not specifically related to the proposals in ED SR1, such as suggestions regarding the use of the Integrated Reporting Framework, and requests to undertake more detailed impact assessments for Group 3 entities.

Areas of significant judgement

- 12 Multiple stakeholders were concerned about the practical ability of auditors to assure significant preparer judgements that pervasively impact the sustainability report presented. Their main comments have been summarised below.
- (a) Applying judgment is difficult for auditors and often requires additional external analysis (and costs) to support the judgment used, resulting in labour-intensive discussions during an already tight audit process.³
 - (b) Challenges arise particularly in relation to scenario analysis and Scope 3 GHG emissions. This is due to the levels of estimation and variability in assumptions while assurance is maturing.⁴
 - (c) Clear and well-defined reporting criteria are crucial for auditors to perform their tasks efficiently. When entities are required to use judgment in providing information, it can hinder the auditors' ability to effectively audit that information.⁵
- 13 Several comment letters also stressed the need to provide clear guidance on areas of significant judgement for preparers and assurance practitioners from the AASB and regulators.⁶ Stakeholders commented on the following:
- (a) Assurance practitioners and ASIC will need to apply significant judgement to be able to strike the right balance in the early years of adoption of ASRS Standards when processes and systems will be maturing in evaluating how the requirements have been applied. The FRC, AASB, AUASB and ASIC should provide guidance to assist entities in considering how the following IFRS S2 concepts should be applied:⁷
 - (i) 'exhaustive search';
 - (ii) 'undue cost and effort'; and
 - (iii) useful information for primary users.
 - (b) Determining what is material for disclosure by a reporting entity, and a material misstatement will be problematic without clearer guidance.⁸
- 14 Additionally, some comment letters seemed to be of the opinion that assurance over forward-looking information was not possible or was "untested".⁹

Staff observations

- 15 Staff observe that there are existing elements of accounting standards in which auditors are required to consider forward-looking information, including but not limited to impairment of assets, assessment of net realisable value, income based approaches to fair value valuation

3 For example, comment letter 75

4 For example, comment letter 44

5 For example, comment letter 88

6 For example, comment letters 37, 41, 65

7 For example, comment letters 7, 41

8 Comment letter 37

9 For example, comment letter 64

and going concern assumptions. Existing accounting standards also require the exercise of preparer judgement in applying similar requirements with regards to “reasonable and supportable information that is available without undue cost or effort”, for example, in AASB 9 *Financial Instruments* and AASB 17 *Insurance Contracts*.

- 16 The language of “reasonable and supportable information, that is available without undue cost or effort” already exists in AASB 9 in relation to assessing changes in credit risk of a financial instrument. AASB 9 paragraph B5.5.15 also uses the language that “an entity need not undertake an exhaustive search for information when determining whether credit risk has increased significantly since initial recognition”.
- 17 Additionally, the Knowledge Hub page of the IFRS Foundation website includes [FAQs](#) that explain what is meant by “use all reasonable and supportable information that is available to the entity at the reporting date without undue cost or effort” and “use an approach that is commensurate with the skills, capabilities and resources that are available to the entity for preparing those disclosures.”

Scope 3 GHG emissions

- 18 A large number of stakeholders listed Scope 3 GHG emissions as a particular area of concern for assurance.
- 19 Staff noted some comment letters appeared to be premised on a misconception that Scope 3 GHG emissions would require primary data from the entity’s value chain, which increased the challenges associated with assurance of Scope 3 GHG emissions.
- 20 Stakeholders’ comments are summarised below.
 - (a) Many entities will rely on third parties to provide Scope 3 GHG information which could often be estimates and therefore prone to inaccuracy.¹⁰
 - (b) Scope 3 GHG emissions are difficult to calculate and assure, and the AASB should look to establish standards that support reasonable efforts for entities to work with suppliers and other sources of Scope 3 GHG emissions to report. Many suppliers to reporting entities are not adequately resourced to deliver data of the quality required for climate-related financial disclosures within a short timeframe.¹¹
 - (c) Appropriate protections must be built into the ASRS Standards and the legislation to protect entities from repercussions of other entities in the supply chain who choose to not provide reporting entities with data to satisfy their mandatory Scope 3 GHG disclosure obligations.¹²
 - (d) Scope 3 GHG data is often coarse, based on industry averages, reliant on companies sharing sensitive data, or, in some cases, unavailable. Quality data from indirect suppliers remains difficult to obtain, and companies are often not in a position to independently verify the reliability or accuracy of information they are supplied regarding their scope 3 GHG emissions.¹³

10 Comment letter 39
11 Comment letter 51
12 Comment letter 79
13 Comment letter 84

Staff observations

21 Staff observe that:

- (a) the current *Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024* includes Scope 3 GHG emissions as a legislative requirement; and
- (b) IFRS S2 does not specify a particular measurement approach to measure GHG emissions. In measuring Scope 3 GHG emissions, IFRS S2:
 - (i) requires an entity to use all reasonable and supportable information that is available to the entity at the reporting date without undue cost or effort (IFRS S2 paragraph B39);
 - (ii) requires an entity to prioritise inputs and assumptions using identifying characteristics, one of which is data from specific activities within the entity's value chain (primary data). That is, an entity is required to prioritise using primary data, but is permitted to use secondary data (data not obtained directly from the entity's value chain) or a combination of both primary and secondary data; and
 - (iii) permits an entity to use information obtained from entities in its value chain that are different from the entity's reporting period subject to meeting specified conditions (IFRS S2 paragraph B19).

22 Staff observe that the Board at its June 2024 meetings decided to incorporate the related IFRS S2 requirements in ASRS 2. Accordingly, an entity would be able to prepare a Scope 3 GHG emissions inventory without the use of supplier-specific primary data but acknowledge that this is a common area of misunderstanding.

Staff conclusions

- 23 Staff consider the feedback received on GMC 32 does not indicate that additional work would be needed before finalising ASRS 1 and ASRS 2.
- 24 Staff acknowledge that there are concepts in sustainability reporting that are new to preparers and assurance practitioners, and therefore areas of significant judgement in sustainability reporting might be difficult to implement. Accordingly, staff consider there is merit in considering whether to develop guidance to assist entities in applying the principles of ASRS 1 and ASRS 2, after the Standards have been finalised.¹⁴

Question for Board members

Q1: Do Board members agree with the staff conclusion that no further work would be needed in respect to GMC 32 before finalising ASRS 1 and ASRS 2? If not, what other work do Board members consider necessary?

¹⁴ Consistent with the Board's decision at its [August 2023 meeting](#) to defer work on developing guidance until after the ASRS Standards have been issued.