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24 March 2023

Submission on Consultation Document - Assurance Engagements over GHG Emissions Disclosures

Dear Sir / Madam

Ernst & Young New Zealand (EY) welcomes the opportunity to comment on the Consultation Document, *Assurance Engagements over GHG Emissions Disclosures* (exposure draft), issued by the External Reporting Board (XRB).

Our view is that non-financial disclosures, particularly significant Environment, Social and Governance (ESG) disclosures, should have the same level of integrity to users as financial statements. We believe independent assurance is a key contributor in ensuring this objective is met and so that users have high level of trust and confidence in non-financial disclosures. The ultimate goal of ESG assurance standards (including greenhouse gas (GHG) emissions assurance standards) should be to align with financial reporting assurance expectations. Over time, there should be desire to move towards an "integrated assurance" approach, reflecting the importance of both financial and ESG information to users in assessing an entity's overall performance and the interconnected nature of this information.

While we understand the purpose behind the exposure draft, it has inadvertently allowed for differing requirements (and lower than financial statement audit requirements) in certain areas, such as ethics, quality management, management representation, selection of assurance criteria, fraud inquiries and independence. The upcoming *International Standard on Sustainability Assurance ISSA 5000, General Requirements for Sustainability Assurance Engagements* (ISSA 5000) to be issued by the International Auditing and Assurance Standards Board (IAASB), which is expected to be the international leading practice, is unlikely to permit differing/lower requirements.

We acknowledge the need to introduce a mechanism that enables a wide range of practitioners to provide GHG assurance when assurance over GHG emissions becomes mandatory in October 2024. We also recognise that ISSA 5000 may not be finalised by then and that "pre-assurance" using the same or similar standards as those which will be used for the required assurance is desirable. Given this, a short-term and more immediate GHG assurance framework is needed.

In our view, the most appropriate existing standards are *International Standard on Assurance Engagements (New Zealand) 3000: Assurance Engagements Other than Audits or Reviews of Historical Financial Information* (ISAE 3000) and *International Standard on Assurance Engagements (New Zealand) 3410: Assurance Engagements on Greenhouse Gas Statements* (ISAE 3410) given these have the same foundations as the financial statement assurance standards. These foundations are the result of many years of experience, as well as regulatory and market requirements, to ensure that high quality assurance is provided and that trust and confidence in the relevant reporting and assurance is maintained.



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If attaining the quality management and similar standards is not possible in the short term, we strongly believe that the XRB should set a clear timeframe in which all practitioners are required to apply assurance standards equivalent to those of financial statements assurance. We believe that any approach which does not seek alignment and consistency, at an appropriately high standard, will lead to a complex assurance landscape that users do not understand and will likely undermine the credibility of assurance over ESG information. We are also concerned that any assurance failures over ESG reporting as a result of having inconsistent and transitional requirements compared to financial confidence, could erode the public confidence in the audit of financial statements as they won't understand the differing requirements and will consider "an audit to be an audit". We are mindful that the existing Professional and Ethical Standards (PES) series and financial statement assurance standards have been developed and strengthened over time as a result of regulator and market demands and that such requirements are needed to ensure robust and consistent quality assurance. Given current and emerging concerns with "greenwashing" and the increased reliance on GHG emissions and other ESG disclosures by statement users, we see no reason to believe that the market and regulators will not demand equivalent rigour and standards in the assurance GHG emissions and (in time) other ESG disclosures.

We welcome the opportunity to contribute to the improvement of assurance over climate-related disclosures that will continue to drive the quality, consistency, and integrity of such disclosures in New Zealand. We would be pleased to discuss our comments with members of XRB and its staff. Should you wish to do so, please contact Pip Best (pip.best@nz.ey.com or on +64 27 263 9045) or Simon O'Connor (simon.oconnor@nz.ey.com).

Yours sincerely

A handwritten signature in black ink, appearing to read 'Simon O'Connor'.

Simon O'Connor
New Zealand Managing Partner

A handwritten signature in black ink, appearing to read 'Pip Best'.

Pip Best
Partner
Climate Change and Sustainability Services



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XRB Consultation - Assurance GHG standard
<i>Consultation Questions Respondents are asked to consider the following specific questions and to respond to the XRB by 24 March 2023:</i>
Design principles and key decisions
Question 1. Do you have any comments on the design principles or key decisions?
<p>We broadly agree with the design principles that have been identified, however we do not agree with all the identified implications and key decisions. We have set out where our views differ by design principle below. From here on, we use the following abbreviations throughout our response:</p> <ul style="list-style-type: none">- International Standard on Assurance Engagements (New Zealand) 3000: Assurance Engagements Other than Audits or Reviews of Historical Financial Information (ISAE 3000)- International Standard on Assurance Engagements (New Zealand) 3410: Assurance Engagements on Greenhouse Gas Statements (ISAE 3410)- Greenhouse gases - Part 3: Specification with guidance for the validation and verification of greenhouse gas assertions (ISO 14064-3, ISO)- Professional and Ethical Standards (PES Series)<ul style="list-style-type: none">o Professional and Ethical Standard 1: 1International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand) (PES 1)o Professional and Ethical Standard 3: Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements (PES 3)o Professional and Ethical Standard 4: Engagement Quality Reviews (PES 4) <p>Trust and confidence - It is paramount to build trust and confidence in ESG assurance. The consultation document suggests that both of the specified international assurance standards are fit for purpose for undertaking assurance over GHG disclosures within climate disclosure statements. Given the current global position, we are unclear as to how this conclusion (ISO and ISAE are both fit for purpose) has been reached since there are clear differences between the standards, as highlighted in Appendix B of the consultation document.</p> <p>Differences in the extent of testing procedures, materiality and reporting is likely to lead to user confusion about the extent of assurance provided and work performed to reach the respective conclusions, as well as ethical and quality management standards underpinning the work.</p> <p>Whilst the proposed standard has attempted to bridge the difference between the ISO and ISAE standards, there are still holistic discrepancies which cannot be addressed by an additional standard. We note that the ISO standard is not publicly available and accordingly, there is a lack of transparency around its requirements to meet a specified level of assurance. This presents a challenge for the public to have trust and confidence in the ISO assurance. ISAE 3410 and ISAE 3000 are publicly available.</p> <p>Temporary nature of the standard - Acknowledging that mandatory assurance over GHG emissions will become effective in October 2024 and the ISSA 5000 is not expected to be finalised until end 2024, it is important that an interim standard is in place before the XRB adopts or aligns to ISSA 5000 (or any alternative standard). While the proposed interim standard may be acceptable as a compromise in the short-term, the identified gaps between ISO and ISAE</p>

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standards need to be appropriately addressed so that users can place trust and confidence in the assurance provided. Additionally, a transition plan must be defined and clear to all practitioners who intend to provide assurance in the medium/longer term. We believe that any approach which does not seek alignment and consistency, at an appropriately high standard, will lead to a complex assurance landscape that users do not understand, and if the ethical and quality management standards are lower than financial statement assurance, this will likely undermine the credibility of assurance over ESG information.

Accountability and clarity - We have nothing further to add to this design principle.

Importance of ethics and quality - The proposed standard offers a high level and principles-based approach for the quality management and ethics elements. However, unless practitioners are already operating in accordance with the PES Series or equivalent requirements, we suspect this level of detail and guidance provided is insufficient to explain what is required from the practitioners to ensure high quality assurance is consistently delivered. We are concerned this will lead to the development of a perceived two-tiered system in the assurance of ESG disclosures. Regulated practitioners (i.e. those registered with NZICA to perform financial statement audits) will still be required to apply the PES series, which further adds to the variations that will develop in the assurance market. The PES series has been formulated over time to develop a robust quality management and ethics standards, as demanded by regulators and other stakeholders. Moving away from this well-established framework risks opening ESG assurance to scrutiny and causing a loss of trust and confidence in the climate disclosures (which has the potential to taint the confidence in audited financial statements as well).

Transparency - We agree that transparency is fundamental to enhance the communicative value of climate assurance reports to users and we are supportive of the identified communicative tools. However, the ISO standards (reporting and assurance) are not publicly available to the users of the assurance report. We consider it highly preferable that the standards used be readily available to ensure transparency of the assurance engagement.

Compliance with existing GHG assurance standards (such as ISAE or ISO)**Question 2. Are you aware of any other assurance standards that are currently being used in New Zealand to undertake GHG emissions assurance engagements?**

We are not aware of any other assurance standards currently being used in New Zealand. Whilst these two standards are the basis for the current assurance market in New Zealand, and the differences between them may seem small/inconsequential, practical implementation suggests that these differences can lead to variations in the nature of the work performed in terms of the application of ethical and quality management practices and in the form of the assurance report. For instance, the application of the principle of independence and the naming conventions of different levels of assurance and different categories of emissions sources.

Users may not understand the difference between the two standards being applied and this could lead to lack of understanding and confidence in GHG emissions disclosures and assurance as well as perceived integrity issues with GHG emissions disclosure assurance. It would help users and increase confidence if one standard was to be used by all practitioners and the same quality and risk management standards were adhered to as for financial assurance.



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Ethical requirements, including independence

Question 3. Do you consider the proposed ethical requirements are appropriate? If you disagree, please explain why.

While we believe the overarching ethics and independence principles included in the exposure draft are appropriate, greater guidance should be provided given not all practitioners will be familiar with the PES series and so may not appropriately apply these principles in practice. We are concerned the current principles-based approach is open to wide and varying interpretation, and that this is particularly likely given previous practical implementation of the principles and differing experience/mindset of practitioners who will use the standard. Such variation would be concerning to users and in a yet-to-be regulated environment, may not easily be identified or moderated.

IESBA are developing profession-agnostic ethics and independence standards for sustainability assurance, which is expected to be international leading practice, and plans to issue final standards by end of 2024. IESBA has already determined that "...certain sustainability assurance engagements must be underpinned by the same high standards of ethical behaviour and independence that apply to audits of financial information. ...". This would suggest more than the currently proposed principles will be required to meet these standards.

Quality management

Question 4. Do you consider the proposed quality management requirements are appropriate? If you disagree, please explain why.

The purpose of this exposure draft is to ensure high quality assurance over GHG emissions is being provided by practitioners. This is to support the overarching objective to ensure climate change disclosures are reliable and trusted and enhance market confidence. Therefore, quality management requirements should be explicitly stated, so that they can be consistently applied by all assurance practitioners. The requirements on quality management set out in the exposure draft may be appropriate. However, because they are principle based and not explicit, they are open to interpretation and could lead to quality concerns and issues from users and regulators, similar to those that have been seen in that past under the previous, less rigorous PES standards (which also led to them being revised over time to their current state). The main concern is that practitioners who are not familiar with the PES standards will not obtain sufficient guidance from the proposed standard. If there is concern in the market that not all practitioners will be able to meet the PES standards immediately, the interim standard should allow for a short/time-lined transition period only, in which time assurance practitioners can establish compliance against appropriate standards akin to the current PES requirements.

Assurance Practitioner's Report

Question 5. Do you consider the proposed requirements in relation to the assurance practitioner's report are appropriate? If you disagree, please explain why.

The exposure draft permits either the ISAE 3410 or ISO 14046-3 to be used for GHG emissions assurance and the resultant reporting. This includes the use of different language and terminology in the assurance statement e.g. "verification", which is a result of different assurance practices being applied. As previously identified, we are concerned that the development of an assurance standard which allows different methods of reporting will lead to market confusion and will likely lead to a perceived two-tiered system.



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Our longer-term view is that integrated assurance will become the leading practice and the non-financial assurance subject matter will expand and become increasingly interlinked to financial information, therefore the standards used by assurance practitioners should have consistent language, integrity and reporting expectations across financial and non-financial subject matters. There are already very different expectations as to what “verification” means in non-financial reporting (such as in the sustainable finance market) and use of terms such as this will increasingly drive integrity concerns if not aligned with the expectations of assurance in financial reporting.

Our overall view is that ISAE3410 and ISAE3000 standards should be the basis for GHG emissions and non-financial assurance before ISSA 5000 is issued by IAASB (which from our understanding is also basing their standard on ISAE3410 and ISAE3000 standards). If the understanding is that ISO standards are of the same/similar quality and risk management and ethical standards to ISAE standards (which we are not convinced is the case), there should be limited challenge for practitioners in implementing the ISAE standards.

Question 6. Do you have any concerns regarding the different terminology that may be used to express the assurance conclusion or opinion? If so, do you have any suggestions to address these concerns?

Please refer to our response to the question above.

Question 7. Do you support the proposed inclusion of Key Matter, Emphasis of Matter, Inherent Uncertainty and Other Matter paragraphs where appropriate?

Yes, these are appropriate in order to highlight matters of consideration and importance to the user as and when required. However, we also believe that illustrative report examples should be developed for the assurance statement which all assurance practitioners must adopt to ensure consistency and that users are gaining understanding, trust and confidence in the disclosures made. The current template appears appropriate overall and appears to include all possible elements of the standard assurance report e.g. OM, EoM, KMs.

Question 8. Are there any other requirements that you consider should be included in relation to the assurance practitioner’s report? If so, please specify.

We believe the following additional elements should be considered for inclusion:

- Mandatory disclosure to describe the basis of materiality that has been used by the practitioner to ensure complete transparency over the assurance provided, and in particular whether the materiality used for scope 1 and 2 emissions differs to that for scope 3.
- A statement on the subjective interpretation of the standard depending on the different stakeholder groups. This will provide further clarity and context, allowing for better understanding of the assurance statement for the user.
- Specification of the users of the assurance report in order to ensure the report is used by the appropriate people and in the appropriate manner.



Competence and reliance on work of others

Question 9. Do you consider the requirements in relation to the assurance practitioners' competence are appropriate? If not, what do you consider should be included in relation to this?

The proposed requirements included in the exposure draft contain high-level subjective requirements. In order to enhance confidence in GHG emissions disclosures, minimum requirements/qualifications should be required, and given the level of maturity in this area, these requirements will likely need to be prescriptive. The subjective nature of the proposed requirements opens this up to interpretation and hence practitioners will need more guidance to ensure compliance. However, this is something we would expect to see addressed by the licensing regime rather than the assurance standard, but if the intention is to capture this within the standard, then we suggest adding in further clarification on these requirements.

We believe the requirements to be an effective and appropriately qualified assurance practitioner for the purposes of GHG emissions should be clearly specified. These requirements do not necessarily have to be the same requirements as for financial assurance, however, should have similar level of qualification(s) and appropriate experience.

In our opinion, the XRB should consider, and where possible, build on the minimum competency standards for GHG emissions assurance practitioners set by other international regulators of GHG emissions assurance, such as the Clean Energy Regulator in Australia. Requirements such as team member hours, number of assurance engagements, participation in continuing professional development, relevant tertiary qualification and technical experience in the underlying legislation should be made relevant to GHG emissions assurance providers.

Question 10. Do you consider the requirements in relation to reliance on the work of others is appropriate? If not, what do you consider should be included in relation to this?

We agree that the relying on the work of others requirement is necessary given the nature of the subject matter. We also agree that 'others' need to be appropriately evaluated for their qualifications, competence and objectivity. However, the requirements in ISAE standards are more prescriptive; detailing that 'others' can be internal or external which is an important clarification missing from the suggested requirements, and hence we recommend these be included.

Other comments

Question 11. Do you have any other comments on the proposed standard? If so, please specify.

No further comments to add.