



23 March 2023

Ms Michele Embling
Chair
New Zealand External Reporting Standards Board
Level 7, 50 Manners Street
Wellington 6142
New Zealand

Re: Submission on the Standard on Assurance Engagements over GHG Emissions Disclosure

Dear Michele

The Auditing and Assurance Standards Committee of the Accounting and Finance Association of Australia and New Zealand (AFAANZ) is pleased to comment on the External Reporting Board's Proposed Standard on Assurance Engagements over GHG Emissions Disclosure.

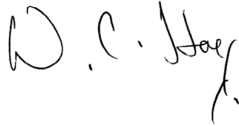
The attached submission consists of our comments on each of the specific questions in the discussion paper.

AFAANZ is the peak regional academic accounting and finance association, and counts among its membership the region's leading and emerging accounting and finance researchers. The Auditing and Assurance Standards Committee is an ad-hoc committee under the governance of AFAANZ's Auditing and Assurance Special Interest Group, formed to give a voice on standard setting deliberations to the academic research literature.

The views expressed in the comments that follow are those of the undersigned Committee members and do not necessarily reflect the official position of AFAANZ. While the views expressed represent a consensus view of the Committee, they do not necessarily reflect the individual views of every member.

If you have any questions on our submission, please contact either of the Committee Co-Chairs (David Hay – d.hay@auckland.ac.nz or Noel Harding – n.harding@unsw.edu.au).

Yours Sincerely,

A handwritten signature in black ink that reads "D. C. Hay". The signature is written in a cursive style with a large initial "D" and a small "C" followed by "Hay".

David Hay
Professor of Auditing, University of Auckland

On behalf of:

Chris Gan (Lincoln University), Irene Ge (UNSW Sydney), Noel Harding (UNSW Sydney), David Hay (University of Auckland), Linh Ho (Lincoln University), Dinithi Ranasinghe (University of Otago), Harj Singh (Curtin University) Nigar Sultana (Curtin University), Shan Zhou (University of Sydney)

Auditing and Assurance Standards Committee of the Accounting and Finance Association of Australia and New Zealand (AFAANZ)

Comments on the Exposure Draft of the Standard on Assurance Engagements over GHG Emissions Disclosure

We attach our submission in response to the questions in the Consultation Document. We are pleased to have the opportunity to comment on this innovative standard about such an important topical issue. We have concentrated in our submission on issues where there is published research that contributes to deciding on the appropriate requirements for this standard.

Question 1. Do you have any comments on the design principles or key decisions?

We have comments, namely that:

1. The proposals allow the use of two alternative standards and this could cause confusion among users.
2. One of the standards, ISO 14064-3 is not freely available to users.
3. We are concerned with a potential lack of consistency and harmonization that will accompany the approval of both ISAE(NZ) 3410 and ISO 14064-3. Although assurance practices will share many similarities, they are likely to be different and this may detract from public trust and confidence in GHG. Several research studies investigating the adoption of International Standards of Auditing suggest that harmonized audit practices and uniformity in those practices enhances public confidence and trust. Krasodomska, Simnett and Street (2021) and Venter and van Eck (2021) note the importance of harmonized assurance practices over Extended External Reporting in facilitating trust and confidence. Recent research by Harding et al. (2023) finds variations in perceptions of audit quality when different standards are referred to in the Auditor's Report. We are concerned that allowing two similar, but different, standards to be used will detract from consistency and comparability and undermine trust and confidence.
4. There is evidence that non-accounting assurance providers are increasingly making use of ISAE 3410 (Ge, Simnett and Zhou 2022).

We recommend that consideration should be given to develop a single self-contained standard using the best of the two current statements. If this is not feasible, then the differences between the types of assurance providers should not be conspicuous, and the same assurance report should be used by both.

Question 2: Are you aware of any other assurance standards that are currently being used in New Zealand to undertake GHG emissions assurance engagements?

A recent study by Hsiao et al (2022) shows that, out of a small number of sustainability assurance engagements in New Zealand, the assurance standards being used were either ISAE 3410 or ISO 14064-3. There is research showing that another standard (AA1000AS) has been used (Farooq and de Villiers 2019), but that standard applies specifically to stand-alone sustainability reports and would not be appropriate for these disclosures.

We are therefore not aware of other assurance standards.

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

The committee members had considerable concern about the issue of ethical requirements.

1. Paragraphs 6 (b), (c), and (d) of the proposed standard which set out that professional and ethical standards are “deactivated” seem likely to raise concern among users and to reduce trust and public confidence in assurance providers.
2. There is a risk that different standards will be applied by different groups of practitioners. Assurance providers who are part of a firm that is subject to PES 1 and PES 3 for other engagements are likely to continue to comply with these standards under their firm policies for their greenhouse gas emission engagements, while other assurance providers will not. This will result in inconsistency, and reduced standards for one group.
3. Non-accounting practitioners are less well-informed about independence. Research by Ge et al. (2022) showed that while 93% of accountant assurance providers acknowledged their compliance with the IESBA Code of Ethics, the non-accountant assurance providers either do not acknowledge their independence, or add a sentence describing their independence in a variety of ways that are not comparable with other reports.
4. The proposed standards requires assurance providers to “address familiarity threats” without being specific. We suggest that more detail is needed so that practitioners know how to address these threats. We recommend a more detailed requirement such as: “address familiarity threats by providing appropriate safeguards such as rotation of the lead assurance provider after seven years”.
5. The issue of whether the greenhouse gas emissions assurance provider may also conduct the audit of the entity’s financial report is a threat to independence that should be addressed. This issue is not directly addressed in the proposed standard, and some entities could be in doubt about whether their financial report auditor may also audit greenhouse gas emission disclosures. There is research showing that companies are less likely to appoint their financial statement auditor as assurance provider for other services such as this when their market is sensitive to provision of other services (Lu et al. 2022). In addition research shows that joint provision of audit and sustainability assurance services by the same practitioner leads to beneficial knowledge spillovers, which also enhance the quality of the sustainability assurance (Ruiz-Barbadillo and Martínez-Ferrero 2020).

Because of issues (1), (2) and (3), we recommend that PES 1 (the Code of Ethics) should apply to Greenhouse Gas engagements.

We recommend that the standard should state clearly whether conducting the audit of the financial report and also providing assurance over GHG emissions is a threat to independence.

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

The subcommittee is concerned that the proposed quality management standards will lead to inconsistency of quality management among the different types of provider. There is evidence

that disclosure of quality management by practitioners from outside the accounting profession is weak, even when they are required to disclose such a framework in their assurance report when they are using ISAE3000/3410. This potentially raises the question as to whether they do not have sufficient quality control management in place or they simply do not follow the requirement in the assurance standard (Ge et al. 2022).

Paragraphs 42 to 46 of the proposed standard do not provide specific guidance on the overall quality management system applied at the practitioner firm level, which is crucial for ensuring practitioners comply with relevant ethical principles.

Because of these issues, we recommend that PES 3 (the standard on quality management) should apply to Greenhouse Gas engagements.

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

We suggest that the statement of the client’s responsibilities in the assurance report should include the responsibilities of directors’ (or those charged with governance) and the responsibilities of management.

We recommend requiring disclosure of materiality. There is research evidence that investors find disclosure of the reliability of information useful when the auditor’s materiality threshold is disclosed but not useful when it is not disclosed (Eilifsen et al. 2021).

We have also made some comments about assurance reports under questions 6 and 7.

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?

We have concerns regarding the different terminology that may be used to express the assurance conclusion or opinion. ISO 14064.3 reports might use terms like “validation”, “verification”, “verified at the limited level of assurance”. These terms are not used in ISA 3410 reports. Different terminology will lead to different actions on the part of assurance practitioners and different interpretations by users. There is evidence in a different context, the choice of audit procedures, that different verbs used in auditing standards, such as assure, verify and validate make a difference to their understanding by readers (Stepankova et al. 2022). Harding, Khan and Stepankova (2023) also find that users perceive different meanings from an auditor’s report when different, but equivalent, standards are referred to in the report. Moreover, different verbs (e.g., validate, verify, assure) are associated with different levels of thinking (e.g., Stepankova et al 2022) meaning that variation in terminology may lead to real and not just perceived differences in the level of assurance perceived.

Research highlights that users do not understand different levels of assurance as it relates to audits. To the extent that the additional terms of verification (limited or reasonable assurance) and validation (limited assurance) are introduced in the GHG setting, this is likely to detract from the public interest by frustrating a consistent interpretation of assurance opinions.

We recommend that the XRB remove the possibility of variation in the terminology employed in the prescribed format of the assurer’s conclusion or opinion.

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

We support including these headings in the assurance report. However, non-accountant assurance providers are likely to be unfamiliar with these terms and we suggest that more explanatory material should be included in the standard. We agree that including Key Matters

is likely to be useful, but we suggest removing the second part of section 31 that refers to enhancing the communicative value of the assurance report, because research evidence does not support that it does (see below – it has beneficial effects in other ways). We also suggest that more explanation is needed about how to identify Key Matters, and of when Emphasis of Matter, Inherent Uncertainty and Other Matter paragraphs should be used.

Research studies using large sample archival data find only limited capital market response to key audit matters in financial statement audit reports (Lennox et al. 2022), but research studies using experiments generally conclude that these additional paragraphs have informational value to users in the context of financial statement audit reports (e.g., Moroney et al. 2021). As GHG related disclosure is inherently more diverse, less standardized and developed and subject to higher level of uncertainty compared to financial information, the additional information contained by including Key Matters in the auditors' report is expected to play a more significant role in adding to the transparency of these disclosures.

Research investigating the merit of reporting KAMs generally reveals that such reporting leads to little if any improvement in user understanding of the audit function (Sirois et al. 2018), but has been shown to lead to higher perceived value in the audit for audits performed by non-big 4 auditors (Moroney et al. 2021) and is associated with improved financial reporting quality. These findings are broadly consistent with the research that has been undertaken in a New Zealand setting (Al-mulla and Bradbury 2022; Li et al. 2019). Section 31 of the Exposure Draft requires that a Key Matters section shall be included in the assurance report when such reporting will improve user understanding of the assurance function. The research suggests that this requirement is unlikely to meet that objective. However, including Key Matters may be beneficial in enhancing perceived confidence in work done by assurance practitioners coming from broader backgrounds as well as encouraging better reporting. With this in mind, the XRB may wish to reconsider the requirement regarding Key Matters to remove reference to improving users' understanding and communicative value of the assurance report.

It is not clear how Key Matters will be identified by the assurance provider. In the case of Key Audit Matters (KAMs) in the audit of a financial report, there is a clear mechanism by which KAMs emerge, namely matters discussed with the audit committee.

We recommend providing guidance on how to identify Key Matters will help to make them more consistent and more useful.

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 do not have any comments regarding question 8.

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?

We do not have any comments regarding question 9.

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?

The proposed standard could benefit from more explicit guidance on the use of experts and their independence.

Research suggests that auditors, when assessing the competence of others, are likely to anchor on their own knowledge in the area in question and inflate their perception of the expert's competence. In a GHG setting, Kim, Green and Johnstone (2016) report that auditors may place excessive reliance on the views/conclusions of those with GHG expertise. These findings are consistent with research showing that auditors are sensitive to source credibility (Hirst 1994) and a general overconfidence bias among auditors ((Koch and Wüstemann 2011; Hardies et al. 2011). We recommend cautioning assurance practitioners on the risk of overreliance on experts' work.

There is also a risk regarding the independence of experts. Boritz et al. (2020), to illustrate, find that auditor's and their experts may not have consistent views on, and levels of, objectivity and professional skepticism. Moreover, auditors were found to trust their experts and relied heavily on their firm's quality control systems to ensure the competence and independence of their specialists. Given that PES 1 and 3 will be 'deactivated', the identified reliance on firm quality controls will not be appropriate in the conduct of GHG assurance. The current requirements in paragraphs 20 and 21, as well as application material in paragraph A25 may not be sufficient.

We recommend that the XRB reconsider the deactivation of PES 3 (or to introduce relevant provisions of PES 3 into the proposed standard).

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

We were concerned about potential contagion effects. If some low-quality assurance services follow the introduction of these proposals, then this might also damage the reputation of other assurance services including auditing.

The research that has been undertaken highlights that there are unique quality threatening dimensions of multidisciplinary teams that we would encourage the XRB to address in the proposed standard. There is evidence that use of multi-disciplinary teams of accountants and non-accountants on sustainability assurance engagements improves the quality of assurance tasks (Farooq and De Villiers, 2019). However, Ekasingh, Simnett and Green (2019) note that, while multidisciplinary teams bring expertise across different disciplines, differences in mindset, different frames of reference and communications/coordination difficulties may impede the team's effectiveness. They find that effective communication on task relevant information and perspectives (i.e., effective elaboration) is necessary to realize the benefits of the diversity in knowledge and experience. Kim, Green and Johnstone (2016) find that multidisciplinary GHG assurance teams may not optimally weight the views of team members with different expertise and that this bias may be exacerbated or attenuated depending on the specific expertise of the reviewer.

We recommend that auditors are cautioned that there are risks when using multidisciplinary assurance teams.

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