THE INVESTMENT ASSOCIATION

IA Response to DBT consultation on developing an oversight regime for assurance of sustainability-related financial disclosures

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £10 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 49% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

IA members welcome DBT's proposal to introduce an oversight regime for sustainability-related assurance in the UK. Last year, the FRC delivered its final recommendations following a market study on Assurance of Sustainability Reporting which found significant appetite for greater regulatory oversight of the assurance market. The IA as part of its response to the market study emphasised the importance of a diverse and competitive market for sustainability-related assurance that offers high-quality and cost-effective services which drive enhancements and innovation in assurance services and bolsters investor confidence in the provision of these services.

Investors have a strong interest in the reliability of sustainability information reported by companies. Investors increasingly need meaningful, comparable, and consistent sustainability reporting to assess long-term risks and opportunities within investee companies. A globally consistent assurance framework is crucial to underpin the trust and confidence in this reporting. The IA has long advocated for a global baseline of sustainability disclosures and assurance standards to support well-informed investment and stewardship decisions, and to this end we welcome that the DBT is also consulting on the endorsement of UK Sustainability Reporting Standards in the UK.

IA members have been keen to flag the importance of government initially focusing on the implementation of the UK SRS before introducing an assurance regime. We note that in July the government announced a delay to the pre-legislative scrutiny of the draft Audit Reform and Corporate Governance Bill, which will impact upon the establishment of ARGA and the registration regime. Given the delays, we think that the government's initial priority should be on ensuring that companies have sufficient time and support to

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apply the new reporting requirements and make sure that decision-useful sustainability information is being delivered to investors.

We believe that there is benefit to establishing a voluntary registration regime for sustainability related assurance. It represents a proportionate, first step given that the market is still developing and will help to provide credibility and confidence in underlying reporting from investee companies. Members have noted that there are quality issues with data that is being voluntarily assured under existing sustainability disclosure frameworks. Having a framework around this will be particularly important pending the government's decision to endorse UKSRS, as there will be a greater volume of data that is reported to investors. It will be important that investors can seek comfort in the quality of this data. To this end, we welcome that the government is taking forward the FRC's recommendations to put the regulatory structures in place to ensure that assurers have the necessary skills and qualifications to undertake high-quality sustainability assurance engagements. Which in turn will help to improve consistency in the quality of assurance provided. We would urge the FRC to consider the following as it refines and develops the framework supporting the registration regime:

- Given the delays to the Draft ARGA reform Bill, we expect the regulator to work with the government to publicly set out what can realistically be achieved in the interim in the absence of legislation.
- While the voluntary registration regime will help to improve the capacity, skills and credibility of assurance providers in the market and in turn the quality of sustainability disclosures, the regulator should consider unintended consequences such as creating a two-tier market for providers, or companies defaulting to only using those providers that are registered. This could negatively impact on smaller boutique firms and competition within the market.
- Mandating registration for firms providing assurance for public interest companies sets a higher bar for firms in a market where practices are still relatively nascent. While mandatory assurance could help to increase the overall resilience and confidence in the market, this regulator should review the need for this once the ISSB standards have had an opportunity to bed in.
- While we agree that ARGA should be equipped with a full range of powers in the event that it needs to investigate poor performance or behaviour, in the first instance in its role as an improvement regulator, ARGA should focus on providing firms with guidance, training and promoting the sharing of best practice to uplift capabilities in the market.
- As the government considers views on mandating assurance in the longer-term, it may consider temporarily relaxing the non-audit services cap to encourage uptake of voluntary assurance amongst companies, provided that this does not undermine a firms' willingness to exercise sufficient scepticism and judgment of management's decisions.
- Mandatory assurance could be a long-term aspiration, but the government should initially assess whether voluntary assurance is delivering the confidence and credibility in reporting that companies and investors are seeking. Addressing challenges such as the skills gap, cost of compliance for smaller companies as well as lessons learnt from CSRD will also be prudent.

Question 1: Do you agree with the government's core proposal to create a voluntary registration regime for sustainability assurance? Provide justification.

Yes. We have split our answer to this question in 2 parts, focusing initially on the proposals to create a voluntary registration regime and then the proposal to mandate registration for firms providing assurance to public interest companies.

We agree with the core objective of the regime which is to increase transparency for companies looking to engage a suitably qualified sustainability assurance provider for assurance over its sustainability-related financial disclosures. As part of our response to the FRC's market study, we noted that there are concerns with the quality and competence of assurance providers within the market and that the development of a diverse and competitive assurance market could enhance the delivery of quality assurance—this is crucial to supporting investor confidence in sustainability disclosures and will help to facilitate well-informed investment decision making.

We agree with the voluntary, opt-in approach to assurance given the current state of the market. It offers a proportionate, first step to improve quality and trust in the sustainability assurance. The approach will help improve market transparency and over time improve the credibility of sustainability-related disclosures. The registration regime should raise standards through ensuring that assurance providers meet a minimum set of criteria to be determined by ARGA once they fall under the registration regime. A list of accredited providers will also help to facilitate greater choice and competition within the assurance market by providing more transparency on the range of providers, beyond the Big 4. As we note at question 2, the commercial implications and additional scrutiny associated with appearing on the register can also incentivise continuous improvements in the quality of service provided. Assurance providers will also benefit from guided oversight from ARGA, both during the engagement process and if an engagement falls short of the regulators' expectations. This will provide users of these services with additional confidence that the regulator has the ability to intervene and improve the quality of services provided—this is particularly important for an industry that is still continuing to develop.

Sustainability-related assurance is still relatively nascent and a voluntary regime provides an opportunity for the registration scheme to develop as best practice in assurance provision continues to evolve. We note that the government has announced a delay to the Audit Reform and Corporate Governance Draft Bill, and that this will have an impact on when the oversight and registration regime can be established. In the interim, we would urge the government to set out what the FRC can achieve in the absence of legislation and to focus its efforts on ensuring that investee companies have enough support to be able to implement the UK SRS requirements, subject to their endorsement.

Some members have questioned whether this regime is simply 'voluntary' in name. It is likely that companies and investors will prefer assurance from an accredited service provider, and from a commercial perspective this could push firms to seek registration due to the risk of not gaining clients. This could potentially result in de-facto mandatory registration of assurance providers without regulation. For smaller, boutique consultancies the cost of complying with mandatory registration could be particularly burdensome which could have negative implications for encouraging greater competition and choice within the market. As we set out at question 2, the government needs to give further consideration to some of the challenges associated with this regime.

A voluntary regime also lays the groundwork in the event that it becomes necessary to mandate sustainability-related assurance at a later stage. Establishing a registration regime and the necessary infrastructure around this will allow industry to develop their capacity and expertise, meaning that in the long-term if assurance is mandated, there will already be a pool of accredited providers in place.

Mandating assurance for firms providing services to public interest companies

The consultation is also considering whether it may need to mandate registration in some circumstances and asks for views on whether registration should be a legal requirement for those providing services to UK companies where there is a strong public and investor interest. The government notes that the FRC will

play a similar role to that which is consistent with its powers over statutory auditors, so it would be responsible for determining the qualifications and criteria to meet registration and it will also monitor providers where they fail to meet expectations.

Mandatory registration for public interest companies could be a useful way of increasing the overall resilience of the market for sustainability-related assurance and quality of services provided, improving trust in service providers and enhancing the level of transparency and accountability provided to a range of stakeholders who rely upon the provision of these services. However, mandatory registration sets a higher bar for firms, particularly given that the market for assurance is still developing. Some members have noted that auditors of Public Interest Entities (PIEs) in the UK are subject to a more stringent set of requirements, including having to register in order to undertake PIE audit work. On this basis, some members believe that it would potentially be unfair to subject financial auditors to a more onerous regime, particularly if there is an expectation of equivalence between the two regimes in the long-term. Given the nascency of the market, it is important for the regulator to consider a proportionate approach. It could consider extending mandatory registration to firms providing assurance to public interest companies, but should review this once the UK SRS standards have had sufficient time to bed in, and subject to their endorsement as this will allow further time for the market to develop and mature.

On the basis that the ARGA proceeds with mandatory registration for public interest companies, there will be specific criteria that firms will need to demonstrate before they can provide assurance to these companies. We would suggest that it draws upon the requirements for the existing registration regime for PIE auditors and would highlight the following as important points for the FRC to consider as part of the registration process:

- Whether firms or individuals have an appropriate level of resources;
- Whether firms maintain an appropriate system of quality management to perform assurance of public interest entities;
- Whether firms have suitable governance arrangements (including individuals who play a key role within the assurance process); and
- If firms can demonstrate that they have sufficient experience and competence (including professional development and training).

As part of its proposal, the government intends for ARGA to maintain and publish the register of sustainability assurance providers, with ARGA determining the conditions that registered assurance providers must uphold. The regulator already has precedent for this through its Public Interest Entity (PIE) Auditor Register list which sets out audit firms and responsible individuals responsible for undertaking statutory audit work for PIEs. We would recommend that the regulator utilises its experience in operating this list, including the level of detail published on registrants, and the circumstances within which they can be removed.

Question 2: In your view what are the advantages and disadvantages of this approach?

We believe that the voluntary approach offers the following benefits:

- **Improved confidence in sustainability-related disclosures**: An official register that is maintained by ARGA which sets out which assurance providers are qualified and vetted for sustainability engagements will help to improve investor confidence in the providers of assurance and in turn improve the credibility of sustainability-related disclosures.
- **A proportionate approach**: A voluntary approach where providers can opt in promotes a proportionate approach by recognising that the market for sustainability-related assurance is still developing and that it could be burdensome to expect all firms to have to register on a mandatory basis.

- **Supports ARGA's role as an 'improvement regulator'**: A voluntary approach in the first instance will help support ARGA's objective as an improvement regulator, particularly as it helps assurance providers and the market to develop and plays a role to facilitate the sharing of best practice and expertise which can help with capacity building as the market grows.
- **Oversight from ARGA**: assurance providers will be expected to meet the robust standards and qualifications set by ARGA once they fall under its oversight. The register of service providers provides greater transparency to companies and investors, as there are potential reputational and commercial risks associated with being removed from the register which could negatively impact on the ability of firms being able to continue to provide their services. This creates strong incentives for providers to continue to provide high quality services.
- **Encourages Competitiveness:** Implementing a UK registration regime can help assurance providers remain competitive both within the UK and at an international level. Transparency as a result of the register of accredited service providers will encourage competition and choice for service providers, with the registration regime and ongoing oversight from ARGA providing companies with greater confidence in the provision of services, particularly outside of the Big 4. The CSRD already requires assurance by accredited service providers- with official recognition of sustainability assurance providers, the UK regime would enable firms to state that they meet high standards across frameworks like the UK SRS, TCFD and CSRD. This would help to remove barriers for UK firms performing assurance engagements internationally.

The government and ARGA should consider the following as they develop the proposals further:

- **Creation of a two-tier market:** not withstanding the points made around the flexibility of an opt-in approach given the nascent state of the market, there is a risk that a voluntary approach could lead to a 2-tier market between those that are registered and those firms that are not. This could lead to inconsistency in the approach taken to providing assurance—creating gaps in the overall coverage of high-quality assurance. Where the cost of assurance increases as a result of providers having to comply with ARGA's registration criteria, some companies may choose assurance providers outside of the regime if it becomes more cost effective. This could potentially penalise those firms that voluntarily opt into the regime.
- **Providers must 'see value' in registering:** The FRC's market study noted that the success of the regime relies on assurance providers seeing the value in registering. Providers will need to decide whether the cost or effort of meeting ARGA's requirements outweigh the commercial benefits. ARGA will need to work on communicating the value of opting into the regime to allow it to achieve a critical mass of participation.
- **Implications for boutique providers:** If companies only decide to use registered providers, this could create pressure on smaller firms to register with ARGA, for example through merging with other firms in order to bear the ongoing costs of registration and oversight. This could have negative consequences in terms of reducing competition in the market over time. We note that ARGA will work with the market to establish the registration criteria and ensure that this is rigorous yet attainable- this will need to take into account the level of skills and expertise in the market at any given time.

Question 3: Do you agree or disagree with the government taking a profession-agnostic approach to sustainability assurance? Provide justification.

The government is proposing to create a new legal concept of sustainability assurance provider, distinct from the profession of statutory auditor. As we set out in our response to the FRC's market study, we believe that a profession agnostic approach offers a number of benefits including allowing sustainability assurance to be provided by practitioners from any professional background (not just auditors). This can make the market more competitive and diverse, improving quality and innovation. By embracing both

accountant and non-accountant assurance providers, the regime avoids replicating the audit market's concentration problems and encourages a broader pool of firms (including specialists and consultancies) to develop assurance expertise. This competition and choice can lead to more cost-effective services and drive higher standards as providers strive to differentiate on quality.

A profession agnostic approach also recognises that effective sustainability assurance requires multi-disciplinary skills, for example subject matter knowledge in climate science, geography or engineering can be just as important as traditional audit skills. It opens the field to experts who may not be certified accountants but they have the relevant expertise, provided they meet rigorous ethical standards as set out in ISSA 5000. While specialist sustainability knowledge will be important to sustainability engagements, our members note that all assurance providers in this space will require the ability to scrutinise and verify complex information, and have the ability to challenge management where necessary.

This model will also avoid replicating the concentration issues seen in the audit market. Instead of only a handful of large firms dominating, new specialist firms can compete, keeping costs reasonable and spurring innovation in assurance techniques. Our members have indicated they are agnostic about the type of firm that provides assurance as long as the assurance is high-quality – they want companies to have the freedom to choose a credible provider from a wide talent pool.

The government has also stated that it does not intend to exclude statutory auditors from the market, as these engagements will require both financial and sustainability expertise. The FRC's market study found that 37% of FTSE100 companies used their financial auditor as their sustainability assurance provider in 2023. Commenting on their experience of companies seeking assurance under the CSRD regime, some members have noted that companies may choose to continue using their financial auditor given they already have an understanding of a company's business model and strategy and in some instances, it may be more cost effective to so. We think that it is important that companies continue to have the choice to use their financial auditor if this meets the needs of their business model and specific circumstances. Some members note that one way for investors to have greater confidence in auditors delivering assurance of sustainability related information is if audit reports include more robust disclosures on the consideration of sustainability-related information presented within the financial statements. This is particularly important given the onus within the ISSB standards on ensuring connectivity between the front end of the annual report and the financial statements. At present, there are concerns that even the largest companies and their auditors are not reporting on this in sufficient detail.

Delivering a profession agnostic approach will require upskilling stakeholders to address the expectation gap in the current level of skills and knowledge amongst assurance providers as well as companies. It is important that a multi stakeholder approach is taken to establishing the registration regime to ensure buy-in and long-term success. We have the following suggestions to help bolster knowledge and expertise:

- **Assurance Providers:** Our members note that in some circumstances assurance engagements have been given to more junior staff who lack experience, given the lack of qualified personnel in this space who require an understanding of finance as well as specialist knowledge. Members note that there is a risk of talent shortage with experts being poached by the companies that they provide assurance services to and that a high rate of turnover in the market can add to the lack of experience within firms and the need for ongoing resourcing and training. Based on experience from companies reporting on CSRD, members have found that issuers from similar sectors can receive different guidance from their assurance providers, leading to differences and inconsistency in reported data. The FRC as part of its role as an 'improvement regulator' and consistent with Sir Donald Brydon's recommendation on establishing an audit profession could help provide a forum for information sharing and best practice on the interpretation challenges that companies face in reporting sustainability related information, including seeking further guidance from standard setters on any common interpretation challenges that require further clarification across the market. This will help to create greater consistency and clarity in the provision of assurance services for both companies and investors.

- **Issuers:** Audit committees and boards are responsible for overseeing and approving sustainability reporting and assurance processes. As such the board needs to receive training and education on assurance practices so that they can have an informed conversation with assurance providers on what is being assured and to what level. Boards can ensure the processes and controls for collection of sustainability information is reliable and aligned with organisational goals, which enhance their accountability and ability to decide on the type and scope of assurance that best suits their needs, including the needs of their shareholders. It will also help the board to assess the quality of the assurance services that they receive. Board oversight can lead to better integration of sustainability into business strategies, which may appear unclear, vague, or simply too difficult to assess for many. This is a high priority for investors.
- **Investors and other users:** We recognise the need for investors and other users of reporting to be upskilled to minimise the expectations gap. Similar to boards, shareholders also require training to have informed discussions about what is being assured and to what level. This knowledge will enable them to understand the assurance process better and engage in meaningful dialogue about it, as well as its limitations and potential risks. A thematic review from the FRC on TCFD disclosures found that while companies had stated they had obtained some form of voluntary assurance over some of their TCFD reporting, it was not always clear to what level this had been provided. There was a lack of clarity with regards to the different types of terminology being used, with terms such as 'verified' often implying that a higher level of assurance had actually been provided. It is important for companies and assurance providers to clarify the assurance levels being delivered to prevent misinterpretation by users, which could lead to decision-making based on incomplete or inaccurate information. This includes the company and assurance provider being transparent as to which elements of the sustainability-report have been subject to assurance. We urge the FRC to work with relevant bodies/industry groups to promote user understanding of the difference between reasonable and limited assurance as well as the results of arising from these engagements.

Question 4: Do you agree or disagree that both individuals and firms should be able to be registered as sustainability assurance providers? Provide justification and explain whether any specific requirements are needed to ensure appropriate accountability.

The UK Government is proposing a profession-agnostic "sustainability assurance provider" category for those who assure sustainability-related financial disclosures. The government is seeking views on whether both individual assurance providers and assurance firms should register as approved sustainability assurance providers. This would take a similar approach to how statutory financial auditors operate where both individual auditors and audit firms can be registered as statutory auditors as long as they meet the relevant qualification and registration requirements.

We broadly support the proposal for both individual assurance providers and assurance firms to be registered under the proposed regime. We believe that there may be a number of benefits to this approach:

- **Diverse skillset:** As we set out at question 3, sustainability disclosures cover a diverse range of topics which require multidisciplinary expertise. By allowing both individual experts and firms to register, the regime will be able to harness a broad range of skillsets needed for effective assurance.
- **International alignment:** Furthermore, this approach will create international alignment as the CSRD already allows either a statutory auditor or accredited independent assurance service

providers (including sole practitioners) to assure sustainability reports. Embracing this dual approach will make it easier for UK- registered providers to provide their services internationally.

- **Meeting the needs of companies in a proportionate way:** It is also important to note that different reporting entities will have different assurance needs. A larger multinational company may prefer the services of a multi-disciplinary firm with global reach. Meanwhile a smaller company or one seeking assurance on a niche metric might require the expertise of an individual specialist. Allowing both to register lets the market match the appropriate provider to a specific engagement depending upon its nature and scale, and keeps the costs proportionate depending upon the specific needs of a business.

Ensuring appropriate levels of accountability

The consultation is also seeking views on how a registration regime can deliver appropriate levels of accountability, particularly where a sustainability assurance engagement fails to meet high standards and where multiple individuals are contributing to an assurance engagement. As a starting point, all registered providers should be required to follow approved assurance and ethical requirements, and we welcome that the regulator has consulted on whether to introduce a UK specific version of the ISSA 5000, on a voluntary basis. This will help improve consistency in the quality of engagements across different providers. Ensuring that all assurance providers are using the same assurance standard can allow the regulator to hold them accountable as performance can be measured against a known and consistent benchmark.

Once a firm or individual have registered under this regime, oversight from the ARGA will be critical to help ensure its ongoing success. The ARGA should monitor the performance of service providers in the same way that it does financial auditors. This could involve periodic quality reviews of assurance engagements, similar to the FRC's Audit Quality Review process. This needs to strike a balance between holding providers accountable while also recognising the ARGA's role as an improvement regulator. Where deficiencies within an assurance engagement are identified, given the nascency of the market the ARGA should promote a culture of continuous learning and improvement within firms. Similar to the approach taken to audit quality supervision, the ARGA's supervisory team should work with firms to develop improvement mechanisms which help firms to address the ARGA's concerns in a timely manner and monitor the integration of those actions over a period of time through constructive engagement, until the ARGA is confident that a risk has been mitigated. The ARGA may consider publishing summary results from its inspections to provide further transparency to the users of these services, particularly where specific issues or areas for improvement have been identified. This will allow users to make better informed decisions about the service provider they choose for future assurance provision.

Balancing accountability with reliance on multiple individuals during the assurance engagement

The government notes that specific mechanisms for accountability may also be required where multiple individuals are contributing to an assurance engagement. In practice, sustainability assurance often involves a team of professionals. To balance accountability when multiple experts contribute, the regime could require that every assurance engagement has a designated senior registered provider in charge (analogous to the "engagement partner" in financial audit). That individual would sign the assurance report and take primary responsibility. If a solo registered practitioner performs the work, the chain of accountability is clear – the individual will take personal responsibility. If a firm is engaged, the firm itself is accountable but it should appoint a registered individual (within the firm) to lead and sign off on the engagement. This ensures there is always a named person answerable for the quality of engagement, which keeps the chain of accountability clear. While individual accountability can be an important aspect of instilling confidence in the provision of a quality service, this is likely to lead to increased regulatory scrutiny and significant commercial implications where for example the regulator identifies deficiencies within the assurance process. This could act as a deterrent to both firms and individuals in registering with ARGA, and as set out at question 2, this is an unintended consequence which the regulator will need to consider as it implements the regime.

Question 5: In broad terms, what are the main principles that ARGA should consider when developing a registration regime for sustainability assurance providers?

We think ARGA should consider the following principles during the development of its registration regime:

Use of robust standards for assurance engagements: To ensure high quality assurance, ARGA should encourage the use of recognised assurance standards. This would align with the government's intention to make ARGA responsible for setting audit standards in the UK, including technical and ethical standards for sustainability assurance. We welcome that the FRC has consulted on the use of a UK equivalent of the ISSA 5000 standard. This will drive consistency and reliability in how sustainability-related information is verified.

Addressing the skills gap through education and training: The FRC's market study emphasises the importance of education and training for those involved in preparing, assuring and using sustainability information and reports. ARGA should work with other stakeholders to help produce a globally recognised sustainability assurance qualification. Given the government's intention for the registration regime to extend to multiple sustainability reporting requirements, the qualification should be recognised internationally so that UK based assurance providers can compete with their global counterparts to provide their services. Ongoing education and training will also help firms to address capacity constraints if demand for sustainability assurance is likely to increase in the future as a result of regulatory requirements (such as mandating assurance in the UK).

International alignment: the scope of the registration regime should be clear, including the intention for the registration regime to align with international global reporting frameworks. Recognising multiple reporting standards in the regime will ensure UK-registered assurers are equipped to work across borders and meet other jurisdictions' requirement. This principle gives the market confidence that the UK regime is comprehensive yet globally consistent.

Supervisory and Enforcement Regime: The new regime should be able to provide unified oversight of sustainability assurance. This should involve consolidating assurance standard setting, monitoring and enforcement under one roof to give companies and investors certainty. While ARGA should have the power to sanction poor performance or misconduct (for example through inspections or public notices) its initial approach should be to provide support and guidance to help improve the market and support the development of assurance providers. This approach is also less likely to deter firms from joining the voluntary scheme. As we set out at question 4, this could involve undertaking quality reviews of assurance engagements, similar to the FRC's Audit Quality Review function. As part of this function, ARGA could consider ways to improve the type and quality of information available to the market in relation to assurance providers. In addition to the transparency provided by the publicly accessible register of sustainability providers, the ARGA could consider publishing aggregate findings from its inspection activities. This would have the dual benefit of providing additional information to companies and investors, and will incentivise the delivery of better quality services and the sharing of best practice in order to help the market develop. This approach is also aligned with ARGA's role as an improvement regulator.

Future Evolution: ARGA should design the regime with future readiness in mind. As noted, the regime is voluntary initially, but ARGA may need to consider making registration mandatory over time if market demand and public interest call for it. Ensuring flexibility and a clear path for evolution (e.g. setting criteria that can be tightened as capabilities grow) will mean the registration framework can seamlessly transition to a more comprehensive assurance requirement in the future. This principle ensures that today's approach lays the groundwork for tomorrow's needs, without having to rebuild the system later.

Question 6: How should ARGA work with other organisations when developing a future registration regime?

ARGA should collaborate with other organisations when developing the future registration regime, working closely with both domestic and international organisations to leverage expertise and ensure alignment. As users of sustainability-related assurance, it is imperative that ARGA works with companies and investors to ensure that the registration regime and associated oversight from ARGA delivers the intended benefits, by helping to increase confidence in the range of service providers in the market that companies can choose to provide assurance, and to improve the credibility of sustainability-related disclosures.

Professional bodies could provide input into the eligibility standards for the registration regime, as well as help to build out the capacity through providing guidance and training. Working with membership bodies could also help ARGA better demonstrate the value of the registration regime to practitioners.

A number of large multi-national companies are now required to seek limited assurance of sustainability-related disclosures under CSRD. ARGA should seek to understand the lessons learnt with regards to assurance under the CSRD regime, including any challenges and opportunities that assurance providers and companies in the EU have faced. This information sharing will also be important in order to meet the aim of UK-based assurance providers being able to provide assurance over other reporting standards.

As ARGA develops its supervisory and oversight processes it should also co-ordinate with other regulators such as the FCA to avoid overlap in any rules. Equally, it may find that it can leverage expertise from other jurisdictions where a registration regime for sustainability related assurance is being considered.

Question 7: Do you agree or disagree that the UK's registration regime should recognise 'sustainability assurance providers' as being capable of providing high-quality assurance over multiple reporting standards (that is, TCFD, UK SRS, ESRS)? Provide justification.

The UK Government proposes that registered sustainability assurance providers be qualified to assure various sustainability reporting frameworks – TCFD, UK Sustainability Reporting Standards (UK SRS), and EU Sustainability Reporting Standards (ESRS) – under one regime. We agree that the UK's registration regime should recognise UK providers as capable of delivering high-quality assurance across multiple standards. This approach is aligned with international moves towards a global baseline for sustainability reporting, provided appropriate safeguards are in place to ensure quality and expertise.

Most multinational companies will have to report under multiple frameworks- appointing one assurance provider to verify all sustainability disclosures avoids duplication of work as well as reducing cost and assurance logistics. At present EU subsidiaries of UK parent companies in scope of EU rules have to use a 3rd party assurer to obtain limited assurance of their disclosures under ESRS- under this regime UK registered professionals would be able to fulfil the role.

Having a globally recognised standard for assurance engagements which can be used against a variety of sustainability disclosures requirements will help to promote consistency and enforce uniform high standards. Encouraging assurance providers to use a UK specific version of ISSA 5000 will drive a rigorous, common approach to assurance for TCFD, UK SRS and ESRS engagements.

There will be more unified regulatory oversight because under the regime operated by ARGA, any registered provider will be subject to the same qualification criteria, ethical standards and supervision, irrespective of the underlying disclosure framework they are assuring. This increases accountability and trust in providers' reports across all sustainability reporting frameworks.

Question 8: Do you agree or disagree that sustainability assurance providers must follow UK equivalent standards to ISSA 5000? Provide justification and, if you disagree, indicate whether any other standards are considered appropriate.

The IA has supported the FRC's recent consultation on issuing ISSA (UK) 5000 for voluntary use in the UK, as this will provide a consistent and internationally aligned framework for sustainability assurance, enhancing trust in sustainability information. At this stage, given the nascency of the market, voluntary adoption of the standard is proportionate. ARGA should monitor and periodically review voluntary adoption of the standard, if the market moves towards this as a matter of course, there is less need to make the standard mandatory. If at the time of ARGA's implementation of the registration regime there is still a divergence in the standards being used to undertake assurance engagements, in order to promote greater consistency and certainty for companies and investors, ARGA could potentially seek to mandate the standard.

Our members are strong proponents of the ISSA 5000 standard and believe that its introduction will yield significant benefits:

- **Global Consistency and Comparability:** Adopting ISSA 5000 in the UK helps establish a *global baseline* for sustainability assurance engagements by mirroring the international standard developed by the IAASB. IA members, as global investors with multinational portfolios, have supported the development of the ISSB's sustainability disclosure standards and now similarly support a globally aligned assurance standard. The implementation of ISSA 5000 in the UK will avoid fragmentation and ensure the UK remains part of an internationally recognised approach, rather than developing a disparate local standard.
- **Investor Confidence in Sustainability Information:** Having an assurance framework in place – even on a voluntary basis – will bolster the credibility and reliability of sustainability disclosures provided by companies. Given that the FRC is considering introducing the standard for use on a voluntary basis, investor confidence is likely to increase where the FRC is able to encourage a critical mass to apply the standard. Investors rely on accurate sustainability data to assess long-term value and risks. The IA's view is that confidence in sustainability reporting will increase if users know that information has been subject to independent assurance under a rigorous standard.
- **Meeting Growing Market and Regulatory Demand:** The introduction of a sustainability assurance standard in the UK is timely. Globally, many jurisdictions, including the UK, are considering how to implement sustainability reporting and assurance through the endorsement of the ISSB standards. By proactively making ISSA 5000 available for use, the FRC ensures the UK keeps pace with international trends and provides UK market participants with an opportunity to voluntarily enhance their reporting credibility now. Introducing ISSA (UK) 5000 now, on a voluntary basis, is a prudent step that allows early movers to proceed while a broader mandate is potentially considered in the future.
- **Interoperability and Framework-Neutrality:** The standard is designed to be framework-neutral and applicable across all sustainability topics. This means it can be used to assure information reported under various frameworks or criteria. ISSA 5000 deliberately provides a flexible assurance umbrella for both single materiality (enterprise value-focused) disclosures and double materiality disclosures that include externalities that are not currently financially material for commercial entities. From the IA's perspective, this flexibility is very important. Different companies may adopt different reporting frameworks, but all should be able to seek assurance under a common standard.
- **Support with Minimal Burden:** Finally, using ISSA 5000 in the UK brings benefits without imposing significant new burdens on business. Because the standard is voluntary and nearly identical to the international version, companies and assurance providers who choose to use it should not face extra costs or complexity relative to using the IAASB's standard. The FRC has indicated that no

additional requirements (beyond one minor safeguard on the use of internal auditors) are being proposed, so the standard remains largely the same.

Question 9. How should ARGA exercise its proposed functions in respect of assurance standard setting in the future?

Once the ISSA 5000 UK standard has had some time to bed in, ARGA should work the industry to understand any implementation challenges that users have experienced, including interpretation of the underlying sustainability disclosure standards. Given the global nature of the standard, it will be important for ARGA to ensure that it is liaising with the IAASB to share knowledge and best practice on specific interpretation issues and how to resolve these. Amendments to the standard would reduce international comparability and consistency with the IAASB standard. As such we would encourage the FRC to undertake a post implementation review and work with the IAASB to issue guidance or Q & A which addresses the interpretative challenges that users of the standard have identified.

Some IA members note that a generic standard and approach to assurance might not capture industry specific sustainability issues. Different sectors face different material sustainability topics and will often use specialised reporting metrics. There may be a need for additional industry specific standards if a sector agnostic regime fails to capture these nuances. Assurance could become a blunt instrument either ignoring key sector metrics and nuances or applying an approach that is not fully relevant. This could result in assurance that is less meaningful for certain industries which could undermine the usefulness of assurance in those sectors. ARGA should draw on experiences from the EU on assurance of CSRD to share lessons learnt and keep the need for sector specific assurance standards under review in the future.

Question 10. What factors should ARGA consider when developing its approach to enforcement? Provide justification.

We believe that it is right that ARGA is equipped with a full range of powers in the event that it needs to investigate poor performance or behaviour. However, we would caution that the use of enforcement mechanisms should be risk based and proportionate. As we have noted elsewhere in our response, ARGA as an improvement regulator should seek to provide firms with guidance, training and promote the sharing of best practice to uplift capabilities. This is particularly important given that sustainability assurance is still a developing field and registration under this regime will initially be voluntary. Intervention that is too extreme or not proportionate given the current state of the market could deter providers from seeking to register.

ARGA already investigates and takes enforcement action in relation to financial audits under the Audit Enforcement Process (AEP). We would recommend that the ARGA uses this as an initial model or framework to build out its enforcement capabilities for sustainability assurance providers. Some members have flagged that there is an ambition for sustainability-related assurance and the audit of financial statements to eventually be of equal quality. We think that it useful to aspire towards this but would also recognise that the audit of financial statements evolved over a sustained period of time and that it would be unfair to hold sustainability assurance providers to the same standards straight away, particularly when it comes to the enforcement mechanisms that the ARGA may use. Equivalence could potentially be achieved through maintaining the connectivity between narrative reporting on sustainability and the financial accounts, which are an important aspect of the UK SRS requirements. It will be important for the government to monitor how the market develops and underlying sustainability reporting matures. As such, in the first instance we would suggest that the regulator focuses on non-financial sanctions. Deregistration should only be used as a tool of last resort once other measures have been exhausted.

Under the AEP, the FRC already issues non-financial sanctions such as severe reprimands, exclusions (e.g. from membership bodies for a specified period of time), conditions/ requirements, undertakings and declarations. This type of sanction is important in the context of ARGA focusing on building knowledge and facilitating the sharing of best practice in order to drive improvements to the quality of service provided. Non-financial sanctions should require firms to identify the root cause of the identified failure and formulate and implement measures to prevent recurrence. Firms should assess and periodically report back to the ARGA on the effectiveness of these measures to provide greater accountability over a specified time period. ARGA should then provide constructive feedback and challenge and if required suggest alternative measures that may need to be implemented. Ongoing oversight and support will be important to help mitigate the risk of recurrence. This is particularly important for a market that is continuing to grow and develop its capabilities and services.

Question 11. Do you agree or disagree that assurance of UK SRS disclosures is desirable in the long term? Explain your view and also indicate whether there are any implementation approaches (for example, timelines for phasing-in requirements) or alternative measures to regulation that the government should consider

Investors have a strong interest in ensuring that sustainability information reported by companies is reliable and accurate. Investors increasingly need meaningful, comparable, and consistent sustainability reporting to assess long-term risks and opportunities within investee companies. There is a growing demand among investors for high-quality assurance to enhance the reliability of corporate reporting. Currently in the UK, assurance of sustainability reports are largely voluntary. We think that this is right approach. Mandatory assurance could be a long-term aspiration, but the government should initially assess whether voluntary assurance is delivering the confidence and credibility in reporting that companies and investors are seeking. In addition, there are a number of challenges that would need to be resolved before assurance can be mandated, which we set out below.

To start with, sustainability-related information typically involves a more extensive narrative component, more forward-looking information over longer time horizons, and more reliance on information pertaining to issuers' value chains. This means that there is great variance amongst issuers in their data collection methodologies and disclosures. As outlined by IOSCO[1], there are inconsistent methodologies for calculating certain metrics, insufficient transparency on the methodologies used, including on the use of estimates, lack of clarity on how forward-looking information has been developed, and a lack of transparency and connectivity between financial and non-financial information. Given these challenges, some members have also flagged concerns that mandatory assurance could divert issuers limited resources and time towards answering questions from assurance providers, rather than ensuring that the underlying figures within the financial statements and narrative reporting are sufficiently robust. Pending the government's decision to endorse UK SRS, preparers will need time to evolve their reporting capabilities in line with UK SRS, but we believe that some of these challenges should be resolved once a standardised approach to reporting is introduced.

Some members have stated that there are still complexities around companies building proprietary systems to gather sustainability-related data in a consistent matter. These will likely need to be updated to reflect the UK SRS standards. Internal processes for data collection need to be more robust and until these systems and controls are in place it represents a challenge for mandatory sustainability assurance.

As outlined at question 3, there is a skills gap and shortage of qualified personnel with adequate expertise to undertake this type of assurance. If it were mandated at this stage, then demand could outstrip the capacity of skilled assurance providers- leading to bottlenecks and reliance on less experienced providers.

[1] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD729.pdf

Some members already note that this type of work has been given to more junior audit staff in big 4 firms and this could be exacerbated if assurance were mandated too early.

There is an argument that mandating assurance would bring the UK more in line with the EU. However, delaying this gives the UK the opportunity to learn from and understand the key challenges that EU counterparts have faced. Assurance practitioners in the EU are drawing attention to uncertainties related to the double materiality assessment process, high levels of measurement uncertainty on certain quantitative metrics, and difficulties comparing sustainability information between entities and over time. There is an opportunity for the FRC to leverage these challenges and address them as part of its role in sharing best practice and knowledge.

Mandatory assurance is also likely to add compliance costs for providers which larger firms can absorb but this could disproportionately impact smaller or mid-sized companies if they fall within scope. Any mandate should consider proportionate application and should also ensure fee transparency. Members consider that it is important to maintain a distinction between audit and non-audit services as this could unfairly benefit auditors by limiting competition in the provision of these services. This is an important consideration to ensure that sustainability assurance remains a separate service with clearly disclosed fees and that audit firms do not get an unfair advantage in bundling services.

Where the government does decide to mandate assurance, we believe that it is important to consider phased-in requirements. For example, the ARGA could require assurance on specific high-impact metrics (like green-house gas emissions or climate risks metrics under TCFD) or for the largest companies first. This targeted mandate ensures the most critical information is assured, where investor need for reliability is greatest, without overburdening assurance providers at once. As confidence and capability grow, the scope of mandatory assurance can also expand.

Question 12. Provide evidence where assurance providers have been excluded from or where you anticipate future barriers to competing for CSRD assurance engagements, due to a lack of UK registration regime or other reasons. Where possible, include quantitative estimates of the scale of impact on UK companies.

The IA does not have any views on this question.

Question 13. Provide evidence where the non-audit services cap has been a barrier to accessing or providing high-quality sustainability assurance. Where possible, include quantitative estimates of the scale of impact.

The FRC market study stated that the current non-audit service cap regulations may be acting as a barrier to providing sustainability assurance services. At present, the provision of sustainability assurance services is treated as a non-audit service for the purposes of the cap meaning that an audit firm may not receive fees deriving from permitted non-audit services that exceed 70% of average of the audit fees for the preceding 3 years. The government perceives this as a particular barrier for firms that carry out financial audits as they'll be restricted by the fee cap. Some stakeholders have noted that the UK rules have stopped firms from taking on assurance work, which puts the EU at a disadvantage to European audit firms who can include sustainability assurance within their regular audit fees.

We understand that the government will be considering potential changes to the cap from the perspective of professional services as one of 8 sectors that can fuel economic expansion. There is recognition amongst the IA membership that while encouraging a sector-agnostic approach to assurance is valuable, a growing number of companies in the EU have chosen their financial auditor to undertake sustainability-related assurance. This is because these firms have well established and pre-existing relationships with companies. Members further note that for larger and more complex companies, it may be more efficient to use a single

provider for both statutory audit and sustainability assurance, which allows for a more streamlined process, reduced resourcing burdens and cost.

The government has signalled that it does not want to exclude financial auditors from being able to provide sustainability assurance services. We have received mixed views from members on whether the cap should be relaxed. Some members have argued that the removal of the cap could undermine a firm's willingness to challenge management and exercise sufficient scepticism. There is also a risk that it leads to an entrenchment of the Big 4, which could lead to less competition and choice in the market for assurance providers, and have an impact on the future resilience of the market. Conversely, some members note that if sustainability assurance is mandated, it will no longer be covered by the non-audit service cap, as is the case in the EU. As such, in the interim whilst the government considers stakeholder views on potentially mandating assurance, it could consider a time limited relaxation to the cap. On balance, we believe that a limited relaxation could be beneficial to allow companies to take advantage of the provision of assurance services on a voluntary basis.