Governance Institute of Australia

T +61 2 23 5744 F +61 2 9232 7174
E info@governanceinstitute com.au
Level 11, 10 Carrington Street,
Sydney NSW 2000
GPO Box 1594, Sydney NSW 2001
W governanceinstitute com au

24 February 2023

climatereportingconsultation@treasury.com.au

Climate Disclosure Unit
Market Conduct Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sirs,

Consultation paper - Climate-related financial disclosure (Consultation Paper)

Who we are

Governance Institute of Australia (GIA) is a national membership association, advocating for our network of 43,000 governance and risk management professionals from the listed, unlisted, public, and not-for-profit sectors.

As the only Australian provider of chartered governance accreditation, we offer a range of short courses, certificates, and postgraduate study. Our mission is to drive better governance in all organisations, which will in turn create a stronger, better society.

Our members have primary responsibility for developing and implementing governance frameworks in public listed, unlisted and private companies, as well as the public sector and not-for-profit organisations. They have a thorough working knowledge of the operations of the markets and the needs of investors. We regularly contribute to the formation of public policy through our interactions with Treasury, ASIC, APRA, ACCC, ASX, ACNC and the ATO.

We are a founding member of the ASX Corporate Governance Council. We are also a member of the ASIC Business Advisory Committee, the Modernising Business Registers Program Business Advisory Group, the ASX Business Committee and the ACNC Sector Users Group.

GIA is a signatory to the joint submission (Joint Submission) dated 24 February 2023 made by the Australian Sustainable Finance Initiative, Chartered Accountants Australia and New Zealand, CPA Australia, the UN Global Compact Australia, CFA Societies, the Group of 100, Australasian Investor Relations Association, Australian Shareholders' Association and the Institute of Public Accountants. This separate Submission addresses other matters of concern to our members which were not addressed in the Joint Submission.

As the Consultation Paper notes, climate change is recognised internationally as a material risk to the global financial system. An important tool to manage both individual and systemic climate-related

financial risks is the disclosure of these risks. GIA supports a global approach to the development of sustainability reporting, particularly climate-related financial disclosure standards and has also expressed strong support for the International Sustainability Standards Board (ISSB) being the global body to issue these standards.[1] GIA is encouraged to see implementation of these standards in Australia under active consideration.

Our members encourage Government to continue to acknowledge, and consider, the international reporting obligations that some Australia entities will have due to non-ISSB aligned reporting structures, for example, the European Union. They consider it would be helpful if all disclosures build on existing domestic legislation such as the National Greenhouse and Energy Reporting Act 2007 (NGER) and Corporate Emissions Reduction Transparency (CERT) Reports to reduce duplication of reporting. Also of note is that many ASX listed companies currently make disclosure of their material exposure to climate change risks under Recommendation 7.4 of the Corporate Governance Principles and Recommendations (Corporate Governance Principles and Recommendations).[2] The commentary to Recommendation 7.4 encourages listed entities to use the Task Force on Climate-related Disclosures (TCFD) Framework for reporting on these risks. Our members also encourage Government to use this opportunity to build on existing reporting and encourage a coordinated national approach to reporting on these issues.

When implementing these reporting requirements, the key steps are:

- Incorporating a climate first approach that recognises the climate risk to the Australian economy, the financial system, the community and investors
- Scalable and practical implementation of leading practice that incorporates a phased approach to adoption across entity types, sectors and/or sizes
- Inclusion of appropriate levels of independent external assurance to lend credibility to sustainability information
- A consideration and adjustment for the local legal context when implementing the ISSB standards in Australia, and
- Ensuring appropriate funding for the body or bodies charged with implementing the Standards in Australia.

Our members' responses to the specific questions are set out below:

Question 3: To which entities should mandatory climate disclosures apply initially?

3.1 What size thresholds would be appropriate to determine a large, listed entity and a large financial institution, respectively?

3.2 Are there any other types of entities (that is, apart from large, listed entities and financial institutions) that should be included in the initial phase?

Our members support:

- aligning coverage with existing reporting and disclosure thresholds rather than creating new creating entirely new bespoke thresholds, and
- a phased approach over an appropriate timeframe for the introduction of mandatory disclosure, noting there are various ways in which this could be implemented but that Government should clearly signal the intended ultimate coverage of the scheme.

---

[1] See *Peak Australian Bodies Submission* to the International Sustainability Standards Board, 15 July 2022.

[2] See Corporate Governance Principles and Recommendations, 4th edition, ASX Corporate Governance Council.

Our members note that a phased approach reflects the approach taken internationally, and also allows for preparers and auditors to scale up steadily to meet the economy-wide demands that will come with these new disclosures, and the disclosure framework applying to all entities on a voluntary or 'opt-in' basis from commencement to encourage early adoption.

Our members consider that there are range of factors which should influence which entities should report first against the new standards which include market listing and capitalisation and sector or operations.

The Australian listed entity sector is notable for its 'long tail', meaning that the bulk of market capitalisation is in the largest entities. By way of illustration: entities in the ASX 200 have market capitalisations ranging from $380M to over $100B, entities in the ASX 300 have market capitalisations over $100M. There is a significant difference between the resources and sophistication of entities with a market capitalisation of over $100B and entities with a market capitalisation of $100M.

Our members consider the most appropriate way to proceed would be to prioritise mandatory disclosure for those that are best prepared, for example large globally-connected entities, government infrastructure and the heaviest emitters. Only four of Australia's ten highest greenhouse gas emitters in 2020-21 are ASX listed entities, with the remainder government or privately owned.[3] This initial group would include:

- large ASX listed and large private or disclosing entities (of the same size)
- all ASX listed entities with a market capitalisation of more than $300 million, and
- all government and public entities

It is important for the initial tranche of reporting to have coverage across keys sector or operations to ensure that heavy emitters, for example, are captured. This will assist in mitigating against the risks of adverse competition impacts between entities not covered by the regime and the regulatory arbitrage referred to in the Consultation Paper.

Our members support the application of the proposed standards to large financial institutions but would welcome more detail about what is considered a 'large' financial institution. They also recommend close collaboration with APRA to ensure the new requirements align with Prudential Practice Guide CPG 229 Climate Change Financial Risks.

Question 7: What considerations should apply to materiality judgements when undertaking climate reporting, and what should be the reference point for materiality (for instance, should it align with ISSB guidance on materiality and is enterprise value a useful consideration)?

We understand that the ISSB is currently considering the definition of materiality. Australian preparers of financial statements are familiar with the International Financial Reporting Standards (IFRS) definition of materiality and will be in a better position to assess whether it is an appropriate reference point. Our members also note that the Australian Accounting Standards Board (AASB) has already issued guidance on the definition of materiality in the context of climate-related and other emerging risks disclosures.[4]

[3] Source Australian Government Clean Energy Regulator.

[44] See Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB/IASB Practice Statement 2, AASB, April 2019.

Our members do not support the concept of a double materiality test, a concept not commonly applied in Australia.

Question 8: What level of assurance should be required for climate disclosures, who should provide assurance (for instance, auditor of the financial report or other expert), and should assurance providers be subject to independence and quality management standards?

While our members support assurance in principle, they consider the level of assurance required should be informed by the objectives of disclosure and the liability regime attaching to the Scheme. Our members consider that the assurance requirements introduced should be proportionate to the risk, size and complexity of the relevant reporting entity. They also consider where assurance is carried out, it is important that the extent and level of assurance is transparently disclosed by the reporting entity.

The other important issue in the context of assurance across sustainability and climate-related disclosures is that there is currently limited capacity within the Australian market of those carrying out assurance. It would likely be problematic to introduce a material, economy-wide step up in assurance levels without the assurance providers being provided an opportunity to build the appropriate capability within their teams.

Our members consider environmental, social and governance (ESG) assurance providers should be subject to the same independence and quality management standards as financial auditors. They also consider the existing systems for quality management standards and independence requirements are appropriate to apply to the ESG space, modified as appropriate to recognise that the service providers will typically not be financial accountants.

While our members acknowledge and expect that market practice will continue to evolve in relation to ESG disclosures, they feel that requiring anything more than limited assurance of ESG disclosures during the early phases of the new Scheme will create a significant burden on reporting entities from a resource and cost perspective.

Our members consider that a phased approach to assurance will be necessary, and that a limited assurance model is appropriate.

Question 15: How suitable are the 'reasonable grounds' requirements and disclosures of uncertainties or assumptions in the context of climate reporting? Are there other tests or measures that could be considered to ensure liability is proportionate to inherent uncertainty within some required climate disclosures?

Our members support improved climate-related financial disclosure. However, as the Consultation Paper notes compared to financial reporting, climate disclosures involve substantial use of forward-looking information and are dependent on externalities that are subject to uncertainty such as climate scenarios, potential global responses to climate change; regulatory and policy developments and the development of technologies and business models not available today. It also refers to the need for careful consideration of how climate disclosures should interact with the Corporations Act provisions to appropriately incentivise accurate, comprehensive and timely disclosure without reporting entities, their directors and officers taking on disproportionate liability risk.

Our members consider that appropriate safeguards (such as safe harbour provisions) will be critical to achieving this outcome. They consider that if the regime does not facilitate disclosure with safeguards in place, entities may be slow or reluctant to make information publicly available. This would be counter to the policy intent of the proposals – to increase the level of publicly available, decision-useful

information. Recent reports indicate that 'green hushing' - entities choosing not to disclose climate targets or other information to avoid scrutiny and allegations of greenwashing is on the rise.[5] Absent appropriate safeguards for good faith disclosures entities will be less inclined to make disclosure of the type contemplated.

Our members note that setting Scope 3 emissions targets can be problematic, as the reporting entities will have no or limited control over these emissions. While companies generally can have a strong degree of confidence in relation to Scope 1 and Scope 2 emissions, it is much more difficult to accurately account for all other indirect emissions that occur in a company's value chain. Often these disclosures can only be made on an estimates basis and are qualitative in nature. For companies in sectors where Scope 3 makes up a significant portion of their emissions profile, the disclosure framework should encourage increased reporting with the objective for additional transparency and understanding of a company's true carbon footprint. A regime that stifles transparent disclosure for fear of 'greenwashing' allegations would be contrary to the achievement of net zero goals.

Under Australian law forward-looking statements must be made on reasonable grounds. Given that climate change measurement is evolving rapidly entities will need to make disclosures based on information or assumptions that may well become out of date or inaccurate very quickly. At the same time ASIC's Regulatory Guide 170 notes that information is not material to investors if it is 'speculative or based on mere opinion or judgement'.[6] As the market regulator ASIC is responsible for bringing proceedings against directors and other officers for breach of their duties. In the US and the UK private individuals bring these actions.

Australia is also 'the most likely jurisdiction outside of the United States in which a corporation will face significant class action litigation'.[7] As a recent report notes 'climate change issues are looming larger in the potential class action risk equation'.[8] It should also be noted that it is more difficult to bring class actions in the United States than Australia and a safe harbour is also available in that jurisdiction for TCFD disclosures. The potential for exposing a company and its officers to a class action on the basis of its climate-related disclosures is another factor which may disincentivise accurate, comprehensive and timely disclosure by reporting entities.

An additional concern is that while the understanding of climate change risk is growing amongst Australian directors and officers, they are not climate experts and will of necessity be required to rely on the expert opinions of others. The extent to which the defence under section 189 of the Corporations Act will be available to assist them in situations where they have relied on climate experts' opinions is unknown

The interaction between periodic climate-related financial disclosures and the continuous-disclosure regime for ASX-listed companies, which is a particular feature of the Australian regulatory landscape will require careful consideration. Some entities currently issue periodic sustainability reports or disclosures which include information they do not consider will have a 'material effect' on the price or the value of their securities from the perspective of continuous disclosure. An entity may, at a later point, change a pathway towards achieving net zero because the pathway becomes blocked or if it fails to reach an interim target and it has disclosed the pathway or target in a periodic report. It can be difficult to assess at what point in time a path becomes blocked and, while this information may be important

---

[5] See *Green hushing is on the rise as companies keep climate plans from scrutiny*, Financial Times, 18 October 2022.
[6] See ASIC Regulatory Guide 170 Prospective Financial Information at page 7, ASIC, 2011.
[7] See Class Actions in Australia, Updated May 2022, Allens Linklaters.
[8] See Class Action Risk 2022, Allens Linklaters.

to some stakeholders, it may not necessarily be market sensitive. The Standards will also require the disclosure of large volumes of information, much of it technical projections. AS LIsted entities will need to monitor and, if needed, provide updates to information previously disclosed to the market to prevent them breaching their obligations under the Corporations Act.

The focus of the legislation should be supporting compliance while acknowledging that there are inherent uncertainties in relation to, for example, some of the data and the technologies underpinning emissions reductions. Our members suggest that it will be impractical for entities to repeat all the uncertainties, assumptions and other information underpinning relevant disclosures each time they are disclosed within an annual report, for example, without the disclosures becoming overly long and complex, and difficult for non-technical readers to understand. Reporting entities will be incentivised to include multiple qualifications to their disclosures to limit potential liability under the new legislation and to reduce the real risk of class actions.

One possible option for addressing these concerns may be to adapt the changes introduced during COVID-19 to the continuous disclosure regime in this context. This would mean that reporting entities only attract civil liability if there is evidence that they knew or were reckless or grossly negligent with respect to reporting. An alternative option may be to adapt a modified business judgement rule where directors and/or entities are taken to have made a business judgement with sufficient care and diligence if there is evidence that they:

- made the judgement in good faith and for a proper purpose
- informed themselves about the subject matter to the extent they reasonably believed was appropriate
- rationally believed that the judgement was in the best interests of the entity, and
- rationally believed that the judgement was reasonable in the circumstances.

Question 16: Are there particular considerations for how other reporting obligations (including continuous disclosure and fundraising documents) would interact with new climate reporting requirements, and how should these interactions be addressed?

See the answer to Question 15 above.

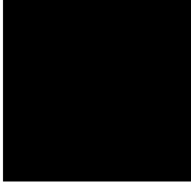
Question 19: Which of the potential structures presented (or any other) would best improve the effectiveness and efficiency of the financial reporting system, including to support introduction of climate related risk reporting? Why?

The expansion of reporting for Australian based entities on this scale raises important questions about whether the existing standard setting framework is adequate for the expansion of international standard setting priorities on climate change and sustainability reporting.

Our members have considered the three models proposed in the Consultation Paper and consider that in the long term Potential Structure 3 may be the most effective way to future proof Australian financial reporting. However, setting up such a body will take time and the development of the new standards is progressing rapidly. From a pragmatic perspective they consider Potential Structure 1 is probably the most effective structure as an interim measure. This is provided: the AASB has members with the appropriate skills to deal with climate change and sustainability reporting and the AASB has sufficient resources to undertake this important work.

Please contact me or [redacted], GM Policy and Research if you have any questions in connection with this submission.

Yours faithfully,



[redacted]

CEO