Governance Institute of Australia

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

Dear Sirs,

Consultation paper - Climate-related financial disclosure June 2023 (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.

1. Preliminary comments

As a preliminary comment our members consider that the Consultation Paper significantly underestimates the impact of the Proposals outlined in the Paper on entities. We understand estimates of the number of entities affected by the Proposals range from 16,000 to 20,000 entities. While the Consultation Paper outlines a phased introduction of the reporting requirements, the impact of the Proposals and the uplift required, particularly for smaller entities, will be significant and they are unlikely

to be in a position to report meaningfully within the timeframes proposed. In addition, many of these companies have limited outside investment and given that the purpose of making the proposed disclosures is to provide high quality, comparable information for investors our members question whether requiring these entities to make public disclosure of climate information will achieve this aim.

Our members also consider the Consultation Paper overestimates the speed at which capacity to carry out audit and assurance of climate-related disclosures will build, absent Government support to assist with increasing capability and capacity across assurance providers. We consider that the number of sufficiently skilled and independent assurance providers are still likely to be in short supply by the end of the phasing period. While our members support the approach of leveraging existing reporting requirements, definitions and concepts to reduce the regulatory burden of the Proposals they consider there may be some potential unintended consequences which are outlined below. The Consultation Paper mentions in several places that further Guidance will be developed. Our members encourage Government to lead on this Guidance as a priority, in thorough consultation with stakeholders over a reasonable timeframe, and to consider ways in which it can support the development of additional assurance capacity in the market. Our members also have concerns – see below - about the operation of the proposed liability carveout and question whether moving to reasonable assurance on Scope 3 emissions by FY2027 for Group 1 entities is achievable.

Given the limited time available for consultation this Submission does not address all of the issues outlined in the Consultation Paper.

2. Reporting entities and phasing

Proposal: that all entities that meet prescribed size thresholds and that are required to lodge financial reports under Chapter 2M of the Corporations Act (Cth) (Corporations Act) would be required to make climate-related financial disclosures.

As noted above, the current Proposals capture a significant number of companies, many of which are not currently required to contemplate, much less report on, the impact of climate change. Our members consider that Groups 1 and 2 are appropriately calibrated but consider that the consolidated revenue threshold for Group 3 is too low. They consider $100M consolidated revenue to be a more appropriate threshold and would align the climate-related financial disclosure regime with other regimes with which companies are familiar including: the Payment Times Reporting Scheme, the Modern Slavery reporting requirements and the Corporate Tax Transparency Code. The consolidated gross assets threshold should also be appropriately adjusted. Given that the stated intention of the Proposals is providing investors with high quality, comparable information and the level of outside investment in entities below the $50M threshold is low, our members question whether requiring these entities to make public disclosure of climate information is useful. It is also unclear how the reporting requirements will apply to corporate groups and stapled entities.

Our members also note recent advice from Treasury during an Industry Briefing session that the reporting requirements are not intended to apply to ACNC registered charities. However, there are a number of not-for-profit entities which will be captured by the Proposals. Is this what is intended?

Our members would also welcome clarification of the information in Table 2 of the Consultation Paper. Is what is intended is that it is an entity of a particular size which is **also** a 'controlling corporation' under the NGER Act is required to report? Alternatively, are entities which are 'controlling corporations' under the NGER Act required to report irrespective of size?

We also note that some entities required to report under Chapter 2M which are impacted by the Proposals are eligible to use the 'Simplified Disclosures' Tier 2 financial reporting framework which came into effect on 1 July 2022. Given the desire to leverage existing reporting frameworks our members consider there should be a corresponding simplified climate-related financial disclosure regime for these entities to mirror the financial reporting regime.

3. Reporting content

Our members continue to encourage Government to acknowledge, and consider the international reporting obligations that some Australian entities will have due to non-ISSB aligned reporting structures, for example, those of the European Union and the United States of America. They consider it would be helpful if all disclosures continue to build on existing domestic legislation such as the NGER Act and CERT Reports to reduce duplication of reporting.

Figure 2 in the Consultation Paper indicates ASIC will develop Guidance to support the climate-related disclosure standards. Given the number of entities which will be subject to the reporting requirements, many of which have not previously made these types of disclosures, this Guidance will be extremely important. We recommend that it be tailored to suit the size and sophistication of the entities concerned and that it be subject to thorough consultation prior to release. Our members consider it will remain important for the Australian regime to continue to respond to developments internationally and we recommend regular review points are built into the Government's timetable to ensure that the legislation is reviewed and updated appropriately over time. It cannot be a 'set and forget' approach given how quickly the international market is moving and the variety of approaches being taken.

Our members support the approach to materiality outlined in the Consultation Paper to ensure harmonisation with existing definitions of financial materiality in the Australian and international standards.

4. Governance

Proposal: From commencement, companies would be required to disclose information about governance processes, controls and procedures used to monitor and manage climate-related financial risks and opportunities.

The Consultation Paper refers to disclosures including information about '…whether (and how) climate-related performance metrics are factored into executive remuneration. This is considered an extension to existing remuneration-related disclosures under annual reporting obligations' (page 12).

Our members would welcome clarification about what is intended in relation to these disclosures as it is likely the extent to which these types of measures are currently incorporated into executive remuneration, and reported on, will depend upon the nature of the entity. Remuneration disclosure, particularly for listed entities is a complex patchwork of Corporations Act and Accounting Standards requirements. Our members would be reluctant to see an already complex area further complicated.

5. Strategy

Proposal: From commencement, reporting entities would be required to use qualitative scenario analysis to inform their disclosures, moving to quantitative scenario analysis by end state.

Our members welcome the acknowledgement in the Consultation Paper that because entities are at different points in their consideration of climate change impacts qualitative scenario analysis will be

required from commencement of the regime with a move to quantitative scenario analysis over time. We do restate our members' concern that given the significant uplift required, particularly for smaller entities, they are unlikely to be in a position to report using quantitative scenario analysis by the end state.

We also consider it would be extremely helpful to maintain a central web-based repository of scenarios and would encourage the inclusion of this initiative in the Government's Sustainable Finance Strategy. Access to appropriate data will be critical in building the capability and capacity in reporting contemplated by the Consultation Paper.

6. Transition planning and climate-related targets

Proposal: From commencement, transition plans would need to be disclosed, including information about offsets, target setting and mitigation strategies.
Proposal: From commencement, all entities would be required to disclose information about any climate-related targets (if they have them) and progress towards these targets.

As noted in our submission on the first Consultation Paper, 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.[1] Notwithstanding the proposed modifications to the liability settings, our members remain concerned about entities' and individuals' potential liability in relation to these disclosures.

7. Metrics & Targets

Greenhouse Gas Emissions

Proposal: From commencement, scope 1 and 2 emissions for the reporting period would be required to be disclosed.

As noted in our 24 February 2023 Submission it is helpful to build disclosures on existing domestic legislation such as the NGER Act and CERT Reports. The Consultation Paper notes (page 16) that the NGER Scheme does not provide for the estimation of emissions from agricultural sources or land use, land use change and forestry and that Guidance on the estimation of emissions from these sources would be provided over time. Given the significant uplift proposed and the fact that there will be entities from sectors unfamiliar with climate-related disclosure we encourage Government to lead on development of this and other Guidance as a priority, in consultation with stakeholders.

Proposal: Disclosure of material scope 3 emissions would be required for all reporting entities from their second reporting year onwards. Scope 3 emissions disclosures made could be in relation to any one-year period that ended up to 12 months prior to the current reporting period.

The Consultation Paper observes that in line with the ISSB's approach to Scope 3 emissions disclosure entities will receive relief in the form of a temporary one-year exemption from reporting Scope 3 emissions, following commencement of the mandatory disclosure requirements for that entity. While our members support the intention of allowing entities time to build capability in relation to Scope 3 calculation and estimation, they question how this is intended to operate with the time-limited

[1] See Climate-related financial disclosure – consultation paper, Governance Institute of Australia, 24 February 2023.

adjustment to liability settings outlined in the Consultation Paper. On one interpretation an entity in Group 1 that takes advantage of the one-year exemption in the 2024/25 financial year would only have the benefit of the time-limited adjustment to liability settings for the following two financial years. The alternative interpretation is that the entity would have this benefit for the full three-year period. It would be helpful to have clarification on this issue.

Our members also note that estimation of Scope 3 emissions is still under development and will require a significant uplift for all entities. While our members note the intention of taking a proportional approach to the disclosure of Scope 3 emissions, our members remain concerned that even with the adjustment to liability settings entities will be concerned at the risk they are assuming in relation to these disclosures.

8. Supporting information

Our members support the development of more Guidance on Scope 3 estimation methodologies, scenarios and transition plans. Again, they encourage Government to take the lead on developing this Guidance as a priority, in consultation with stakeholders.

9. Reporting framework and assurance

Reporting location, frequency and timing

Our members support the approach of leveraging existing reporting requirements, definitions and concepts to reduce the regulatory burden of the Proposals by locating disclosures in annual reports. However, they report that in recent years, annual reports have become less of a focus for investors compared to other reports such as sustainability reports. Many of our members report that when engaging with their investors the chief topic of engagement is their sustainability report. As a practical matter, while some entities release their annual report and sustainability (or similar) report simultaneously, many do not. It is likely that in the future they will need to release these reports at the same time as their annual report, which is likely to create sequencing issues and may lead to entities reporting later.

We also note that as part of the process of finalising financial statements directors are required to declare, amongst other things that the financial statements are true and fair. There is also the requirement in section 295A of the Corporations for the CEO and CFO to provide a declaration in similar terms. This creates potential liability for directors and these officers, particularly in the early years of the regime. An additional concern is that directors and officers 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. Our members consider there should be transitional relief available, particularly where disclosures are incomplete, given that as the Consultation Paper notes matters such as Scope 3 emissions estimation and scenario analysis are evolving. We would also note that for those companies with an international value chain, the ability to obtain sufficiently accurate Scope 3 emissions' data will be reliant on the regimes in place in those jurisdictions. As this is an emerging area, it may take longer than the three years included in the Proposals for the disclosures to be up to the standard where directors will feel confident in providing such a declaration. The ability to assure data to the reasonable assurance level will also be reliant on the maturity of the market and the international approach.

10. Format requirements

Requirement to publish reports

As noted above listed entities report that sustainability and similar reports are the reports with which their investors engage most closely and the Consultation Paper explicitly acknowledges that this practice can continue with appropriate cross-referencing and indexing. In addition, there has been a significant trend over some years to reduce the number of hard copy annual reports produced and distributed to members. Since 2007 when the Corporations Act was amended to enable members who do not elect to receive a hard copy of the annual report to access it on a website, more than 90 per cent of members no longer receive a hard copy annual report in the mail.[2] If significant additional information is required it is likely that the costs associated with additional pages in the annual report will lead to increased production and postage costs for those entities which still send hard-copy annual reports to shareholders.

As a matter of practice, it is likely that many annual reports containing climate-related financial disclosures will be available online. Our members suggest that consideration should also be given to permitting key disclosures to be included in the annual report, but providing entities with the option to incorporate further disclosures by reference to an online resource such as a dedicated corporate website as some of our members no longer produce hard copy sustainability reporting. Our members also question the imposition of an additional requirement to make publicly available climate disclosures on entities which have no other public reporting requirements.

11. Modified liability approach

Proposal: Climate-related financial disclosure requirements would be drafted as civil penalty provisions in the Corporations Act. The application of misleading and deceptive conduct provisions to scope 3 emissions and forward-looking statements would be limited to regulator-only actions for a fixed period of three years.

Our members have the following questions and concerns about how the regime will operate:

- At the end of the three-year period are statements made during that period protected? Can action be taken in the future in relation to those statements?
- When will the three-year period start? On commencement of the legislation or from when the first reports are released? If the period starts on commencement of the legislation it is conceivable that there are no reports at that point. Depending on the timing of the passage of the legislation it would also potentially shorten the period during which the modified liability settings are available. Our members consider the three-year period should align with the reporting requirements.
- Group 3 companies are due to make their first reports at a time when the three-year modified liability regime is about to or has expired. Group 3 is the group least prepared for the significant uplift involved in the new reporting requirements and has the least resources. Our members consider the modified liability regime should be extended for a period for Group 3 entities.
- How does the modified liability approach sit with other reporting requirements?

[2] See Submission Corporations Amendment (Virtual Meetings and Electronic Communications) Bill 2020 (Bill), Governance Institute of Australia, 30 October 2020 at page 8.

- How will the modified liability approach and the proposed requirements operate alongside existing legal frameworks, for example the implications for declarations under sections 294(5) and 295A of the Corporations Act?
- There is no protection provided for disclosure made outside of the mandatory disclosure regime. For listed entities, continuous disclosure obligations will continue to apply in their current form without the benefit of the modified liability approach – see below.

12. Continuous disclosure

The Consultation Paper refers to the possibility of further Guidance from ASIC and ASX in the context of fundraising and continuous disclosure. Our members support the need for this Guidance and encourage its development as a priority, in consultation with stakeholders.

We note that while there is provision for a modified liability regime it is not intended to make any adjustments to the continuous disclosure regime. Our members remain concerned about the interaction between periodic climate-related financial disclosures and the continuous-disclosure regime for ASX-listed companies. As noted in our 24 February 2023 Submission, 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. These entities 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. Given the difficulty of assessing the point at which a path becomes blocked and, while this information may be important to some stakeholders, it may not necessarily be market sensitive. The reporting requirements will also require the disclosure of large volumes of information, much of it technical projections.

There are inherent uncertainties in relation to, for example, some of the data and the technologies underpinning emissions reductions. While the Consultation Paper (p.22) comments that 'It is not expected that all changes to underlying assumptions relating to climate disclosure would need to be reported to the market', our members consider this understates the complexities involved in making judgements around these issues. There is also the risk of being perceived to be misleading and deceptive and therefore falling within the jurisdiction of the Australian Competition and Consumer Commission if all of the underlying assumptions are not laid out. Is there likely to be Guidance on what is considered to be a material underlying assumption? For these reasons, our members consider it is likely that reporting entities will include multiple qualifications to their disclosures to limit potential liability. This is likely to increase the length and complexity of disclosures making them difficult for non-technical readers to understand. Our members consider there is a need for clear, regularly updated Guidance from the regulator or the accounting bodies as to what constitutes 'reasonable grounds' in the context of climate-related financial disclosure for industry sectors.

Our members continue to advocate that the most appropriate option for addressing these concerns would be to adapt the changes introduced during COVID-19 to the continuous disclosure regime. 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 adopt 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.

13. Assurance

While our members support the policy settings in relation to assurance, they consider that the Consultation Paper understates the significant difference between limited and reasonable assurance in terms of what is required from both the disclosing entity and the assurance provider. They also question what support Government will provide to build capability and capacity in the assurance profession.

The Consultation Paper proposes that financial auditors would lead climate disclosure assurance engagements. This seems to indicate that the financial auditor would also provide assurance over climate-related financial disclosures. Our members advise that for those companies that currently obtain assurance over this information this may not necessarily be the same person. They also understand that who will provide final assurance is still an open question under active consideration by the auditing bodies. Our members also consider that the uplift in the capability of disclosing entities and the availability of independent, qualified personnel to carry out assurance is likely to take longer than anticipated. They also consider that it is likely to take longer than anticipated for assurance providers to develop the new skills and expertise needed for providing assurance in relation transition plans, scenarios and Scope 3 emissions. Our members also encourage the development of Guidance on making and assessing transition plans as a priority.

14. Other matters

Our members have the following additional comments:

- Education about the impact of the proposals will be critical given that the requirements will capture entities unfamiliar with climate change concepts. Our members encourage Government to lead on this aspect of the Proposals with assistance from industry.
- Our members would welcome clarification about how the new regime will apply to wholly owned Australian subsidiaries if the parent entity is required to report under the new regime.
- The AASB and AuASB have a significant task ahead of them in developing the Australian Standards. It is critical that these bodies have sufficient funding and resources.

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

Yours faithfully,

Megan Motto

CEO