21 July 2023

Climate Disclosure Unit

Market Conduct and Digital Division

The Treasury

Langton Crescent

PARKES ACT 2600

By email: climatereportingconsultation@treasury.gov.au

Dear Sir/Madam

Treasury Consultation Paper "Climate-related financial disclosure" (June 2023)

The Institute of Public Accountants (IPA) welcomes the opportunity to comment on the Consultation Paper.

Consistent with our submission to the first consultation paper issued in December 2022, IPA supports the majority of the proposals in the Consultation Paper. IPA is pleased to note that the proposed requirements incorporate the stakeholder feedback on the first consultation paper and accordingly provide a framework that is workable and proportionately targeted. The IPA supports the proposal that Registered Company Auditor (RCAs), as the financial statement auditor, will be the lead auditor over the climate-related disclosure assurance engagements. However, IPA also supports a provision that would allow other appropriately qualified professionals to be included in the auditing process

In relation to the framework this is particularly reflected in the proposed:

Phased implementation approach of initially requiring very large entities to the mandatory CFD (commencing 2024-25) and expanding that to progressively smaller entities over a two-year period. The delay in mandatory CFD for smaller entities is especially important for IPA members, who predominately operate in the small-to-medium enterprise (SME) sector. The delay will enable our members to acquire the necessary resources, capacity and expertise to implement and/or provide services relating to CFD. Additionally, the staggered timeframe for application enables the profession to build up its capabilities at a workable pace.

Adoption of the financial materiality concept, which has been in practice for some time and is well understood by practitioners. This approach is consistent with IPA's view that where possible, the definition and concepts used for sustainability reporting and financial reporting should be consistent, as this would increase the alignment of ISSB's definitions on the core principles in its sustainability standards with those for financial reporting and also caters for the ISSB's future projects, such as integration in reporting.

In general, we support the proposed disclosures about the entity's governance, strategy, transition planning and climate-related targets, risks and opportunities as best practice that all entities should aim to comply with. However, we note some of these disclosures, such as scenario analysis can be complex and difficult to undertake, especially for SMEs, which are unlikely to have the capabilities and resources to comply when the ISSB standards become applicable. Accordingly, our support for the disclosure proposals is conditional on:

Learning from the experiences of larger entities (eg the scenario analysis for disclosures)

ISSB's potential simplification of the requirements for SMEs and guidance developed by the ISSB or the marketplace to assist SMEs in undertaking the analysis when the sustainability standards become applicable for SMEs.

IPA also notes that it has been some time since the first consultation paper was issued and the ISSB has recently issued IFRS Sustainability Disclosure Standards S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and S2 *Climate-related Disclosures* (in June 2023), and yet Australia does not have a framework to operationalise sustainability reporting. Therefore, we urge the finalisation of the CFD framework to be expedited so that Australian entities can have certainty on the expectation of who the reporting entities are, the mandatory content of the reporting and the application date for reporting.

Reporting framework and assurance

Audit and assurance practitioner upskilling, capability and experience

We support the proposal that RCAs as the financial statement auditor, will be the lead auditor over the climate-related disclosure assurance engagements; and that other appropriately qualified professionals/ practitioners be included given the anticipated demand for these services.

Further, we support the three-phased proposed roadmap for mandatory disclosure requirements which will eventually (2027-28 onwards) capture large entities that are currently required to report under Charter 2M of the Corporations Act and meet the 'controlling corporation' under the NGER Act.

However, given assurance over climate-related disclosure is an emerging field there is a need to consider the upskilling of RCAs who are currently responsible for auditing large private entities (and have no prior experience with carbon and sustainability reporting). The same applies to other professionals/ practitioners.

Limited assurance initially over climate-related disclosure and the three-year phased-in approach will assist audit and assurance practitioners to build capability and capacity, however, a level of competency type standards should be considered to assist practitioners build their capability.

The lack of an accreditation framework (including courses, training and accredited providers) will constrain RCAs and other professionals from undertaking appropriate upskilling. Consideration needs to be given to phasing-in the required level of experience given the field is in its infancy and emerging.

If RCAs and other professionals do not have sufficient time to upskill, to enable them to provide audit and assurance services for climate-related disclosures, there may be the unintended consequences of either poor audit quality of climate-related disclosures particularly around auditing scenario analysis; or a limited number of practitioners who have the required skill set.

The number of practitioners who have the required capability to assure climate-related disclosures may be limited due to independence and conflict of interest issues as they may have provided technical assistance to the entity and therefore cannot provide assurance services.

<u>Content and framework</u>

Audit and assurance practitioner – limited and reasonable assurance

Requiring scope 3 emissions by the second reporting year onwards (with one-year relief available) does not seem sufficient time to build capability and capacity for those audit and assurance practitioners new to climate-related disclosures. However, where there is a phased-in approach to the level of reporting required under scope 3 emissions, guidance will need to be provided as to what level of assurance would be required.

Careful consideration should be given to the ability to provide assurance over Scope 3 emissions reporting, particularly the ability to obtain relevant and reliable data from an entity's supply chain for large private entities where they transact with SMEs. This area may result in qualifications to Scope 3 emissions which become 'standard' qualifications.

Where there is limited and reasonable assurance in the same report, there will need to be guidance for both the preparer and assurance practitioner to ensure clarity for report users.

We recommend flexibility in location of assured information (not only for listed entities) to locate disclosures in a separate report to prevent difficulties in clearly distinguishing the level and conditions of assurance related to climate-related disclosures.

Assurance practitioner – qualified and experienced independent provider

Providing a definition for 'qualified and experienced independent provider' to carry out assurance over climate-related disclosures without an established competency framework may have the unintended consequence that the lead auditor (who is the financial auditor) may not upskill their capability and rely on other technical experts. Not all entities have the same level of complexity with respect to climate-related disclosures and therefore, a competency framework would help lead auditors understand whether they have the adequate skills and capability.

Enforcement

The Regulator should also have a phased-in approach to overseeing assurance practitioners and their level of audit quality, initially having the role of guidance and education.

Further details on our comments above and our response to the specific proposals in the Consultation Paper are in Attachment 1.

Sincerely,

Vicki Stylianou

Group Executive Advocacy & Policy

Institute of Public Accountants

The IPA is one of the three professional accounting bodies in Australia, representing over 50,000 members and students in Australia and in over 100 countries. Approximately three-quarters of the IPA's members work in or are advisers to small business and small to medium enterprises.

ATTACHMENT 1 IPA's response to the Consultation Paper's specific proposals

1. Reporting entities and proposed roadmap for mandatory requirements

Proposal: That all entities that meet prescribed size thresholds and that are required to lodge financial reports under Chapter 2M of the *Corporations Act 2001* (Cth) (Corporations Act) would be required to make climate-related financial disclosures.

IPA supports the proposal:

Criteria for determining which entity should make climate-related financial disclosures (CFD). That is:

entities that are required to report under Chapter 2M of the Corporations Act and meet the prescribed size thresholds must make CFD; and

entities that are required to report under Chapter 2M of the Corporations Act and are registered as a 'Controlling Corporation' reporting under the *National Greenhouse and Energy Reporting (NGER) Act 2007* would be covered under climate-related risk disclosures requirements, even if they do not meet the threshold criteria.

Prescribed size thresholds that are based on consolidated revenue, consolidated gross assets and employee numbers.

Roadmap for mandatory disclosure requirements of requiring very large entities (Group 1) to commence CFD from 2024-25 onwards, followed by large entities (Group 2) from 2026-27, and small-to-medium sized entities (SMEs) (Group 3) from 2027-28.

The reasons for our support of the above proposals are:

The proposed reporting thresholds use concepts of revenue, assets and employee numbers, that have been in practice for some time and are well understood by practitioners. This is a better approach than the alternative proposals that are based on an entity's turnover or the extent to which the entity faces material climate risks, as it avoids relying on an entity's judgements and subjectivity in determining if it faces material climate risks for CFD.

The proposed reporting thresholds and the phased-in mandatory disclosures timeframe allow entities time to acquire the necessary resources, capacity and expertise to comply with the requirements. This delay in mandatory CFD for SMEs is especially important for IPA members, who predominately operate in the SME sector, as this sector would not currently be disclosing or assuring CFD.

Additionally, the phased-in approach enables the profession to cater for the increasing demand for professional services progressively, especially for audit and assurance. All of these factors would contribute to ensuring the successful implementation of CFD.

2. Materiality

Proposal: Principles of financial materiality would apply.

IPA supports the proposal to use the definition and principles of financial materiality to apply across all aspects of the reporting content of CFD, with the exception of scope 1 and scope 2. This is consistent with IPA's view that where possible, the definition and concepts used in sustainability reporting and financial reporting should be consistent. This approach would align the materiality concept in the ISSB sustainability standards and financial reporting generally in Australian and international standards. This approach would also assist in the ISSB's future project of integration in reporting of connecting an entity's financial and sustainability information and performance – a project that is likely to be applicable in Australia.

3. 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.

IPA supports this proposal, as information about an entity's governance arrangements would assist an investor in assessing the entity's processes, oversight and management of climate-related financial risks and opportunities.

4. Strategy

Scenario analysis

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.

IPA acknowledges the importance for an entity to disclose strategy-related information that demonstrates it has examined and evaluated the possible climate-related futures and factored this into its business strategies and plans. Consequently, we support the proposals in general that:

Entities must disclose information that assists users to understand the basis of scenario analysis undertaken by the entity, including methodology, limitations and critical assumptions.

During the transition period, entities at a minimum must undertake some form of qualitative scenario analysis that is proportionate to the experiences of the entities.

By end state, entities must undertake some form of quantitative scenario analysis that is proportionate to the experiences of the entities.

IPA's support for the above proposals is based on our view that scenario analysis would increase the transparency, comparability and consistency of disclosures, particularly quantitative scenario analysis. However, any meaningful qualitative and quantitative scenario analysis is dependent on an entity's ability to undertake such analysis.

Whilst we support the above proposals as best practice that all entities should aim to comply with, we note the methods of scenario analysis can be complex and difficult to undertake, especially for SMEs, which are unlikely to have the capabilities and resources to undertake this when the ISSB standards become applicable. Accordingly, our support for the above proposals is conditional on:

Learning from the experiences of larger entities (from their scenario analysis of disclosures) and

ISSB's potential simplification of the requirements for SMEs and guidance developed by the ISSB or the marketplace to assist SMEs in undertaking the analysis when the sustainability standards become applicable for SMEs.

Proposal: From commencement, reporting entities would be required to disclose climate resilience assessments against at least two possible future states, one of which must be consistent with the global temperature goal set out in the *Climate Change Act 2022*.

IPA supports, in general, the proposed requirement to disclose climate resilience assessments for the reasons and reservations stated for the above proposal to disclose scenario analysis for SMEs by the application date.

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.

IPA supports the proposals to require the disclosure:

of an entity's transition plans that are commensurate to the level of the entity's exposure to climate-related risk with a focus on transparency rather than the transitioning activities or the entity's goals.

about any climate-related targets (if any) that the entity may have and the progress towards achieving these targets.

of an entity's material climate-related risks to and opportunities for their business.

We are also supportive of the proposals that where an entity does not have a transition plan and/or has not developed or stated future targets, the disclosure is met by stating these facts. These proposals are particularly relevant for IPA members who operate in the SME sector that would need to develop the transition plans and climate-related targets from scratch.

5. Risks and opportunities

Proposal: From commencement, entities would be required to disclose information about material climate-related risks and opportunities to their business, as well as how the entity identifies, assesses and manages risk and opportunities.

IPA supports, in general, the proposed disclosure of information about material climate-related risks and opportunities to their business, as well as how the entity identifies, assesses and manages risk and opportunities.

Our conditional support is for similar reasons as those stated in our comments to the 'Strategy' section above.

6. Metrics and targets

Greenhouse gas emissions

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

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.

IPA supports, in general, the proposal that:

From commencement, entities are required to disclose scope 1 and 2 emissions.

From the second year of reporting, entities are required to disclose scope 3 emissions. IPA notes the temporary one-year exemption for scope 3 emission disclosure is a pragmatic approach to enable entities to build capabilities for calculating and estimating the emissions.

However, IPA is of the view that SMEs are likely to experience difficulties in making the disclosures, particularly for scope 3 emissions, as reflected in the statement in the Consultation Paper that "It is expected that in the immediate term, most scope 3 disclosures would be estimates, reflecting information that is accessible at the time of disclosure. As some reporting entities may lack internal capability to undertake scope 3 estimation to a high level of sophistication, the proposed requirements would take a proportional approach, in line with what has been indicated by the ISSB to date." (paragraph 2, page 17 of the Consultation Paper). As such, our support for the disclosures is on a conditional basis for similar reasons as those stated in our comments to the 'Strategy' section above.

Industry-based metrics

Proposal: By end state, reporting entities would be required to have regard to disclosing industry-based metrics, where there are well-established and understood metrics available for the reporting entity.

IPA supports the proposal that, where industry-based metrics are available that are appropriate for Australian industry specific sectors, entities are required to disclose against such metrics. Such disclosures would increase the quality and comparability of the disclosures across entities over time. Additionally, the proposal is a pragmatic approach that allows Australia time to develop the industry-based metrics, for which there is currently limited availability.

7. Reporting framework and assurance

IPA's views on the remaining matters canvassed in the Consultation Paper are contained in the table below.

	IPA's preference	**Reasons for IPA's preference**
Location of climate disclosures	Published in entity's annual report as part of both the director's report and the financial report.	As per those outlined in the Consultation Paper.
Format requirements – index table	Inclusion of an index table within the annual report showing climate disclosure requirements of governance, strategy, risk management, metrics and targets, and correlating section and page number.	The index table would assist users' ability to navigate the information and thereby increasing readability of the annual report and climate disclosures, and the entity's compliance with the climate disclosure requirements.
Format requirements – option for listed entities	Providing listed entities with an option to report some climate-related information (such as 'metrics and target' standards) in a separate report, that would be subject to the same requirements as the annual report.	The separate report would reduce the length of the annual report and allow for further sustainability reporting matters (such as biodiversity) in the future.
Timing of lodgement	The timing of lodgment should remain consistent with current requirements under the Corporations Act.	To maintain consistency with current Corporations Act requirements.

Requirement to publish reports	Climate disclosures in the annual report should be available to the public, as currently required for large proprietary companies, public companies, disclosing entities and registered investment schemes.	This requirement ensures CFD are readily accessible to users of the reports. It also further aligns sustainability reporting obligations with those of the financial report.
Liability and enforcement – modified liability approach	CFD requirements to 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 is limited to regulator-only actions for a fixed period of three years.	This approach would protect company officers and entities where they have acted honestly and for certain mandatory disclosures, such as scope 3 reporting, the approach would afford time-limited protection from misleading or deceptive conduct, false or misleading representations and similar claims.