Ernst & Young
8 Exhibition Street
Melbourne VIC 3000 Australia
GPO Box 67 Melbourne VIC 3001

Tel: +61 3 9288 8000
Fax: +61 3 8650 7777
ey.com/au

Building a better working world

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

21 July 2023

Submitted via email: climatereportingconsultation@treasury.gov.au

EY Submission on climate-related financial disclosure consultation paper

Ernst & Young ("EY") welcomes the opportunity to comment on Treasury's second consultation paper *Climate-related financial disclosure*, which was published in June 2023. Our views have been informed by our extensive experience in supporting the growth of climate and sustainability-related reporting, climate risk and financed emissions analysis and reporting, sustainable finance products, framework and labelling support as well as our strong expertise in providing audit and assurance.

Overall comments

EY is very supportive of Treasury's proposals to introduce a mandatory climate-related financial disclosure regime in Australia.

We agree that all entities that meet the prescribed size thresholds proposed in the consultation paper and that are required to lodge financial reports under Chapter 2M of the *Corporations Act 2001* ("Corporations Act") should be required to make climate-related financial disclosures, subject to the financial reporting relief in *ASIC Corporation (Wholly-owned Companies) Instruments 2016/785* being extended to include these proposed disclosures. We also agree with the proposals to:

- phase-in implementation, starting with very large entities in the 2024-25 financial year and for all in-scope entities in 2027-28 financial year
- ultimately require all climate-related financial disclosures to be subject to reasonable assurance so that investors can place greater reliance on that information, however we recommend that the timeframe for reaching reasonable assurance on disclosures of Scope 3 emissions and scenario analysis should be extended so that the timeframe is consistent with the requirements in comparable jurisdictions such as Europe (this is discussed further below)
- specify that the financial statement auditor should lead the assurance of the climate-related financial disclosures, noting that the financial statement auditor must have access to sufficient climate technical capability to support the required assurance of those disclosures
- require climate disclosures to be published in an entity's annual report, made available to the public and lodged within existing financial reporting timeframes
- provide some interim liability protections for entities and company officers relating to the disclosure of Scope 3 emissions and forward-looking statements.

Although not identified as a specific proposal, we strongly recommend that the objective in developing an Australian climate disclosure standard should be that an Australian entity that complies with that standard should also be able to simultaneously claim compliance with IFRS Sustainability Disclosure

Standards (assuming that the entity also chose to comply with all other requirements in IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*). This replicates the approach adopted in setting Australian Accounting Standards and, in doing so, is regarded as lowering the cost of capital for Australian entities because they can claim that their financial statements comply with IFRS Accounting Standards. We intend to make the same comments to the Australian Accounting Standards Board (AASB) when it publishes an exposure draft of its climate disclosure standard for public comment later in the year.

Taken together and consistent with the views we expressed in our response to Treasury's initial consultation paper, we consider that these proposals will provide investors and the market more generally with access to consistent, comparable and reliable information about climate-related risks and opportunities. Mandating the disclosure of this information will help strengthen and inform assessments and pricing of risk, inform investment decision-making, build capability across industry for managing climate risks and support increased capital flows into climate and decarbonisation solutions.

Because we agree with the direction of all proposals in the consultation paper, we will not comment on each proposal unless we have an observation, clarification or other suggestion to make.

Assurance

We agree with the statement in the consultation paper that assurance will enhance the credibility of climate disclosures. For that reason, we agree that reasonable assurance over all climate-related financial disclosures should be the objective. Further, given the importance of connection between the financial report and the climate disclosures, and for the application of financial materiality, we also agree that the financial statement auditor should lead the required assurance over the climate disclosures. The financial statement auditor leading the assurance engagement should be required to have appropriate knowledge available to the assurance team, such as ensuring appropriate expertise with respect to climate risk assessments, scenario analysis and the measurement of Scope 3 emissions. This will ensure assurance can be provided with technical climate and financial statement auditing expertise and be communicated in a consistent manner and will facilitate over time the movement towards a single integrated Assurance Report.

The staged approach being proposed, whereby progressively more disclosures will be subject to assurance and that the nature of assurance will progress from limited to reasonable assurance over time, is considered appropriate. We believe this will enable entities to enhance their climate disclosure processes in a practical and sustainable way, and also support with undertaking any internal assurance and/or readiness activities so that entities are suitably prepared for external assurance activities.

That said, the timeline is ambitious. We have observed a wide degree of maturity in entities' existing reporting approaches, particularly relating to Scope 3 emissions measurement and analysis of potential future climate impacts on the business via climate risk/opportunity analysis against climate scenarios, which we consider will impact the quality of those disclosures until entities have had sufficient time to implement data, system and process improvements to support the disclosure of this information. For this reason, we strongly recommend that consideration is given to extending the timeframe before Scope 3 emissions and quantitative scenario analysis disclosures are subject to reasonable assurance.

Reasonable assurance is a high level of assurance. To obtain reasonable assurance, Auditing Standard ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with*

Australian Auditing Standards requires an auditor to "obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion".[1] Although EY has been investing in upskilling our non-financial assurance teams and our financial statement auditors to meet the expectations and timeframes proposed in the consultation paper, we recommend that Treasury undertakes further analysis to assess:

- the readiness of entities within scope of the climate disclosure regime to have developed sufficient data, systems and processes to support the preparation of Scope 3 emissions and quantitative scenario analysis disclosures to withstand an audit at a reasonable assurance level; and
- the readiness of other financial and non-financial auditors of those entities to provide reasonable assurance on all of the climate-related financial disclosures for all entities within the scope of the climate disclosure regime within the annual reporting deadlines.

At this moment, it is difficult to recommend the date when reasonable assurance should be required for Scope 3 emissions and quantitative scenario analysis. In our view, such a decision should be made after considering:

- the quality of disclosures made by Group 1 entities during the transition period to 2027-28;
- the decisions of comparable jurisdictions such as Europe, such that the climate-related financial disclosures of Australian entities are subject to the same level of assurance as their international peers (and therefore participants in the global capital markets have access to comparable information from Australian entities and their international peers when they make investment decisions); and
- analogous practices in existing domestic financial reporting, such as comparisons between quantitative scenario analysis and the forecasts provided in prospectus documentation for initial public offerings, whereby market practice is for those forecasts to be subject to limited assurance with entities opting for reasonable assurance in rare instances.

Application to financial services sector

The inclusion of financial institutions within the scope of the proposed climate reporting regime is considered necessary for achieving Treasury's overarching objective for greater transparency and accountability of climate risk management. That said, we recommend Treasury further clarify the coverage of the intended climate reporting requirements to financial institutions given the different structure of some of these entities. In some cases, a responsible entity (and which is a Corporations Act entity) of an investment fund or managed investment scheme will include the fund or scheme in its consolidated group because the responsible entity controls the fund or scheme (in accordance with AASB 10 *Consolidated Financial Statements*). However, in many other cases, the responsible entity does not control the fund or scheme. In those cases, it is unclear whether the assets and operations of the fund or scheme would be within the scope of the proposed climate-related financial disclosure requirements because the responsible entity may manage the total assets and the revenues generated from those assets but the responsible entity does not control those assets or revenue.

If Treasury intends for investment funds and managed investment schemes that are not controlled by the responsible entity to be included within the scope of the climate-related financial disclosures, we

[1] ASA 200 paragraph 17

recommend clarifying how the proposed reporting entity requirements would apply to those entities. This is because:

- the investment fund or managed investment scheme may not be Corporations Act entities, with any reporting requirements for the fund or scheme instead set out in the trust deed for those arrangements
- assessing whether the responsible entity of the fund or scheme is within the scope of the disclosure requirements (on the basis that the responsible entity is a Corporations Act entity) also depends on whether the assets, revenue and employee thresholds apply to:
  - the responsible entity itself;
  - the responsible entity plus each fund or scheme individually (i.e., an individual fund/scheme basis); or
  - the responsible entity plus the aggregate of all its funds and schemes (i.e., a portfolio basis).

Whilst entities across all sectors will likely need to rely on third-parties to obtain data and information that supports the robust measurement of Scope 3 emissions, this may be more burdensome for financial institutions in measuring Scope 3 'financed' emissions under Category 15 per the Greenhouse Gas (GHG) Protocol. That said, the GHG Protocol supports the application of elevated accounting methods (or applied levels of data) over time. Further, as we see within various aspects of financial reporting, the utilisation – and disclosure – of accounting estimates, assumptions and judgements is commonplace. It is also accepted as appropriate to enable an entity to measure and disclose certain impacts based on the best available information at a particular point in time to support users of general-purpose financial reporting, for example, in making valuations of unlisted assets.

In the context of disclosing Scope 3 emissions, we understand that entities will have easier access to higher quality information when other entities commence reporting Scope 1 and Scope 2 emissions and also when those disclosures are subject to assurance. For that reason, we recommend that the climate disclosure requirements should clearly acknowledge that the quality of Scope 3 emissions disclosures will mature over time as a consequence of more information about other entities' emissions becoming available.

Education

The shift from voluntary disclosure based on the recommendations of the Taskforce for Climate-related Financial Disclosures to mandatory disclosure based on requirements of a climate disclosure standard will sharpen the focus on whether an entity's climate disclosures are complete and present fairly the entity's exposure to climate-related risks and opportunities. Significant attention will also be directed towards the consistent interpretation and application of those disclosure requirements. As such, efforts will be needed to build capability across the market through providing guidance and education. The AASB should be appropriately funded to support the implementation of its climate-related disclosure standard. Furthermore, on the basis that the forthcoming Australian climate disclosure standard is consistent with the requirements in IFRS S2 *Climate-related Disclosures*, the guidance materials and discussion forums that the International Sustainability Standards Board (ISSB) is planning to support the implementation of the IFRS Sustainability Disclosure Standards would also be relevant to Australian entities applying the Australian climate disclosure standard. We encourage the AASB to continue to liaise with the ISSB so that Australian perspectives are considered when the ISSB prepares guidance and education materials.

Other sustainability topics

We recognise the value of a ‘climate-first’ approach for mandatory reporting in Australia. However, there is likely to be other sustainability-related risks and opportunities that might also be reasonably expected to affect the entity’s prospects over the short, medium and long term. Information on those risks and opportunities could be as important to the investor and providers of capital as information about climate risks. For this reason, we strongly recommend that Treasury outlines a timeframe for the implementation of mandatory disclosure on other sustainability risks and opportunities. As a matter of completeness and also to meet investor expectations, we anticipate that some entities will continue to disclose information about sustainability-related risks and opportunities other than climate that affect their prospects over the short, medium and long term. In our view, assurance over voluntary disclosures about other sustainability-related risks and opportunities should be encouraged because of the benefit that investors would derive from the knowledge that those disclosures are also subject to assurance.

Treasury should consider aligning with the timelines of global developments and in other jurisdictions, such as Europe. This would also support any Australian entities with potential dual reporting obligations in other jurisdictions, such as those entities that will be subject to Europe’s Corporate Sustainability Reporting Directive.

Given the importance of other sustainability-related risks and opportunities, we recommend that the AASB should also consider developing an Australian equivalent of IFRS S1. To ensure that Australian entities are not required to provide disclosure of sustainability-related financial information other than climate, the AASB could extend the transition relief in paragraph E6 of IFRS S1 indefinitely until the Government decides to make those disclosures mandatory.

Other comments outlined in attachment

Our other comments are organised based on the structure of the consultation paper’s discussion of proposed positions relating to coverage, content, framework and enforcement. These comments are included as an attachment to this letter.

Should you wish to discuss our comments further, please contact me at glenn.carmody@au.ey.com or on 03 9288 8467.

Yours sincerely

Glenn Carmody
Ernst & Young

Attachment: Other comments on Treasury consultation paper

ATTACHMENT

Other comments on Treasury consultation paper

Reporting entities and phasing

Coverage

We support the proposed timeline and scaled thresholds for a phased implementation of the climate-related financial disclosure requirements whereby the first group of mandatory reporters will provide their climate disclosures for the 2024-25 financial year and by all in-scope entities for the 2027-28 financial year. Commencing mandatory reporting in 2024-25 is also closely aligned with when mandatory disclosures are expected in Europe.

Although the time and effort required to implement these disclosure requirements could be substantial for some entities, we consider the proposed timelines and thresholds represent an appropriate balance between providing entities with sufficient time for an orderly and effective implementation and providing the market with the information it needs to understand and assess climate-related risks and opportunities. Recent experience with implementing new accounting standards has indicated that deferring the effective date of a new standard to allow entities more time for implementation has the unintended consequence of many entities subsequently deprioritising their implementation efforts in favour of other priorities. For that reason, if many respondents request a deferral, we question how effective a deferral decision would be. In our view, a better approach would be for all participants in the financial system to appreciate that it will take some time to achieve maturity and consistent practices and interpretations in the disclosures being made. We acknowledge that this fact has also been appreciated by the proposals, for instance in the proposed liability settings.

Clarifying the commencement date

The consultation paper does not clearly identify when an entity will be required to make its first climate-related financial disclosures. Based on a Government media release,[2] we understand that the first reporting period for the Group 1 entities will be from 1 July 2024. On that basis, we assume that a Group 1 entity with a 31 December year end would first be required to make climate disclosures as part of its 31 December 2025 annual report. Similarly, Group 2 and Group 3 entities with the same year end would make their first climate disclosures in their annual reports for 31 December 2027 and 31 December 2028 respectively.

Entities that subsequently fall below Group 3 reporting threshold

Some entities that are initially within the scope of the climate disclosure requirements may subsequently fall below the reporting thresholds within a given reporting period. We expect that many of those entities might continue to disclose their climate-related financial disclosures, especially given that (as noted in the consultation paper) "existing obligations under the Corporations Act in relation to the disclosure of material financial risks would continue to apply". However, if an entity chose not to make those disclosures for the reporting period when they were not within scope (and they were not in contravention of the general obligations in the Corporation Act), it is unclear whether the entity would subsequently

[2] https://ministers.treasury.gov.au/ministers/stephen-jones-2022/media-releases/maximising-investment-opportunities-and-managing

have to disclose comparative information if and when the entity subsequently exceeds the reporting threshold in a future reporting period.

Application to subsidiaries

Similar to financial reports, we recommend that climate disclosures should only be required to be provided by the consolidated group and not separately for each subsidiary within the consolidated group where those subsidiaries are relieved from lodging financial reports by *ASIC Corporation (Wholly-owned Companies) Instruments 2016/785*. For inbound Australian subsidiaries of international groups, the reporting level should apply to the consolidated group that relates to the ultimate Australian parent of the Australian operations subject to the same relief applying to other subsidiaries within the Australian consolidated group.

In our view, the disclosure of climate-related financial information supplements an entity's financial report and, therefore, the reporting obligations for climate-related financial disclosures should not be set to include entities that are not otherwise required to lodge financial reports.

Reporting thresholds

A consequence of the proposed size thresholds for mandatory climate reporting is that some entities that are required by the Corporations Act to prepare financial reports will not also be required to make climate-related financial disclosures because those entities do not meet the proposed Group 3 size threshold. For example, there is no similar size-based threshold that applies to financial reporting by listed companies. As noted above, we consider that the proposals have got the balance right for the disclosure of climate-related financial information for the short-to-medium term. However, we consider that the longer-term goal should be that climate-related financial disclosures should be provided by all entities that are required by the Corporations Act to prepare financial reports (and are not eligible for financial reporting relief). As part of that longer-term goal, we recommend that Treasury considers providing some relief on the extent of climate-related disclosures required for those entities that are required to prepare financial reports but are below the Group 3 reporting threshold. The nature of the disclosure relief could be similar to the simplified disclosure framework in Australian Accounting Standards that applies to the preparation of financial reports by entities without public accountability.

Not-for-profit private sector entities and public sector entities

An entity's exposure to climate-related risks and opportunities does not depend on the nature of the entity or whether it operates in the private, public or not-for-profit sector. Consequently, the primary users of the general-purpose financial reports of not-for-profit private sector entities and public sector entities will also demand information about an entity's exposure and management's response to those risks and opportunities. We recommend that Treasury provides further information on the process and potential timelines for climate disclosures for these entities (to the extent that the reporting requirements are in the control of the Commonwealth Government).

Reporting content

We support the proposal for entities to initially use qualitative scenario analysis and moving towards quantitative scenario analysis by end state. The consultation defines end state as the 2027-28 reporting year, however, it does not specify expectations with regards to qualitative and quantitative scenario analysis. We assume that end state quantitative scenario analysis would require entities to have made an assessment of climate related impacts in such a way as to determine potential financial impacts, and thereby support the evaluation of the impact on the financial performance and position of the entity.

We suggest further clarity is needed regarding the timeline for entities to be using quantitative scenario analysis, for example, how this applies to entities within Groups 2 and 3 and whether end state could instead involve two years post the commencement year for Groups 2 and 3. Additionally, guidance should be provided to support more consistent and comparable application of quantitative scenario analysis, such as clarity on expected outcomes, indicative examples and possibly even guidance on which climate scenarios and/or resources are considered appropriate. This guidance could be provided by the AASB.

Reporting framework and assurance

Timing of lodgement

Transition relief should be offered for lodgement deadlines such that the climate disclosures can be lodged after the financial report in the first year of application of the climate disclosure requirements. IFRS S1 allows for similar transition relief. We recommend that the same relief should be available for Australian entities applying these requirements.

Liability and enforcement

Modified liability approach

Providing a specified period of relief regarding the application of misleading and deceptive conduct provisions relating to entities' disclosures of scope 3 emissions and forward-looking statements appears to strike an appropriate balance to encourage transparent disclosure, whilst recognising time required to mature reporting and disclosure processes. We recommend that the relief for Group 1 entities should be extended to four years so that the relief applies until such time as all inputs to Group 1 entities' disclosures (from Group 2 and Group 3 entities) are subject to assurance. Clarification is also required for how the fixed period of relief applies to entities within Groups 2 and 3. For example, whether this period commences from FY25, or the first reporting period for the entity. We recommend the fixed period of relief is applied from the time an entity is required to prepare its climate related financial disclosure, being the commencement period for each respective Group. Furthermore, we recommend that the financial statement auditor should be provided the same relief afforded to the directors of the entity.