MONASH University

MONASH BUSINESS SCHOOL

Submission to the Australian Government Treasury Consultation

Climate-related financial disclosure

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We generally support the proposed approach to mandatory climate risk disclosure, and offer some additional comments and suggestions in relation to particular aspects of the discussion paper.

Reporting entities and phasing

The proposed approach to phase in reporting requirements over time, beginning with the largest public and private companies and significant greenhouse gas emitters, is generally supported.

Group 1 companies can be reasonably expected to be well-prepared for mandatory climate risk reporting, given the high uptake of and familiarity with TCFD reporting standards among ASX-listed companies, well-established investor expectations on climate risk disclosure, and (for many companies) their existing obligations to report greenhouse gas emissions under the NGER scheme. In light of recent international developments, including the introduction of mandatory climate risk disclosure in a range of comparative jurisdictions (United Kingdom, New Zealand, United States), the introduction of similar rules in Australia would have been foreseeable for these large companies.

Reporting content

Materiality – Although this is the approach that the ISSB has taken, the adoption of a narrow definition of 'financial materiality' to guide the application of disclosure rules and development of standards represents a missed opportunity to align Australian reporting standards with those that have since emerged in the most progressive, advanced jurisdictions which are leading sustainable finance reforms globally.

In Europe, the concept of ***double materiality*** is now firmly embedded in sustainability disclosure rules (Corporate Sustainability Reporting Directive). This is in recognition of the limits of the financial materiality approach in addressing emerging sustainability risks including those that pose systemic risks across the economy (e.g. biodiversity loss), and the critical role that the private sector can play in realising global and national sustainability goals, such as those set out in the Paris Agreement on Climate Change and the Kunming-Montreal Global Biodiversity Framework. Under a *double materiality* approach, entities are required to disclose matters that meet either financial or impact materiality thresholds, with *impact materiality* defined as 'actual or potential significant impacts by the undertaking on people or the environment over the short, medium or long term' including direct operational impacts and those linked to the company's value chain.

For climate change, there is now strong understanding of financial risks at the individual entity scale and at the systemic scale, yet the Treasury nonetheless proposes that entities be required to provide additional disclosure of climate *impacts* (scope 1 and 2 GHG emissions) regardless of a company's materiality assessment. Further, Treasury also proposes that entities be required to disclose a climate transition plan detailing emissions reduction targets, strategies to achieve these etc. As such, for climate change, the proposed approach appears to at least partially recognise that disclosure of the climate-related *impacts* caused by a company (e.g., GHG emissions) is important in addressing the systemic risks posed by climate change to financial systems, and further, can help to align corporate activities with global climate goals which seek to minimise these risks (a key Reform Principle guiding this consultation). In essence, the approach proposed for climate change does require some level of *impact disclosure* consistent with the concept of double materiality.

Beyond climate change, many sustainability issues are not currently widely understood as financially material and are difficult to quantify in this way. This is particularly the case for risks associated with biodiversity loss or social inequity, where understanding of how these issues pose risks to individual entities and to the financial system is under-developed. While these risks certainly represent emerging systemic or economy-wide risks, the financial imperative to address such systemic risks is not fully understood across the financial sector, and these risks are unlikely to be broadly picked up by the processes that individual companies use to assess financial materiality, which focuses on their own strategy and context and tend to adopt relatively short (3-5 year) timeframes.

Future development of risk disclosure rules for sustainability matters beyond climate change would benefit from a more explicit adoption of a double materiality approach. The experience with climate risk reporting in Australia to date suggests that until specific reporting standards are introduced and mandated for biodiversity and other social *impacts*, the quantity and quality of corporate disclosures on these broader social and environmental issues will likely remain highly varied and inadequate and certainly not well aligned to relevant global and national goals.

Governance – Treasury notes the importance of information about governance arrangements and that expected disclosure would include how governance bodies are involved in monitoring risks and opportunities, how risk is incorporated into policy and procedures and, how climate performace metrics are factored into remuneration. This last point has not been included in the bold text of the proposal. We feel it should be as this is a key element of governance and would avoid responses that merely list various committees and roles which include an element of climate change. We feel this extends the proposal from merely listing responsibility to identifying accountability.

Strategy – Proposed requirements for more standardised use of scenario analayis as a foundation for climate risk disclosure are generally supported. It will be important for the AASB to provide clear guidance on the use of Paris-aligned emissions reduction scenarios in the forthcoming reporting standards, as there is a range of different scenarios commonly in use across the market and well-acknowledged problems with companies choosing to use and report on scenarios that are favourable to their interests. One approach may be to adopt one standard scenario with companies able to compare this to one or more alternative scenarios.

Transition planning and Climate-related Targets – Proposed requirements for the disclosure of climate transition plans with information about climate-related targets and mitigation strategies (including any proposed reliance on offsets) are generally supported and a critically important part of the proposed scheme. However, these requirements could be strengthened by requiring that transition plans and climate targets align with global climate goals set out in the Paris Agreement (and setting out guidance and standardised frameworks for companies to do so), or providing incentives to do so (e.g., access to public procurement limited to companies with Paris-aligned transition plans, similar to the UK). A key Reform Principle guiding this consultation is that climate disclosure reforms should assist with Australia's transition to net zero emissions by 2050. Requiring, or strongly incentivising, alignment of corporate targets and transition plans would more directly enable adequate and timely private sector contributions to meeting Australia's national goals and the goals of the international Paris Agreement. Further, setting out an agreed framework for transition plans and targets would greatly assist in ensuring appropriate and adequate assurance of disclosures.

Metrics and Targets – Proposed requirements to disclose scope 1 and 2 GHG emissions (and scope 3 emissions where material) are generally supported, along with the proposed approach to phasing in scope 3 disclosure obligations. However, it is important that emissions data is presented against relevant climate targets to enable users to easily understand and track progress in climate risk management. It may be useful for climate disclosure standards to indicate the types of situations in which scope 3 emissions would be considered to be material for a company (e.g., examples of upstream and downstream scope 3 emissions sources and associated transition risks, relative size of the emissions source as a proportion of total company emissions and as related to company revenue or value). Further, to facilitate assessment by users it would be useful to require both long-term and interim targets. For example, either five-yearly targets or targets for specified years such as 2030, 2035, 2040, 2045 and 2050.

Reporting Framework and Assurance

Location – Proposed requirements to include climate disclosures in the Annual Report, with further information on metrics and targets in a separate report, are generally supported.

Assurance – Proposed requirements for the phased introduction of independent assurance requirements are considered appropriate in light of the need to upskill and build capacity for an independent audit of climate disclosures, including scope 3 emissions. Information should be presented in a way that allows verification even if there is no requirement for an independent audit (i.e., for those companies not required to have reports fully independently audited in earlier phases). Given the specialised skill set required for audit of climate and sustainability risk disclosures, it would be useful to require auditors to disclose their expertise, or the expertise engaged on the audit.

Liability and Enforcement

Modified liability approach – Extensive safe harbours for company directors in relation to liability for misleading disclosure would undermine the strength of the new mandatory reporting regime and its contribution to meeting national and global climate goals. While protection from liability for misleading statements may encourage more robust and comprehensive forward-looking disclosures, existing requirements to have 'reasonable grounds' when disclosing forward-looking information provide an appropriate amount of protection for directors. The current proposal for a modified and time-bound liability approach appears to be a reasonable response to the range of concerns expressed in this area.