Business Council of Australia

Climate-related Financial Disclosure Consultation paper June 2023

BCA Submission

July 2023

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Overview

The Business Council of Australia welcomes the opportunity to provide views on Treasury's proposed positions for the detailed implementation and sequencing of standardised, internationally aligned requirements for disclosure of climate related financial risks and opportunities in Australia (the new requirements).

Our members support continuous improvement in the quality of climate-related financial disclosures to guide investment decision making that has due regard for climate related risks and opportunities impacting investments.

It is the BCA's strong contention that the primary purpose of the new requirements should be to help investors form the most rigorous view possible of climate risks and opportunities as they pertain to investments in corporations.

With this purpose in mind, we make the following key comments on the positions proposed in the consultation paper.

- Close alignment of Australia's requirements with the new International Sustainability Standards Board (ISSB) Standards is important so that investors can make valid comparisons between different corporations in different areas.
- There should be a 'subsidiary exemption' available to entities with parent corporations that are required to report climate related financial disclosures at an aggregated level in jurisdictions aligned to the new ISSB Standards.
- The commencement date should give all covered entities, including Group 1, a minimum of 12 months from the date legislation is proclaimed and climate disclosure standards have been finalised to develop internal capabilities and capacity to meet the disclosure requirements.
- Government can greatly assist by making 'off the shelf' scenarios available for use by reporting entities, as an option, but it is critical that reporting entities be allowed to use scenarios from other sources at their discretion.
- The timing and level of third party assurance, particularly across different reporting content and disclosures, needs to be gradual and pragmatic.
- A modified liability approach is supported and the proposed transition period should be expanded in its scope and reviewed in its third year (and potentially extended to five years if needed).

Reporting entities

Financial reporting under Chapter 2M of the Corporations Act is a sound basis for coverage of the new requirements, subject to the proposed size thresholds.

However, where decision useful information is already provided for investors and other stakeholders, duplication or separate reporting on a local entity level is not warranted. We note that other jurisdictions do not require separate reporting at the entity level for subsidiaries in such circumstances.

There should be a 'subsidiary exemption' available to entities with parent corporations that are required to report climate related financial disclosures at an aggregated level — either in Australia under these new requirements or in another jurisdiction aligned to the new ISSB Standards.

This would serve the primary purpose of the new requirements and avoid creating duplication of effort and excessive reporting burden for reporting entities.

As flagged in the consultation paper, it is also important to progress development of appropriate arrangements for comparable public sector entities to disclose their exposure to climate related financial risks and opportunities.

Phased implementation approach

Phasing in the coverage of new requirements in order of entity size is a practical basis for implementation.

The proposed roadmap contemplates that Group 1 will report from 2024-25 onwards. However, the commencement date should give all covered entities, including Group 1, a minimum of 12 months from the date legislation is proclaimed and climate disclosure standards have been finalised to develop internal capabilities and capacity to meet the disclosure requirements.

Government must take into account that the new requirements will increase entities' costs — for example, in gathering data, further developing and evolving transition plans, monitoring compliance, and assuring any climate related financial disclosures at an accelerated pace, relative to international peers. These costs are likely to be more than expected (or modelled by Treasury) given the nascent state of the climate strategy and assurance industries, with evidence in the market that the costs associated with climate related advice and services are rising faster than inflation.

This would serve the primary purpose of the new requirements by ensuring that reporting entities are capable of meeting the new disclosures requirements from the outset.

Reporting content

When developing Australia's climate disclosure standards, strong alignment with the new ISSB Standards is critically important to minimise compliance costs and reporting burden for reporting entities and to improve comparability of information globally for investors.

- An approach to materiality for the new requirements that aligns with the ISSB Standards and existing definitions of materiality governing financial statements will support consistency in reporting across accounting and sustainability standards.
- Investors will undoubtedly need information about reporting entities' governance processes, controls and procedures when forming a view of corporations' climate risks and opportunities.
- Strategy related information is arguably the most critical to investors when forming a view of corporations' climate risks and opportunities.
- A mix of qualitative and quantitative scenario analysis will be drawn up on by reporting entities as they examine and evaluate different possible futures states for their specific operations in order to best manage and respond to climate risks and opportunities.
- However, the form of the scenarios should not be prescribed in standards — with the exception of at least one scenario being consistent with global temperature goals set out in the *Climate Change Act* 2022 (noting the multiple scenario options available).
- The government can greatly assist by making 'off the shelf' scenarios available for use by reporting entities, as an option, but it is critical that reporting entities be allowed to use scenarios from other sources at their discretion.
- Adopt the approach taken by the ISSB which supports a focus on transparency — rather than prescribing certain transition planning activities or a level of ambition.

- We note the intention of government to consider arrangements to "strengthen the development and disclosure of company transition plans" but caution that this does not inadvertently undermine the accountability and responsibility of boards to determine the strategic direction of corporations.
- The details and dimensions of transition plans should not be prescribed in standards — for example, the precise time horizons, the level of value chain integration and the cycle upon which plans need to be updated.
- Investors will undoubtedly need information disclosures relating to reporting entities' climate related targets and progress towards these meeting these targets but entities are best placed to determine which targets are material and therefore require disclosure.
- There needs to be clarity and certainty about what constitutes "well established and understood" industry based metrics well ahead of any requirements for reporting entities to disclose against such metrics.
- The government has an important role to play in providing supporting information to help address gaps in data and capability in priority areas, such as scope 3 emissions estimation, appropriate scenario selection, and the provision of transition plan templates.
- For scope 3 emissions, entities require flexibility to select the emissions factors which are most relevant to their activities and operations — for example, National Greenhouse Accounts Factors are not suitable for entities with global supply chains, who require emissions factors that consider multi-region and multi-industry operations.
- Regulatory guidance should include illustrative examples of minimum standards of compliance for all disclosure obligations to help entities understand the new requirements sufficiently (especially initially) and avoid being penalised despite best endeavours to meet the new requirements.
- The development of climate disclosure standards should protect reporting entities from having to divulge 'security' sensitive information when making disclosures — for example, the location of data centres in some industries, or fuel use and related performance data in defence contracts.
- There needs to be transitional relief available for comparative disclosures when accounting standards are implemented for the first time (for a given entity Group) and there is a requirement to disclose comparative information from the previous year, before the new disclosure standards existed.

Reporting framework

Close alignment of climate disclosures with existing corporate reporting practices serves the primary purpose of the new requirements by making climate risks and responses transparent in the context of entities' broader decision making. It is also likely to minimise the administrative burden of the new requirements, as it streamlines all reporting activities and processes for reporting entities .

Assurance

Third party assurance plays an important role in enhancing the credibility of climate disclosures for investors, but the timing and level of assurance, particularly across different reporting content and disclosures, needs to be gradual and pragmatic.

We note the indicative timetable provided in the consultation paper for the phasing in of minimum assurance requirements is overly ambitious in some parts. It remains the be seen when and to what extent reasonable assurance for some disclosures, such as those relating to forward looking statements and scope 3 emissions, is practically achievable.

- Capacity building in the assurance provider sector needs sufficient time to scale up to the additional demand that the new requirements will create for financial auditors and sustainability professionals, particularly given the additional demand created for such services by other climate policies changes, such as the reformed Safeguard Mechanism.
- The government has a key role to play in supporting education and training, including through the university sector, to build capacity and scale in the assurance provider sector.
- Progress in addressing data limitations needs to drive the timing and level of assurance requirements for scope 3 emission disclosures, which is expected to occur at different rates across different industry value chains.
- The liability and enforcement framework needs to provide effective protection to entities who work in good faith to comply with assurance requirements but are unable to do so due to factors out of their control — for example, if reliable scope 3 emissions data is not available or if there is insufficient capacity in the assurance provider sector.
- Clarity around how assurance might apply to transition plans and scenario analysis needs to be provided before firm dates for assurance of these disclosures are contemplated.
- Subject to the above, assurance requirements should be aligned with international standards as far as possible — to minimise compliance costs and reporting burden for reporting entities and to improve global comparability of information for investors.
- Requiring financial auditors to lead climate disclosure assurance engagements, supported by technical climate and sustainability experts, increases the available pool of assurance providers while maintaining professional, ethical, and quality controls.

Liability and enforcement

A modified liability framework is required to balance the importance of disclosing decision useful information with appropriate protections for reporting entities and directors, given the inherent uncertainties associated with climate change.

The proposed transition period should be enhanced as follows.

- Impose an embargo on any private claims arising out of or related to the first 3 years of reporting under the new requirements (even if the actual claim is made after the embargo period has expired).
- Similarly, an embargo should be imposed on enforcement action by regulators for the same period unless the regulator can demonstrate that the entity concerned was reckless or grossly negligent.
- It should be reviewed in year three and potentially extended to five years — in light of the development of the government's Sustainable Finance Strategy, the extent of remaining capability and data gaps and the development of guidance and other supporting information provided by government.
- It should apply to all forward-looking disclosures required under IFRS S2 (under the new ISSB Standards) — not just scenario analysis and transition plans because all forward-looking disclosures suffer from a high degree of measurement and outcome uncertainty and are highly novel in the Australian context.
- Incorporate the additional fault based elements applying to continuous disclosure obligations, for all climate related financial disclosures.

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