21 July 2023

[redacted]

Climate Disclosure Unit

Market Conduct Division
The Treasury
Langton Crescent
Parkes ACT 2600

Via email: climatereportingconsultation@treasury.gov.au

Dear Sir/Madam

**SUBMISSION – CLIMATE-RELATED FINANCIAL DISCLOSURE: CONSULTATION PAPER JUNE 2023**

We appreciate the opportunity to provide comment to Treasury on the Climate-related Financial Disclosure Consultation Paper June 2023 (the Consultation Paper).

Pitcher Partners is an association of independent firms operating from all major cities in Australia. Firms in the Pitcher Partners network are full service firms and we are committed to high ethical standards across all areas of our practice. Our clients come from a wide range of industries and include listed and non-listed disclosing entities, large private businesses, family groups, government entities, not-for-profit entities and small to medium sized enterprises.

Pitcher Partners are fully supportive of the need to respond appropriately to climate change which we and others locally and internationally recognise as presenting material risks to the global financial system – risks which need to be managed by capital markets, regulators and corporations. We acknowledge that climate change risks include physical risks of climate change and the transition risks associated with policy as well as the regulatory and technological changes which will be necessary as part of our efforts to mitigate climate change.

Disclosure represents a small part of the changes required in businesses to reflect climate change, we recognise that an important tool to manage both individual and systemic climate-related financial risks is identification, quantification and disclosure of those risks. The establishment of the International Sustainability Standards Board (ISSB) in 2021 to develop comprehensive baseline global standards for climate disclosure (based on the recommendations of the Taskforce on Climate-Related Financial Disclosures) and sustainability reporting is part of the overall response to climate change.

Overall, we support the Government commitment to applying standardized climate-related financial disclosure requirements to certain businesses in order to meet the growing demand for disclosure from some users of the financial statements in some sectors of the market. However, we have concerns regarding either the effectiveness and or clarity of some of the proposals in the Consultation Paper to make a meaningful impact in addressing climate change in the current economic environment, namely:

- The breadth of the application of the disclosures particularly to large privately held businesses
- The timing of the roll out particularly given concerns about the availability of resources
- The cost implications of the roll out given concerns about the availability of resources, and the capacity of business to absorb another increase in costs both internal and external given current economic conditions

- The uncertainty over how this will impact audit quality given concerns about the availability of resources
- The capacity of audit firms to provide assurance and meet deadlines given the concerns about availability of resource and the increase in work required without any change in reporting timelines.
- The inconsistency in the treatment of the estimates for climate disclosure looking 3 years out relative to other forward-looking estimates such as going concern 12 months from reporting date.
- The differential assurance provided between the climate disclosures (limited assurance) and the financial report (reasonable assurance), while being combined within one audit report. Will users appreciate the differential or in substance assume that the level of assurance is consistent? We consider that users would be better and more accurately informed by keeping climate disclosures separate from financial disclosures, particularly given the predominantly historic nature of financial statement disclosures and the prospective nature of climate related financial disclosure.
- What commencement means, is it from the commencement of the legislation or from the various Group's commencement dates e.g. does a Group 2 entity have to disclose from the date of the legislation or from when Group 2 is required to report?
- Where the climate related disclosure will be in the financial statements, a standalone section similar to the directors report or remuneration report, a standalone note or embedded throughout the financial statements?

Additionally, we have provided responses to the specific proposals in the attached appendix. We appreciate the desire to introduce disclosure requirements as soon as feasible once the international disclosure standards have been issued by the ISSB. However, it is critical that for effective implementation sufficient time is given to companies to mandatorily adopt the requirements. We recommend that any requirements introduced apply mandatorily no earlier than 2 years from the date they are issued for any entity, providing the issuing body, professional bodies and other organisations sufficient time to roll out education and awareness initiatives and relevant guidance materials.

Please contact [redacted], Director – Technical Standards [redacted], in relation to any of the matters outlined in this submission.

Yours sincerely,

[redacted]

[redacted]
Partner

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[redacted]
Director, Technical Standards

**Appendix**

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| **<u>Reporting entities</u>**<br>**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.** |
| We do not support the proposal.<br>We consider that large privately held businesses should not be included in the scope for mandatory climate-related financial disclosures (except if already required to report under National Greenhouse and Energy Reporting) as the costs would greatly exceed any benefits. These entities have a fraction of Australia's net emissions, do not have any investors requiring such information as the owners are mainly the users of the financial information and should have the ability to report voluntarily, if desired. The additional costs faced in preparing, monitoring and reporting on these disclosures for large privately held businesses would be significant for very little benefit in identifying material and genuine sustainability risks.<br>Further, the application to not-for-profit limited by guarantee companies would also seem to impose a cost that would greatly exceed any benefits gained.<br>Further, it is unclear whether the thresholds proposed relate to the entity/consolidated entity within Australia or do they relate to the consolidated entity that an Australian entity may be part of globally? Related to this will the requirements to report address Australian climate impacts i.e. those generated in Australia or globally? |
| **<u>Materiality</u>**<br>**Proposal: Principles of financial materiality would apply.** |
| It is unclear how exactly financial materiality will apply firstly to qualitative disclosures and secondly given some of the potential disclosures have yet to be determined whether in substance due to the future uncertainties over measurement of climate impact it will be possible to apply financial materiality to the disclosures in a meaningful manner. Further does this mean in determining the materiality which should reflect the users of the financial statements per ASA 320, climate should be a contributory factor and if so how does climate align with the factors currenting in ASA 320 which are all based on numeric values, such as profit before tax, assets, expenses, etc. ? |
| **<u>Governance</u>**<br>**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.** |
| We agree with the proposal in principle.<br><br>However, for large privately held enterprises in particular, firstly it is unlikely there will be sufficient resources available with appropriate expertise in Australia to assist both clients in designing, the processes and controls and procedures to monitor and manage climate related financial risks, and auditors to audit these. Further while there is a timetable for implementation the resource impact will occur sooner than anticipated as suppliers to "Group 1" and other entities electing to adopt these disclosures early will accelerate the pressure on resources, at a time when the same resources will be learning.<br>This is likely to have an inflationary impact on the cost of these resources similar to the significant increase in cost of experts in value added taxes, when the GST was introduced. Whether this will enhance audit quality, or facilitate business due to the extra costs is unclear. Consequently, we would recommend that any requirements introduced apply mandatorily no earlier than 2 years from the date they are issued for any entity. |

**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.**

We do not agree with the proposal.

For large privately held enterprises in particular, qualitative scenario analysis is going to be challenging for assurance practitioners to address, in particular in relation to financial materiality, as by nature qualitative analysis is less aligned to financial outcomes. Consequently, we would recommend that any requirements introduced apply mandatorily no earlier than 2 years from the date they are issued for any entity.

**Strategy**

**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.***

We do not support this proposal.

The requirement to outline two future states is different from every other estimate in the financial report where a single outcome is reported. We question the inclusion of more than one single outcome, because:

- It is not consistent with financial reporting measurements which require a single outcome along with disclosures of inputs and assumptions; and
- Given the nature of the uncertainty the disclosure of one other outcome is unlikely to benefit users, given there are multiple outcomes that could result not just two;
- We consider that disclosure of multiple outcomes, along with the differential limited assurance on climate disclosures, will likely confuse users rather than provide them information to make informed investment decisions
- Additional work is involved in auditing and preparing multiple estimates, beyond any benefit such multiple estimates would provide as detailed above, and will increase the pressures on client and auditors who are resource constrained.

**Transition planning**

**Proposal: From commencement, transition plans would need to be disclosed, including information about offsets, target setting and mitigation strategies.**

We do not support this proposal.

We consider the proposal should indicate that from commencement, the entities progress in development transition plans should not be disclosed. This is because we consider that entities will need to be educated to create transition plans, particular in the Group 2 and Group 3 scoping if these are to remain within scope using the current thresholds. The incremental costs of developing and implementing these plans as businesses seek to control their expenditure with increasing interest rates is unlikely to enhance adoption, or to encourage early action. Further the availability of resources will also hamper the transition.

**Transition planning**

**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.**

In principle we support this proposal.

However, further clarity on whether commencement means from the commencement of the legislation or from the various Group's commencement dates is important, particularly if it applies from the commencement of the legislation. Additionally, we would recommend that any requirements introduced apply mandatorily no earlier than 2 years from the date they are issued for any entity.

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| **<u>Risks and Opportunities</u>**<br>**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.** |
| We do not support this proposal.<br>As referenced earlier there is little incentive for many businesses to disclose progress in the large privately held enterprise space, as costs are already a core focus. Additionally large privately held businesses are lean and generally seek to limit expenditure to core business activities.<br>However, for large privately held enterprises in particular, because of the lack of clarity regarding materiality, and the resource constraints to identify these and the ongoing uncertainty about how climate related risks and opportunities are identified. Consequently, we would recommend that any requirements introduced apply mandatorily no earlier than 2 years from the date they are issued for any entity. Further, does commencement mean from the commencement of the legislation or from the various Group's commencement dates? |
| **<u>Metrics and targets</u>**<br>**Proposal: From commencement, scope 1 and 2 emissions for the reporting period would be required to be disclosed.** |
| We do not support this proposal.<br>However, for large privately held enterprises in particular, reporting on scope 1 and 2 emissions is going to be challenging because of resource constraints. Consequently, we would recommend that any requirements introduced apply mandatorily no earlier than 2 years from the date they are issued for any entity. Further, does commencement mean from the commencement of the legislation or from the various Group's commencement dates? |
| **<u>Metrics and targets</u>**<br>**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.** |
| Similar to above will clients know or be able to report on these and what impact will this have on the audit report. Are these scope 3 emissions in relation to the Australian entities in Australia or Australian entities globally or Global entities which an Australian entity is part of. If either of the latter two options it is unclear how a business in Australia is supposed to obtain the information to comply with the requirements. Equally reporting on emissions which an entity cannot control or potentially even quantify given the behaviour of a customer can change the emission profile how this can practically be identified and reported is uncertain. |
| **<u>Industry-based metrics</u>**<br>**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.** |
| We do not support this proposal.<br>We consider it is too early to support this proposal until there are well-established and understood metrics, which can be appropriately evaluated from a cost benefit perspective. |

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| **<u>Liability and enforcement</u>**<br><br>**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.** |
| We are not clear on the proposal. Does this mean that entities cannot be sued for 3 years or that the information disclosed in those three years they cannot be sued over i.e. can legal action simply not commence until the three years are lapsed or are those years protected from legal action? Clarification is required of the proposal before we can comment any further. We do consider that it will take some time for disclosures to develop fully, and during this period of ‘development’ there should not be the ability for civil penalty provisions in the Corporations Act to be applicable. |