Climate-related financial disclosure: Second consultation

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21 July 2023

Dear Treasury,

RE: Submission for consultation paper on climate-related financial disclosure

Please find below Ndevr Environmental's, response to the Government's position for the implementation and sequencing of requirements for disclosing climate-related financial risks and opportunities in Australia. Our comments follow the headings of the Consultation Paper.

Who We Are

Ndevr Environmental, part of Anthesis Group, is a specialist climate change and human rights advisory firm dedicated to accelerating the transition to a net zero future. For over a decade we have forged partnerships with companies and government entities to design innovative business-led solutions to meet the planet's emerging challenges and ensure the sustainability and prosperity of Australian businesses. Anthesis Group is the largest group of dedicated sustainability professionals globally.

Ndevr Environmental is one of only a few specialist environmental consultancies that are accredited auditors under the NSW Independent Pricing and Regulatory Tribunal (IPART) Energy Savings Scheme, the Victorian Government's Essential Services Commission VEU Scheme and Federally on the Clean Energy Regulator's Auditor panel. Ndevr Environmental is led by Matthew Drum who is one of Australia's most experienced and highly accredited Registered Greenhouse and Energy Auditors (RGEAs) and holds the highest level of greenhouse and energy audit accreditation in Australia, Category 2 RGEA. The wider team has completed many climate-related compliance audits, managed complex projects, and provided specialist consulting services and strategic advice for some of Australia's largest and most well-respected corporations, including expert advisory on climate risk and transition planning.

General Position

Ndevr Environmental welcomes the Treasury's proposed mandatory disclosure requirements as they represent a pivotal development in Australia's approach to climate-related assessments and disclosure. This transformative step will have a profound impact on how businesses approach the reporting, target setting, and disclosure of climate-related information. Companies and investors stand to benefit immensely from adopting these disclosure requirements, as they will facilitate more effective measurement and management of both transition and physical climate risks. Moreover, they will contribute to the efficient allocation of capital as the global economy undergoes a transformative shift towards achieving net zero emissions.

The inclusion of mandatory assurance, based on international standards and provided by qualified and accredited professionals, is a crucial aspect that ensures the credibility and reliability of the disclosed information. The Treasury's aim to broaden the scope and encourage competition among auditors is a welcome effort. However, we do not believe that the scope as it stands recognises the unique expertise and capabilities of RGEAs in this regime, but instead makes provisions that will allow further consolidation of assurance services among large financial audit firms. We have concerns around the requirement for climate disclosure assurances to be led by financial auditors, as well as the presumed understanding in the Consultation Paper that RGEAs do not have the suitable professional qualifications, knowledge of assurance processes, independence requirements and quality control or management necessary to lead audits of climate-related information. We propose that audited bodies under this regime should reserve the right to appoint either a financial auditor or a RGEA Cat 2 to lead the audit of their climate-related disclosures.

Climate-related financial disclosure standards

Proposal: The AASB will be responsible for developing Australian climate disclosure standards, which are envisaged to closely align to the requirements in IFRS S2 Climate-related Disclosures. It is anticipated that the AASB will conduct a public consultation process as part of developing the Australian standards.

We support the Government's proposal to align the Australian climate-related disclosure regime with international developments and standards. The ISSB Sustainability Disclosure Standards represent a welcome standardisation of the global sustainability reporting landscape and will significantly streamline reporting and enhance value to readers and users of sustainability-related disclosures.

Assurance

Proposal: The preferred policy parameters for climate disclosure assurance include:

- *a requirement for limited assurance, moving to reasonable assurance over time.*
- *reasonable assurance of scope 3 as a final step in scaling requirements.*
- *assurance would need to be provided against the Australian equivalent standards to the ISSB and Corporations Act/Corporations Regulations, in line with AUASB standards.*
- *assurance to be carried out by a qualified and experienced independent provider (conducted or led by the financial auditor).*

It is proposed that further consultation on areas that extend beyond climate disclosure assurance is conducted by the AUASB, after the release of draft international sustainability assurance standards.

Scope 3 emissions accounting and assurance inherently carry a high level of uncertainty due to varying levels of visibility and control. We recommend that Scope 3 emissions be assured to a limited assurance level. The audit program for the climate disclosure can be conducted to both limited and reasonable assurance levels for the different components.

We further recommend Treasury amend the final preferred policy parameter to expand the list of auditors conducting or leading the assurance process and include, at minimum, RGEA Category 2 assurance providers.

We have provided further details and recommendations in the following paragraphs under "International Sustainability Auditing and Assurance Standards" and "Assurance Providers and Professional Requirements".

International Sustainability Auditing and Assurance Standards

Proposal: The International Auditing and Assurance Standards Board (IAASB) is currently working on a project to develop an overarching standard for assurance on sustainability reporting, which would address both limited and reasonable assurance. The IAASB is targeting July/August 2023 to release the exposure draft and is aiming for final approval in late 2024. Stakeholders have recommended that Australian climate-related disclosures assurance is aligned with international standards when complete. Treasury will continue to monitor progress of the IAASB's assurance on sustainability reporting project. To minimise compliance costs for entities that operate internationally, assurance should be aligned with IAASB standards as far as possible.

We agree that any Australian sustainability related assurance standard should be aligned with an international standard. When reviewing the current scope of work by the International Auditing and Assurance Standards Board's (IAASB's) on releasing the ISSA 5000 exposure draft General Requirements for Sustainable Assurance Engagements (ED-5000), which might become the international standard that Treasury is referring to in this consultation paper, we notice one objective being that the standard should be "Implementable by all assurance practitioners (i.e., professional accountants and other professionals performing assurance engagements)". We propose that Treasury and the Australian Assurance Standards Board (AUASB) make this IAASB objective part of the objectives for an Australian standard as well and include RGEA Cat 2 assurance providers as "other professionals".

We draw attention specifically to any paragraphs relating to the characteristics of the Engagement Leader in the proposed ISSA 5000 standard, whereby an Engagement Leader shall have sufficient sustainability competence which constitutes the Engagement Leader making professional judgment on factors such as the nature and complexity of the sustainability matters, previous experience in relation to sustainability matters, a judgment on the applicability of sustainable information disclosed or whether the criteria of the sustainable information disclosed is suitable for the engagement circumstances. All of these are particularly relevant to RGEA Cat 2's who additionally meet all relevant ethical requirements set out within the proposed ISSA 5000 standard.

Assurance Providers and Professional Requirements

Proposal: It is proposed that financial auditors would lead climate disclosure assurance engagements, supported by technical climate and sustainability experts, when required.

We agree that while financial auditors have the requisite professional qualifications and knowledge of assurance processes, they may not possess the skills or technical expertise to provide climate-specific assurance. In this respect, RGEA Cat 2's are uniquely suited to lead audits of climate-related disclosures. RGEA Cat 2's must meet stringent general assurance as well as climate-related requirements to achieve their auditor accreditation, some of which include:

- *ASAE 3000 Assurance Engagements Other than Audits or Reviews of Historical Information*

- *ASAE 3100 Compliance Engagements*
- *ASAE 3410 Assurance on Greenhouse Gas Statements*
- *ASA102 Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements*
- *ASAE 3450 Assurance Engagements involving Corporate Fundraisings and/or Prospective Financial Information*
- *ASQM 1 Quality Management for Firms that Perform Audits or Reviews of Financial Reports and Other Financial Information, and Other Assurance or related Services Engagements*
- *ASQM 2 Engagement Quality Reviews*
- *National Greenhouse and Energy Reporting (Audit) Determination 2009*

The designation of financial auditors to lead the assurance of climate-related disclosures, with the option to delegate to RGEAs, does not recognise the capabilities of RGEAs to lead the entire assurance process. In fact, if this requirement is mandated as it stands, delegation to the appropriately skilled and qualified climate-related auditors is unlikely as large financial audit firms would have the capability to consolidate climate-related assurance within their existing financial assurance services. An RGEA Cat 2 auditor should be able to lead an audit program in its entirety as long as they can demonstrate that the audit team has the requisite financial and corporate audit expertise in the team.

Treasury recognises the importance of new players being encouraged to enter the market and build capacity. We understand that Treasury also recognises the skillset and capabilities of RGEAs, given that the register of auditors maintained by the Clean Energy Regulator is acknowledged as a key resource to equip the audit team with the required technical expertise. However, we do not believe this aligns with the delineation of financial auditors having sole authority to lead these audits, with the option to subcontract the audit of climate-related disclosures. We believe that authorising RGEA Cat 2's to lead the audits of climate-related disclosures, when they already have the skills to lead audits of other climate-related information, will be a crucial factor to avoid entrenching the highly concentrated assurance market.

Alternatives Considered

Proposal: Restricting providers to registered company auditors, without an option to delegate audit and assurance tasks to experts, would exacerbate market concentration and stifle opportunities for greater competition in the market. While it is paramount that climate disclosure auditors are appropriately qualified and experienced, it is acknowledged that this area is relatively nascent in comparison to financial audit and assurance. Detailed and specific consultation on professional audit and assurance requirements is proposed to be conducted at a later stage, rather than prior to the commencement of first phase reporting and assurance requirements.

We note the Treasury has concerns regarding restricting the market and exacerbating concentration of the assurance space, while emphasising the need for sufficient qualifications required for climate-related audits. We would like to echo this concern; as auditors in the climate-related assurance space for over a decade, we have witnessed the dangers of overreliance on a small pool of financial audit and advisory firms for all assurance and advisory needs, including conflicts of interest. We further note that if the audit firms leading climate-related assurance engagements remains a small, concentrated group, costs are likely to be high and a large portion of the market may simply not be able to be serviced. We recommend a decoupling of environmental assurance services by allowing RGEAs to lead assurance engagements for climate-related disclosures.

We would like to once again reiterate that RGEAs meet stringent requirements set out by the Australian Standard on Assurance Engagements and the National Greenhouse and Energy Reporting audit framework. While the climate assurance space is indeed nascent in comparison to financial assurance, RGEAs have been conducting audits of climate-related information since the inception of the NGER Audit Determination. RGEAs therefore have more than a decade of experience with the climate-related legislative landscape in Australia and internationally, and have the capability to draw on dedicated climate risk experts to build this expertise further. In our view, RGEAs are in fact relatively more qualified and skilled to lead the audits of climate-related disclosures as compared to solely financial auditors.

We welcome the Treasury's proposal to conduct a separate detailed and specific consultation on professional audit and assurance requirements. In line with this, we recommend that the clear designation of financial auditors to lead assurance of climate-related disclosures be removed until such time that the final decision in this respect is made and after careful consideration of the qualifications and experience of RGEAs and in line with Treasury's recommendations to increase the available pool of auditors.

Proposed Assurance Roadmap and Timeline

Proposal: To provide reasonable assurance for all climate disclosures by the end state.

We agree with the Treasury's proposed timeline on providing assurance but have concerns about reasonable assurance for Scope 3 emissions and for narratives within the disclosure to be included in the scope of works. As with assurance of financial statements, narratives within the director's report are not in scope of the audit report and we recommend adopting this same approach for climate disclosures until such time that specific standards relating to assurance of sustainability-related narratives are developed and released.

Similarly, Scope 3 emissions are inherently uncertain with accurate data being challenging to obtain, for the reporting entity and for assurance providers. We believe that including Scope 3 emissions into reasonable assurance would lead to an increased disagreement from stakeholders and might lead to a stall in the Treasury's proposed roadmap. Additionally, we question whether the cost of the work in providing reasonable assurance of Scope 3 emissions would outweigh the benefits. Our proposed alternative is to provide limited assurance for Scope 3 emissions, also in the final stage of the rollout.

Modified Liability Approach

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.

Treasury's proposal is drafted in favour of the reporting entity and its directors without taking the assurance provider and the relationship between the assurance provider, the reporting entity and the intended users of the disclosure into consideration. The concern is that assurance providers might become the subject to shareholders' class actions for matters that are the responsibility of the reporting entity and its directors, but which cannot be claimed.

As pointed out in the consultation paper, there is heightened concern about Scope 3 emissions and Forward-looking statements being inherently uncertain matters and with the three-party engagement nature of the AUASB Assurance framework, considerations around the liability of assurance providers shall be included in the disclosure framework.

We suggest amending this provision to ensure Directors are allowed to obtain third party assurance in support of their approval of the reporting entity's climate-related disclosures, and that any assurance reports be required to be made public. This would allow for sufficient protections of both Directors in discharging their responsibilities to shareholders, as well as auditors who will only be directly liable to the directors.

Providing initial protection of auditors would also encourage new players to enter the market which, again, helps increase the pool of assurance providers.

Similar to the scope of the provision of assurance on Scope 3 emissions, and for the same reasons, we propose to exclude the application of civil penalty provisions to Scope 3 emissions.

Closing

Ndevr Environmental appreciates the opportunity to submit a response to the Treasury's Consultation Paper and welcomes the development of a climate-related disclosure regime in Australia.

Yours sincerely,

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Managing Director | Ndevr Environmental, part of Anthesis
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