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Submission to The Treasury's Climate-Related Financial Disclosure Consultation Document (June 2023)

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The UNSW Institute for Climate Risk and Response (ICRR) is a new initiative at UNSW Sydney bringing together experts in the physical, economic, behavioral, financial and governance approaches to understanding the risks and opportunities of climate change. In this submission, members of the ICRR have provided comment on four specific aspects of the Consultation document: 1) precision of physical risk assessments; 2) scenario selection for disclosure; 3) decisions regarding size thresholds and Scope 2 and 3 reporting; and 4) assurance of the disclosures. We also offer a preliminary observation on the Reform Principle for the disclosures to be “well-understood”.

Comment on Reform Principle #3: “well understood”

We agree that businesses, investors, regulators and the public should have a clear and common understanding about obligations for entities to disclose climate-related financial risks. Achieving this goal will require careful consideration of the way in which the various aspects of disclosure are communicated and interpreted, especially by members of the public. As noted throughout the document, there are many types of uncertainty inherent in the disclosures – not least the uncertainties associated with selecting different scenarios (see Point #2) – and the implications thereof, especially for comparability across entities. To ensure that the public genuinely understand the implications of what is being disclosed, we recommend following advice and guidelines garnered from the behavioural science literature regarding the perception and understanding of risk and uncertainty, especially as it pertains to climate change.

1. Physical Risk Precision

Current estimates of regional / local climate risks are sourced from version 6 of the Coupled Model Intercomparison Project (CMIP6) which is currently being replaced by CMIP7 (over next 5 years). At the scale of risk to businesses, the **sign** (not merely the magnitude) of material climate risks from many climate drivers may change between CMIP6 and CMIP7. A company disclosing risk using CMIP6-based products may have to fundamentally change its disclosed exposure to climate risk when CMIP7 comes out.

Somewhat more complicated are how products that purport to provide physical climate risk at regional and local scales generate these data from CMIP6 data – a company can choose method “x” and find limited material risk, or use method “y” and find extremely confronting levels of risk, and both methods can ultimately use the same CMIP6/7 modelling systems. There is no “best way” to create spatially detailed climate risk information, and it is possible that there is genuinely no way at present to robustly estimate physical climate risks below a level of detail of ~100 x 100 km.



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Disclosure of *how* physical climate risks have been derived requires a level of openness that is rare in business – describing the approach is insufficient, rather the approach needs to be independently reproducible with assumptions transparent and testable. Broadly there seems to be an assumption that it is possible to reasonably robustly assess material climate risks to business – and we are not sure that is generally true. Disclosures that jump around from apparently very serious to seemingly limited (or vice versa) as new climate projections emerge might lead to some problematic unintended consequences. We think this becomes **far** worse when you move to quantitative assessments.

One medium term (at least 5 years) solution to this is to avoid quantitative assessments of physical risk. Encourage business to continue assessing these risks qualitatively. There is simply no evidence that the precision offered by physical risk assessments are more reliable or robust than assessments sourced from a qualitative assessment.

2. Scenario selection

In its current form, the proposed disclosure of climate resilience against at least two possible future states overemphasises the transition risks of decarbonisation. The mandated scenario for business to use is the objectives outlined in the Climate Change Act 2022, which stipulates that the increase in global average temperatures is held well below 2 degrees Celsius. The second scenario, which is currently left for businesses to decide, can also incorporate significant decarbonisation (e.g., net zero by 2050 which is listed as an example in the consultation paper).

Scenarios with significant decarbonisation have larger transition risks and smaller physical risks than scenarios with more gradual emission reductions. Accordingly, if businesses are asked to disclose their resilience to only two possible future states, and the one that is mandated involves significant decarbonisation, then it is intuitive for the second scenario to highlight the physical risks of climate change in some way.

The TCFD recommendation, which specifies use of at least one scenario with a 2-degree warming objective, is a step in the right direction. We would recommend changing the language slightly to specify use of at least one scenario with *at least* 2 degrees of warming in global mean temperature. In this way, the business will need to disclose their resilience to both the transition risks from decarbonisation and the physical risks from warming (even if the physical risks are only disclosed in a qualitative manner as discussed in Point 1).

3. Size Thresholds and Scope 2 and 3 Reporting

We note that the consultation paper is titled Climate-related financial disclosure while the ISSB Standard is simply Climate-related disclosure. This will likely impact how materiality is interpreted as financial materiality is clear cut, while the ISSB standard uses “significant”. This is not an issue in the short-term as the financial impact will likely be known. However, medium- and long-term financial effects may not be measurable in the current reporting period. This may provide some leeway for entities not to disclose as the financial impact is uncertain as of the reporting date.

We agree with the proposal to use prescribed size thresholds as required to lodge financial reports under Chapter 2M of the Corporations Act to be consistent with current practice and to avoid confusion as to which entities will be covered and will be required to make climate-related disclosures. The proposed threshold will already dramatically increase from 900 (covered by NGER Scheme) to more than 21,000 reporting entities (CPA Australia) covered by the Act. Smaller entities may also be covered if they are part of the value chain of a reporting entity. This level of reporting is as ambitious as the EU’s Corporate Sustainability Reporting Directive (adopted in 2022) which will increase the number of entities reporting ESG matters from 11,700 to 50,000.

We also agree with a phased-in approach where the final state will not be in-place until financial year 2027-2028. This will allow smaller entities to build competencies to get ready with the new reporting paradigm.

We agree on the proposal to disclose information about the governance processes, controls and procedures of entities to monitor climate-related risks and opportunities. This is already covered in part by the ASX Corporate Governance Principles, in particular Recommendation 7.4 where “a listed entity should disclose whether it has any material exposure to environmental or social risks and, if it does, how it manages or intends to manage those risks”.

We agree on the reporting of Scope 2 using both location-based and market-based accounting methods. Accounting of Scope 2 emissions under NGER are currently calculated on the basis of location-based observations of annual average emissions intensity at the state and territory level (see *NGER Technical Guidelines* Section 7.2) However, increasingly there are large interstate transfers not only of (renewable) electricity, but also of the rights associated with that electricity. For example, transfers under the Large-scale Renewable Energy Target (LRET) scheme, or increasingly, by power purchase agreements (PPAs). However, these (legitimate) claims are not reconciled with the claims of parties who are relying on location-based emissions estimates. As a consequence, the abatement effect of much renewable electricity that is exported across National Energy Market regional boundaries is double counted. This will be reduced if a reconciliation is done, and the Scope 2 using the market-based accounting method is reported.

We agree on the disclosure of material scope 3 emissions considering that Scope 3 is excluded from the NGER scheme. Although some entities voluntarily disclose selected Scope 3 information the voluntary nature of this disclosure results to lack of comparability and often cover insignificant aspects of the entities' value chain (e.g., air travel and paper use). Considering the progress that has occurred in carbon measurement over the recent years, we support that Scope 3 that are significant to the entities' value chain should be disclosed (e.g., bank's loan and investment value chain). Guidance such as the Greenhouse Gas Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard helps entities to assess their entire value chain emissions impact using Scope 3 Evaluator. This is a free, web-based tool from Greenhouse Gas Protocol and Quantification that makes it easier for companies to measure, report, and reduce emissions throughout their value chain.

4. Assurance Dimensions

Assurance over climate related financial disclosures is essential if the proposals are to achieve their objectives. Assurance adds to the actual and perceived credibility of the information disclosed and contributes to trust in the broad reporting ecosystem. Independence is a cornerstone principle underlying the value in assurance.

We note the following proposals outlined in the Consultation Paper;

- A staged implementation of the level of assurance, and the subject matter over which assurance will be provided, aligned with the phased implementation of mandatory disclosures across reporting entities of different sizes.
- Assurance to be provided with reference to the standards of the Australian Auditing and Assurance Standards Board (AUASB).
- Assurance to be provided by financial auditors, supported (when required) by, technical climate and sustainability experts.
- Auditors to be independent of the entity.

We agree with all of these proposals. Financial auditors are best positioned to effectively (and efficiently) provide assurance over climate related financial disclosures. In auditing the financial statements, they are already independent. They are also already incorporating climate risks in their financial statement audit work, have at their disposal robust standards supporting the use of and reliance on the work of internal and external subject matter experts, and are subject to strong quality control and ethical requirements. In addition, the benefits noted in the consultation paper around including disclosures in the entity's Annual Report are supported by having a single assurer providing assurance over the entire contents of the Report.

Reference to the AUASB as the single authority for standards guiding assurance is appropriate in that it supports consistency in assurance practice across providers and across subject matter. The terms limited and reasonable assurance have the same meaning across standards focussing on different subject matter and this will limit confusion across those in the reporting ecosystem.

We also broadly agree with the staged implementation of assurance level and subject matter being assured (across four years for each group of companies) in that it provides time for capability (and capacity) uplift while minimising the need for resources to be re-assigned away from other audit and assurance activities (and potential unintended consequences of a reduction in quality, particularly audit quality). It also allows for processes to develop such that assurance (and higher levels of assurance) can be provided at scale. We do, however, note that Group 1 entities are large reporting entities that are likely covered by the NGER Scheme and have mature internal reporting management systems for GHG emissions that are assurable. There is also a current standard on assurance engagements (ISAE/ASAE 3410) that is currently being effectively used. This suggests that a more mature capability for the assurance of Group 1 entities' Scope 1 and Scope 2 emissions than that which is recognised in the current staged implementation. We believe that consideration should be given to requiring reasonable assurance of Scope 1 and Scope 2 emissions of Group 1 entities from the first year of implementation. Given the less mature capabilities for Group 2 and Group 3 entities, we believe that the initial requirement for limited assurance is appropriate.

The staged approach, however, does give rise to a very fragmented market until all entities and all disclosures are subject to reasonable assurance in 2031. Care will need to be exercised to ensure that users of the climate related financial disclosures are aware of what disclosures are being assured and at what level (as this will vary across different entities).

Finally, although supply side constraints are noted in the consultation paper, we caution against underestimating the considerable challenges that the profession faces in attracting and retaining qualified assurance providers such that there is sufficient capacity to meet requirements. As noted above, the proposed scope is ambitious and there will be a considerable increase in the demand for assurance that will need to be met. There is a risk (especially for Group 3 entities) that entities may not be able to engage a quality assurer when required. To support the policies being proposed, there will be a need for accompanying policies aimed at increasing the number of qualified assurers.

Summary: We thank Treasury for the opportunity to comment on the consultation document. We are in broad agreement with the key reform principles and the structure of the wider framework for reporting. We hope that the comments we have provided will assist in the development and refinement of the disclosure process.

Contact: If Treasury would like to follow up with further questions about any aspect of this submission, please contact the **UNSW Institute for Climate Risk & Response:** [REDACTED]