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Submission – Climate-related financial disclosure: Exposure Draft Legislation

Dear Sir / Madam,

I am writing in response to the Climate-related financial disclosures documents issued on 12 January 2024.

By way of background, as an accounting professional and then an academic teaching and researching in the area of financial reporting for over 40 years I have significant knowledge and experience of financial reporting. I have an ongoing interest in the development of corporate reporting, and most recently this has been focused on digital reporting.

Most aspects of the proposed legislation are not contentious, and the rationale for expanded corporate reporting is well understood and accepted. However, there remain some aspects that are problematic and this is where further attention is required.

1. Breadth of Application of Climate Reporting

The breadth of application has always been the most problematic aspect of the expansion of corporate reporting to include climate reporting. Alignment of the requirement for financial reporting and climate reporting in Part 2M of the Corporations Act while theoretically simple is impractical and gives rise to considerable uncertainty. Over 23,000 entities lodge financial reports in accordance with Part 2M of the Corporations Act (figure from ASIC). Reducing this number through exclusions (for which limited information is available due to the format in which ASIC records information – not digital) is fraught and subject to error. In this regard it is notable that in the Policy Impact Analysis only 6,033 entities are identified as potentially impacted.

Group	Entities
1	723
2	755
3	4,555
	<hr/> 6,033

No explanation is given to specific criteria that are applied and for why this is significantly less than the firms lodging financial reports under Part 2M (i.e., the basis for exclusion is not disclosed) which is the starting point for determining the need to prepare climate reports. It is noted that there is provision for Group 3 firms to identify

immaterial climate risks and use this as the basis for an exception to preparing a climate report and this might reduce the number of small medium entities impacted. However, the extent to which this is applied is not identified.

Materiality is defined in ISSB S1, and problematically this emphasises decision making about the subject entity. Not whether it is material in relation to contributing to or achieving national global emission targets, or trigger a regulatory action. A consequence of this is that an entity may be a significant contributor to national emissions but if is able to pass on any costs this would mitigate any risk and it would form the basis for not reporting. In contrast a small medium business exposed to significant business risks arising from energy costs which are impacted by climate action plans would be required to report. (In this situation disclosure of energy expenses is probably sufficient to identify the risk.) Furthermore, the consequence of limiting through exceptions is that there is considerable uncertainty about the entities excluded and those remaining and impacted. Understanding this is critical for being able to conduct a meaningful cost – benefit analysis, and given the significant costs of climate reporting it would be punitive for small medium enterprises. For example, an (unnamed) ASX company was identified and it has a market capitalisation of \$300m, revenue of \$150m, assets of \$250m and profit of \$23m. The cost of initial application could be as much as 4% of annual profitability. This is unjustifiable and would swamp any benefit in relation to cost of capital. To avoid this uncertainty the criteria to provide climate reports should be linked to climate impact criteria, as already occurs with NGER. This would identify who should prepare climate reports (rather than trying to compile a list of who should be excluded).

An issue when linking the requirements for financial and climate reporting is that for many small medium entities the costs of compliance with financial accounting standards is mitigated by the requirements of many (complex) financial accounting standards not being applicable, or application being relatively straightforward (e.g., AASB 9). This is akin to the automatic transmission in a car. There is no such feature for climate reports. It is also notable that there is provision for reduced disclosure in financial reports for small medium entities. Again there is no provision for this with climate reports. There are no protections for small medium enterprises.

Finally, there are no legislative protections for small medium enterprises. Large enterprises will be required to report Scope 3 emissions. To enable large enterprises to determine Scope 3 emissions they may require small medium entities in their supply chain to prepare climate reports, or subsets of information required in climate reports. This may preclude these small medium entities from supplying large enterprises. There needs to be explicit legislative protections for these small medium entities from any such requirements that would egregiously expand the scope of climate reporting to small medium entities (possibly an unintended consequence).

Clearly, the issue of the extent to which small medium entities need to prepare climate reports requires further consideration.

2. Scope 3 Emissions

There can be theoretical arguments about whether entities should report emissions by other entities, and this highlights the relative immaturity of climate reporting relative to financial reporting. (The analogous point is that Boeing doesn't report sales or profits made by Qantas). However, the more practical issue is how can Scope 3 emissions be calculated reliably and subjected to audit. There is a significant risk of this simply being a 'modelling exercise' and unable to provide information for decision making. The alternative is for entities preparing climate reports to require all other entities in their supply chain to prepare climate reports (discussed above).

3. Digital Reporting

Any expansion of corporate reporting must be accompanied by the adoption of digital reporting. Otherwise, the volume of information provided will not be able to be used in an informed manner. Digital reporting has been allowed voluntarily in Australia for over a decade and there has been ZERO adoption. This occurs notwithstanding Australian firms that are SEC registrants being required to prepare reports in this format, and if you want to access them it is best done through the SEC EDGAR database rather than the entity website. The current policy of voluntary adoption is a failure, with an extensive history of failure. In all other countries digital financial reporting is mandated.

Hence my recommendation is that a much more targeted reporting requirement be adopted (positively including entities rather than excluding) or there will be a significant cost for many entities with little benefit. Furthermore, there must be explicit protections for small medium entities.

Yours faithfully

A handwritten signature in blue ink, appearing to read 'Peter Wells', with a stylized, cursive script.

Peter Wells

Entities Preparing and Lodging General Purpose Financial Reports in accordance with the Corporations Act, Part 2M. (source – ASIC Annual Report)

Description	Number	Source for population numbers
ASX listed Australian formed entities	2,190	Derived from data on Morningstar DatAnalysis - 23 May 2023.
NSX listed Australian formed entities	42	NSX listed entities at 5 May 2023.
Unlisted public companies limited by shares	4,428	Number of financial reports lodged in the 12 months to 30 June 2022.
Unlisted public companies limited by guarantee	1,328	Number of financial reports lodged in the 12 months to 30 June 2022.
Registered schemes	3,656	Number of registered schemes as at 30 June 2022 per ASIC Annual Report 2021-22.
Corporate Collective Investment Vehicle sub-funds	4	As at 23 May 2023 ASIC had registered 3 CCIVs that have 4 sub-funds in total.
Registrable Superannuation Entities (excluding Small APRA funds, Approved Deposit Funds and Pooled Superannuation Entities)	140	From APRA statistics at 15 May 2023. Legislation was enacted last week to bringing these entities under Chapter 2M from years commencing on or after 1 July 2023.
Large proprietary companies that are not disclosing entities	6,544	Number of financial reports lodged in the 12 months to 30 June 2022.
Grandfathered large proprietary companies	1,104	Maximum number from notifications in 1995/6 less those that ceased to exist or since lodged financial reports. These companies are required to lodge for year ending on or after 10 August 2022.
Small proprietary companies that are controlled by a foreign company for all or part of the period and where the company's profit or loss for the period is not covered by the statements lodged with ASIC by a registered foreign company, company, registered scheme, or disclosing entity	3,708	Number of financial reports lodged in the 12 months to 30 June 2022.
TOTAL	23,144	

