Director - Climate Disclosure Unit
Climate & Energy Division, Treasury
Langton Cres
Parkes ACT 2600

2 February 2023

Dear Director

Deakin Integrated Reporting Centre Submission to Treasury Climate Reporting Consultation

Thank you for the opportunity for us as leaders of the Deakin University Integrated Reporting Centre to make a submission from the Centre on this important consultation.

The Deakin University Integrated Reporting Centre (DIRC) is an independent thought leadership centre with deep connections into academia, accounting and assurance standard-setting, and the business world. It provides leadership across three pillars of excellence in better business reporting and in particular integrated reporting: thought leadership and engagement, education and training, and research. It also provides the Secretariat for the Australian Business Reporting Leaders Forum (BRLF).

The BRLF is a discussion forum. It is the IFRS Foundation's designated Integrated Reporting Community for Australia and is a reporting stakeholder to the Financial Reporting Council (FRC). Accordingly, it has direct international connectivity and a strong local voice. Its mission is to drive better business reporting in Australia as well as contributing to the global discussion, with a focus on integrated reporting and integrated reporting assurance, and producing research, thought leadership and education in integrated reporting and integrated reporting assurance.

A Changed and Changing External Reporting Environment

The world has seen a period of rapid change in the corporate reporting ecosystem over the last few years as it became clear that sustainability reporting needed to be brought into the mainstream of corporate reporting in a clear and coherent, and consistent and comparable, manner at a time when such reporting had become fragmented, complex and additive. The tendency was to add on rather than work according to an underlying strategy. The tendency has been to add to the corporate reporting burden over time for new reportable matters or to address transparency failures, rather than rework what is most relevant without necessarily adding to the burden.

In response there has been unprecedented consolidation of relevant institutions and simplification of corporate reporting over the last three years. Of particular note were the creation of the International Sustainability Standards Board (ISSB) by the IFRS Foundation, such that the ISSB has now issued IFRS

Sustainability Disclosure Standards S1 and S2; and the issue by the International Auditing and Assurance Standards Board of the exposure draft of its general requirements sustainability reporting assurance standard, ISSA 5000. We are moving towards one system of sustainability reporting and a global baseline set of sustainability disclosure standards issued by the ISSB, which are closely connected to IFRS Accounting Standards issued by the International Accounting Standards Board, as core components of the overall corporate reporting ecosystem.

Pleasingly, through Treasury's climate reporting consultation, Australia is now moving towards international alignment. We note the concurrent consultation by the Australian Accounting Standards Board on Australian equivalents for S1 and S2. We also note with endorsement the intention expressed by Treasury to be aligned with international disclosure and assurance standards to the extent possible.

This submission is consistent with earlier submissions made by DIRC on relevant consultations which focus on maximised international alignment, more integration in reporting and use of one integrated report as the primary corporate report. These themes are consistent with the main objects set out in Section 224 of the ASIC Act in terms of facilitating the Australian economy by reducing the cost of capital; enabling Australian entities to compete effectively overseas; having accounting and auditing standards, to be expanded to sustainability reporting and assurance standards through the draft legislation subject to this submission, that are clearly stated and easy to understand; and maintaining investor confidence in the Australian economy including its capital markets (the components of section 224).

<u>Our concerns</u>

While we are generally supportive of the proposals put forward in the climate reporting consultation, we have three major concerns about the proposals:

- The proposed two new reports for inclusion in annual reports – the Sustainability Report and the Climate Statement within it. An existing location – preferably an integrated report - should be the repository for disclosures under Australian Sustainability Reporting Standards, with an aim of reducing the number of reports and volume and complexity of reporting, while enhancing its integration and clarity for the benefit of investors and other stakeholders.

  Such a report would represent a flagship report for investors and other stakeholders on the business, its performance and prospects for which the board of directors would be responsible, and which would provide the basis of suitable criteria for assurance; and

- Climate-first or climate-only? The draft legislation and accompanying papers ('package') are silent on this question and readers can only conclude from reading the package that the strategy is 'climate-only'. The package should make it clear that climate-related disclosures are the first in a series of sustainability-related financial disclosures:

- Giving investors and other stakeholders confidence that Australian sustainability reporting will be truly internationally aligned.
- Confirming that the Australian Accounting Standards Board has the mandate to fully align Australian Sustainability Reporting Standard 1 (ASRS 1) with IFRS Sustainability Disclosure Standard S1 (S1), such that the ISSB endorses Australia as being internationally aligned.

- The introduction of a third audit / assurance report to annual reports – the audit report on the sustainability report. We believe that we should be moving towards more integrated assurance in annual reports, not less.

These concerns are explained in the attached submission. We make this submission on behalf of the DIRC and offer any required assistance to Treasury.

Yours faithfully

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Submission by Deakin Integrated Reporting Centre to Treasury on Climate Reporting Consultation

This submission builds on and is consistent with the themes of Deakin Integrated Reporting Centre submissions on the December 2022 Treasury discovery and the June 2023 Treasury position paper consultations: maximised international alignment, more integration in reporting and the use of one integrated report as the primary corporate report.

Our submission on the December 2022 discovery consultation also recommended broader system reform. In particular, we recommended an enhanced 'Option 2', which includes enhancing the mandate and resourcing of the Financial Reporting Council to embrace oversight of and direct involvement with integrated reporting in Australia; and considering the formation of a separate Australian Sustainability Standards Board which would be the Australian equivalent of the International Sustainability Standards Board. We will build on these ideas on a forthcoming consultation on the proposed reforms to the FRC, Australian Accounting Standards Board and Australian Auditing and Assurance Standards Board announced by the Treasurer in December 2023.

<u>Proposed Additional Reports: The 'Sustainability Report' and 'Climate Statement'</u>

We need less reports and reporting, not more. We need to simplify, consolidate and integrate current reports and reporting, not add to their volume and complexity, with the aim of providing a common understanding of the business, its performance and prospects for investors and other stakeholders.

However, with an international trend towards more integration in corporate reporting, we believe that is most unfortunate that the proposed legislation will create two new reports to be included in annual reports – the Sustainability Report and Climate Statement.

The annual report has proven to be a useful repository for:

- the various statutory reports required by the Corporations Law – the Directors Report, including the Remuneration Report, Review of Operations under section 299A and other information required by section 299A, and the Audited Financial Statements;
- the Corporate Governance Statement required under ASX Listing Rules. The ASX Corporate Governance Council took the opportunity to amend the relevant listing rule to allow listed entities to locate the Corporate Governance Statement in an online location which is cross-referenced in the annual report; and
- an Operating and Financial Review (OFR) under ASIC guidance (RG247). The OFR itself has proven to be a useful repository for required information about a company's strategy and prospects under section 299A of the Corporations Act.

There is nothing to prevent an entity including a summary of key governance points in its OFR (or equivalent for non-listed entities) or elsewhere in the annual report. It should be noted that reports named an 'annual report' and an 'operating and financial review' are not required to be produced under the Corporations Act which provides flexibility for restructuring annual reports for the better.

In addition, the OFR has fallen behind in not requiring sustainability and governance disclosures, and disclosures of how the business model operates. These topics will need to be addressed by Australian companies in applying ASRS 1 and ASRS 2 and in making the required disclosures in the Sustainability Report and the Climate Statement within it.

Annual reports under the proposed legislation

Under the package, Australian annual reports in the future will typically comprise the following:

Report / Other Content	**Derived From**
Chair and CEO Report(s)	Voluntary
Directors Report, including Review of Operations and other section 299A information	Corporations Act
Audited Remuneration Report	Corporations Act
Operating and Financial Review (OFR)	ASX Listing Rules
Corporate Governance Statement	ASX Listing Rules
Audited Sustainability Report, including Climate Statement	Corporations Act
Audited Financial Statements	Corporations Act
Other Corporate Information	Various

Under the approach in the proposed legislation, it is likely that there will be duplication and potentially inconsistency between the reports in the annual report in terms of describing *the business*[1]:

- Governance information – potential duplication and inconsistency in the Directors Report, Operating and Financial Review, Sustainability Report (location of ASRS 1 / ASRS 2 disclosures), Remuneration Report and Corporate Governance Statement.
- Strategy information – potential duplication and inconsistency in the Directors Report, Operating and Financial Review, Sustainability Report (location of ASRS 1 / ASRS 2 disclosures) and Remuneration Report.
- Risk management information – potential duplication and inconsistency in the Directors Report, Operating and Financial Review, Audited Financial Statements (associated with financial instruments) and Sustainability Report (location of ASRS 1 / ASRS 2 disclosures).

[1] We use the term 'the business' to describe the components of the business according to the three fundamental concepts of the Integrated Reporting Framework: value creation or in other words the *what* of the business – its organizational overview and external environment, risks and opportunities, strategy; the capitals or in other words the *with* of the business – its resources and relationships; the value creation process or in other words the *how* of the business – its business model, including the governance, strategy and risk management business processes.

In addition, important business model information is missing across all current reports included in the annual report except where an entity has applied relevant principles set out in the Integrated Reporting Framework. While business model disclosures are recommended by ASIC under RG247, these tend to be 'static' in nature rather than providing insight into how the business model works in practice as the 'engine room' of value creation, including the governance, strategy, risk management, materiality determination, stakeholder management and reporting processes, as well as metrics measuring the performance of those business processes. An integrated report provides a window into the quality of the entity's integrated thinking[2] by focusing on the design and operation of these business processes.

One Integrated Report

In our view the optimal approach would be to require an Integrated Report rather than a Sustainability Report, or at least renaming the OFR as a 'Sustainability[3], Operating and Financial Report' (SOFR) and encouraging that it be prepared in accordance with the Integrated Reporting Framework[4]. Such a report will explain to investors in a comprehensive yet concise, clear and integrated, manner how an entity creates value over the short, medium and long term. It will also provide an entry point to more detailed information (for example, online data repositories with detailed climate-related metrics and associated disclosures) that investors and indeed other stakeholders may like to access to assist with aspects of their decision-making.

Among other things, this would require the report to include the directors' declaration contained in the draft legislation, and a basis of preparation and presentation along the lines set out in Section 4H of the Integrated Reporting Framework:

- a summary of the entity's materiality determination process;
- a description of the reporting boundary and how it has been determined;

[2] Integrated thinking is "the active consideration by an organization of the relationship between its various operating and functional units and the capitals that the organization uses or affects. Integrated thinking leads to integrated decision-making and actions that consider the creation, preservation or erosion of value over the short, medium and long term." International Integrated Reporting Framework, January 2021, IFRS - Integrated Reporting Framework.

[3] The IFRS Foundation and ISSB use a broad sustainability concept based upon the concept of enterprise value (net present value of estimated future cash flows / market value of equity and debt) and the six fundamental concepts of the Integrated Reporting Framework, particularly the (six) capitals – which is significantly broader than the narrower concept of ESG even though that concept includes governance in relation to the 'E' and the 'S'.

The UK uses a report named the Strategic Report, which also does not include governance as it is covered by another report (a corporate governance report). We raise the name 'strategic report' as it is a precedent and because it captures the concept of strategy. However it does not embrace governance. Accordingly, we prefer the term 'integrated report' or at least 'sustainability, operating and financial report' as this recognises the broad concept of sustainability.

[4] The Integrated Reporting Framework is a continuing key resource of the IFRS Foundation. The IFRS Foundation has encouraged its continued adoption and is expected to re-iterate this recommendation.

- a summary of the significant frameworks and methods used to quantify or evaluate material matters, for instance:
    - applicable accounting and sustainability disclosure standards used;
    - entity-defined measures for business matters such as customer satisfaction;
- a description of the reporting process, including risks and internal controls therein.

Business model disclosures of the type envisaged above will be made in applying the Integrated Reporting Framework.

We do not believe that Sustainability Reports should be required. We also believe that entities should be able to locate Climate Statements or the information contained therein in an online repository, similar to what is possible with corporate governance statements, with disclosures which are material to investors being included in the integrated report (or SOFR). The world needs leadership in moving to rationalise reporting not the continuation of add ons.

Similarly, disclosures made in OFRs which are not material to investors can be made in an online location or within the Directors Report, again with disclosures which are material to investors being included in the integrated report. There would be no need for a separate OFR.

Cross-referencing between reports in the integrated report and remainder of the annual report, and between the integrated report and online sources, should be maximised to enhance the conciseness of the annual report and indeed the entire corporate reporting portfolio (that is, including information located online). For example, metrics are often recorded in a data book, with commentary included the annual report on material and / or unexpected changes; and the financial effect of climate matters may also be reflected in audited financial statements.

Assurance

By creating a separate sustainability report with a separate assurance requirement will add a further audit and assurance report to annual reports, adding to the financial statements and remuneration report audit reports. This will be a further fragmentation of corporate reporting rather than a move towards greater integration. This legislation needs to drive towards greater integration in assurance of financial and sustainability information as well as reporting.

We also note the proposal to retain limited assurance until 2030. The EU at least will be transitioning to reasonable assurance more quickly than this, which creates another potential obstacle for Australian entities seeking international comparability and funding.

We note the proposal to use the term ‘audit’ and not ‘assurance’, and also refer to ‘auditor’ rather than ‘assurance practitioner’. This will be another point of potential confusion for international investors as a difference between IAASB and AUASB sustainability reporting assurance standards, which appears to be unnecessary. We recommend that the terms 'assurance' and 'assurance practitioner' be used.

Benefits of our recommended approach

In this way, the volume and complexity of annual reports can be reduced in a manner which is useful for investors and other stakeholders, is internationally aligned, and the costs of reporting for companies may be reduced. The integrated report would contain the description of the business, providing business context for metrics required by accounting and sustainability disclosure standards and self-determined business-critical metrics not currently required by standards. The integrated report would become the primary corporate report for investors and be of interest to all other stakeholders, providing a common and concise starting point for investors and other stakeholders in navigating to the detailed information they need.

Such a report would form the basis of suitable criteria for assurance under the International Auditing and Assurance Standards Board's proposed general requirements sustainability reporting assurance standard, ISSA 5000. Independent external assurance of the integrated report will enhance the credibility of the report and so the confidence of investors in using the report in their decision-making. It will also assisting organisations of managing their cost of obtaining assurance.

A template for the IFRS Foundation?

We believe that our recommended approach may provide a template for the IFRS Foundation, ISSB and other jurisdictions as they contemplate a project to standardise the location of sustainability-related financial disclosures at some point in the future. A consistent location for these disclosures in the context of a comprehensive description of the business would be in the interest of investors and other stakeholders.

If our recommendation is not accepted

If we are to have a separate audited Sustainability Report with a Climate Statement as its only component, it should be made clear that the report can be prepared in accordance with the Integrated Reporting Framework, so including descriptive material about the business, particularly the business model, and other sustainability information in addition to the Climate Statement (eg on social matters). There is no apparent prohibition on including other information in addition to the Climate Statement in the proposed Sustainability Report.

<u>A key strategic question: Climate-first or climate-only?</u>

This section of our proposal leaves aside the matter of whether or not a Sustainability Report is mandated. It focuses on the source of the climate-related financial disclosures to be contained in a Sustainability Report or some other location – Australian equivalents to IFRS Sustainability Disclosure Standards. We welcome the expressed desire to be aligned with those international baseline standards.

However, we note that the only components of the Sustainability Report to be specified in the draft legislation and accompanying material are climate-related:

- Climate Statement
- Notes to the Climate Statement
- Index table that enables users to easily navigate the climate disclosures.
- Information specified under any legislative instrument under s292A(1)(c) and s296B and C of the Corporations Act
- Directors Declaration
- Auditors Report (limited assurance until 2030)

Sustainability report is in substance a climate reporting proposal

In effect, the proposed Sustainability Report is a climate-only Sustainability Report. The draft legislation and accompanying material is next to silent on whether the underlying strategy is to follow the ISSB's strategy of building a suite of sustainability disclosure standards, covering social matters such as biodiversity, human rights and human capital, potentially in a broader business context and developed with reference to a conceptual framework for corporate reporting. Integrated thinking about these matters is what makes a business sustainable and allows an entity to focus its corporate reporting to investors and other stakeholders on its sustainability and resilience as a business.

In this regard, we note the following:

- The reference only to 'other matters concerning <u>environmental</u> sustainability' (our emphasis), rather than anticipating social and other sustainability matters, in this package.
- The AASB is drafting the Australian equivalent of S1 (ASRS 1) on a climate-only basis[5]. If this approach is retained, ASRS 1 will need to be amended for each new Australian Sustainability Reporting Standard that is introduced, rather than the approach used in S1 of providing a conceptual basis (based on the Integrated Reporting Framework and TCFD Recommendations) and a catch-all standard for sustainability-related financial disclosures beyond climate before topic-specific standards are introduced.

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[5] It should be noted that the Treasury Laws Amendment (2023 Measures No 1) Bill 2023, which was passed by both houses of Parliament and received Royal Assent in late-2023, did not restrict the definition of 'international sustainability standards' and therefore the AASB's power to make Australian equivalents to these standards on climate-related matters. Accordingly, it appears that the AASB has power to set Australian Sustainability Reporting Standards for all IFRS Sustainability Disclosure Standards, including S1 and future sustainability-related financial disclosure standards. The same is true of the Financial Reporting Council's oversight of Australian Sustainability Reporting Standards.

- Industry-specific disclosures are fundamental to IFRS Sustainability Disclosure Standards. The ISSB's strategy has been to internationalise SASB Standards to enable this. The AASB is proposing not to require the adoption of that aspect of S2 which reflects internationalised SASB Standards. This is another aspect of the proposed ASRS 2 not being internationally aligned. The proposed climate reporting legislation package accommodates this misalignment by proposing not to mandate the disclosure of industry-based metrics until 2030. We believe that this timeline needs to be significantly shortened on the basis of investor demand for industry-specific metrics.

Proposal does not achieve international alignment

As such, the proposals do not achieve international alignment in form or in substance. This is not good for attracting international investment in Australia, nor for meeting the main objects set out in section 224 of the ASIC Act, particularly when one of the drivers of such finance being available is attention to broader sustainability matters. These proposals will take Australia further behind the UK, EU and some other jurisdictions.

There needs to be an explanation in material accompanying the legislation of why the only component of the Sustainability Report is a Climate Statement. Is this because further sustainability topic disclosure standards are expected in the future which can be included in the Sustainability Report but outside the Climate Statement? In this regard it would be good for this package to cross-reference to and build on the November 2023 sustainable financing strategy consultation paper, which on page 10 stated:

> "The Government will continue to closely monitor international developments on sustainability disclosure frameworks. Expanded sustainability disclosure requirements in Australia will be considered as international standards emerge, consistent with the commitments Australia has made to support global efforts to strengthen nature and biodiversity related reporting."

Need to confirm a climate-first strategy

It is imperative that a 'climate-first' not 'climate-only' strategy with policy and legislative backing be communicated urgently through this climate reporting package if the AASB is to act and achieve true international alignment. It is not too late to broaden ASRS 1 to be fully aligned with S1 and embrace broader sustainability matters, even its release is delayed slightly beyond the release of ASRS 2 but retaining the same effective date.

To not take this approach will be to place Australian entities in the same position as they were in for the 2005-09 period when the International Accounting Standards Committee (IASC) had transitioned to the IFRS Foundation and International Accounting Standards Board (IASB) and IASC standards were replaced by IFRS Accounting Standards. IASC standards retained alternative accounting treatments and the IASB removed these choices.

The Australian Accounting Standards Board (AASB) retained those choices between 2005 and 2009. Some Australian companies were happy about this as they could keep doing what they were doing. Others were frustrated that they had to make complex compliance disclosures as they could not say that they were meeting IFRS Accounting Standards simply by complying with Australian Accounting Standards. They had to incur additional cost to also claim compliance with IFRS Accounting Standards and risked confusing potential international investors, affecting their international competitiveness and cost of capital. This situation was rectified in 2009.

Australia needs to avoid making the same mistake now. It needs to be made as easy as possible for Australian entities to claim adoption of S1 and S2 *by* complying with ASRS. Barriers to raising sustainability funding internationally need to be minimised.