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Submitted via email: climatereportingconsultation@treasury.gov.au

EY Submission on climate-related financial disclosure: exposure draft legislation

Ernst & Young ("EY") welcomes the opportunity to comment on Treasury's exposure draft legislation on climate-related financial disclosure, which was published on 12 January 2024.

Given the purpose of the exposure draft, we have focused our comments on areas where either:

- it is unclear whether the Government's policy decisions as articulated in the policy position statement are consistent with the exposure draft legislation and explanatory materials; or
- the intended effect of the exposure draft legislation is unclear.

Accordingly, the purpose of our letter is not to offer comments on whether we agree with the policy positions detailed in the exposure draft.

The main areas where we consider further clarification should be provided in the amendments to the *Corporations Act 2001* and related explanatory materials relate to:

- Asset owners
- Assurance pathway
- Modified liability for forward looking information
- Entities in a consolidated group
- Making sustainability reports publicly available on the entity's website
- Listing climate statement disclosures in the Corporations Act
- No material climate-related risks or opportunities
- Revenue thresholds

Our specific comments are included as an attachment to this letter.

Should you wish to discuss our comments further, please contact me at glenn.carmody@au.ey.com or on 03 9288 8467.

Yours sincerely

Glenn Carmody
Ernst & Young

Attachment: Exposure draft legislation clarifications

Building a better working world

ATTACHMENT

Exposure draft legislation clarifications

Asset owners

The exposure draft introduces ‘asset owners’ as a new reporting entity criterion. We have observed some uncertainty regarding the intended application of this criterion. This is because the ‘asset owners’ criterion appears to be focused on financial services entities, based on the commentary in the policy position statement, which states that:

> *“Asset owners (such as registrable superannuation entities and registered schemes) will be considered large if funds under management are more than $5 billion. Reporting by asset owners will support consistent reporting of climate-related risks and opportunities across the financial sector, noting the significance of these entities in Australia’s financial system.”*

Some have therefore understood this criterion to apply only to financial services entities. However, the exposure draft legislation does not define an ‘asset owner’—or even use that terminology—and does not restrict the application of the criterion to any specific sectors. Instead, draft sections 292A(7) and 296B(5) simply (and indirectly) refer to an ‘asset owner’ based on whether the value of the entity’s assets equals or exceeds $5 billion. If Treasury’s intention is that this criterion should apply to all entities regardless of sector, we recommend clarifying that this outcome is consistent with the policy intent even though Treasury’s focus in referring to ‘asset owners’ appears to be financial services entities. We expect that most asset owners that fail to meet the Group 1 size threshold typically will be financial services entities, however it is conceivable (but unlikely) that entities from other sectors could meet the asset owner criterion without meeting either the Group 1 or Group 2 size thresholds. For example, a ‘project entity’ that is established to construct, own and operate very large energy-related assets that are currently in the construction or development phase.

Some have understood the ‘asset owners’ criterion and the general size threshold to be mutually exclusive. This is based on the views of some that the ‘asset owners’ criterion was introduced to provide relief to financial services entities based on concerns raised by the sector in Treasury’s previous consultation steps. Furthermore, the reporting entities table in the policy position statement identifies that it is “N/A” (i.e., not applicable) for asset owners to be Group 1 entities. However, draft section 1705 of the exposure draft legislation, which sets out the timing of reporting for Group 1 entities, makes no mention of the ‘asset owner’ criterion, which indicates that the exposure draft legislation is not contemplating that the ‘asset owner’ criterion and general size thresholds are mutually exclusive. In other words, based on the draft legislation, asset owners that meet the Group 1 size test could still be in ‘Group 1’.

The policy position statement interchangeably refers to the ‘asset owners’ criterion being based on “funds under management” and “assets under management” whereas draft sections 292A(7) and 296B(5) refer only to “assets”. If the policy intention is for the ‘asset owners’ criterion to be assessed according to the value of ‘assets under management’, we recommend that the draft legislation clearly defines the scope of ‘assets under management’ including, for example, whether it includes private equity arrangements.

Furthermore, there are differences in the determination of assets under the ‘asset owners’ criterion and in the general size thresholds, as detailed in the table below:

Reporting entity criteria	Assets included in the criteria
Asset owners	"the value of assets at the end of the financial year of the entity and the entities it controls (if any)"
General size threshold	"the value of the **consolidated gross** assets at the end of the financial year of the entity and the entities it controls (if any)" [emphasis added]

Greater clarity is needed on the assets that are intended to be included in the 'asset owners' criterion. For instance, is the focus on the size of assets on the balance sheet (i.e., controlled by the entity) or managed by the entity (e.g., an Investor Directed Portfolio). If there is intended to be a difference between the assets test for asset owners compared to the general size test, this should be clearly explained to avoid confusion.

For these reasons, we recommend that Treasury clarifies:

- whether the 'asset owners' criterion is intended to apply only to entities operating within the financial services sector
- whether the 'asset owners' criterion is intended to be mutually exclusive of the other reporting entity criteria in the exposure draft
- whether the criterion is intended to be assessed based on the amount of assets under management, the entity's assets or the entity's total consolidated assets.

Assurance pathway

The exposure draft explains that:

- the assurance requirements that apply at commencement (i.e., for financial years commencing on or after 1 July 2024) and at end state (i.e., for financial years commencing on or after 1 July 2030) will be prescribed by the draft amendments to the Corporations Act (see sections 301A and 301B); and
- the pathway to reach reasonable assurance of all climate disclosures by the end state will be determined by the AUASB. The explanatory materials at paragraph 1.72 states:

> *"The AUASB will also set out a pathway for phasing in requirements over time, which would commence with assurance of Scope 1 and 2 emissions disclosures from 1 July 2024 onwards and end with assurance of all climate disclosures made from 1 July 2030 onwards."*

However, the drafting of section 301B of the exposure draft legislation does not appear to contemplate or accommodate the ability of the AUASB to make an auditing standard to phase in assurance requirements for climate disclosures. This is because:

- section 336(1) of the Corporations Act states that *"The AUASB may, by legislative instrument, make auditing standards for the purposes of this Act.* ***The standards must not be inconsistent with this Act*** *or the regulations."* [emphasis added]
- in the context of requiring sustainability reports to be reviewed (i.e, subject to limited assurance) before 2030, draft section 301B(2) states that *"However, the review is* ***only*** *required to cover contents of the sustainability report that are climate statements relating to scope 1 emissions or scope 2 emissions of greenhouse gases"*. [emphasis added]

Given the limitations placed on the AUASB by section 336(1), it is unclear how the AUASB could make an auditing standard that prescribes a pathway for phased-in assurance requirements without creating an inconsistency with draft section 301B(2), which specifically states that before 2030 a review is only required over an entity's Scope 1 and 2 greenhouse gas emissions. For this reason, we recommend that the interactions between the assurance requirements imposed by the Corporations Act and those to be imposed by the AUASB are clarified.

The lack of clarity in the interaction with the forthcoming AUASB pathway makes it difficult to fully comment on the implications of the assurance requirements as set out in the draft legislation and introduces some uncertainty on the exact nature of assurance requirements for companies covered by the reporting obligations. For this reason, although we understand the reasons for delegating to the AUASB decisions on the pathway for phasing-in assurance requirements, the process and timeline for setting out that pathway needs to be clearly communicated so that entities and assurance providers can plan for implementation of those requirements. Given the Government's commitment to improve the quality of climate-related financial disclosures, we consider that it is important that those disclosures are accurate, and as such limited assurance of those disclosures should be required from commencement.

Modified liability for forward looking information

The policy position statement states that *"Entities will be provided relief for a fixed three-year period for disclosures relating to Scope 3 emissions and certain climate-related forward-looking statements".* Draft section 1705B(1)(b)(ii) refers only to scenario analysis, which suggests it is the only climate-related forward-looking statement that is eligible for the limited immunity provided by draft section 1705B. However, an entity applying draft ASRS 2 *Climate-related Financial Disclosures* is required to disclose its *interpretation of* the results of its scenario analysis but it is not required to disclose the results of its scenario analysis. This is clarified in draft paragraph Aus 22.2, which states that:

> *"For the purposes of paragraphs 22–Aus22.1, an entity need not disclose the detailed modelling adopted in carrying out its climate-related scenario analysis. An entity is required to disclose the inputs and assumptions used in its climate-related scenario analysis and the related outcomes set out in paragraph 22."*

For this reason, we recommend that Treasury clarifies:

- whether the temporary relief in section 1705B(1)(b)(ii) should apply to the broader climate resilience assessment disclosures required by draft ASRS 2, noting that the resilience assessment will be informed by the scenario analysis performed by the entity;
- whether the intention was to include other climate-related forward-looking statements within the scope of the temporary relief in section 1705B(1)(b)(ii), such as disclosures about:
    - the anticipated effects of climate-related risks and opportunities on the entity's financial position, financial performance and cash flows over the short, medium and long term, taking into consideration how those climate-related risks and opportunities have been factored into the entity's financial planning (see draft ASRS 1 *General Requirements for Disclosure of Climate-related Financial Information* paragraphs 35(c)-(d))
    - the amount and percentage of assets or business activities vulnerable to climate-related transition risks (see draft ASRS 2.29(b))
    - the amount and percentage of assets or business activities vulnerable to climate-related physical risks (see draft ASRS 2.29(c))

- the amount and percentage of assets or business activities aligned with climate-related opportunities (see draft ASRS 2.29(d)).

Entities in a consolidated group

Draft section 292A(2) allows an entity to not prepare and lodge a sustainability report if the entity is in a consolidated group and the head entity of the consolidated group prepares a consolidated sustainability report (as well as consolidated financial statements). To aid comprehension, we recommend that Treasury clarifies whether this relief applies only:

- when the head entity is required to prepare and lodge financial reports in accordance with Chapter 2M of the Corporations Act (in which case, for example, it would not apply if the head entity was a company limited by guarantee that is registered with the Australian Charities and Not-for-profits Commission)
- to subsidiaries of the head entity (i.e., entities controlled by the head entity) and therefore the relief does not apply to, for example, equity accounted investments of the head entity (i.e., entities that are associates or joint ventures).

Making sustainability reports publicly available on the entity's website

Draft section 316B has been added to require 'other entities' to make their sustainability reports publicly available on their website. The explanatory materials at paragraph 1.56 explains that this requirement is intended to apply to entities that are not required to disclose this report to its members. In our view, given the importance of connectivity between the financial report and the sustainability report, the principle should be that the sustainability report should be available to users of those reports on the same basis as the financial report. To aid comprehension, we recommend that Treasury clarifies which entities are intended to be within the scope of this requirement. We note that the second consultation paper provided some clarity on this proposal previously, which stated:

> *"…Large proprietary companies, public companies, disclosing entities and registered investment schemes are currently obliged to make their financial report available to members by publishing it on their website or sending it directly to members…*
>
> *Where an entity is subject to the climate disclosure requirements, and does not fall into the categories listed above, an additional requirement to make climate disclosures publicly available would be imposed."*

Listing climate statement disclosures in the Corporations Act

Draft section 296D lists some disclosures that must be included in a climate statement. Given draft section 296C(1) requires climate statements and notes to comply with the sustainability standards which the AASB is currently developing, the purpose of including draft section 296D in the Corporations Act is unclear. Furthermore, by 'hard coding' those disclosures in the Act, there is a risk that this draft section could limit the ability of:

- the AASB to set or amend sustainability standards that seek to address any practical implementation issues or other unforeseen circumstances that arise in the future; and
- entities to make judgements about whether disclosing that information would be material in accordance with the Australian Sustainability Reporting Standards.

No material climate-related risks or opportunities

The inclusion of a materiality exemption for Group 3 entities is explained in the policy position statement and also in paragraphs 1.46-1.47 of the explanatory materials. In particular, the exposure draft legislation specifies that the climate statement of a Group 3 entity that does not have material climate risks or opportunities for the financial year only needs to include a statement to that effect. However, given the drafting of the exemption in draft section 296B(1) and the list of disclosures in draft section 296D, it appears that a Group 1 or Group 2 entity will need to include climate-related financial disclosures in its climate statement (such as on governance arrangements and greenhouse gas emissions) even if it also assesses that it has no material climate-related risks or opportunities.

We recommend that Treasury clarifies its intention in relation to the disclosures a Group 1 or Group 2 entity would be required to make when it has assessed it has no material climate risks or opportunities. Treasury may also need to work with the AASB to ensure that there is no inconsistency between the Act and the application of the Australian Sustainability Reporting Standards in relation to these materiality judgements.

Revenue thresholds

The reporting entity size thresholds in the exposure draft legislation are based on the same tests as the existing Corporations Act definition of 'large proprietary company', which requires an entity to satisfy at least 2 of 3 tests based on revenue, assets and employee metrics. Although these existing size thresholds are well established, we have observed that, despite guidance such as in draft sections 292A(5) and 292A(7), there are some application questions regarding the revenue test by financial services entities. These questions about the application of the thresholds are more pronounced in relation to the exposure draft legislation due to the phased implementation of mandatory climate-related financial disclosures. For this reason, we recommend that Treasury consider providing some additional application guidance to assist financial services entities in assessing whether they meet the revenue thresholds.

Additional consequential amendments

The following consequential amendments are listed for Treasury to consider:

#	Act	Section	Comment
1	Corporations Act	Section 111L(1), item 10 in the table:	Add a reference to 'sustainability report' to item 10 of the table (which is about provisions of the Act that do not apply to bodies corporate registered under the ACNC Act) given amendment 6 in the exposure draft legislation
2	Corporations Act	Section 45A(3)	We note that the 'large proprietary company' thresholds set out in section 45A(3) of Corporations Act were updated in 2019 by section 1.0.02B of the *Corporations Regulations 2001*. Because the threshold was updated by regulations, the updated thresholds are not evident when reading section 45A(3) of the Act (including compiled versions of that Act on www.legislation.gov.au). We would encourage

			Treasury to use this opportunity to tidy up section 45A(3) and directly amend the thresholds and repeal the related regulation. This will also aid comprehension of the Act