7 February 2024

Climate Disclosure Unit
Market Conduct Division
The Treasury
Langton Crescent
PARKES ACT 2600

Re: <u>Climate-related financial disclosure: Exposure draft legislation</u>

Dear Sir/Madam,

We welcome the opportunity to make a submission and are pleased to have the opportunity to comment on the Government's climate-related financial disclosure exposure draft (ED) legislation and the associated Documentation (hereinafter – Documentation) released on 12 January 2024.

We commend the work the Treasury has devoted to establishing and promulgating legislative requirements on climate-related financial disclosures in the Australian jurisdiction. We draw on our research expertise in the fields of corporate non-financial reporting and auditing and assurance to comment on the Documentation generally and on some specific aspects.

General Comment

Further attention and clarification to the inconsistent terminologies are required to clarify doubts that may arise when the reporting entity executes its reporting practice on climate-related financial disclosures.

Usage of 'sustainability' and 'climate-related'

In the ED legislation, starting from Subsection 285(1), "The sustainability report includes the following: climate statements; disclosures and notes; statements required by legislative instrument; directors' declaration" (p. 4). However, starting from Subsection 286A Obligation to keep sustainability records, "…any notes to the climate statements" (p. 5); and starting from Subsection 296A Contents of annual sustainability report, "..any notes to the climate statements" (p.8). From the listed few examples, it is clear that climate statements are added/omitted occasionally in the ED legislation.

Terminologies – sustainability, corporate social responsibility, climate-related and environmental disclosures – have been used interchangeably in academic papers, and that has resulted in issues, such as inconclusive findings and the difficulty in comparing results across different studies (e.g., a study uses sustainability but focuses only on environmental disclosures). Therefore, we believe such inconsistencies in the proposed changes in the legislation may result in misleading and flawed disclosures when reporting entities execute their disclosure practices.

Usage of 'audit' and 'assurance'

We acknowledge and recognise the importance and necessity of verifying climate-related disclosures. It is great to see the consistent use of 'assurance' in the released Policy Statement, but 'assurance' and 'audit' are mixed in the draft legislation. The terminology 'assurance' has been widely used and is still recognised as the most appropriate word to refer to verifying non-financial disclosures in practice and by academics. We think that referring to the outcomes of both engagements as the auditor's reports (e.g., starting from Subsection 285(1) (after table item 1A) (ED legislation), "have the sustainability report audit and obtain auditor's report…" (p. 19)) will cause confusion, especially when annual financial audits provide reasonable assurance and most sustainability report engagements provide limited assurance as a review. Given a choice of a review or reasonable assurance engagement, many clients will opt for the cheaper service. Financial review engagements are common for interim financial reporting, potentially creating even more confusion about the differential levels of assurance provided for financial and sustainability engagements and widening the expectation gap between what the public generally expects and what practitioners, audit or assurance, can provide.

Specific Comments

Phasing

We support a phased-out approach for climate disclosure requirements rolling out and recommend that a one-year transition period be granted to Group 1 entities. Therefore, a commencement date should be confirmed in conjunction with the release date of the first official version of the Australian Sustainability Reporting Standards (hereinafter – ASRS) by the Australian Accounting Standards Board (AASB)[1].

Drawing on findings from our recent project facilitated by the Australian Accounting Standards Board (AASB) and presented at the 2023 AASB Research Forum (report will soon be available through the AASB's SSRN facility), we find that although companies have upped their game on reporting climate-related matters, more effort is needed to achieve full compliance with the relevant standards[2]. In that study, we analysed 1,697 of Australia's largest listed companies responsible for 3,513 documents published in financial year 2022, including annual reports, sustainability reports or equivalent, and corporate governance statements. We found that the proportion of the sample disclosing four selected future-oriented concepts – 'connected information', 'climate-related targets', 'scenario analysis' and 'three-time horizons (short-, medium-, and long-term)' was low in each GICS industry sector. Additionally, a high likelihood of greenwashing appears in disclosing 'scenario-analysis' and 'three-time horizon' concepts.

Requiring the Group 1 entities to execute their reporting practice complying with the ASRS with a one-year transition period after its introduction will allow appropriate time for fully understanding the final version of the ASRS. Doing so aligns with other jurisdictions' practices in this regard. For example, New Zealand's External Reporting Board promulgated its first Aotearoa New Zealand Climate Standards on 15 December 2022, which applied to accounting

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[1] The AASB seeks views on its released Exposure Draft ED SR1 *Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information* (hereinafter – ED SR1) until 1 March 2024.

[2] We acknowledge that we examine the readiness of Australian listed companies to report against *ISSB's IFRS S2 Climate-related Disclosure Standards* instead of the ED SR1. The ED SR1 was introduced close to the completion of our project. We believe our results are in good to also reflect the Australian listed companies' climate-related reporting practice against the ED S1 given it was designed on the basis of IFRS S2.

reporting periods starting on or after 1 January 2023. An entity with a 31 December and 30 June financial reporting balance date is required to prepare the first climate statement as part of its 31 December 2023 reporting and its 30 June 2024 reporting, respectively[3].

Reporting Content

We appreciate the draft Bill's effort in pointing out that the reporting entities should disclose against industry-based metrics. We support such proposed requirements and believe they are critical for reporting entities, especially when reporting material climate-related risks and opportunities as stated in the Documentation and Exposure Draft ED SR1 *Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information*. We strongly suggest that the Government and/or its delegated group plan out the route to introduce industry-based metrics in reference to disclosure topics described in the *Industry-based Guidance on Implementing IFRS S2*. The former Sustainability Accounting Standards Board (SASB) Materiality Map (now the intellectual property of the ISSB) acknowledges the industry-specific nature of materiality, given that different industry classification systems are used[4]; however, we believe that applying SASB industry-based metrics will be challenging for Australian reporting entities, despite the ISSB's current efforts to globalize the SASB industry standards. Mapping GICS and SASB industry classifications is not straight forward.

Reporting Framework

We welcome the draft Bill's inclusion of the suggestion for entities to include an index table to cross-reference climate-related financial disclosures across reports. Extensively long sustainability reports containing climate-related disclosures have been questioned and represent one challenge investors have faced for a long time. This issue still appears in reporting practices in Australia. When analysing the 3,513 documents mentioned above, we find companies make disclosures repeatedly using the same sentence or disclosing very similar information within the same report or across their annual report, corporate governance statement, and sustainability report. We believe simply issuing repetitive climate-related financial disclosures cannot win over investors and create enough impact, but learning how to communicate such disclosures concisely can.

We recommend that sustainability reports or equivalent be used as the home for general climate disclosures if a reporting entity issues such reports in a stand-alone format or creates a sub-section within the annual reports and that any climate disclosures related to line items of financial reports be located within the notes to the financial statements. This can improve conciseness and minimise duplication to better connect climate-related matters within the financial statements to meet the 'Connectivity' disclosure requirements set out in IFRS S2 and the SR, thereby reducing the sheer volume of disclosures, which often constitute a means of greenwashing.

Assurance Requirements

We are in support of assurance of climate disclosures to improve the transparency and credibility of disclosures and combat greenwashing but have reserves about the Government's recommendation for '…entities to obtain an assurance report from their financial auditors who

[3] External Reporting Board. (2023), "When did the mandatory reporting commence?", available at: https://www.xrb.govt.nz/standards/climate-related-disclosures/resources/ (accessed 7 February 2024).
[4] Sustainability Accounting Standard Board. (2024), "SICS classification request", available at: https://sasb.org/sics-classification-request/ (accessed 7 February 2024).

will use technical climate and sustainability experts where required.'(The Treasury, 2024, p. 4)[5]. Using the incumbent audit firm to assure non-financial information, on the one hand, can create knowledge spillover, but on the other hand, can result in audit and assurance independence being questioned and thus harming the quality of both audit and assurance. Mandating assurance over climate-related matters is essential but should not be done in a way that compromises the current practice of financial auditing or the quality of audit and assurance. In a recent consultation by the International Ethics Standards Board of Accountants (IESBA)[6], non-professional accountants (non-PAs) are considered alongside professional accountants (PAs) when the IESBA proposes changes made to address ethics and independence requirements for sustainability practitioners. We suggest the use of different practitioners for audit and assurance services and extend the scope of independent assurance practitioners to not only PAs but also non-PAs and PAs.

Thank you again for the opportunity to provide our views. We look forward to a final release of the relevant legislation. Should you wish to discuss our comments further, please contact us on zihan.liu@otago.ac.nz or cjubb@swin.edu.au.

Yours sincerely,

Dr Zihan Liu	Prof. Christine Jubb
Lecturer in Accounting	Professor of Accounting
University of Otago (New Zealand)	Swinburne University of Technology (Australia)

[5] The Treasury. (2024). Mandatory climate-related financial disclosures (The Treasury: Australia).

[6] International Ethics Standards Board for Accountants. (2024). *Explanatory memorandum for proposed International Ethics Standards for Sustainability Assurance (including International Independence Standards) (IESSA) and other revisions to the code relating to sustainability assurance and reporting* (International Ethics Standards Board for Accountants: U.S).