

Climate Disclosure Unit
Market Conduct Division
Treasury
Langton Cres
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climatereportingconsultation@treasury.gov.au

12 February 2023

Dear Sir/Madam:

RE: CLIMATE-RELATED FINANCIAL DISCLOSURE

I refer to the above matter and your call for submissions and offer the following for your consideration.

I am an academic member of staff in the Faculty of Law, Bond University. My teaching and research focus on corporate conduct, directors' duties and climate sustainability disclosure. I am currently completing my doctoral thesis at University of Tasmania. The thesis investigates whether: (1) domestically, the mandatory disclosure requirements imposed by the *Corporations Act 2001* (Cth) and *National Greenhouse and Energy Reporting Act 2007* (Cth); and/or (2) the voluntarily subscribed TCFD and GRI disclosure mechanisms are sufficient to enhance financial institutions' (specifically, ADIs) transparency of climate sustainability performance, increase accountability and enable market regulation (specifically, investors) of the sector.

The submissions in this document are my own, and do not reflect the view of Bond University.

Best Regards

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Question 1: What are the costs and benefits of Australia aligning with international practice on climate-related financial risk disclosure (including mandatory reporting for certain entities)? In particular:

1.1 What are the costs and benefits of meeting existing climate reporting expectations?

The primary regulatory instrument of the corporate sector, the *Corporations Act* ('CA'), does not specifically address climate risks. However, the proceedings commenced by two shareholders of Commonwealth Bank ('CBA') against the bank in 2017 show that, to an extent, existing provisions may be interpreted to give rise to disclosure obligations around climate matters. The shareholders alleged that in failing to acknowledge and address the risks posed by climate change to its operations, the bank's published financial statements failed to give a 'true and fair view' of its financial position and performance as required by ss 297 and 299A. The proceedings were discontinued, as CBA undertook, and proceeded, to address climate risks in its future reports. Other banks have followed suit. Additionally, the *National Greenhouse and Energy Reporting Act* ('NGER Act') mandates that corporate entities, meeting particular criteria, disclose their GHG emissions, energy production and energy consumption to the regulator annually

Therefore, to an extent, corporate entities in Australia already disclose information about climate risks and GHG emissions. However, these existing mechanisms for climate risk disclosures do not go as far as those proposed by TCFD. Although ss 297 and 299A CA give rise to disclosure of climate risks, TCFD is more prescriptive in relation to the content of disclosure (ie. what constitutes risks and opportunities, how to measure, etc), including a requirement for scenario analysis (a distinctly TCFD feature). As such, TCFD is more conducive to standardisation in reporting, and increases inter- and intra- organisational comparability. In relation to GHG emissions, NGER Act require entities to report to the regulator only (not to the public; though the regulator must publish reported data annually); and to report Scope 1 and 2 emissions only, but not Scope 3. However, for particular industries, such as banking, Scope 3 emissions account for most of their overall emissions.¹

Reporting consistent with TCFD requirements goes further than existing domestic climate risks disclosure obligations.

1.2 What are the costs and benefits of Australia not aligning with international practice and in particular global baseline standards for climate reporting?

TCFD is not without its criticisms: the framework lacks oversight and enforcement mechanisms, leaving it to the reporting organisations themselves to internally implement assurance mechanisms; disclosure requirements are worded broadly, enabling interpretative plurality and potentially leading to managerial capture; scenario analysis at the company level is relatively new (most existing scenarios were developed for global and macro-assessment of climate-related impacts, whose primary consumers are scientists and policy makers) and therefore the reported data may not be accurate; etc. If Australia does not adopt existing international climate disclosure frameworks (such as TCFD), it has an opportunity to develop its own disclosure framework, potentially addressing TCFD's shortcomings.

The Corporate Reporting Dialogue completed a review of the disclosure standards published by TCFD, GRI, CDP (Carbon Disclosure Project) and SASB (Sustainability Accounting Standards Board). Its report

¹ Taskforce on Climate-related Financial Disclosures, *Guidance on Metrics, Targets, and Transition Plans* (Report, October 2021) 55-56 citing Kepler Cheuvreux, *Carbon Compass: Investor Guide to Carbon Footprinting* (360 Report, 23 November 2015) 20.

showed broad alignment across metrics between these standards.² In December 2020, CDP, CDSB (Carbon Disclosure Standards Board), GRI, IIRC (International Integrated Reporting Council) and SASB published a prototype climate-related financial disclosure standard, consistent with existing TCFD disclosure recommendations.³ GRI and ISSB,⁴ in 2022, announced a collaboration agreement, with a view to harmonise the two disclosure standards, including disclosures, guidance, concepts and definitions.⁵ Given these concerted efforts to harmonise existing climate disclosure standards, if Australia chooses to develop a standard uniquely its own, it will increasingly diverge from international practice. In circumstances where companies operate internationally and transnationally, such a practice would impose additional costs to compliance.

Question 2: Should Australia adopt a phased approach to climate disclosure, with the first report for initially covered entities being financial year 2024-25?

- 2.1 What considerations should apply to determining the cohorts covered in subsequent phases of mandatory disclosure, and the timing of future phases?

In 2019, ASX endorsed TCFD as best practice disclosure for traded entities with material exposure to climate change risks. In 2021, APRA indicated its support for financial institutions disclosing their climate risks consistent with TCFD. Therefore, a significant number of companies may already report pursuant to TCFD. Considerations as to when reporting should commence, and the timing of future phases, necessitate an understanding of which companies already do so, and the time/expertise resources needed for a company to develop and implement the necessary infrastructure to enable report preparation and publishing.

Question 3: To which entities should mandatory climate disclosures apply initially?

- 3.1 What size thresholds would be appropriate to determine a large, listed entity and a large financial institution, respectively?

Not addressed.

- 3.2 Are there any other types of entities (that is, apart from large, listed entities and financial institutions) that should be included in the initial phase?

Climate risk disclosure focuses primarily on the ability of the reporting company to identify, assess and address the risks posed to its operations by changes in the climate. However, these risks are a consequence of composite GHG emissions. This self-reinforcing relationship is recognised by TCFD itself, as it requires disclosure of GHG emissions. Therefore, a strict focus on large, listed entities and large financial institutions (however defined) as the primary objects of disclosure, may not account for entities which are significant GHG emitters, and therefore significant contributors to climate risks.

² Carbon Disclosure Project, 'Corporate Reporting Dialogue shows high level of alignment between major global reporting frameworks on TCFD recommendations' *CDP* (Web page, 24 September 2019) < <https://www.cdp.net/en/articles/media/corporate-reporting-dialogue-shows-high-level-of-alignment-between-major-global-reporting-frameworks-on-tcfid-recommendations>>.

³ Taskforce on Climate-related Financial Disclosures, *Guidance on Metrics, Targets and Transition Plans* (Report, October 2021) 3.

⁴ ISSB is a sustainability standard setting body established in 2021/22 under the IFRS Foundation. IFRS is a not-for-profit, public interest body, established to develop a universally accepted accounting and sustainability disclosure standards. For more information, see <https://www.ifrs.org/about-us/who-we-are/#about-us>.

⁵ 'ISSB and GRI provide update on ongoing collaboration' *IFRS* (Web page, 23 June 2022) < <https://www.ifrs.org/news-and-events/news/2022/06/issb-and-gri-provide-update-on-ongoing-collaboration/>>.

Question 4: Should Australia seek to align our climate reporting requirements with the global baseline envisaged by the International Sustainability Boards?

- 4.1 Are there particular considerations that should apply in the Australian context regarding the ISSB implementation of disclosures relating to: governance, strategy, risk management and/or metrics and targets?

This is addressed at Question 1.2.

- 4.2 Are the climate disclosure standards being issued by the ISSB the most appropriate for entities in Australia, or should alternative standards be considered?

Not addressed.

Question 5: What are the key considerations that should inform the design of a new regulatory framework, in particular when setting overarching climate disclosure obligations (strategy, governance, risk management and targets)?

In designing a new regulatory framework, Gunningham and Grabosky's principles of 'regulatory pluralism' and 'regulatory design' should be considered. Corporate entities are subject to multiple regulators and regulatory instruments. Any new regulatory intervention should act synergistically with the existing regulatory space, and should enable the diffusion of regulatory oversight across multiple stakeholders. A framework's ability to regulate conduct depends on its substantive provisions (ie. clarity of disclosure obligations, etc), as well as supporting oversight and enforcement mechanisms. The framework's design must consider the parties undertaking these roles, costs, abilities, etc.

A disclosure framework does not directly/explicitly require reporting organisations to change their conduct, only to report it. The act of reporting enables self-reflection and indirectly nudges behaviour toward a desired state. The degree to which it does so depends on whether entities are able to observe and measure their conduct. In the context of metrics and targets, the framework should be clear and specific as to how GHG emissions are to be measured and calculated.

Question 6: Where should new climate reporting requirements be situated in relation to other periodic reporting requirements? For instance, should they continue to be included in an operating and financial review, or in an alternative separate report included as part of the annual report?

The current practice is for companies to produce a number of reports, with climate related matters being reported across several publications. This makes it difficult for report users to locate relevant information. The Annual Report remains the primary document outlining a company's performance, and the one consulted by investors when assessing investment opportunities. How a company addresses climate risks impacts its future performance, and cogently should form part of the Annual Report.

GHG emissions information should equally form part of the Annual Report. The publication of such data in separate reports sends the message that this aspect of a company's performance is of lesser importance to the company (as it does not form part of the primary communicative tool between the company and its stakeholders). At the same time it assumes that investors and investment decisions are independent of such considerations, which is erroneous given the rise in green investments.

Question 7: What considerations should apply to materiality judgements when undertaking climate reporting, and what should be the reference point for materiality (for instance, should it align with ISSB guidance on materiality and is enterprise value a useful consideration)?

It is difficult to see how materiality considerations, as a function of company value, could be used to determine whether disclosure of GHG emissions is appropriate/necessary. Materiality does not/cannot/should not be used to determine disclosure of GHG emissions.

Question 8: What level of assurance should be required for climate disclosures, who should provide assurance (for instance, auditor of the financial report or other expert), and should assurance providers be subject to independence and quality management standards?

The respondents in a 2017 study conducted by Safari and Areeb indicated that their respective organisations opted to develop and implement internal controls to ensure the integrity and accuracy of their GRI reporting. The choice to do so was due to: (a) auditing companies lacking necessary technical and scientific knowledge to understand and assess the quality of the reports; (b) mistrust about the genuine level of independence of auditing companies, in circumstances where the market is dominated by a few large consulting entities providing the service; (c) lack of regulation of external assurance organisations; and (d) lack of standardisation of the processes employed to assess sustainability reports' quality and integrity.⁶ That same year, a study by Boiral and Henry, looking at GRI reports by mining companies, concluded that those subject to external assurance processes, were not of better quality, more complete or more rigorous than those subject to internal assurance only.⁷

Therefore, whether reports should be subject to internal and/or external assurance processes, and by whom depends on a number of other considerations which must be addressed first.

Question 9: What considerations should apply to requirements to report emissions (Scope 1, 2 and 3) including use of any relevant Australian emissions reporting frameworks?

Qualifying companies are subject to GHG emissions disclosure obligations imposed by NGER Act. However, the NGER Act does not require disclosure of Scope 3 emissions. However, for particular companies, such as financial institutions, Scope 3 emissions form the bulk of their emissions. The proposed framework should be inclusive of Scope 3 emissions.

Question 10: Should a common baseline of metrics be defined so that there is a degree of consistency between disclosures, including industry-specific metrics?

Generally, GHG emissions are reported in metric tons of CO₂ equivalent. However, companies are also advised to report their GHG emissions ratios. The ratio is calculated as follows:

$$\text{absolute GHG emissions/organisation's specific metric}$$

The specific metric may be: units of product, production volume (such as metric tons, litres, or MWh), size (such as m² floor space), number of full-time employees, or monetary units (such as revenue or sales). The choice of metric is discretionary to each reporting organisation. However, this flexibility impedes inter organisational comparability in instances where different metrics are used.

⁶ Maryam Safari and Amreen Areeb, 'A qualitative analysis of GRI principles for defining sustainability report quality: an Australian case from the preparers' perspective' (2020) 44(4) *Accounting Forum* 344, 348, 364.

⁷ Olivier Boiral and Jean-Francois Henri, 'Is Sustainability Performance Comparable? A Study of GRI Reports of Mining Organisations' (2017) 56(2) *Business & Society* 283, 309.

Therefore, a prescribed single metric for all reporting organisations, or at a minimum for each industry, is advised.

Question 11: What considerations should apply to ensure covered entities provide transparent information about how they are managing climate related risks, including what transition plans they have in place and any use of greenhouse gas emissions offsets to meet their published targets?

Companies may not be fully transparent due to inadequate oversight/enforcement mechanisms ensuring transparency (in the case of intentional recalcitrance), and/or uncertainty as to what must be disclosed and how. In relation to the latter, this can be mitigated through careful drafting. Disclosure obligations should be clear and prescriptive in their requirements, minimising interpretative flexibility and pluralism. Additionally, companies should be required to outline their processes, methodologies and assumptions. Where and to whom such information should be provided requires further consideration. If this information forms part of the company's Annual Report, it enables stakeholders other than the State to regulate company conduct; however, the resultant report may become too voluminous or difficult to understand. If the information is for the purposes of ensuring verifiability, the regulatory burden (and cost) remains with the State, with attendant consequences.

Question 12: Should particular disclosure requirements and/or assurance of those requirements commence in different phases, and why?

No. The four pillars identified by TCFD (strategy, governance, risk management and metrics/targets) are interrelated. Therefore, they should be measured and reported at the same time. Not doing so would provide report users with incomplete information and potentially create confusion. For companies, not addressing all pillars concomitantly will impede their understanding of climate risks and how to mitigate them.

Question 13: Are there any specific capability or data challenges in the Australian context that should be considered when implementing new requirements?

- 13.1 How and by whom might any data gaps be addressed?
- 13.2 Are there any specific initiatives in comparable jurisdictions that may assist users and preparers of this information in addressing these challenges?

Not addressed.

Question 14: Regarding any supporting information necessary to meet required disclosures (for instance, climate scenarios), is there a case for a particular entity or entities to provide that information and the governance of such information?

TCFD does not operate in a vacuum. For example, TCFD Knowledge Hub provides link titled *The GHG Protocol Technical Guidance for Calculating Scope 3 Emissions*, to assist companies to calculate their Scope 3 emissions. The link is to a document prepared by Greenhouse Gas Protocol, in partnership with the Carbon Trust, with assistance from World Business Council for Sustainable Development and World Resources Institute. Therefore, particular organisations have already taken on the task of providing this type of information. To the degree that these organisations are acknowledged as appropriate and suitable to do so, with processes in place to ensure quality and accuracy of information, they should be relied on and utilised.

Question 15: How suitable are the 'reasonable grounds' requirements and disclosures of uncertainties or assumptions in the context of climate reporting? Are there other tests or measures that could

be considered to ensure liability is proportionate to inherent uncertainty within some required climate disclosures?

Not addressed.

Question 16: Are there particular considerations for how other reporting obligations (including continuous disclosure and fundraising documents) would interact with new climate reporting requirements, and how should these interactions be addressed?

The continuous disclosure obligations (s 674 CA and ASX Listing Rule 3.1) do not define what constitutes 'information' for the purposes of disclosure. However, Chapter 3 of the Listing Rules provides non-exhaustive examples of the type of information that may require disclosure.⁸ The examples provided by ASX share points of commonality: the events listed all are financially quantifiable and affect the company's performance, and therefore the value of its tradeable securities, and they arise relatively suddenly. Although climate risks would satisfy the first two requirements, it is arguable that they would satisfy the third (ie. arise suddenly). However, one particular circumstance, namely a listed entity becoming subject to 'a material lawsuit', may give rise to disclosure of climate sustainability performance. ASX Listing Rules – Guidance Note 8 document, provides an example of what would constitute a 'material lawsuit'. Entity J, a mining exploration company whose principal asset is a mining tenement, is served with legal proceedings by entity K, challenging J's title and asserting a competing claim to it.⁹ In these circumstances the lawsuit is regarded as 'material' because its outcome fundamentally affects the very viability of entity J as a business, and the value of its shares.

Though not impossible, it is unlikely that climate risks would enliven the continuous disclosure obligations.

Question 17: While the focus of this reform is on climate reporting, how much should flexibility to incorporate the growth of other sustainability reporting be considered in the practical design of these reforms?

Not addressed.

Question 18: Should digital reporting be mandated for sustainability risk reporting? What are the barriers and costs for implementing digital reporting?

Not addressed.

Question 19: Which of the potential structures presented (or any other) would best improve the effectiveness and efficiency of the financial reporting system, including to support introduction of climate related risk reporting? Why?

While not strictly addressing this question, I note that delay in implementing the proposed framework is cited as a concern depending on the potential structure chosen. However, qualifying companies must disclose their Scope 1 and 2 GHG emissions pursuant to NGER Act, and following 2017 companies acknowledge their climate risks to the extent that CA requires it. Additionally, a significant proportion of companies voluntarily subscribe to TCFD. As such, depending on the number of companies that do not come within the ambit of these existing disclosure obligations, delay may be less of a concern than anticipated.

⁸ ASX, *ASX Listing Rules* (online, 9 April 2018) <<https://www.asx.com.au/regulation/rules/asx-listing-rules.htm>> 302.

⁹ ASX Compliance, *Continuous Disclosure: Listing Rules 3.1-3.1B* (11 May 2018) ASX Listing Rules Guidance Note 8 <https://www.asx.com.au/documents/rules/gn08_continuous_disclosure.pdf> 73.