Submission to the Consultation Paper on Climate-Related Financial disclosure

A collective response from carbon accounting practitioners

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Structure of submission

Introduction

We welcome the opportunity to submit feedback to this consultation and applaud the intent to implement standardised, internationally aligned, climate-related financial disclosure requirements. We support increased company participation in reporting, greater accuracy and credibility of data reported, and increased scope of reported emissions.

In line with Chartered Accountants ANZ[1], we believe there will be a growing need for accountants and the skills to measure and assure sustainability performance. Foundational to their role will be rigorous carbon accounting data, deepened with information on:

- Provenance of data (for reasons of legal probity and technical transparency)
- Assurance of data (information on data pedigree: appropriate geography, currency, accuracy, uncertainty)
- Application of data (not just where data comes from but what it can or cannot be used for).

There has been a recent explosion in carbon accounting and information services (and investment therein) without commensurate oversight of the quality of data and information used. Some of the data used to inform measures of progress toward net zero are outdated, based on European or US data, generated through AI or machine learning and/or proxy data is used when better data is available.

We have generated this coordinated response from expert Australian carbon accounting practitioners because we believe there's a need for depth and rigour in the metrics and data support for greenhouse gas (GHG) emissions accounting, and a corresponding 'carbon literacy and numeracy' at either end of the carbon information and services market, especially on the use and meaning of scope 3 emission factors. This rigour will serve to strengthen trust in carbon reporting, which is critical if national and international carbon reduction targets are to be met.

Our submission contains common views, observations and insights on the practice of corporate carbon accounting and responds to selected specific questions of the consultation paper.

[1] see comments in *Australian Financial Review* 21 September 2022, https://www.afr.com/companies/professional-services/adopt-global-sustainability-standards-urgently-accountants-warn-20220919-p5bja5

Covered Entities and Timing

Question 2

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

Yes, a phased approach recognises the differing levels of emissions magnitude, stakeholder expectations and readiness across the economy, and provides certainty to all parties on what is needed by when. This supports participation and compliance, as well as encouraging better quality data to be used.

Question 2.1

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

The relative carbon footprint significance per sector, and the relative size of organisations within these sectors.

Question 3

To which entities should mandatory climate disclosures apply initially?

The requirements should *initially* apply to those organisations that have a significant impact and influence on Australia's ability to rapidly reduce its carbon emissions. By extending beyond publicly listed and financial organisations, the initial cohort within scope could cover a larger proportion of the economy. A starting point similar to that proposed by the EU for its *Corporate Sustainability Reporting Directive*[2] would be suitable.

Question 3.1

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

Referring to the EU *Corporate Sustainability Reporting Directive*, we recommend the thresholds of employee number, turnover, and total assets be scaled down to better reflect the Australian economy.

Question 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?

We recommend the threshold should extend into the 'medium' company space, possibly through voluntary reporting initially but moving to mandatory reporting. In our view, a focus only on 'large' companies will not provide sufficient momentum and this extension would address more of the economy.

[2] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464 (Updated December 2022)

SMEs contribute more than half our national GDP and employ over two-thirds of the workforce, often in key emissions-related industries of manufacturing, food production, and healthcare[3]. Currently, NGER thresholds[4] are 25Kt CO2-e for facilities and 50Kt CO2-e for corporate groups. This captures large organisations, or (Scope 1 and 2) emissions-intensive activity, such as: electricity generation and distribution; basic metals production and manufacture; waste collection; fertilizer manufacture and; some agricultural activities.

It would be essential to capture information on high Scope 3 emitters, which may be smaller in size but large in number and distal from primary production or even secondary industry.

Extending the threshold to medium-sized high Scope 3 emitters will also increase the proportion of small businesses that will be influenced by the requirements i.e. as suppliers of large and medium companies.

Materiality and Assurance

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)?

The revised *Greenhouse Gas Protocol: Corporate Accounting and Reporting Standard*[5] is incorporated by reference in the SASB technical protocols for GHG emissions metrics[6], and materiality[7], which are now part of the ISSB's guidance.

The *Greenhouse Gas Protocol* is undergoing periodical review, and there are other international standards for environmental reporting and management e.g. the ISO 14001 series[8], notably ISO/DIS 14016, and the European Financial Reporting Advisory Group (EFRAG) is developing sustainability reporting standards[9].

The *Greenhouse Gas Protocol* is more specific to GHG emissions reporting and accounting. On materiality, we refer Treasury to the advice therein on scope of activities referred to in Chapter 10 and noting the section on Completeness (p8). As organisations like the TCFD

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[3] https://www.csiro.au/en/work-with-us/funding-programs/SME/Enablers-and-barriers

[4] https://www.cleanenergyregulator.gov.au/NGER/Reporting-cycle/Assess-your-obligations/Reporting-thresholds

[5] https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf

[6] The Sustainability Accounting Standards Board (SASB) has been consolidated under the IFRS Foundation, which established the new International Sustainability Standards Board (ISSB)

[7] https://www.sasb.org/standards/materiality-map/

[8] https://www.iso.org/iso-14001-environmental-management.html

[9] https://www.efrag.org/Activities/2105191406363055/Sustainability-reporting-standards-interim-draft

also refer to SASB and the *Greenhouse Gas Protocol* for guidance on materiality, we think the *Greenhouse Gas Protocol* is the key reference point.

We acknowledge the 'bootstrapping' challenges around assessing materiality for value chain emissions without some estimation or scan being done first. While businesses are getting better at this, there is still a tendency for elements of scope 3 emissions to be assumed to be immaterial until they are assessed and (often) judged as material. In those reports that *do* present Scope 3 assessments from members of the Partnership for Carbon Accounting Financials (PCAF)[10], these often exceed the combined Scope 1+2 assessment.

The position stated in the revised *Greenhouse Gas Protocol* is:

"*...companies need to make a good faith effort to provide a complete, accurate, and consistent accounting of their GHG emissions. For cases where emissions have not been estimated, or estimated at an insufficient level of quality, it is important that this is transparently documented and justified*". (p8)

Datasets that can support organisations to do full Scope 3 estimation as a starting point are a key tool that is needed. We strongly recommend that the initial scope requirement for company emissions reporting include all relevant Scope 1 + 2 as well as at least a Scope 3 emissions scan. This concurs with the TCFD's financial materiality principles though we would emphasise materiality as connected to level of emissions not enterprise value. That emphasis anticipates a medium-term decarbonisation future where the former becomes more relevant.

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?

Assurance should be in accordance with the latest guidance and the *Greenhouse Gas Protocol*, and should cover full Scope 1 + 2 + 3. Currently, levels of assurance referred to by the Clean Energy Regulator[11] are comparable to concepts in the IAASB standards[12].

Acknowledging the challenges mentioned above in response to Q7, Limited Assurance may be an early option. Given the importance of effective climate action enabled by rigorous reporting and data support, the industry standard should move toward Reasonable Assurance.

[10] https://carbonaccountingfinancials.com/financial-institutions-taking-action

[11] https://www.cleanenergyregulator.gov.au/Infohub/Audits/Pages/Forms%20and%20resources/Audit%20determination%20handbook/Levels-of-assurance-explained.aspx

[12] https://www.iaasb.org/focus-areas/sustainability-assurance

ISAE3410 is a suitable audit standard for carbon emissions of organisations. Note that there is an Australian ASAE3410[13] standard that is "*intended to mirror*" ISAE3410, and compliance with ASAE3410 enables compliance with ISAE3410. A review may indicate a more direct international alignment to ISAE3410 could be more efficient.

In our view the Auditor does not need to be the same as for financial disclosure, but in practice this may occur. The key requirement is that the auditor is suitably qualified for conducting assurance for carbon emissions. The requirements for Third-Party Validation Types in the Climate Active Licence Agreement[14] are a guide to those qualifications and skills (see Table 4 reproduced in the Appendix of this submission).

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?

Any reporting requirements or guidelines should be designed to provide clear and accessible information on the carbon emissions of the reporting entity, which can be used by investors, consumers, and other stakeholders to make informed decisions and have as a goal to facilitate and support the transition to a low-carbon economy.

It would be desirable to include industry-specific disclosure requirements. In different sectors, metrics will place a greater emphasis on the need for quality assured primary data for Scope 3 assessments. For some industries (e.g. those dominated by SMEs), gathering raw data may be prohibitively difficult. Setting a single standard of reporting for all industry, may not be realistic.

The salient point here is that the quality and appropriateness of data used for reporting should be stated in a way that enables comparison across industry. The quantum of emissions reported should be presented with a (standardised) statement of the quality of data and any modelling used to derive that report.

This is related to declaring the "data pedigree" as part of standard reporting requirements - see also our later section on "Data and capability to support climate reporting".

Question 10

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

Yes, but the alignment needs to be focused on global industry efforts to define standards. For example, the SASB's draft *IFRS S2 Climate-related Disclosures Appendix B: Industry-based disclosure requirements* is an international effort to outline industry-specific requirements, and duplication of this effort (running to 640 pages of guidance) to adopt to the Australian context would not be efficient. We acknowledge that some Australia-

[13] https://standards.auasb.gov.au/asae-3410-may-2017

[14] https://www.climateactive.org.au/sites/default/files/2022-07/climate-active-licence-agreement.pdf

specific technical adjustments may be required e.g. SASB industry sectors may not align with ANZSIC coded sectors.

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?

The use of carbon offsets remains a weak area of climate strategy for companies, in terms of confidence that such offsets are effective and meaningful, and their contribution to 'net zero' target efforts. All company reporting on climate strategy progress should clearly state carbon offsets separately from gross emissions footprints. In addition, the critical quality of information on offset provenance and assurance must be included in disclosures.

Question 12

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

Reporting on S1+2+3 (scan) should be required as a minimum threshold for meeting the requirements. Scope 3 scans are critical for a company beginning to understand its emissions influence outside direct operations. Validation assurance should be the minimum requirement for disclosure, although the requirement could be phased in. Inclusion of at least 'limited' assurance would strengthen the need for company management and disclosure of data quality.

Data and capability to support climate reporting

There is growing international recognition of data challenges. Consistently measured Scope 1 and 2 emissions disclosures by a reporting entity's suppliers would improve the entity's ability to estimate Scope 3 (indirect) emissions. Views are sought on how data challenges could impact entities applying new requirements in Australia and how they might be addressed.

A related issue is the capability of users and preparers to collect, interpret and report data required to make climate disclosures. Views are sought on the extent to which these capabilities can be augmented ahead of common international timelines for mandatory climate reporting (2024-2025), whether there are salient data and capability gaps in specific disclosure requirements, and whether there are particular international initiatives that could help address these challenges.

Australian institutions currently have world-class capacity to supply Scope 1, 2, and 3 carbon footprint data. From resources like the University of New South Wales (UNSW),

IELab[15], and the Australian Life Cycle Assessment Society[16] (ALCAS), the breadth and coverage of carbon intensity data may already be sufficient for initial phases of climate-related financial disclosure.

Having said that, the levels of available detail, and variety of standardisation in sources means that integration with company level information, and updating of data (ensuring clean, consistent and current data) could be problematic without coordination efforts.

These issues are not confined to carbon accounting or sustainability reporting. They continue to affect scientific reports and sustainability research and, while improvements in data sources are continuing, there are standard protocols for disclosing data quality. These provide important context on the limits and veracity of reporting.

In the established scientific literature[17] and the Life Cycle Assessment community this is referred to as "data pedigree". We highly recommend a scientific approach to disclosure of the pedigree of data or models used to effect reporting. Relevant features of such an approach would include:

- **Provenance of data (for reasons of legal probity and technical transparency)**
- **Assurance of data (information on appropriate geography, currency, accuracy, uncertainty)**
- **Application of data (not just where data comes from but what it can or cannot be used for)**

Scope 3 data availability and quality assurance remains a challenge in Australia and in other countries. Companies may struggle to find appropriate data for areas of Scope 3 reporting where they do not have good relationships with others in the value chain. This will take time, but to commence on the path to improvement, the use of industry average data like that derived from input-output methods or the national physical process databases (AusLCI), are useful, alongside a standardised expressions of data pedigree.

Confounding the main points in the recommendation for data transparency, are "black box" calculation methods such as AI or machine learning. These ingest, aggregate and manipulate (large) quantities of data to enable automated ESG analytics. There is a place for such approaches in dealing with heterogenous, messy or under-specified company records, but not in the production of credible carbon intensities where questions of provenance and validity are a concern.

[15] https://ielab.info/
[16] https://www.alcas.asn.au/
[17] Weidema, B.P., Wesnæs, M.S., 1996. Data quality management for life cycle inventories-an example of using data quality indicators. *Journal of Cleaner Production* https://doi.org/10.1016/S0959-6526(96)00043-1

Question 13.1

How and by whom might any data gaps be addressed?

Currently, primary data is generated by a small number of expert suppliers (compared to the number of data 'retailers' such as carbon calculator apps). Many of these are academics who already work closely with statistical agencies to resolve data gaps and other issues. For example, the IELab community hosted by the University of Sydney and UNSW, ALCAS, and the University of Melbourne[18] among others.

However, the processes of updating and improving data quality could be more systematic, coordinated, and systematically funded/supported by analogy to any other important service from infrastructure.

The Japanese Government's Green Value Chain Platform[19], which has been active since 2012 is a leading global example of how a government can build capability to enable action by companies and encourage alignment in disclosures. The platform is a significant reason why large Japanese companies have been leading Scope 3 disclosure internationally.

Separately, regarding data governance, perhaps a non-departmental agency managing standards could provide long-term continuity as an authority independent of change in government. An analogous role is served by the Australian Government's Auditing and Assurance Standards Board[20].

We also believe that these efforts to improve the quality assurance, and therefore trust in key data sources, need to progress in parallel to companies scaling up their reporting efforts. It is important that both elements are incorporated into the proposed approach.

Question 13.2

Are there any specific initiatives in comparable jurisdictions that may assist users and preparers of this information in addressing these challenges?

Industry groups are increasingly working internationally to develop clearer guidance on climate risk and emissions disclosure. Developments in these areas e.g. PCAF for the financial sector (which outlines a data quality hierarchy for different components of financed emissions reporting) should be referred to by users and preparers. One interesting option that could support all local businesses making progress is if the Australian Government took a similar programme-based approach, as in the aforementioned Japanese Green Value Chain Platform

[18] https://msd.unimelb.edu.au/research/projects/current/environmental-performance-in-construction/epic-database

[19] https://www.env.go.jp/earth/ondanka/supply_chain/gvc/en/index.html

[20] https://www.auasb.gov.au/

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?

With regard to scientific information or methods for calculating emissions (particularly scope 3 emissions) we recommend initially encouraging and later requiring transparency on how these figures are arrived at from raw data or via analytics tools on the market. Many choices are made in the calculation of carbon emissions that will materially affect the result, and these should be disclosed (and potentially benchmarked over time).

Question 18

Should digital reporting be mandated for sustainability risk reporting?

Digital sustainability reporting presents an important opportunity. If companies would provide carbon disclosure or other sustainability reports in (confidentialised) machine-readable formats, then a substantial 'bottom-up' database of standardised corporate emissions information could be generated and updated very efficiently. We strongly recommend digital reporting be mandated, which will also support the data transparency recommendations we have advocated for earlier in this submission.

Educating the Carbon Information Market

An area of common anxiety, that is a friction against transparent reporting and managing climate risks, is the ambiguity around *responsibility* for Scope 3 emissions. It would aid the "good faith" in corporate emissions reporting if the market first conceives of the need for Scope 3 reporting for awareness. It's important to know where the emissions embodied in production ultimately end up in consumption or other activity, and if that presents as a financial risk/liability. This is what Scope 3 tells us. Then there is the question of attribution: what or where are the causes of emissions (e.g. in supply chains). Only with awareness and understanding from these preceding steps can we resolve questions of where responsibility lies.

The mis-perception (and, we suspect, cause of anxiety) is that *all* of reported Scope 3 emissions are the responsibility of the (downstream) end-consumer, or (upstream) investor. This need not be the case. There are a number of schemas[21] for distributing responsibility, which may be handled with mathematical clarity[22] or it may be a negotiated process.

Knowing that awareness and understanding of Scope 3 emissions precedes the distributed and negotiated responsibility, may relieve some of the disincentives for companies to report accurately and transparently.

Another aspect where there's a need for carbon literacy and numeracy is in the appropriate application of different measures of carbon intensity to arrive at Scope 3 reports for financial risk disclosure.

Even in reports that adhere to standard reporting guidelines, different Scope 3 results can be calculated depending on factors such as inclusion (or not) of imports, retail and wholesale margins, freight margins, taxes, land use change. Mis-application of a Scope 3 carbon intensity can significantly affect the subsequent calculation and disclosure of climate-related financial risk.

Complementing earlier recommendations on data sourcing and transparency, we recommend at least guidelines (preferably requirements) for disclosure related to the correct application/use of data and models. This should be aligned with the IFRS *General Requirements For Disclosure Of Sustainability-Related Financial Information*[23] paragraphs 27-35 on Metrics and Targets, noting especially Paragraph 31.

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[21] Gopalakrishnan *Nature Climate Change* (2022) https://www.nature.com/articles/s41558-022-01543-x

[22] Gallego and Lenzen, *Econ Syst. Research* (2006) https://doi.org/10.1080/09535310500283492

[23] https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf

The Market's Latent Understanding of Scope 3 Reporting Requirements

Requirements for corporate reporting on GHG emissions in Australia are mostly about Scope 1 and 2 (see the National Greenhouse and Energy Reporting Scheme[24]). Until very recently, Australian Climate Active certification needed only a limited relevance appraisal of Scope 3 and no downstream Scope 3 emissions, except for the component of investments (Category 15). By comparison, international standards required all Scope 3 emissions sources to be assessed for relevance – see Figure 3. The latest (January 2023) Climate Active Technical Guidance[25] now matches the *GHG Protocol*, though there will be some latency in the market's awareness of these requirements.

Figure 3 Guidance on Scope 3 emissions from (left) previous Climate Active Technical Guidance Manual - September 2021[26], and (right) Greenhouse Gas Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard (Accessed December 2022)[27]

Scope 3 emission sources	Must test for relevance	Should test for relevance
Category 1 - Purchased goods and services		✓
Category 2 - Capital goods		✓
Category 3 - Fuel-related and energy-related activities	✓	
Category 4 - Upstream transportation and distribution		✓
Category 5 - Waste generated in operations	✓	
Category 6 - Business travel	✓	
Category 7 - Employee commuting	✓	
Category 8 - Upstream leased assets		✓
Category 9 - Downstream transportation and distribution		✓
Category 10 - Processing of sold products		✓
Category 11 - Use of sold products		✓
Category 12 - End-of-life treatment of sold products		✓
Category 13 - Downstream leased assets		✓
Category 14 - Franchises		✓
Category 15 - Investments	✓	

Upstream or downstream	*Scope 3 category*
Upstream scope 3 emissions	1. Purchased goods and services 2. Capital goods 3. Fuel- and energy-related activities (not included in scope 1 or scope 2) 4. Upstream transportation and distribution 5. Waste generated in operations 6. Business travel 7. Employee commuting 8. Upstream leased assets
Downstream scope 3 emissions	9. Downstream transportation and distribution 10. Processing of sold products 11. Use of sold products 12. End-of-life treatment of sold products 13. Downstream leased assets 14. Franchises 15. Investments

[24] http://www.cleanenergyregulator.gov.au/NGER/About-the-National-Greenhouse-and-Energy-Reporting-scheme/Greenhouse-gases-and-energy

[25] https://www.climateactive.org.au/sites/default/files/2023-01/Technical%20Guidance%20Manual_Jan2023.pdf

[26] https://www.climateactive.org.au/be-climate-active/tools-and-resources/technical-guidance-manual (page 63 as accessed July 2022)

[27] https://ghgprotocol.org/standards/scope-3-standard (Table 5.3, page 32)

Appendix

Third Party Validation Types

Table 4: Third Party Validation Types

Third Party Validation Type	Methodology
Type 1 (Small and medium organisation and simple service verification)	Verification by • A Registered Greenhouse and Energy Auditor (register available at www.cleanenergyregulator.gov.au/Infohub/Audits/register-of-auditors); or • A chartered accountant (directory available at www.charteredaccountantsanz.com/find-a-ca); or • A certified practicing accountant (directory available at www.cpaaustralia.com.au/FindACpa/Locate.mvc/Index); or • An environmental auditor accredited under international standard ISO 14001.
Type 2 (Assurance Audit)	Assurance audit by • A Registered Greenhouse and Energy Auditor (register available at www.cleanenergyregulator.gov.au/Infohub/Audits/register-of-auditors); or • An auditor accredited to the international standard ISO 14065:2013.
Type 3 (Product/complex service verification)	Product or service verification by • An ALCAS Certified Life Cycle Assessment (LCA) Practitioner (register available at www.alcas.asn.au/certified-practioners) who also meets Type 1 or Type 2 Validation requirements; or • An ALCAS Certified Life Cycle Assessment (LCA) Practitioner (register available at www.alcas.asn.au/certified-practioners) who is also an approved verifier under the EPD Australasia program (register available at www.epd-australasia.com/about-us/certified-verifiers); or • An auditor or accountant (meeting Type 1 or Type 2 Validation requirements) with in-depth knowledge of the LCA methodology who has: 1. access to AusLCI, ecoinvent or similar Life Cycle Inventory database; and 2. relevant skills through one of the following - Training in international standard ISO 14040/ISO14044 or ISO 14067 - Degree in LCA at the undergraduate or graduate level; and 3. relevant experience through one of the following - Five independent third party LCA reviews according to ISO 14040/14044 - Five years experience applying the LCA methodology, for example, through published LCAs or LCA consultancy work

The Responsible Entity must provide evidence that the third party meets the criteria specified in Table 4 if requested by the Department.