Corporations Branch
Market Conduct Division, Treasury
Langton Crescent
Parkes ACT 2600

17 February 2023

The Officer Responsible for Climate Reporting Consultation

Submission by Deakin University Integrated Reporting Centre

Congratulations on launching this very timely consultation and thank you for the opportunity for us as leaders of the Deakin University Integrated Reporting Centre to make a submission.

The Deakin University Integrated Reporting Centre

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 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 with a focus on integrated reporting and producing support research, thought leadership and education in integrated reporting.

This consultation is core to the missions of both the DIRC and BRLF given the importance of climate disclosure within a better business reporting context. We make this submission on behalf of the DIRC.

Yours faithfully

[redacted]

[redacted]
Chancellor,
Deakin University

[redacted]

[redacted]
Professor of Practice (Integrated Reporting), Deakin University

Director of Thought Leadership and Industry Engagement, Deakin University Integrated Reporting Centre

Special adviser – Connectivity and Integrated Reporting, IFRS Foundation

[redacted]

[redacted]
Director of Research, Deakin University Integrated Reporting Centre

Professorial Research Fellow, Deakin Integrated Reporting Centre, Deakin University
Emeritus Professor, UNSW Sydney

[redacted]

[redacted]
Executive Director, Deakin University Integrated Reporting Centre

Deakin University Integrated Reporting Centre
Email: [redacted]
Burwood Campus
221 Burwood Highway, Burwood, Victoria, Australia
deakin.edu.au

Executive Summary

Before answering the individual questions in the Treasury consultation, it is first necessary to trace the evolution of the Australian financial reporting system, as Part 4 of the ASIC Act was introduced in 2001, and analyse international developments since then, including in relation to integrated reporting, to evaluate whether it would make sense to introduce a third board and / or reform other institutions in the system.

Question 19 brings together the strands of the other 18 questions by way of posing a question about the system. In our view, Potential Structures One and Two are not either / or choices. In our view, they should be viewed as phases or building blocks of the end game of appropriate system change in the interests of the Australian economy and society.

We do not favour Potential Structure Three as it implies that a new institution would be needed to replace the Financial Reporting Council (FRC), the powers and legislative protections around the Australian Accounting Standards Board (AASB) and Australian Auditing and Assurance Standards Board (AUASB) would be diminished, and the New Zealand External Reporting Board (XRB) model would be followed. We do not believe any of these would be appropriate.

On the other hand, we favour a model which goes beyond Potential Structure Two. We recommend a hybrid model which builds upon and enhances Proposed Structure Two and has some of the features of Potential Structure Three as the end game.

It would begin with Potential Structure One (an AASB enabled to create Australian equivalents to IFRS Sustainability Standards focused on proposed IFRS S1, *General Requirements for Disclosure of Sustainability-related Financial Information* (IFRS S1) and IFRS S2, *Climate-related Disclosures (*IFRS S2)). This power would transition to an Australian equivalent of the International Sustainability Standards Board (ISSB) - referred to here as the Australian Sustainability Standards Board (ASSB) - Potential Structure Two.

The model would go beyond Potential Structure Two as contemplated in the consultation paper by enhancing the power, resourcing and international alignment of the FRC, and would give the FRC direct responsibility for integrated reporting in Australia in a manner aligned with the IFRS Foundation's approach to integrated reporting. It would also bring the ASX Corporate Governance Principles and Recommendations within the FRC's oversight to the extent that they relate to corporate reporting.

This submission expands on these matters.

Evolution of the Australian Financial Reporting System

The evolution of the Australian Financial Reporting System is highly relevant context for our submission. In the interests of the flow of our submission we have located our detailed analysis of that evolution and implications for our answers in the Appendix. We recommend that our answers be read having regard to the Appendix.

The Australian financial reporting system has served the country well since IFRS Accounting Standards were introduced, the IFRS Foundation was formed, and Australian equivalents to International Accounting Standards were published around 20 years ago. At that time, financial reporting was the dominant form of corporate reporting. Sustainability reporting was emerging, but apparently not contemplated for standard setting at the time. Integrated reporting as such had not been created.

Australia moved quickly at that time in aligning with international developments in terms of financial reporting institutions and accounting and auditing standards. The FRC was formed to oversee the system and the AASB and the AUASB were formed to set legally binding accounting and assurance standards.

Some would say that 'Australia punched above its weight' globally at that time. Because of this, Australia was awarded 'seats at the global table' such that the global standards and associated products were capable of introduction in Australia with minimal amendment. Australia has largely been able to be a standards taker, allowing it to focus mainly on stress-testing international standards for local adoption, and advocacy and outreach activities, optimising Australia's investment.

The world has changed fundamentally over the last decade. Australia has not kept pace. Anecdotally, it has been said in international circles that 'Australia has been missing in action.' Evidence in relation to this point is provided by Australia not achieving representation on the ISSB Board or its advisory bodies and not being in the discussion about potential locations for ISSB regional offices.

In addition to the ISSB being formed by the IFRS Foundation to preside over IFRS Sustainability Standards, the IFRS Foundation now has among its resources, the Integrated Reporting Framework and Integrated Thinking Principles.

The IASB and ISSB have joint responsibility for these integrated reporting resources. The Integrated Reporting and Connectivity Council (IRCC) provides advice to the IFRS Foundation Trustees and both boards on matters relating to integrated reporting and connectivity.

In the interests of international alignment, integrated reporting accountability in Australia should lie with the FRC and not either the AASB or AUASB. Such an approach should enable Australia to move quickly as international integrated reporting developments occur and should enhance the case for an Australian to again be appointed to the IFRS Foundation Trustees. This is why we favour an 'enhanced Potential Structure Two' end game.

John Stanhope, Chancellor of Deakin University, AM[1] wrote to Treasury on 13 December 2022 in response to Treasury's invitation to comment on proposed changes to the ASIC Act to enable the Australian Accounting Standards Board (AASB) to set Australian equivalents to IFRS Sustainability Standards to be issued by the International Sustainability Standards Board (ISSB), including the proposed IFRS S1 and IFRS S2.

The 13 December letter (attached for convenience) made five recommendations in relation to what has become Potential Structure One, which will be enabled by the proposed changes to the ASIC Act. The letter explained the issues being addressed and the solutions being proposed. These recommendations were made in the context of what is already possible in Australia on sustainability and integrated reporting, which will be enhanced by the proposed changes to the ASIC Act.

Pursuing the core objects of the Australian Financial Reporting System as set out in section 224 of the ASIC Act in 2001 has served Australia well, but the world has changed, and Australia needs to change with it.

This does not mean changing the core objects but will involve changes to the implementation mechanisms. These changes include but go beyond climate disclosure.

Australia needs to take a whole-of-system approach with an international perspective, with a clear end game, aligned building blocks and a rapid timeline to achieve the end game. We have fallen behind developments in the global corporate reporting system and have not invested in retaining the right to the

[1] John Stanhope is also a Company Director, Member of the Integrated Reporting and Connectivity Council, Chair of the Deakin University Integrated Reporting Centre Advisory Board and Chair of the Australian Business Reporting Leaders Forum

‘seat at the global table’ and ability to express a voice that we used to have. We need to move quickly to regain that seat and voice.

Mandating internationally consistent climate disclosures is the right starting point as set out in the 13 December letter and will be achieved through implementing Potential Structure One. However, there have been further relevant developments post-13 December that are relevant to our submission regarding that potential structure. We comment on these developments in our response to Question 19:

- Implementing Potential Structure One through the currently proposed changes to the ASIC Act will be a ‘quick win’. If the intended starting date for adoption of IFRS S1 and S2 is 2024-2025, present activities, supplemented by the recommendations in this submission in relation to that potential structure should deliver that win;
- Potential Structure Two will be needed when:
    - the ISSB issues further standards beyond IFRS S1 and S2
    - interoperability with, for instance, GRI Standards needs to be achieved
    - the standards of the former Sustainability Standards Board (SASB) become further embedded in IFRS Sustainability Standards
    - the International Auditing and Assurance Standards Board’s (IAASB) Sustainability Reporting Assurance Standard, ISSA 5000, is issued in 2025

  We believe this will require having a ‘third board’ (a sustainability reporting standards board, referred to in this submission as the ASSB) to be in place in time for 2025-26 reporting.

- Enhanced Potential Structure Two will be required when integrated reporting and integrated reporting assurance is ready to take its place in the global and Australian corporate reporting mainstream.
  Today, integrated reporting is referenced in Recommendation 4.3 of the ASX Corporate Governance Principles and Recommendations and is thus outside the remit of the FRC.
  It should be noted that the FRC has expressed support for the principles of integrated reporting and integrated reporting is referenced in ASIC’s RG 247.

Incorporating integrated reporting into the Australian financial reporting system

It is important to note that, while the principles and concepts included in the Integrated Reporting Framework are being incorporated into the standard setting and technical work of both boards, the practice of integrated reporting is driven by the market as the Integrated Reporting Framework is, at least currently, a non-mandatory framework best driven through best practice (‘if not, why not?) corporate governance codes rather than through IFRS Accounting or Sustainability Standards.

Within the IFRS Foundation the IASB and ISSB have joint responsibility for integrated reporting. A dedicated team within the IFRS Foundation (the Connectivity and Integrated Reporting, or CIR, Team) reports to both boards. The Integrated Reporting and Connectivity Council (IRCC) is an advisory body of the IFRS Foundation, providing advice to the IFRS Foundation and both boards on integrated reporting and connectivity matters.

Integrated reporting assurance is in-scope for the overarching, framework-neutral ISSA 5000 as integrated reporting is a component of sustainability-related financial reporting as that term and the concept of ‘sustainability’ is understood within the IFRS Foundation and IAASB.

It is likely that the IFRS Foundation will have defined the long-term future of integrated reporting and the Integrated Reporting Framework in the same timeframe that ISSA 5000 comes to market, so Australia will need to be ready for integrated reporting and integrated reporting assurance being a core component of the mainstream corporate reporting system in the next two or three years. This will need oversight by the peak oversight body within the Australian financial reporting system, the Financial Reporting Council (FRC).

Rather than creating a '*new* single, flexible entity' to oversee the Australian financial reporting system, we believe that it will be appropriate to reform the *existing* FRC to ensure that it is and will remain as flexible as possible in the interests of the needs of the Australian economy and international developments:

- It should be provided with a mandate to oversee integrated reporting in Australia
- It could be supported by a body, possibly a sub-committee of the FRC, comparable to the IFRS Foundation's Connectivity and Integrated Reporting Committee.
  That committee could be supported by a dedicated team and advised by a body such as the Australian Business Reporting Leaders Forum, the IFRS Foundation's designated integrated reporting community for Australia
- It should be provided with sufficient integrated reporting and integrated reporting assurance expertise, sustainability-related financial disclosure standards expertise, and financial resources, to discharge that mandate
- The ASX Corporate Governance Principles and Recommendations should be brought within the FRC's oversight to the extent to which they deal with corporate reporting and assurance
- Its name could be changed to, for example, the Corporate Reporting Council, or Corporate Reporting Foundation, to emphasise its international alignment and coverage of all of integrated reporting, accounting standards, sustainability-related financial disclosure standards and all other sustainability-related disclosures.

  Discussion would need to be had as to how to avoid any implication that the body does not oversee external reporting by non-corporate organisations.

If the sustainability reporting assurance model we put forward in our answer to Question 8 is to be developed by building on ASIC as it is today, ASIC's knowledge, skills and experience would need to be bolstered with specialist resources in integrated reporting and the Integrated Reporting Framework, IFRS Sustainability Reporting Standards and sustainability and integrated reporting assurance.

Approaching system reform in this way should enhance the prospects of Australia again securing appropriate Australian appointments to the IFRS Foundation Trustees.

An enhancement of Potential Structure Two and not Potential Structure Three

The consultation paper says the following about Potential Structure Three:

> *"The body could operate like the New Zealand External Reporting Board (XRB). The XRB includes a nine-member governing board responsible for establishing and maintaining New Zealand's financial reporting strategy, governance of the XRB, and appointment and monitoring of the XRB's standard setting functions. While the board remains responsible for all functions and responsibilities of the XRB, it has established and delegated accounting and auditing standard setting functions to the New Zealand Accounting Standards Board (NZASB) and New Zealand Auditing and Assurance Standards Board (NZAUASB) respectively. Under this arrangement, the boards address the technical aspects of standard setting and the XRB Board focuses on oversight and strategic decision making."*

We agree with the analysis and conclusions reached as to uncertainties and mitigants but not all the above detail:

- We do not think it is necessary to create a *new* body to achieve the desirable level of flexibility and international alignment. We do think that this alignment and flexibility needs to accommodate the speed at which integrated reporting and integrating reporting assurance are becoming mainstream in the global corporate reporting system.

  We believe that this can be achieved by making changes to the existing FRC in addition to the creation of an ASSB.

- We do not agree with the New Zealand XRB model being followed. We believe in maximised international alignment; that is, with the IFRS Foundation (and within that, the IASB and ISSB) and IAASB. New Zealand has chosen to act in a fashion less internationally aligned than we believe appropriate for Australia.
- In designing and implementing our proposed structure focused on reforming the FRC, we believe there should be no dissipation of the existing powers and legislative protections in relation to the AASB, and in time ASSB, and the AUASB. This could be consequence of effectively relegating the standard-setting boards to the status of sub-committees as would be the case under the New Zealand model.
  The AASB and AUASB are well-connected with their international counterparts, the IASB and IAASB. Like the IAASB, the AUASB is well-suited to having responsibility for setting Australian equivalents of IAASB sustainability assurance standards, beginning with International Standard on Sustainability Assurance, ISSA 5000, in 2025.
  The ISSB through IFRS Sustainability Standards S1 and S2 will for the first time bring standards for making sustainability-related (including climate-related) financial disclosures, as distinct from ***all-of-sustainability*** disclosures; that is, including both sustainability-related financial disclosures and other sustainability disclosures. The GRI Standards do not make this distinction and embrace *all-of-sustainability* disclosures.

The ASSB and AUASB will require knowledge and experience in relation to each of sustainability-related financial disclosures and other sustainability disclosures, and assurance thereon.

By definition, that experience does not yet exist in relation to IFRS Sustainability Standards S1 and S2 and assurance thereon as those standards have not yet been issued. However, the SASB Standards and TCFD Recommendations, which are both building blocks of IFRS Sustainability Standards S1 and S2, share an investor focus on material sustainability-related *financial* disclosures, and so appropriate experience at this stage could come from expertise in applying and assuring under those standards and recommendations.

The current Australian system has a distinct advantage over the global system in relation to assurance. Both the AASB and AUASB are subject to the oversight of the FRC. This enhances the prospects of strong alignment between accounting and auditing and assurance standard-setting. In contrast, the IFRS Foundation and IAASB are separate bodies. This has necessitated the IAASB to act quickly to catch up to and keep up with the IFRS Foundation in relation to IFRS Sustainability Standards and frameworks, such as the Integrated reporting Framework.

This matter should be a feature of the Australian Government's response to the ISSA 5000 Exposure Draft which is expected to be released in September 2023.

We believe that this hybrid structure, an enhancement of but going beyond the writeup of Proposed Structure Two in the consultation paper, should enhance the prospects of appropriate Australian appointments to each of the IASB, ISSB, IFRS Foundation Trustees and IAASB.

So that Australia does not again fall behind – and Australia is well placed to be a global leader on integrated reporting and integrated reporting assurance – our recommended structure needs to be in place by 2025. Accordingly, Potential Structures One, Two our enhancement of Two need to be pursued in parallel fashion, beginning with being contemplated in implementing Potential Structure One.

Pursuing this integrated approach to corporate reporting[2] reform will allow Australia to minimise the required overall investment while maximising the benefits, in ways not previously contemplated in relation to the financial reporting system except in sections 224(g) and (h) of the ASIC Act, and through the existing powers of the FRC under section 225 of the ASIC Act.

Set out below are our responses to the questions asked.

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?

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

We refer to the above analysis and recommendations and the Appendix. We leave it to others to comment on the detail of these questions.

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?

We refer to the above analysis and recommendations and the Appendix. We leave it to others to comment on the detail of these questions.

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?

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 refer to the above analysis and recommendations and the Appendix. We leave it to others to comment on the detail of these questions.

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

We believe that Australia should align its climate disclosure requirements with the global baseline envisaged by the ISSB to the greatest extent possible. Refer to John Stanhope's letter to Treasury of 13 December 2022.

The independent research in which the DIRC has been involved has emphasised the importance to stakeholders of reporting in accordance with IFRS Sustainability Disclosure Standards – for example, the

[2] In this submission we refer to 'corporate reporting' to encompass both *financial reporting* under IFRS and AASB Accounting Standards and sustainability reporting under IFRS Sustainability Standards, GRI Standards and Australian equivalents.

survey of ASX 300 audit committee chairs (https://www.auasb.gov.au/media/4ujeedno/auasb_researchreport9_12-22.pdf).

The ISSB Standards should be adopted as the global baseline in Australia. In common with the approach adopted with IFRS Accounting Standards, 'Australian paragraphs' should only be added when there is a clear and compelling Australian need.

It will always be open to Australian organisations to complement the outcomes of applying those standards with the outcomes from applying other frameworks and standards that are judged to be appropriate to the needs and interests of their stakeholders.

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?

There are no 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.

Australian organisations who have adopted integrated reporting or the TCFD Recommendations will be well prepared for IFRS S1 and S2 as the Integrated Reporting Framework and TCFD Recommendations are building blocks of both IFRS S1 and S2.

Other organisations who have not done so should begin their journeys on the basis of an analysis of available business benefits and given that well qualified local implementation support resources are in existence.

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?

The climate disclosure standard being issued by the ISSB is the most appropriate global baseline. The survey of ASX 300 Audit Committee Chairs referred to above supports this view surveyhttps://www.auasb.gov.au/media/4ujeedno/auasb_researchreport9_12-22.pdf.).

It will always be open to Australian organisations to complement the outcomes of applying those standards with the outcomes from applying other frameworks and standards that are judged to be appropriate to the needs and interests of their stakeholders.

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?*

We refer to John Stanhope's letter of 13 December 2022 and the above analysis and recommendations and the Appendix. We leave it to others to comment on the detail of this question.

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?*

Refer to John Stanhope's 13 December 2022 letter and its content regarding integrated reports and operating and financial reviews.

Research to which members of the DIRC has contributed, an AASB / AUASB research paper on disclosure trends regarding climate-related information, is relevant on this point (https://www.auasb.gov.au/media/3tsbowik/aasb-auasb_rr_climaterelateddisclosures_12-22.pdf). The paper shows a strong trend to disclosing in the annual report, and also a trend to including climate information in the financial report.

The 'flagship corporate report' should be a concise, comprehensive and insightful integrated report in accordance with the Integrated Reporting Framework, and where possible with independent external assurance.

Metrics and associated disclosures which are not material to enterprise value creation can be included in separate sustainability reports or in online data repositories which are connected in a manner which is easy for stakeholders to navigate.

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)?*

Refer to John Stanhope's letter of 13 December 2022 in relation to the *Dynamic Materiality Diagram*.

The reference point for materiality should align with ISSB standards and guidance on materiality. Enterprise value is a useful consideration as in the long run, all sustainability matters will be material to enterprise value and therefore relevant to investors as well as other stakeholders. Assessments of what is a material matter may change over time:

- If an organisation loses its social licence to operate, this is likely to have a significant effect on long term future cash flows

  It may destroy the terminal value for purposes of a discounted cash flow model. Terminal value often represents 40-50% of total enterprise value
- If significant conditions are placed on an organisation's licence to operate, it could have a significant impact its medium-term future cash flows
- If significant fines are imposed for a breach of licences to operate there may be a significant effect on short term cash flows
- Any of these matters may have a significant impact on the discount rate at which investors discount estimated future cash flows

Information to assist investors in making these judgements should be contained in an integrated report, and confidence for investors to make these judgements will be enhanced by independent external assurance. It may be useful to analogise this 'investor thinking' to the decision-making processes of other stakeholders.

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?*

John Stanhope made assurance-related comments in his letter of 13 December 2022.

The research report referred to above in relation to the views of ASX 300 Audit Committee Chairs indicated that all believe that independent external assurance is required, starting with limited assurance before moving onto reasonable assurance.

The International Auditing and Assurance Standards Board (IAASB) currently has a Sustainability Assurance Project under way through its Sustainability Assurance Working Group (SAWG). Bill Edge, Chair of the Australian Auditing and Assurance Standards Board (AUASB) and a member of the FRC, is a member of the SAWG through his being a member of the IAASB. Refer Assurance on Sustainability Reporting | IFAC (iaasb.org)

The SATF is advised by two reference groups, one comprised of experts in sustainability assurance representing the accounting profession and the other of experts in sustainability assurance representing other professional assurance practitioners.

Michael Bray is a member of the first group given his role in drafting Example 10 on integrated reporting assurance for inclusion in the IAASB's 2021 Extended External Reporting Assurance Guidance', and his position in the IFRS Foundation; and Jo Cain a member of the second. Jo is a former member of the AUASB. Refer Reference Group members .pdf (ifac.org).

The IAASB is planning to issue an exposure draft of its sustainability assurance standard, to be titled ISSA 5000, '*General Requirements for Sustainability Assurance Engagements',* in September 2023 and a final standard in 2025.

ISSA 5000 will be an overarching, framework-neutral assurance standard that covers all sustainability assurance standards and frameworks, including the Integrated Reporting Framework, IFRS Sustainability Standards and GRI Standards. The nature of integrated reporting assurance and the responsibility of boards of directors for the integrity of integrated reports and underlying reporting processes are discussed in detail in the first two instalments of IFAC's Integrated Reporting Assurance series:

- Accelerating Integrated Reporting Assurance in the Public Interest | IFAC
- Executing the Board's Governance Responsibility for Integrated Reporting | IFAC

The second instalment links to the credibility enhancement / assurance element of Recommendation 4.3 of the ASX Corporate Governance Principles and Recommendations.

It is likely that the AUASB will issue an Australian assurance standard closely resembling ISSA 5000, which will have as building blocks, ISAE 3000, '*Assurance Engagements Other than Audits or Reviews of Historical Financial Information*', ISAE 3410, '*Assurance Engagements on Greenhouse Gas Statements'*, the IAASB's 2021 '*Extended External Reporting Assurance Guidance*' referred to above, and relevant aspects of other IAASB auditing and assurance standards such as the assurance standards on 'other information' and going concern.

Sustainability reporting, including integrated reporting, assurance engagements around the world to date have mostly been conducted under ISAE 3000 and with reference to the other standards and guidance referred to above (refer to IFAC's 2021 sustainability assurance benchmarking report, '*The State of Play in Sustainability Assurance'* and the 2022 and 2023 updates. Refer Sustainability Assurance | IFAC)

Level of assurance

The level of assurance to be required for climate disclosures should be set with reference to ASAE 3000 (the Australian equivalent to ISAE 3000) and subsequently the Australian equivalent to ISSA 5000, which requires a consideration of 'rational purpose' as one of the pre-conditions for assurance.

ASAE 3000 defines the level of assurance in terms of 'limited assurance' and 'reasonable assurance'. A consideration of rational propose means having regard to the likely use of the output of an assurance engagement (the assurance report) – whether users will value limited assurance in the first instance, and later whether they will get incremental value from reasonable assurance.

It is likely that most organisations will begin with limited assurance and later move to reasonable assurance when that will be valued by users. A very important consideration about whether assurance can be provided at all is the assurance practitioner evaluating whether the pre-conditions for assurance have been met. If the practitioner misjudges in this evaluation, there is likely to be a more-than-necessary number of assurance report modifications (qualifications), and potentially defective assurance conclusions, which may bring into question the value of sustainability reporting assurance.

These matters are complex and need to be fully evaluated before Treasury forms a position on the level of assurance that should be required for climate disclosures. The Deakin University Integrated Reporting Centre has a focus on integrated reporting assurance and indeed all sustainability reporting assurance and would be delighted to carry out research or other activities on this matter for Treasury.

Who should provide assurance?

We believe that a financial statement auditor (current, or past with appropriate recent experience) will be best suited to lead integrated reporting assurance engagements in the interests of *effectiveness* as:

- financial statements auditors know how to develop a strong understanding of the business of the report preparer
- have appropriate auditing and assurance knowledge, skills and experience
- are normally adept at interacting with the boards and senior executives of their clients

It will often be appropriate in integrated reporting assurance engagements for the assurance practitioner to engage appropriate experts either from within their own firms or externally and in both cases to have regard to ASA 620, '*Using the work of an auditor's expert*.' Such experts could include subject matter experts in Environmental, Social and Governance matters, but may also include subject matter experts in governance, strategy, business models or risk management as reporting on these matters is part of the subject matter information of such assurance engagements.

We believe that the entity's financial statement auditor will be best suited to lead integrated reporting assurance engagements in the interests of *efficiency* as the financial statement auditor will already have a sound knowledge of the business under ASA 315, '*Identifying and assessing the risks of material misstatement through understanding the entity and its environment*.' A separate integrated reporting assurance practitioner would have to develop its own understanding of the business, which would impose unnecessary cost on the organisation obtaining assurance.

In cases where the financial statement auditor also provides the integrated reporting assurance, there will be no independence concerns as assurance practitioners using ISAE 3000 (and presumably ISSA 5000) must be independent, as they must be in carrying out financial statement audits.

Assurance providers must be subject to independence and quality management standards to comply with ISAE 3000. Auditing practitioners conducting sustainability reporting engagements under ISAE 3000 (and presumably ISSA 5000) will therefore automatically be subject to appropriate independence and quality management standards as the assurance practitioner must:

- comply with fundamental ethical principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour, and also the '*Code of Ethics for Professional*

Accountants' issued by the IESBA internationally and AESBA in Australia, which covers independence, under paragraph 9 of ISAE 3000

- implement extensive quality control procedures as part of a quality control system under paragraph 12 of ISAE 3000

Regulatory supervision and enforcement

It is critically important that the provision of sustainability reporting assurance of all forms is subject to regulatory supervision and enforcement, in the same way as financial statement auditors are regulated by ASIC through the Registered Company Auditors regime.

Treasury should form a position to require any practitioner purporting to assure climate disclosures do so under ASAE 3000 and later ISSA 5000 and that all sustainability reporting assurance practice be under the regulatory coverage of ASIC, potentially through a model emulating the Registered Company Auditors regime. If that model is to be developed by building on ASIC as it is today, ASIC's knowledge, skills and experience would need to be bolstered with specialist resources in integrated reporting and the Integrated Reporting Framework, IFRS Sustainability Reporting Standards and sustainability and integrated reporting assurance.

In conclusion

We believe that ISSA 5000, and before it is available for use, ISAE / ASAE 3000 supported by the other sources of sustainability reporting assurance standards, guidance and regulatory supervision as noted above, will provide the best approach to ensuring high quality sustainability reporting assurance, including in relation to climate disclosures.

Mandating the use of ASAE 3000 / ISSA 5000 is the best approach to assurance of all sustainability reporting, which will itself drive determination of the level of assurance. This will provide a strong Australian sustainability reporting credibility enhancement environment and a strong mitigant to the so-called practice of 'greenwashing'.

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?*

We refer to the above analysis and recommendations and the Appendix. We believe that requirements to report emissions, including use of any relevant Australian emissions reporting frameworks, should be aligned with the requirements of IFRS Sustainability Disclosure Standards.

We believe that requirements to report emissions will best be done in integrated reports under the Integrated Reporting Framework. Such integrated reports will put the climate disclosures into the context of the way that the business is governed and managed, and will drive what aspects are included in the integrated report given materiality considerations. Other aspects can be included in places such as online ESG repositories, and connectivity between the two - how to navigate all sources of information – can be achieved.

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

Industry-specific metrics are highly important to achieving consistency between disclosures.

The provision of industry-specific metrics was a key reason for the existence of the former Sustainability Accounting Standards Board (SASB). SASB merged with the IIRC in 2021 to become the Value Reporting

Foundation, which itself was consolidated into the IFRS Foundation in 2022. Through this consolidation, the Integrated Reporting Framework and SASB Standards became resources of the IFRS Foundation.

The Integrated Reporting Framework and SASB Standards, as well as the TCFD Recommendations, are core building blocks of the IFRS Sustainability Reporting Standards, the first two of which are IFRS S1 (the 'general requirements' standard) and IFRS 2, the climate disclosure standard.

The 70+ industry-based SASB standards will be central to future IFRS Sustainability Standards and are expected to themselves be standards after going through the ISSB's due process.

Treasury should define the common baseline of metrics with specific reference to the SASB Standards.

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?*

We refer to John Stanhope's letter of 13 December 2022, the above analysis and recommendations and the Appendix. We leave it to others to comment on the detail.

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

We refer to John Stanhope's letter of 13 December 2022 and the above analysis and recommendations. We leave it to others to comment on the detail of this question.

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?

We leave it to others to comment on the detail of these questions.

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?*

We leave it to others to comment on the detail of this question.

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?*

We leave it to others to comment on the detail of these questions.

We note that research of relevance has been undertaken. For example, Huggins A., R. Simnett and A. Hargovan. 2015. "Integrated Reporting and Directors' Concerns about Personal Liability Exposure: Law Reform Options"[3]. Huggins, Simnett and Hargovan concluded that current safe harbour provisions are adequate and outlined and explored four ways forward.

In addition, the Australian Council of Superannuation Investors released a relevant legal opinion in February 2023 ISSB standards 'consistent with existing requirements' for company directors, legal opinion confirms |

[3] Companies and Securities Law Journal, vol. 33 (May), 176-195

ACSI ISSB standards ‘consistent with existing requirements’ for company directors, legal opinion confirms ISSB standards ‘consistent with existing requirements’ for company directors, legal opinion confirms.

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?*

Recommendation 7.4 and associated commentary of the ASX Corporate Governance Principles and Recommendations interact with new climate reporting obligations. Recommendation 7.4:

> ***Recommendation 7.4***
>
> *A listed entity should disclose whether it has any material exposure to environmental or social risks and, if it does, how it manages or intends to manage those risks*
>
> ***Commentary***
>
> *To make the disclosures called for under this recommendation does not require a listed entity to publish an ‘integrated report’ or ‘sustainability report’. However, an entity that does publish an integrated report in accordance with the International Integrated Reporting Council’s International <IR> Framework, or a sustainability report in accordance with a recognised international standard*, may meet this recommendation simply by cross-referencing to this report.*
>
> *The Council would encourage entities that believe they do not have any material exposure to environmental or social risks to carefully consider their basis for that belief and to benchmark their disclosures in this regard against those made by their peers.*
>
> *The Council would encourage entities to consider whether they have a material exposure to climate change risk by reference to the recommendations of the Financial Stability Board’s Task Force on Climate-related Financial Disclosures and, if they do, to consider making the disclosures recommended by the TCFD.*
>
> **Footnote refers to GRI, SASB and CDSB*

Periodic corporate reports are at a point in time. Continuous disclosures are a separate matter. The responsibilities of boards of directors are different between the two.

Directors potentially have a defence under section 180 of the Corporations Act for the group of business judgements made in relation to integrated reporting:

- business judgements in relation to the organisation’s approach to governance, the strategy and business model design and operation
- business judgements as to whether to prepare a point-in-time integrated report given that integrated reporting is not mandatory, as well as
- business judgements in relation to *how to report* on the above-mentioned business judgements as to governance, strategy and business models made by the board and management, in the integrated report

Unlike compliance with legally-binding accounting standards, business judgements made in relation to integrated reports are not compliance matters. On the other hand, continuous disclosure rules are a matter of compliance and need to be subject to their own internal processes, systems and controls.

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?*

Full flexibility to incorporate the growth of other forms of sustainability reporting should be considered in the practical design of these reforms. The above analysis of the evolution of the Australian financial reporting system, and current and future international developments therein, should provide background information for the practical design of these reforms.

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

Digital reporting should be mandated when:

- sustainability reporting has a similar level of maturity as financial reporting. Otherwise the form of digital reporting chosen may require costly and arguably unnecessary costs in making changes. The reporting system must be stable before digital reporting is mandated, although a parallel process of development will be appropriate
- rigorous and cost-effective technologies are available. Consistent technologies should be used across all forms of sustainability reporting, including integrated reporting

Treasury may find the attached KPMG report to be useful background information, *'Automating Business Reporting Performance insight through Better Business Reporting'.*

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?*

We refer to the analysis at the start of this submission and in the Appendix for context for our comments on all three potential structures.

Quick Win – Potential Structure One – Confirm the AASB as the entity responsible for developing, making and monitoring climate and sustainability related standards

Achieving Potential Structure One will be somewhat of a 'quick win' if achieved in 2023. The quick win will be through:

- adopting Australian equivalents of IFRS S1 and IFRS S2 as soon as possible and future other IFRS Sustainability Standards thereafter; and
- encouraging market participants to continue or start preparing integrated reports in accordance with or with reference to the Integrated Reporting Framework

Australia is already well on the way to achieving this quick win with:

- the proposed changes to the ASIC Act
- the appointment of people with strong climate / GRI skills to the AASB and AUASB
- there being:
  - strong momentum for sustainability reporting (including with the TCFD Recommendations) and sustainability reporting assurance
  - good momentum for adopting the concepts of integrated reporting, and

- the emergence of integrated reporting assurance

However, more will need to be done to ensure the success of Potential Structure One. We refer to the recommendations in John Stanhope's letter of 13 December 2022:

- The integrated report should be recognised as the flagship corporate report for investors, and the Integrated Reporting Framework should be recognised as the umbrella for Australian corporate reporting
- The integrated reporting 'story' should be explained to the public by Treasury in communications accompanying the amendments to the ASIC Act. Treasury should also recommend to the ASX Corporate Governance Council that Recommendation 4.3 be strengthened
- A joint communication on integrated reporting and integrated reporting assurance from Treasury and the ASX Corporate Governance Council to the market would appear to be appropriate in the light of the significant momentum globally towards a more integrated approach to assurance
- Treasury should instigate inter-departmental dialogue on integrated reporting education, possibly through the Department of Prime Minister and Cabinet, in relation to integrated reporting education being a significant opportunity to optimise capacity in the Australian corporate reporting system
- The appointment of Michael Bray to the FRC. Michael is Professor of Practice (Integrated Reporting) at Deakin University; is on secondment from KPMG International as Special Advisor, Connectivity and Integrated Reporting to the IFRS Foundation; and is a member of the Expert Reference Group for the IAASB's sustainability assurance project

In addition:

- We understand that the FRC is considering transitioning the BRLF's relationship with the FRC from 'reporting stakeholder' to a formal advisory body.

  This would be akin to the Integrated Reporting and Connectivity Council being an advisory body to the IFRS Foundation Trustee and the Joint Connectivity and Integrated Reporting Committee of the IASB and ISSB

- The IFRS Foundation will issue an agenda consultation in the first half of this year which will consider future sustainability topics for IFRS Sustainability Standards and the long term future of the Integrated Reporting Framework in the IFRS Foundation.

  We urge the FRC to strongly support the Integrated Reporting brand in its submission and would be delighted to provide Treasury with support as it drafts its submission.

- The BRLF will hold briefings on what is possible now in terms of integrated reporting and integrated reporting assurance, probably in late April or early May 2023. We encourage appropriate Treasury officers to attend

- We recommend that the groundwork for transitioning to Potential Structure Two should be laid as Potential Structure One is put in place, which will be needed as:

  - more IFRS Sustainability Standards, also building on the Integrated Reporting Framework and TCFD Recommendations, appear
  - the industry-based SASB Standards are bolted on to the base IFRS Sustainability Standards
  - the required work on interoperability between the IFRS Sustainability and GRI Standards is carried out

- preparations for aligning with ISSA 5000 in time for 2025 occur

Potential Structure Two – Establish a separate sustainability standards board

The groundwork for making Australian equivalents to IFRS Sustainability Disclosure Standards will have been established under the leadership of the AASB. Potential Structure Two, which would result in that power being transferred to an Australian Sustainability Standards Board will have been laid through Potential Structure One.

However, going into 2024, there are likely to be lingering questions about the interoperability of IFRS Sustainability and GRI Standards, where the SASB industry-based standards fit; where integrated reporting comes in, and what 'Australian paragraphs' will be required. To this we refer to John Stanhope's letter of 13 December 2022 and its discussion of the Dynamic Materiality Diagram, the concept of enterprise value, and the modern concept of 'sustainability' which relates to long term value creation.

Delivering Australian equivalents of IFRS Sustainability Standards would be likely to soon overwhelm the AASB as it already has a lot to do in dealing with the Australian Accounting Standards. The 'Australian Sustainability Standards Board' (ASSB) will require:

- A clear government mandate, including that the ASSB produce an annual integrated reporting, with independent assurance, in accordance with the Integrated Reporting Framework and including the outputs from applying IFRS Sustainability Standards
- Specific, measurable, achievable, relevant and time-bound objectives expressed in terms consistent with section 224 of the ASIC Act
- Dedicated full time specialist resources, who are expert in IFRS Sustainability Standards and how the Integrated Reporting Framework and TCFD Recommendations underpin IFRS Sustainability Standards
- Adequate funding to achieve the government mandate

Without a separate sustainability reporting standards board, perceptions of Australia not being fully on board with international alignment will persist.

The AUASB will need to consider ISSA 5000 and the broader suite of IFRS Sustainability Standards in its interaction with the ASSB.

Achieving Potential Structure Two will have laid the foundations for Australia to achieve appointments to the ISSB or at least its advisory bodies, and the potential to start realising the overall benefits to the Australian economy discussed above.

Enhanced Potential Structure Two – reform existing financial reporting bodies to achieve greater flexibility and international alignment – ready for 2024

Enhanced Potential Structure Two would require greater funding of the FRC as the oversight body. This would be entirely appropriate given need to oversee an emerging and evolving financial reporting system that remains in flux.

Having put Potential Structure Two in place, Australia will have realised the benefits of pursuing Potential Structures One and Two, although Enhanced Potential Structure Two should be pursued in parallel with Potential Structure Two through which:

- A dedicated ASSB will be in place
- Greater integrated reporting expertise will be on the FRC

- The integrated report will be recognised as the flagship corporate report for investors, and the Integrated Reporting Framework recognised as the foundational framework for Australian corporate reporting
- A stronger ASX Corporate Governance Recommendation 4.3 will be achieved
- A more integrated approach to assurance will be in place
- Treasury will be focused on the broader benefits to the Australian economy of being strongly aligned with the resources of the IFRS Foundation and IAASB
- Treasury will be better focused on its resource providing a significant opportunity to benefit the Australian economy through the Australian financial reporting system

The IFRS Foundation is a single entity which houses both the IASB and ISSB. It only has a loose connection with the IAASB. Australia has an advantage here in that the FRC oversees both the AASB and AUASB, and the 'ASSB' if Potential Structure Two is put in place. We believe that the FRC should closely follow the IFRS Foundation model in overseeing the entire financial reporting system, including the AUASB and ASX Corporate Governance Council's Corporate Governance Principles and Recommendations, pursuant to section 224 of the ASIC Act. This could be a model of international appeal.

The FRC's name has served it well over 20 years, and we understand that having 'financial' in the name has been important in the financial reporting era. In addition, the IFRS Foundation's mandate stops at 'financial' although 2022 showed that 'financial' means more than being recognised in financial statements under IFRS Accounting Standards. The IFRS Foundation's boundary currently stops at investors, and their interest is enterprise value which is broader financial value than financial value recognised on balance sheets under IFRS Accounting Standards. That investor focus may broaden to all stakeholders if the outcomes of recent Royal Commissions lead to change.

Other forms of reporting, such as under GRI Standards, are also important in Australia. In reality, the Australian corporate reporting system extends across all three boxes in the Dynamic Materiality Diagram, and the overseer of corporate reporting needs to have accountability for this. Accordingly, we recommend Treasury should consider changing the name of the FRC to the Corporate Reporting Foundation or Council, or something similar.

However, further action will be required to ensure that the FRC can and does oversee the entire financial reporting system:

- It will require dedicated full time specialist resources, who are expert in all of:
  - IFRS Sustainability Standards
  - the Integrated Reporting Framework
  - integrated reporting assurance as a form of sustainability reporting assurance, IAASB Sustainability Reporting Standards and ISSA 5000 in particular
  - how the Integrated Reporting Framework and TCFD Recommendations underpin IFRS Sustainability Standards
  - the Integrated Thinking Principles
- the objective of international alignment needs to be strengthened by the Minister making a direction to the FRC under s224 of the ASIC Act
- the BRLF should be consolidated into the FRC in a manner similar to the Value Reporting Foundation being consolidated into the IFRS Foundation in 2022

- the ASX Corporate Governance Council needs to be brought into the oversight of the FRC as it relates to corporate reporting (Recommendations 4.3 and 7.4)
- Australia needs to establish a more formal link with the IFRS Foundation, starting with having one or more IFRS Foundation Trustees appointed
- adequate budgetary resources need to be provided to the FRC
- Australia should work to achieve a Regional or Liaison Office of the IFRS Foundation characterised by the value proposition discussed briefly above and in detail in the Appendix

A clear government mandate is needed, including that the ASSB and FRC produce an annual integrated report, with independent assurance, in accordance with the Integrated Reporting Framework and including the outputs from applying IFRS Sustainability Standards.

In achieving Enhanced Potential Structure Two, Australia will have achieved a flexible, globally connected corporate reporting system led by a single, flexible and internationally connected corporate reporting oversight body, and with an ASSB as a core component where both are ready to anticipate change and act quickly and appropriately thereon. The core objects of section 224, incorporating a business productivity objective as it relates to corporate reporting (refer Appendix), can be fully met.

In conclusion

The Deakin University Integrated Reporting Centre would be delighted to be commissioned by Treasury to support it on thinking through Enhanced Potential Structure Two and how Potential Structures One and Two can naturally evolve to it by 2025. We would also be delighted to have a key position within an Australian Regional or Liaison Office for the IFRS Foundation, and be an independent research centre for Treasury on an ongoing basis.

We trust that our recommendations are of assistance as Treasury writes its position paper in advance of the second consultation.

Appendix - Evolution of the Australian Financial Reporting System

Section 224 of the ASIC Act sets out the main objects for the system which include facilitating the development of:

- clearly stated and easily understood accounting standards in relation to financial information appropriate for user needs and which assist directors in discharging their duties in relation to financial reporting; and
- auditing and assurance standards and related guidance materials that are also clearly stated and easily understood.

The FRC was given powers and functions under section 225 of the ASIC Act in relation to oversight of the processes for setting accounting and auditing standards and reporting to the Minister thereon.

Importantly, section 224 of the ASIC Act (in sub-sections (b) and (c) went beyond financial reporting accounting and auditing standards by adding a core object that the Australian financial reporting system needed to also *facilitate the Australian economy by reducing the cost of capital, enabling Australian entities to compete effectively overseas, and maintaining investor confidence in the Australian economy, including its capital markets*[4].

The FRC was also given functions and powers to advance and promote the main objects set out in section 224, including facilitating the Australian economy and maintaining investor confidence in the Australian capital markets; and any other function conferred on the FRC by the Minister (sub-sections (g) and (h) of section 225).

It is important to note that these functions were not confined to accounting and auditing standards. They went to the health of the Australian economy. The Minister, Treasury and FRC already have what is needed to adapt as global conditions change.

The world has changed fundamentally over the last decade. Australia has not kept pace. It has been said in international circles that 'Australia has been missing in action.' Importantly, sub-sections (b) and (c) of section 224, coupled with sub-sections (g) and (h) of section 225, provide the opportunity for Australia to change relatively quickly if the change is approached systematically and in an international context.

Those sub-sections of the Act are critically important with the advent of sustainability reporting becoming a core component of the global financial reporting system with the IFRS Foundation in 2022:

- creating the ISSB and issuing exposure drafts of IFRS S1 and S2, including a climate disclosure standard in IFRS S2

  Widespread global support is being expressed for the ISSB standards. S1 and S2 are expected to be finalised around June 2023 such that they become available for local adoption.

- consolidating the Value Reporting Foundation, VRF (comprising the International Integrated Reporting Council, IIRC, and SASB) into the IFRS Foundation and in the process acquiring the Integrated Reporting Framework, Integrated Thinking Principles and SASB Standards

'Sustainability', 'sustainability-related financial', 'interoperability' and integrated reporting

---

[4] We now know that these matters require more than the accounting and auditing standards that were contemplated 20 years ago – refer below.

In addition, the ISSB:

- clarified the concept of 'sustainability' and in particular 'sustainability-related financial' at its December 2022 board meeting, such that ISSB standards and the Integrated Reporting Framework are clearly in-scope for the global corporate reporting system overseen by the IFRS Foundation.

  A Staff Paper, titled Fundamental Concepts was presented to that meeting. The ISSB Staff made a number of recommendations about 'value and sustainability' which will clarify the framing and objective of IFRS S1, and which will drive how the Integrated Reporting Framework and TCFD Recommendations are used as building blocks in IFRS S1 and S2.

  The framing and objective will describe how:

  - the value created, preserved or eroded for an entity (and its providers of financial capital) is inextricably linked to other stakeholders, society and the natural environment
  - an entity relies on these resources and relationships (which some refer to as 'capitals') to create value for itself and providers of financial capital
  - in interacting with these resources, an entity creates impacts and dependencies on them, which may positively or negatively affect the resources, and give rise to sustainability-related risks and opportunities that the entity is exposed to
  - sustainability-related risks and opportunities can affect the entity's performance or prospects, influence its business model or strategy and create or erode the value of the entity or the returns for providers of financial capital over the short, medium and long term

- demonstrated the interoperability of ISSB and GRI Standards, and the foundational and connectivity role played by the Integrated Reporting Framework as visualised in the so-called *Dynamic Materiality Diagram* - refer to John Stanhope's 13 December 2022 letter to Treasury for an explanation of this diagram and the underlying sustainability concept

Sustainability reporting assurance within the global corporate reporting system

Finally, the place of assurance as a core component of the global corporate reporting system, and the role of the IAASB as a core component of that system, should not be overlooked. It is pleasing to see that a question in the Treasury consultation deals with assurance.

The IAASB expects to release an exposure draft of its 'framework-neutral, overarching' sustainability assurance standard, ISSA 5000, in September 2023 and a final standard in 2025.

The Minister, Treasury and FRC have the power to bring clarity to the implications of these international developments for Australia on a timely basis under existing legislation.

<u>Integrated reporting – a core IFRS Foundation resource</u>

In relation to integrated reporting, the chairs of the IASB and ISSB committed to the future of integrated reporting in their 25 May 2022 encouragement to organisations to continue using the Integrated Reporting Framework:

"We are convinced that the Integrated Reporting Framework drives high-quality corporate reporting and connectivity between financial statements and sustainability-related financial disclosures which improves the quality of information provided to investors. Therefore, we strongly encourage continued use of the Integrated Reporting Framework and the Integrated Thinking Principles underpinning it". **Andreas Barckow, Chair of the IASB, and Emmanuel Faber, Chair of the ISSB, 25 May 2022**

2023 will be an important year for integrated reporting and the Integrated Reporting Framework within the IFRS Foundation. The 25 May 2022 announcement went further than the above statement of encouragement, providing a roadmap for integrated reporting developments since that date:

Commitment	**Developments / Progress Since 25 May 2022**
The Integrated Reporting Framework	
Integrated Reporting Framework to become part of materials of IFRS Foundation	Done via 1 August 2022 consolidation – refer above quote
Integrated Reporting Framework initially to be positioned as a voluntary resource for preparers and have a prominent place on the Foundation's website	Done – refer IFRS - Integrated Reporting Framework
IFRS Foundation and Chairs of IASB and ISSB actively encourage continued adoption of the Integrated Reporting Framework by preparers	25 May 2022 announcement – refer above quote
Governance	
On consolidation of VRF, IASB and ISSB will assume responsibility for Integrated Reporting Framework	Done.
Chairs and Vice-Chair(s) of IASB and ISSB undertake that IASB and ISSB will work together to agree on how to build on and integrate Integrated Reporting Framework into their standard-setting projects and requirements. Could include joint projects undertaken to evolve and enhance Integrated Reporting Framework resulting in the publication of materials applicable to both boards	Project underway on integrating Integrated Reporting Framework and IASB's Management Commentary Practice Statement
Communication to the market	
IFRS Foundation to undertake engagement program to help market participants understand process of transitioning Integrated Reporting Framework to a resource used by both boards, as well as advocating use and development of Integrated Thinking Principles	Jurisdictional Integrated Reporting Communities program is being re-invigorated by the IFRS Foundation through the CIR Team. Michael Bray leads this workstream and is supported by Liz Prescott. February and March events for jurisdictional Integrated Reporting Communities.
Building on the Integrated Reporting Framework	
The IASB and ISSB to utilise principles and concepts from Integrated Reporting Framework their standard-setting work. Includes seeking opportunities to align and incorporate concepts in	Chairs of IASB and ISSB committed to long-term role for a corporate reporting framework, incorporating principles and concepts from the current Integrated

Commitment	**Developments / Progress Since 25 May 2022**
Integrated Reporting Framework with similar concepts in IASB and SASB conceptual frameworks into a cohesive whole	Reporting Framework. Would provide guidance to companies on how to prepare an integrated report and / or otherwise support connectivity between the reporting required by the IASB and the ISSB.
Market consultation will inform timing and approach to the future development of Integrated Reporting Framework through the IFRS Foundation's due process.	Agenda consultation likely Q2 2023
On consolidation of VRF, former Integrated Reporting Framework Board concluded. Members to be invited to participate in advisory bodies established for projects that build on the Integrated Reporting Framework	Done. Connectivity and Integrated Reporting Team formed.
The Integrated Thinking Principles	
Integrated Thinking Principles to become materials of IFRS Foundation and have a prominent place on the Foundation's website	Done – refer IFRS - Integrated Thinking Principles
IFRS Foundation and Chairs of IASB and ISSB encourage continued use of Integrated Thinking Principles and engagement by stakeholders in developing them as practical guidance to enhance quality of corporate governance and reporting	Done. Integrated Thinking Conference being held in Frankfurt in June 2023
The Integrated Reporting Council	
On consolidation of VRF, Integrated Reporting Council will become an advisory body to IFRS Foundation Trustees and both boards. Council will provide advice on how reporting required by IASB and ISSB should be integrated and on how principles from Integrated Reporting Framework should be considered in relevant projects by boards	Done. Integrated Reporting and Connectivity Council formed to succeed IIRC. Met for the first time in November 2022. John Stanhope, Simon Grant of CAANZ, Patrick Viljoen of CPA Australia and Pru Bennett of the Brunswick Group are members. Michael Bray and Liz Prescott participate in meetings as members of the IFRS Foundation Connectivity and Integrated Reporting (CIR) Team.

These commitments and achievements will be built upon in 2023 and are critical to us recommending a phased approach with an end game of an Enhanced Potential Structure Two. The following matters have become clearer since the letter of 13 December 2022 and are important to the detail of my recommendations under Potential Structures Two and Enhanced Potential Structure Two.

The jurisdictional *Integrated Reporting Communities Program*, a program for around 30 jurisdictional Integrated Reporting Communities around the world, including Australia, the USA, UK, various countries in the EU, Japan, China, Canada and Brazil, is being re-invigorated under the leadership of Michael Bray with the support of Liz Prescott.

Key events for the Integrated Reporting Communities will be held on 28 February and 28 March 2023, during which Integrated Reporting Community leaders will be brought up to date on integrated reporting developments between the 25 May 2022 announcement and the consolidation of the VRF into the IFRS Foundation in August 2022, as well as planned developments for 2023 and beyond.

Attendees at the February and March events will hear for the first time about integrated reporting from within the IFRS Foundation:

- Sue Lloyd, Vice-Chair of the ISSB and Andreas Barckow, Chair of the IASB, will speak on the importance of integrated reporting and integrated thinking to boards, investors and the IFRS Foundation, and on their commitment to the Integrated Reporting Communities Program
- Charles Tilley, Chair of the IRCC, will speak on the role, composition, objectives and plans of the IRCC
- Mardie McBrien, Director of Strategic Affairs in the IFRS Foundation, will speak on the IFRS Foundation's capacity building program which includes capacity to adopt both IFRS Sustainability Standards and the Integrated Reporting Framework
- Jonathan Labrey, Leader of the IFRS Foundation Connectivity and Integrated Reporting Team, and Michael Bray, Special Adviser to Jonathan and workstream leader for the Integrated Reporting Communities Program and for assurance integration

  Jonathan will talk about the importance of the Integrated Reporting Program to achieving high quality and widespread adoption of integrated reporting, integrated reporting assurance and integrated thinking around the world. He will also speak about the IFRS Foundation's agenda consultation, including on the branding / identity of integrated reporting and the status / authority of the Integrated Reporting Framework.

  Michael will talk about what is possible now with integrated reporting and integrated reporting assurance using case studies, given the importance of integrated reporting and integrated reporting assurance.

The March event will be a working session where individual jurisdictional integrated reporting community leaders outline their own business models and have a chance to learn from each other as they deploy and implement the messages from both the February and March events throughout their communities.

Australian Business Reporting Leaders Forum

Australia's Integrated Reporting Community is the *Australian Business Reporting Leaders Forum* (BRLF), which is chaired by John Stanhope. The Vice-Chair is Pru Bennett. The Secretariat for the BRLF is provided by the *Deakin Integrated Reporting Centre* (DIRC). Michael Bray is the Director of the BRLF. John Stanhope also chairs the DIRC Advisory Board and Liz Prescott is a member. The BRLF is a reporting stakeholder of the FRC.

A BRLF meeting will be held in April or May 2023 for the entire Australian Integrated Reporting Community, which has had over 200 participants since its formation in 2010. Treasury will be invited to attend this meeting to:

- observe first-hand the reactions of a wide cross-section of participants within the Australian financial reporting system to what is happening on integrated reporting internationally
- consider appropriate Australian responses including in the Treasury climate disclosure position paper. The BRLF agenda is highly relevant to the Treasury consultation and this meeting will presumably take place before or around the time that Treasury finalises its position paper for the second consultation.

<u>ASX Corporate Governance Principles and Recommendations</u>

Another important development since the introduction of the ASIC Act in 2001 has been the convening of the ASX Corporate Governance Council by the ASX in 2002. In the first two editions of its Corporate Governance Principles and Recommendations (issued between 2003 and 2010), the FRC and ASX Corporate Governance Principles were relatively harmonised and focused on director responsibilities in relation to financial reporting and accounting standards.

John Stanhope's 13 December 2022 letter touched on the ASX Corporate Governance Council, its Corporate Governance Principles and Recommendations (pages 10-11) and how they have become part of the Australian financial reporting system. Set out below is further context as it is important to our comments in relation to the Enhanced Potential Structure Two.

An often-overlooked divergence emerged in the 3rd Edition in 2014, when the reference to 'financial reporting' in Principle 4 was replaced with a reference to 'corporate reporting'. The change in terminology alone did not promote significant change in corporate reporting practice as the term 'corporate reporting' was not defined. Further, no recommendations were added to the previous recommendations in relation to Principle 4 regarding financial reporting. Practice has demonstrated that the Recommendations are the real drivers of action or change.

However, Recommendation 7.4 was added to Principle 7, which foreshadowed the emergence of sustainability reporting as an element of good practice in corporate governance. Directors were asked, on an 'if not, why not? basis, to report on environmental and social risks, including risks in relation to climate change.

The 4th Edition (2019) went further with the addition of Recommendation 4.3, in some ways globally ground-breaking, and a change to Recommendation 7.4 so that it was aligned with the new Recommendation 4.3. Recommendation 4.3 asked directors to report on an 'if not, why not?' basis on their processes for ensuring the integrity of the processes underlying all their 'periodic corporate reports' other than audited financial reports.

'*Periodic corporate reports'* were defined to include operating and financial reviews, integrated reports (as that term is defined in the Integrated Reporting Framework), and sustainability reports. Recommendation 7.4 anticipated and endorsed the recommended disclosures being included in integrated reports. Importantly, Recommendation 4.3 included a process integrity and credibility enhancement element and implied that independent external assurance could be a strong basis for directors to assert adoption of Recommendation 4.3 regarding reports of most significance to investors.

As compliance with ASX Corporate Governance Principles and Recommendations is required under ASX Listing Rules, Recommendations 4.3 and 7.4 have quasi-regulatory teeth, and the ASX has monitoring obligations as to the quality of Recommendation 4.3 and 7.4 disclosures under section 792 of the Corporations Act and enforcement powers under ASX Listing Rules. The ASX is expected to refer serious breaches of its Listing Rules to ASIC for enforcement action. This would include poor quality Recommendation 4.3 disclosures, including no disclosure.

The 2022 Deakin University Integrated Reporting Centre Recommendation 4.3 white paper

First time disclosures under Recommendation 4.3 were required under ASX Listing Rules for years commencing on or after 1 January 2020. The DIRC reviewed first time disclosures for the ASX 300 and reported thereon in a white paper published in 2022 Deakin Integrated Reporting Centre | Deakin. (https://www.deakin.edu.au/business/research/deakin-integrated-reporting-centre)

The white paper reported significant disparities between entities in the level and quality of their responses to Recommendation 4.3. 12% of entities provided no identifiable disclosure in relation to Recommendation 4.3 and a further 15% did not provide entity-specific disclosures (they were 'boilerplate'), in total 27% or almost a third of the population. A further 48% provided entity-specific disclosures but with only limited detail on how their integrity enhancing processes operated in practice. Accordingly, 75% of entities (three quarters) did not reach what Deakin would have rated as providing insightful disclosures for investors.

While 25% provided clear and comprehensive entity-specific descriptions of processes used to ensure the integrity of unaudited periodic corporate reports, these results indicate significant room for improvement. On that basis, the white paper made recommendations to each of preparers of corporate reports, the ASX Corporate Governance Council, the ASX and the professional accountancy bodies. The recommendation to the ASX was that it initiate an ongoing process (or strengthen any existing process) to monitor the quality of Recommendation 4.3 disclosures as required by section 792 of the Corporations Act.

Through Recommendations 4.3 and 7.4, the ASX Corporate Governance Council became a key participant in the Australian corporate reporting system. In so doing, the ASX Corporate Governance Principles and Recommendations have moved ahead of the ASIC Act in relation to corporate reporting. The ASX Corporate Governance Council was prescient given the subsequent developments in the global corporate reporting system in 2021 and 2022 in relation to integrated and sustainability reporting referred to above.

It would be appropriate to recognise the ASX Corporate Governance Council and ASX Corporate Governance Principles and Recommendations as a core component of the Australian corporate reporting system (refer comments below on Enhanced Potential Structure Two).

Australia is behind and must move quickly to catch up and benefit

Australia is perceived to be (and has been) 'missing in action' internationally for at least the last decade. This is evidenced by Australia achieving no initial appointments to the ISSB or its advisory bodies, not ranking for a regional centre / office of the ISSB, and no recent appointments to the IFRS Foundation Trustees being made.

On the other hand, Australia is well placed internationally on integrated reporting, integrated reporting assurance and integrated thinking through the DIRC and BRLF, and international roles of Australians, to take a lead. Given that these areas are all now within the peak global bodies for reporting and assurance, the IFRS Foundation and IAASB, Australia has channels through which it already has some influence internationally and so a channel to make our case for positions on the ISSB and IFRS Foundation Trustees.

However, having channels and even creating a 'third board' which looks like an Australian version of the ISSB, will not be enough. To turn this around will require the FRC looking more like the IFRS Foundation Trustees and IFRS Foundation organisation and Australia having a footprint within the IFRS Foundation's global operations, as countries such as Canada, Germany, Japan and China have achieved with the ISSB. The governments of those countries invested significant resources in having ISSB Regional Offices in the ISSB's multi-location model in advance of any IFRS Sustainability Standards being issued. In so doing, each country established a point of difference.

Integrated reporting and assurance and intangibles as a point of difference for Australia

Intangibles are a critical component of integrated reporting and integrated reporting is critical to an organisation getting the most out of its intangibles and communicating this to investors and other stakeholders.

We believe that an Australian point of difference *can* be shaped around integrated reporting, integrated thinking and integrated reporting assurance, given the importance of integrated reporting and integrated thinking to intangibles, and correspondingly the importance of intangibles to integrated reporting and integrated thinking. This will take time and investment. Under the 'six capitals' fundamental concept of the Integrated Reporting Framework, intellectual and human capital[5] provide the bulk of an organisation's intangibles.

In relation to human capital, intangibles extend further than diversity, equity and inclusion, which are the traditional focuses of ESG reporting. It extends to the strategic alignment of the organisation's people – its board of directors, management and the organisation at large, to how their goals are set and whether they align with the organisation's strategic objectives, how they perform in achieving those goals, and whether they are recognised, rewarded and remunerated according to that performance.

We believe that:

- integrated thinking and integrated reporting respectively provide CEOs with the ability to *unlock* **latent** intrinsic value of intangibles through **more integrated thinking**, complementing already known value, and
- integrated reporting and integrated reporting assurance provide boards of directors with a channel to *reveal* that latent intrinsic value to investors and other stakeholders in an **integrated report with independent assurance** as it is unlocked, such that a more optimal capital (all six capitals) allocation is achieved.

Research by EverEdge, a specialist management consultancy on intangibles, estimates that 85% of the enterprise value is comprised of intangibles, including the use of intangibles to manage ESG matters EverEdge Intangible Benchmark Index™ – EverEdge Global. That in itself is a case for integrated reporting.

The report revealed that Australia as a country struggles with unlocking the full intrinsic value of its intangibles. EverEdge estimated that the comparable metric in Australia is 56% of enterprise value. They argue that a proportion of this lower-than-global percentage is attributable to the dominant position of financial services in Australia, and the fact that Australia exports a significant proportion of its energy and natural resources without much value adding.

[5] Broadly, an organisation's intangible resources such as its innovative capability, intellectual property, technology and governance, strategic management and stakeholder relationship processes, and the relationships that it has with its stakeholders such as its customers, employees, suppliers, regulators and communities.

It would also be arguable that a proportion of the gap will be related to latent intrinsic value of intangibles, waiting to be unlocked through more integrated thinking and reported to stakeholders in independently assured integrated reports. The same is likely to be true in other countries around the world[6].

An IFRS Foundation Liaison Office in Australia?

We believe that integrated reporting, integrated thinking, integrated reporting assurance and intangibles can be a point of difference in Australia making the case to have a Regional or Liaison Office for the IFRS Foundation based on benefits to the IFRS Foundation as well as Australia in terms of its cost of capital, international competitiveness and confidence in its capital markets, matters referred to in Section 224 of the ASIC Act, **as well as business productivity**. These benefits would be transferrable globally.

This would of course require a significant up-front investment, in advance of the benefits being realised. However, the benefits would multiply the benefits from an Enhanced Potential Structure Two investment well beyond those that would be available from a 'reporting only' approach. This is our response to Questions 1 and 2 of the consultation.

We are making the case for Treasury to lift its sights well beyond climate disclosure and its own boundaries in compiling the position paper resulting from this consultation. In relation to Enhanced Potential Structure Two , we are suggesting:

- Building on the outcomes of and benefits from adopting Preferred Structures One and Two in reforming Australia's peak body for the Australian financial reporting system, the FRC
- Having at the centre of the FRC's mission all aspects of better business reporting and business practice, with a focus on alignment with the IFRS Foundation and its resources and the IAASB and its standards
- Aligning Australian financial reporting institutions and standard setting bodies with this mission
- Commissioning a study on the business case in relation to our recommendations, which would appear to be in line with the Treasurer's recent essay, to take to the IFRS Foundation Trustees. Deakin University through the DIRC would be delighted to conduct this study
- Treasury using the Deakin University Integrated Reporting Centre as an independent research centre
- Equipping the reformed FRC to pursue the model that emerges from the business case both in terms of specialist and financial resources
- Creating an IFRS Foundation Regional or Liaison Office, and housing within it an *Intangibles Centre of Excellence*, which would have as partners, interested governments and institutions from other jurisdictions such as New Zealand, Japan and Italy

To return to section 224 of the ASIC Act:

[6] This was likely to have been a key driver of Japan, including its Ministry of Economy, Trade and Industry, being one of the founders of the World Intellectual Capital Initiative (WICI), and the Japan Cabinet office being interested in the area of intangibles and WICI, and issuing the Japan Cabinet Office Guidelines for Governance and Disclosure of Intangible Assets

.

> "The **main objects** of this Part are … (b) to facilitate the Australian economy by: (i) reducing the cost of capital; and (ii) enabling Australian entities to compete effectively overseas; … and (c) to maintain investor confidence in the Australian economy (including its capital markets)."

Unlocking latent intrinsic value of intangibles through more integrated thinking, complementing already known value, and revealing that latent intrinsic value to investors and other stakeholders in an integrated report with independent assurance must be in the interests of a better Australian economy with:

- a lower cost of capital
- enhanced international competitiveness and confidence in its capital markets, and
- **improved business productivity**

We recommend that the third leg above be added to the main objects under section 224 of the ASIC Act.

This would go hand in hand with the existing functions of the FRC under section 225 of the ASIC Act which include, *"The FRC functions are: (g) to advance and promote the main objects of this Part."* The change to section 224 would re-define the role of the FRC to be more in keeping with the Treasurer's vision for a modernised version of capitalism which goes beyond how financial reporting is done to its outcomes and impacts.

Timeliness of Treasury consultation

The world has changed and the global corporate reporting system has changed with it. Australia should not forget how it 'punched above its weight' 20 years ago – the world benefit from Australia catching up as well as Australia. Australia should want to take a similar approach to what it did 20 years ago with the IFRS Sustainability Standards, Integrated Reporting Framework, Integrated Thinking Principles and IAASB Sustainability Assurance Standards.

The Treasury climate-related financial disclosure consultation paper is timely and relevant from a whole-of-system perspective given international developments in relation to IFRS S1 and S2, future IFRS Sustainability Standards and the Integrated Reporting Framework, as well as the currently proposed changes to the ASIC Act to enable the AASB to develop Australian equivalents of ISSB standards.

If the need for change was only about climate reporting and the ISSB's proposed standard IFRS S2, Potential Structure One may be sufficient. However, the global developments and role of the ASX Corporate Governance Principles and Recommendations are more pervasive and deserve the Australian Government / Treasury's attention now, in relation to this consultation. They lead us to conclude that Potential Structures One and Two and Enhanced Potential Structure Three should be pursued on a phased but parallel basis.