

**Response to
The Australian Government
Climate-related financial disclosure consultation paper**

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By Ken Garrard



Background:

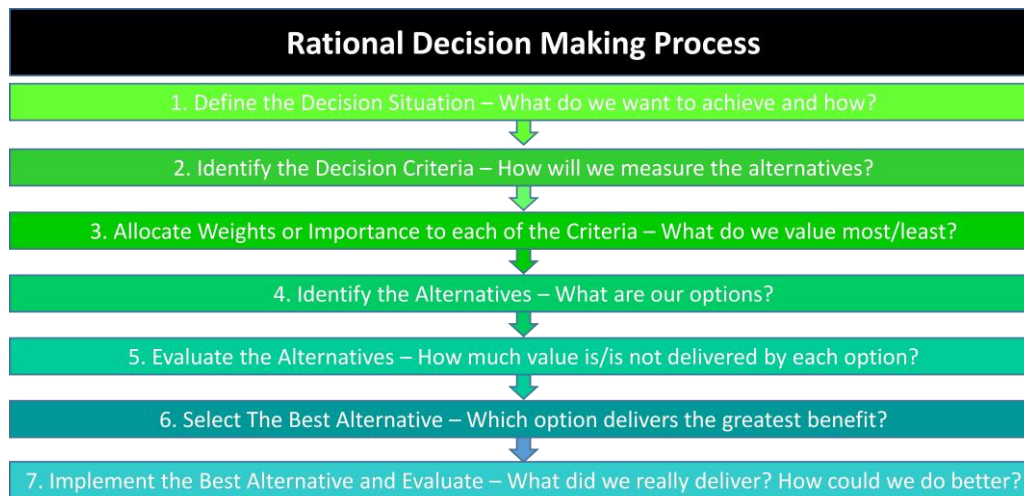
Ken is a C-level technology and business professional with more than four decades steering strategy and visionary transformation and technology plans for large and complex entities.

Ken is an acknowledge subject matter expert in strategy, portfolio, program, project, organisational change and benefits management. Ken is also acknowledged by his peers as a thought leader in identification, analysis, optimisation, selection and prioritisation of project portfolios.

Ken and his wife, Patricia have established a company, Kepa Software Pty Ltd, and a product, AppO, that helps business select and prioritise project portfolios.

Before I start, let's just confirm the basics.

- A. Every person or business on the planet makes decisions which, if they are rational, should be delivered through the Rational Decision Making Process:



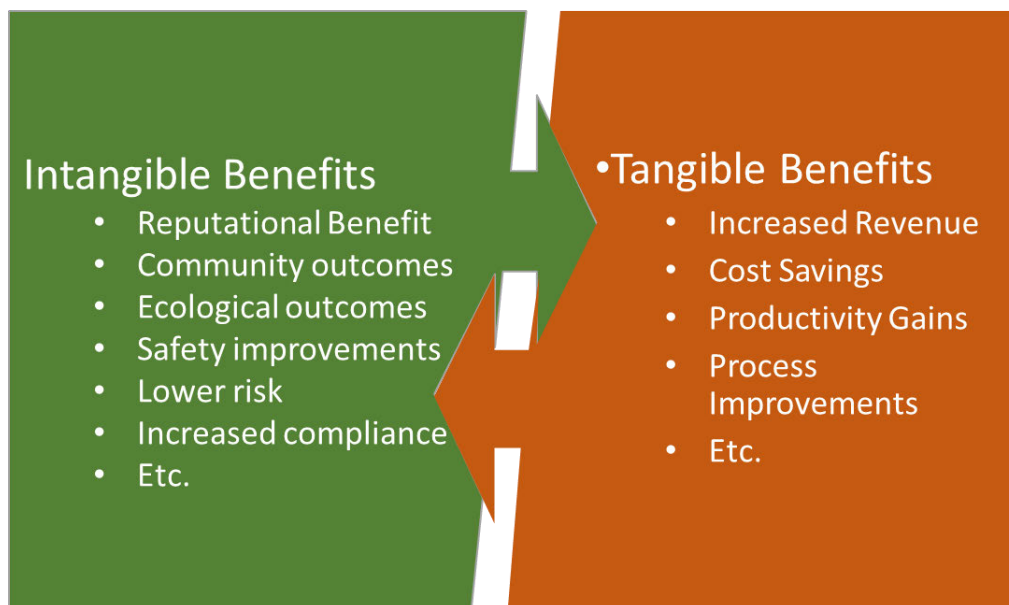
- B. Selection of strategic and tactical activities by an organisation are decisions not to select a single solution but to select and prioritise a range of solutions designed to meet perceived business requirements. The injection of requirements for climate-related disclosures will forcibly inject a range of strategic and tactical activities that will need to be prioritised with others injected by the organisation's strategy development and continuous improvement processes.
- C. Sadly, when making decisions people take short-cuts, receive poor advice, or inject some emotion or bias that leads to less than optimal outcomes. It is these impediments to decision-making that **MUST** be addressed in any system that purports to deliver ethics and transparency.
- D. It is claimed that "The disclosure requirements would force businesses and parts of the public sector to disclose whether their activities are **environmentally sustainable**", which is flawed because the way in which requirements appear to be framed would force businesses and parts of the public sector to disclose whether their activities are **financially sustainable, as opposed to environmentally sustainable**.
- E. Many jurisdictions that have established programs to legislate or regulate climate related disclosures have inappropriately narrowed their focus to only include financial disclosures rather than a broader view of climate-related behaviours. Australia has an opportunity to lead the world by broadening the focus.
- F. Step 5 of the Rational Decision Making Process implies an iterative approach by testing various scenarios to cover risk management, sensitivity analysis etc.

So, now let's get to it

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)?

1. As time proceeds the risk to Australia and Australian business due to climate change will vary relative to success or otherwise of global initiatives to combat climate change. Therefore, behaviours must be driven relative to a changing risk profile.

2. While the cost of many outcomes and activities such as deaths attributable to GHG emissions, mitigation of some forms of risk, and replacement of non-sustainable assets can be calculated and therefore used in financial statements there are value measures (expected benefits or dis-benefits) such as some scope 3 emissions, reputational changes, some forms of risk, and changes in operational safety that cannot be assessed financially or would not be economic to estimate financially. An organisation's natural response will be to generally ignore value measures that cannot be financially assessed or are not economic to do so.
3. A key dimension in any business decision is the importance ascribed to any value measure used in the decision, as per Step 3 of the Rational Decision Making Process. It is useless to regulate financial disclosure without some assurance that appropriate consideration has been given to each value measure used in the decision-making process.
4. Governance and gateway review processes within both government and corporate organisations will need to be adjusted to ensure that activities are appropriately selected (as per Step 2 of the Rational Decision Making Process) and prioritised (as per Step 3 of the Rational Decision Making Process) taking into account value measures such as ecological outcomes (GHG emissions for example) rather than solely financial outcomes. Those processes must therefore be able to compare tangible and intangible value measures (In Step 5 of the Rational Decision Making Process) with appropriate weighting applied to each, which is beyond the capability of most Australian businesses due to their lack of application of multi-criteria decision analysis (MCDA) in support of those processes.



5. MCDA is routinely used around the world to support a very broad array of complex decisions, such as those involving a large number of alternative solutions that must be assessed using a complex mix of tangible and intangible value measures. MCDA, when applied to business transformation project portfolios has been demonstrated to provide significant savings, largely from identification of what is not of sufficient value to execute.
6. As global or even local risk increases or decreases, an appropriate focus must be applied to addressing specific tangible and intangible outcomes. It would therefore be appropriate to legislate the use of MCDA in selecting and prioritising activities to address the outcomes of climate-related change and regulate standards for MCDA application including:
 - Regulate the ranges of importance that could be applied during MCDA for specific groups of value measures relative to current (and changeable) levels of global risk. This

will provide government an ability to change key levers driving climate-related activities over time as required without legislative change.

- Regulate the usage of MCDA outputs in support of climate-related disclosure.
- Regulate the requirement for appropriate levels of audit of the rationale for selection of value measures and assigning importance to any value measures used in MCDA. This will provide an extremely strong level of assurance to investors that reported climate-related activities are being selected and prioritised transparently and rationally. In this scenario “greenwashing” cannot exist. Australia’s climate-related disclosure regime will be among the most transparent and therefore trusted in the world.

It is my contention that any attempt to provide assurance of ethical behaviour and transparency will need to regulate Steps 2 to 5 of the Rational Decision Making Process:

2. The selection of value measures (benefits or dis-benefits) used to assess the effect of investment in activity to address climate-related impacts. This could be accommodated by setting framework standards and providing guidance for value the measures that can be included.
3. The definition of the importance (weighting) of value measures relative to each other. This could be accommodated by regulating a clear process by which a consensus position and related scenario positions might be generated.
4. The identification of alternatives that might address the problem. This could be accommodated by providing guidelines related to ethical behaviours in the identification process.
5. The evaluation of the alternatives. This could be accommodated by defining standards for evaluation of the alternatives.

If we do not regulate acceptable behaviour in each of these steps we will leave the system open to deceitful behaviour, currently known as “Greenwashing”.

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

Assurance should be provided by both internal and external audit to allow for differences in size and complexity of organisations, smaller organisations may not require external audit. External audit services could be provided by accredited climate-related assessors. Assessment must be kept separate from regulatory and governance bodies.

As an example of the impetus to drive standards for ESG professionals, The Chartered Financial Analyst Institute (CFA Institute) located in Virginia, U.S.A, offers an academically recognised Certificate in ESG Investing that is available in most global markets but notably not mainland China. From “Future of Sustainability”, CFA Institute, 2020 - *“There are more than 170,000 CFA® charterholders worldwide, 85% of which now take E, S and/or G factors into consideration.”*

According to The Sustainability Institute there are already over 650 organisations, currently unregulated, that rate and rank companies and provide ESG data to the global market, which has led to a pool of behaviour and performance data and a sharp rise in the routine usage of that data for investment due diligence, organisation valuation and monitoring of investments, which has also then logically led to differentials in share prices of organisations that can demonstrate appropriate ESG credentials.

It will be incumbent upon the Australian government to ensure that climate-related assessments have similar levels of rigour to our existing financial regimes thus the government should consider setting accreditation standards with requirements for tertiary qualifications for licenced climate-related assessors in support of the assessment of climate-related disclosures.

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?

Please see the above response to Question 5.

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?

The single most important data challenge to understanding if an organisation's climate-related disclosures are transparent and their behaviour is appropriate and ethical is being able to identify which value measures (benefits and dis-benefits) are being used to value the opportunities and the relative importance of the value measures.

For example, if an organisation is incapable of assessing a critical value measure they will most often ignore that value measure or put risk management behaviour in place rather than address the source of the issue. Even if a critical value measure is assigned relatively small importance the resultant activity is very likely to be similar to the measure being ignored and it will not be possible to understand if:

- The activity has been selected rationally and appropriately relative to the importance of addressing climate-related change; or
- Climate-related disclosures are transparent.

While there are millions of possible applications of multi-criteria decision analysis (MCDA) it is routinely used by a relatively small number of organisations, such as NASA, and generally by only a few industries, such as healthcare. MCDA could significantly benefit businesses around the world by helping them make much more robust decisions in the light of complexity driven from multiple possible solutions that have to be assessed by a complex mix of tangible and intangible value measures. The cost of MCDA will be determined by the cost of tools and the cost of expended people resource, the total of which has almost universally been shown to be significantly exceeded by the savings derived from improved decision-making.

If an organisation uses MCDA embodied in an appropriate tool they will need to provide four inputs to the tool:

- Define the alternative solutions to the decision, such as the projects – /activities to be considered – This activity is required even if they don't use MCDA and will normally be readily available within their governance and gateway review processes and systems
- Define the measures used to value the alternative solutions – To some extent this activity is required even if they don't use MCDA and will normally be readily available within their governance and gateway review processes and systems

- Define the relative importance of value measures when assessing the alternative solutions – Most organisations ignore other than financial measures, which is a basic flaw if the decision includes non-tangible value measures. The effort involved will usually be less than a person-week for a basic approach and will then be subject to continuous improvement processes.
- Assess the likely outcomes from each alternative solution in relation to each value measure – Since most organisations only use financial measures there will be marginal additional work in assessment.

If all of these four inputs are auditable it creates a process and data sufficient to prove the transparency of decision-making and thus the selection and execution of climate-related activities as well as the transparency of climate-related disclosures. If such were to occur Australia would lead the world in climate-related disclosure standards and transparency.

Additionally, it is my contention that legislating/regulating the usage of MCDA broadly across Australian enterprise will provide savings that could approach one percent of the entire cost base.

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?

Please refer to my responses to Questions 5 and 13 above. In those responses you will note my contention that any system that purports to provide assurance of ethical behaviour and reporting transparency must regulate Steps 2 to 5 of the Rational Decision Making Process as shown above (prior to responses to any questions).

The application of scenarios will apply at Step 5 of the Rational Decision Making Process.

I believe the way to control Step 5 includes:

- Regulating the framework of value measures (benefits and dis-benefits) to be used in assessing potential opportunities (Control Step 2 of the Rational Decision Making Process). It may not be possible to identify a single framework, however, it would be possible for government to provide a minimal framework and guidance for the selection of additional value measures. N.B. If an opportunity does not contribute to a particular benefit or dis-benefit the total assessment of impact (business value) will not be affected.
- Regulating the relative importance of value measures (benefits or dis-benefits) to be used in evaluating the alternative solutions (Control Step 3 of the Rational Decision Making Process). There should definitely be guidance on the allowable range of values for importance of the group of value measures that relate to GHG emissions, perhaps by setting a minimum.
- Regulating the identification of alternatives that might address the problem. This could be accommodated by providing guidelines related to ethical behaviours in the identification process (Control Step 4 of the Rational Decision Making Process).
- The evaluation of the alternatives. This could be accommodated by defining standards for evaluation of the alternatives (Control Step 5 of the Rational Decision Making Process).

Standards for application of Multi-criteria Decision Analysis could be provided by the existing entities that regulate and govern existing financial standards.

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?

By legislating the use of Multi-criteria Decision Analysis and regulating standards and guidelines for value measure (benefits and dis-benefits) frameworks and relative importance of value measures government will have provided the levers to control behaviours and outcomes while also providing sufficient flexibility to adjust frameworks and relative importance over time.