THE UNIVERSITY OF MELBOURNE

FACULTY OF BUSINESS & ECONOMICS

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

TO WHOM IT MAY CONCERN

Please find following for responses to key questions contained in the Treasury consultation paper on Climate-related financial disclosure. We greatly appreciate the opportunity to provide our input.

Should you have any questions in relation to the responses herein, or seek any additional information, please do not hesitate to contact us as per the details below.

We hope these responses are helpful.

Yours sincerely,

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Submission to the Treasury's consultation paper on Climate-related financial disclosure

Friday, 17 February 2023

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Process

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?

Given the measurement and conceptual complexities involved (Christensen et al, 2021), we are in favour of a careful, but also rigorous and informed debate about the costs and benefits of climate reporting. There is little doubt that significant changes to the reporting requirements for firms can have significant cost implications. Further, where these costs do occur, they are likely to be visible in dollar terms and immediate (short term). However, while benefits from this additional reporting may flow to the firms, they are unlikely to be immediately evident in dollar terms. Such benefits are likely to be derived within firms where improved reporting leads to better information and systems and an enhanced ability to understand and manage their exposures related to climate change and other sustainability issues. A greater benefit will likely be for report users and society more generally. Research has provided evidence of benefits to providing information to investors, with concomitant effects on market valuations. This imbalance in benefit across stakeholders should not be a hurdle to meeting expectations.

Christensen, H.B., Hail, L. & Leuz, C. Mandatory CSR and sustainability reporting: economic analysis and literature review. Rev Account Stud 26, 1176–1248 (2021). https://doi.org/10.1007/s11142-021-09609-5.

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

Failing to align with international practice will put Australian firms at a global disadvantage and could constrain the flow of capital into the country.

Covered entities and timing

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

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

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?

Regarding the coverage and timing of the requirements, we do not believe legal structure or size of firm to be the best concept for determining/driving implementation. We believe the correct concept to drive rollout and implementation of the requirements should be the materiality of climate impacts.

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?

Companies that are already mandated to disclose carbon emissions and other climate-related disclosures should be included in the first phase. Companies should be asked to "disclose or explain why not" because this helps distinguish no disclosure from non-disclosure.

International alignment of disclosures

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

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

We do not see anything particularly unique/different about the Australian context that requires changes to the nature or approach to implementation.

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?

Given the alignment of Australia with IASB, we believe the basic approach by the ISSB should be employed in Australia. However, we believe that there is an immediate opportunity to require Australian firms to provide more informative disclosure regarding climate scenario analysis. There is significant variation in the nature and type of climate disclosures by ASX 100 (Ding et al. 2023) and yet we have fewer institutional impediments for developing effective disclosures. There is a clear opportunity to improve disclosure in this regard. More specifically, we could consider mandating reporting based upon standardized scenarios or provide specific disclosure requirements (such as assumptions employed) that would help stakeholders to interpret the risks and management strategies related to climate change.

Ding, T., Jona, J., Potter, B. and Soderstrom, N. (2023) Research report on Climate Scenario Disclosure by ASX 100 (2020-2021), Research prepared for the Australian Accounting Standards Board.

Regulatory framework for required disclosures

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 believe that Australia should incorporate the obligations for disclosure into legislation and that the detailed requirements should be built out and implemented via standards and guidance. This way, the requirements would have greater chance of becoming deeply/appropriately embedded into the existing legislation and standard setting framework rather than as a separate disclosure mandate via regulators such as ASIC. If these disclosures are seen as an add-on, or somehow separate and distinct from existing reporting, implementation may also be disconnected and ad hoc, leading to variability in key dimensions of reporting, impeding comparisons and benchmarking. This will reduce a continuing need to harmonize across regulations and will provide the basis for future expansion/evolution of sustainability reporting to incorporate other dimensions. This strategy will also reduce the costs associated with development and implementation of the requirements and costs of compliance with the regulations.

Periodic reporting requirements

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?

We do not believe that the specific location of the information within the reports is crucial, what is most important is the connectedness of the information. This applies as long as: 1) the timing and periodicity of the information reported (financial, climate) reports is the same; 2) users have specific links to allow access to the entirety of the disclosures available across platforms; and 3) the reporting provides explicit conceptual linkages and value-related implications between the financial and non-financial information provided. An obvious example of this last point is in the case of the valuation of long term assets and the potential implications of climate for influencing the valuations disclosed.

Materiality of climate risks & Assurance of climate risks

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)?

Materiality is problematic in the financial setting, with relevant research findings consistently indicating that key stakeholders in financial reporting typically revert to using quantitative-based heuristics in making materiality judgements (Choudhary et al. 2019). It becomes more complicated when sustainability considerations are included (Reimsbach et al. 2020). We believe that adding sustainability-related guidance regarding the definition of materiality is crucial. The guidance must be clear on to whom issues are material, in order for the disclosures to become appropriately embedded in reports produced by companies. If the primary user of financial reporting is providers of capital, then materiality should be focused on their decisions. We realize that sustainability is related to longer term considerations, but without providing some focus, companies will be able to manage their approach to materiality, which can impair the quality of reporting for the focal decision-makers.

Choudhary, P., Merkley, K., & Schipper, K. (2019). Auditors' quantitative materiality judgments: Properties and implications for financial reporting reliability. Journal of Accounting Research, 57(5), 1303-1351.

Reimsbach, D., Schiemann, F., Hahn, R., & Schmiedchen, E. (2020). In the Eyes of the Beholder: Experimental Evidence on the Contested Nature of Materiality in Sustainability Reporting. Organization & Environment, 33(4), 624–651. https://doi.org/10.1177/1086026619875436

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?

Assurers should be independent and should satisfy quality standards. Research has consistently shown that the market values high levels of assurance by high quality financial statement auditors. Assurance of sustainability-related information has also been shown to be valuable to the market.

Reporting of metrics (including emissions), offsets and transition plans

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 believe only material emissions should be reported.

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

Yes, common baseline of metrics is important for comparison and benchmarking and to give report users confidence in the information being reported. The disclosure of these metrics should occur, predicated on their materiality.

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?

Consistent with our response to 4.2, above there should be standardized disclosures in key dimensions of sustainability. In this area, such disclosures should include specific information about the governance structures regarding climate risk management such as existence of a committee of the board of directors, existence of a Chief Sustainability Officer, design of the reporting structure for climate-related matters, etc.

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

We do not have strong views on this question.

Data and capability to support climate reporting

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

The capability challenges are extreme. Most universities are seeking to address this, in part, in accredited courses, but it will take several years for current graduates to be meaningfully helping companies in this area. We need a platform and government support/sponsorship of training programs that can make the expertise that is available at our universities more immediately accessible to business as they adapt to the new disclosure regulations. This type of resource is necessary for current accounting and finance professionals, assurance providers, and particularly, small business owners. A more environmentally sustainable future is not merely a technical issue that can be entirely driven by the development and implementation of technical reporting requirements for which compliance is required. We agree this is a key part, but in in addition, if disclosure is to be a catalyst for a more sustainable business sector, then capability development is required to assist these groups to think differently about how to achieve a more sustainable future.

13.1 How and by whom might any data gaps be addressed?

We believe there is a collective responsibility to address these gaps. Universities are an important platform that can convene multiple actors and catalyse action nationally.

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

We are not aware of any initiatives in overseas jurisdictions that are particularly useful for Australia.

Governance of supporting information for disclosures

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?

Standardized sources of information/data for input into scenario analysis needs to be readily accessible, with experts or leads to resources available to help businesses implement the scenario analyses. This is crucial for benchmarking and comparison.

Proportionate application of liability

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?

The reasonable grounds test regarding disclosure of forward-looking estimates should be sufficient.

Interaction with other reporting obligations

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?

Climate risk does not tend to materially change based upon specific events. Any specific costs/benefits arising from specific events should be reported their financial consequences through the normal reporting channels. As a result, we do not believe that there should be a conflict with other reporting obligations.

Other implementation issues

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?

See our answer to Question 5.

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

The key for effective climate-related reporting is that it is meaningfully connected to other parts of the firm activities and particularly the core business (and financial results) of the firm.

Ensuring the financial reporting framework is fit for purpose to support climate risk disclosures

Potential Structure 1. Confirm the AASB as the entity responsible for developing, making, and monitoring climate and sustainability related standard

Potential Structure 2. Establish a separate sustainability standards board

Potential Structure 3. Reform existing financial reporting bodies into a single, flexible entity

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 believe that Structure 1 is preferred. Since sustainability reporting to be an extension of corporate reporting as overseen by the AASB, we believe the appropriate home for sustainability reporting should be the AASB. The AASB has an established standard setting infrastructure that can be drawn on, creating efficiencies. However, it is also clear that developing the structure to support the AASB in overseeing such a significant change in the nature of reporting is critical. This will likely involve extending the board further and bringing in further technical expertise. It is important to develop and implement appropriate mechanisms to manage effectively the sustainability workplan and agenda.