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Office of Australian Accounting Standards Board

PO Box 204
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Australia

RE: Exposure Draft ED SR1 Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information

Who we are

Governance Institute of Australia (Governance Institute) is a national membership association that advocates for a community of governance and risk management professionals, equipping over 8,000 members with the tools to drive better governance within their organisation. Our members have primary responsibility for developing and implementing governance frameworks in public listed, unlisted, and private companies, as well as the public sector and not-for-profit organisations. They have a thorough working knowledge of the operations of the markets and the needs of investors.

We regularly contribute to the formation of public policy through our interactions with Treasury, ASIC, APRA, ACCC, ASX, ACNC and the ATO. We are a founding member of the ASX Corporate Governance Council. We are also a member of the ASIC Business Advisory Committee, the ASX Business Committee and the ACNC Sector Users Group.

Our members response to the consultation issues is set out below. Overall, we support standards that are internationally aligned, interoperable, flexible and allow for reduced or voluntary disclosure requirements for not-for-profits and smaller entities.

1. **Presenting the core content of IFRS S1 in ASRS Standards**

Climate-related financial disclosure is international in character and is advancing and changing quickly, which means that there will be changes to IFRS S1 and S2 continuing into the foreseeable future. Close alignment with international standards is necessary to allow international investors to compare and assess risk across capital markets more effectively. Climate-related financial disclosures by Australian entities should reflect international standards to minimise any friction or unintended impact on foreign investment. Governance Institute's members have considered all three options presented and consider Option 2 as the most appropriate course. It is critical at the

early stages of developing the ASRS that harmonisation and interoperability with international standards be prioritised.

A core concern for our members is that the current proposed drafting of ASRS 1 and 2 is a significant departure from IFRS S1 and S2. The replacement of terms and removal of paragraphs means that further updates to ASRS to reflect changes globally will become a difficult and costly exercise. ASRS should be designed to be harmonised, interoperable and agile to keep pace with changes at the international level.

To simplify the implementation and any future amendment processes, the addition of a scope paragraph or clause where it refers sustainability to mean climate to give effect to ASRS 2 should be considered. The addition, amendment or removal of a scope paragraph will allow for domestic standards to respond more flexibly to international standards' changes as and when needed. For instance, the scope of reporting or expansion beyond climate to incorporate further environmental externalities such as nature reporting can be adjusted via the scope paragraph rather than requiring extensive, costly and time-consuming amendments to the substantive elements of the ASRS 1 and 2.

Governance Institute recommends:

- The adoption of Option 2 – two ASRS Standards where the same requirements in respect to disclosures of governance, strategy and risk management would be included in both Standards.
- Implementation of a scope paragraph in ASRS 1 that refers 'sustainability' to mean 'climate' to give effect to ASRS 2.
- Prioritisation of alignment and interoperability with international standards to allow for more effective global investor risk assessment and decision making.

2. Entities that do not have material climate-related risks and opportunities.

Governance Institute's members consider it necessary to clarify how materiality should be assessed in a way that satisfies the requirements under the Corporations Act, noting that these have not yet been finalised. Under the current draft of the Standard, if an entity determines that there are no material climate-related risks and opportunities that could reasonably be expected to affect the entity's prospects, the entity is to disclose that fact and explain how it came to that conclusion in its general-purpose financial reports.

Our members consider there are potential issues because there may be different concepts of materiality and what it constitutes. For this reason, there needs to be a clear definition of materiality and how materiality risks should be assessed. The concept of materiality is further complicated when applied to entities in the not-for-profit sector or business entity types that are comprised of members rather than investors such as companies limited by guarantee. Materiality assessments should be a relatively simple and cost-effective exercise.

Minimum standards of appropriate methodology and governance processes should be outlined in the Standard as a guide to ensure that directors have confidence in an entity's position on materiality. This will require further guidance on materiality in the context of ASRS S1 and S2.

Governance Institute recommends:

- A clear definition of materiality and how materiality risk should be assessed including guidance on methods or governance processes that would reasonably satisfy the proposed regulatory requirements.

3. **Climate resilience**

IFRS S2 does not prescribe the number of scenarios an entity is required to consider to meet the disclosure objective of IFRS S2 paragraph 22. The Australian Government's Policy Position states that entities should use at least two possible future scenarios - one of these scenarios must align with the most ambitious global temperature goal in the *Climate Change Act 2022*.

Governance Institute's members support the intent of reporting entities aligning with the Paris Agreement's ambitious 1.5-degree temperature target, however, given the current projections, global temperatures are expected to increase by 1.5 degrees Celsius above pre-industrial levels much sooner than previously projected. Global temperatures are on track to increase by 2.5-2.9 degrees by the end of the century based on ratified Nationally Determined Commitments (NDCs) globally.

Our members consider that a minimum of two scenarios should be standardised and that requiring entities to report on three or more is likely to create significant costs of compliance. Some flexibility for entities to determine an upper-bound temperature target is required. The Standards could provide guidance to reporting entities about the models to be used. Without this guidance, reporting entities may use vastly different upper-temperature scenarios resulting in significantly different climate future, impacts and opportunities. This would also make it difficult for investors to compare and assess this information across entities.

It may prove useful to consider a streamlined scenario reporting standard for smaller entities that may find it too complex or difficult to report on two or more scenarios. The standard for smaller entity types could refer to a smaller sub-set of scenario analyses that may be based on more qualitative data rather than costly quantitative data that may be subject to large error margins.

Governance Institute recommends:

- Limiting the minimum number of scenarios to no more than two but acknowledging that voluntary reporting of more than two scenarios is permitted.
- Providing guidance to reporting entities on the models to be used.
- Consideration of simplified scenario analysis/reporting for smaller entity types

4. **GHG emissions – definition of greenhouse gases**

Governance Institute's members do not support the AASB's proposal to incorporate in ASRS 2 the definition of greenhouse gases from IFRS S2 without any modification, as one of those gases, nitrogen trifluoride (NF_3), is not listed in the *National Greenhouse and Energy Reporting Act 2007* and related regulations (NGER Scheme legislation) as a class of greenhouse gas.

As Australian entities do not have a significant presence in the manufacturing of items containing NF_3 it is not useful for Australian entities to caveat reporting of NF_3 emissions. This also creates an additional difference between NGER Scheme and the ASRS, which should be avoided where possible.

Governance Institute recommends:

- Removing nitrogen trifluoride (NF_3), from the ASRS 2 definition of Greenhouse gases.

5. GHG emissions—GHG measurement methodologies

Governance Institute's members emphasise the need for flexibility over the prioritisation of measurement methodologies. GHG measurement methodology standards should provide entities with some flexibility to report according to existing internationally aligned measurement methodologies, under the GHG protocol whilst appreciating the world-class reporting standard of NGERs. This is to reflect the fact that NGERs does not cover all industries or scope 3 methodologies and that some large entities are already reporting in line with GHG protocol methodologies. Flexibility is required to allow for reporting entities to decide what best reflect their requirements, particularly for internationally exposed businesses that may already report under EU directives and the GHG protocol.

A further issue raised in our submission to the Treasury consultation on Climate-related financial disclosure legislation is that there is no provision for interaction between the NGER reporting requirements and the proposed climate-related financial disclosures.[1] NGER reports are due on 31 October each year while most Australian entities produce financial reports as of 30 June each year. This means that some entities may not be able to provide the required data by 1 July each year and/or will need to create a second set of data to meet the new reporting requirements. This may result in companies expediting other regulatory reporting resulting in increased risk of errors and misstatements.

A further issue is identified in Clause 31.1(d), that requires disclosing entities to 31.1(d)(i) to disaggregate emissions from the consolidated accounting group and other investees excluded from (d)(i) such as associates, joint ventures, and unconsolidated subsidiaries. This suggests that disclosing entities would need to report using the equity-share approach from associates, joint ventures, and unconsolidated subsidiaries, while attempting to align with NGERs, which uses the operational control approach.

An equity-share approach is fundamentally at odds with the operational control approach in the NGERS scheme. IFRS S2, clause B27 in Appendix B provides some clarity for disclosing entities under the ISSB which gives the option of using the control approach. However, this clause has been deleted from the ASRS. Requiring disclosing entities to adopt the equity share (rather than the operational control) approach conflates Scope 1 and Scope 2 with Scope 3 data under the operational control approach and may result in duplication in datasets where entities such as incorporated joint venture emissions are reported twice. There are significant implications for

[1] https://www.governanceinstitute.com.au/app/uploads/2024/02/Submission-Treasury-TLAB-2024-Climate-related-financial-disclosure-Final-9-February-2023-1.pdf

disclosing entities' and auditors' ability to assure datasets that fall under another organisation's control in a timely manner.

The reporting cycle of the ASRS (for 30 June financial year reporters) is out of sync with the reporting date for the NGER scheme (31 October annually). This may result in companies expediting other regulatory reporting resulting in increased risk of errors and misstatements.

Governance Institute recommends:

- Providing entities with the flexibility to adopt the GHG methodology standards that best suit their practical business requirements and existing international reporting requirements.
- Considering the practical effect of the mismatch of reporting dates between NGERs reporting, due 31 October and financial reporting timelines due end of the financial year, June 30.

6. GHG emissions—Scope 3 GHG emission categories

The AASB's proposal to include the Scope 3 GHG emission categories in IFRS S2 as examples of categories that an entity could consider when disclosing the sources of its Scope 3 GHG emissions will not go far enough in driving consistency of reporting. However, it would be practically useful for smaller entities to be guided and supported in provided this information up the supply chain. A requirement to categorise the sources of emissions in accordance with those listed in the GHG Protocol Standard is critical when disclosing the sources of Scope 3 GHG emissions as this will drive consistency across international supply chains. We anticipate that smaller sized entities will be guided by larger entities across this complex area of reporting.

We note that, Scope 3 emissions are defined in the draft legislation of the Climate-related financial disclosures legislation as having the same meaning as in the Corporate Value Chain (Scope 3) Accounting and Reporting Standard, published by the World Business Council for Sustainable Development and the World Resources Institute, as existing on the commencement of this definition. We consider that any such amendments to that definition by the World Business Council following the commencement date of the legislation would have the effect of creating inconsistency. It is suggested that the definition of Scope 3 emissions and associated categories reflects up-to-date definitions and prescribes entities to report against consistent GHG emissions categories under the GHG Protocol Standard.

Governance Institute recommends:

- Entities should be required to categorise the sources of emissions in accordance with categories of the GHG Protocol Standards to drive consistency across international supply chains.
- Supporting smaller entities through practical guidance on how to identify and categorise Scope 3 emissions across the value chain as required.

7. Cross-industry metrics disclosures – remuneration disclosure

Governance Institute does not support the proposed requirements in draft ASRS 2 paragraphs 29(g) and Aus29.1 to disclose:

a) a description of whether and how climate-related considerations are factored into executive remuneration; and
b) the percentage of executive management remuneration recognised in the current period that is linked to climate-related considerations.

It would be practically impossible to report how climate-related considerations are factored into executive remuneration for most entities and the requirement lacks clarity or specificity on what would be required. Most large entities struggle to quantify this measure, and we are of the view that industry does not have sufficient maturity to provide practically useful information. Our members are also concerned about publishing this type of commercially sensitive information.

Governance Institute recommends:

- Abolition or deferral of the proposed remuneration disclosure standard based on the practical difficulties to provide useful information and the commercially sensitive nature of the information required.

8. Not-for-profit and smaller-sized entities

Governance Institute emphasises the scalability and cost-benefit concerns of climate-related financial disclosure requirements for not-for-profit and smaller entities. The lack of proportionality of IFRS Sustainability Disclosure Standards are a significant barrier to implementation for small-to-medium sized entities and not-for-profit private sector entities. Further, the significant upskilling required and the resource gap in the domestic and international markets in preparation for climate-related financial information is an issue that would be exacerbated across the not-for-profit sector due to time and resource constraints of those entities.

Not-for-profit entities should not be required to undertake an exhaustive search for information to identify climate-related risks and opportunities that could reasonably be expected to affect their prospects. The proposed requirement to prepare material climate-related financial information for which reasonable and supportable information is available to the entity at the reporting date without undue cost or effort is emphasised however a better view is that not-for-profit entities should be excluded from reporting. Voluntary reporting by not-for-profits should be encouraged and there should be greater efforts to build capacity over the short-to-medium term.

Capturing qualitative information on the current effects of climate-related risks and opportunities on these entities business models, strategy and decision making will still require upskilling and guidance. The preparation of information, to determine the overall risk profile and risk management processes to identify, assess, prioritise and monitor climate-related risks and opportunities is also likely to be costly.

Our members have concerns with the proposed objective for a not-for-profit entity to disclose information about climate-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, access to finance or cost of capital, and its ability to further its objectives, over the short, medium or long term. The expectation to provide this type of information would prove potentially costly and problematic for a not-for-profit entity to consider and disclose. For instance, access to finance and cost of capital is more accurately assessed and

measured by financial institutions when assessing credit risk and it is unknown what value a not-for-profit entity's qualitative assessment would have. There is no confidence that not-for-profit entities would have the skills to provide this type of information. This is further complicated by the proposed direction to assess material credit risks over the short, medium and long-term.

Our members consider that the regulatory burden of the proposals on Group 3 entities is disproportionate to the benefits of requiring these entities to make climate-related financial disclosures, given many of them currently have no external reporting obligations. We are of the view that not-for-profits should be excluded from the reporting requirements.

Governance Institute recommends:

- A reduced or voluntary disclosure regime for not-for-profit and smaller entities.
- Abolition of the expectation to report on the risk and opportunities on an entity's cash flow, access to finance or cost of capital in the short, medium and long term as this information is more accurately captured by financial institution when assessing credit risk.

Governance Institute emphasises the need for standards that are internationally aligned, interoperable, flexible and allow for reduced or voluntary disclosure requirements for not-for-profits and smaller entities.

If you have any questions in connection with this Submission, please contact me or Daniel Popovski, Senior Advisor, Policy and Advocacy.

Yours faithfully,

Megan Motto
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