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1 March 2024

Australian Accounting Standards Board

Submitted electronically

To whom it may concern,

Climateworks Centre submission on Exposure Draft ED SR1 Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information

Climateworks Centre welcomes the opportunity to respond to the Australian Accounting Standards Board's (AASB) consultation on Exposure Draft ED SR1 (the Exposure Draft). Climateworks bridges the gap between research and climate action, operating as an independent not-for-profit within Monash University. Climateworks develops specialist knowledge to accelerate emissions reduction, in line with the global 1.5°C temperature goal, across Australia, Southeast Asia and the Pacific.

Climateworks responded to the three rounds of Treasury consultation on this topic, drawing on our extensive work with corporations and business associations to encourage effective business reporting on climate risks, opportunities and credible transition plans. Our work includes developing frameworks for meeting International Sustainability Standards Board (ISSB) guidance – as well as other emerging international best practice such as those developed by the United Kingdom Transition Plan Taskforce – and advising on climate scenarios and emissions reduction actions. In 2022, Climateworks supported the Australian Council of Superannuation Investors (ACSI) to assess transition planning and climate risk in ASX200 companies (ACSI 2022).

Climateworks is engaging with leading Australian corporations, other stakeholders, and international initiatives involved in developing and assessing credible net zero emissions transition plan frameworks to investigate how they will operate in Australia. Climateworks supports the expansion and improvement of sustainable finance as a key lever to decarbonise the economy. Climateworks' CEO, Anna Skarbek, is a member of the Advisory Committee of the Australian Sustainable Finance Initiative, the Glasgow Financial Alliance for Net Zero's (GFANZ) Asia–Pacific Advisory Board, and the Net Zero Economy Agency Advisory Board.

Submission summary

Climateworks supports the introduction of mandatory climate-related financial disclosure, with the aim of reducing barriers to investment in Australia's pathway to net zero. These standards provide a crucial opportunity to help mobilise private investment for corporations to finance their transition to net zero, through improving transparency and ensuring Australian corporations stay competitive given the changing international regulatory landscape. Climateworks supports the introduction of standards that create disclosures that will allow investors, shareholders and regulators to assess climate- and nature-related risk and the actions that entities are taking to reduce their exposure to risk. We note that standards for this work are expected to evolve as international expectations around disclosure changes. This is particularly relevant to the work of the Taskforce for Nature-related Risk Disclosure and on the disclosure of transition plans, and setting standards to ensure such plans are credible.

Overall, Climateworks supports the framework introduced in the Exposure Draft as a first step towards additional disclosures in the future. In particular, Climateworks supports the AASB proposals that:

- Scenario analysis must include a 1.5°C-aligned scenario.
- Entities with a non-material risk should be required to present why they should be exempted from reporting.
- Mandatory standards should be implemented as per the timeline set out in the exposure draft legislation.

To strengthen the standards proposed, Climateworks recommends that the AASB:

- review wording in the Exposure Draft to clarify that scenarios used should be both ‘Paris-consistent’, and specific to Australia
- set standards that include requirements for entities to prepare a credible transition plan as part of their mandatory climate disclosures
- propose to Treasury that every entity that has a material risk should have a credible transition plan, in line with international best-practice
- highlight to Treasury the weaknesses of relying solely on the *National Greenhouse and Energy Reporting Act* (NGERs) for methodologies for reporting data, especially as regards methane
- include Australian Carbon Credit Units (ACCUs) in a separate category for a time limited period for the carbon credit used. Highlight with government and the Clean Energy Regulator that the lack of serialisation of ACCUs means they do not meet ISSB standards for mandatory disclosure
- propose that the Department of Finance standards for Stream 1 and Stream 2 Commonwealth entities and Commonwealth companies are consistent with the transparency and ambition provided by the AASB standards for mandatory corporate disclosures
- clarify the specific circumstances in which data can be withheld for commercially-sensitive reasons
- monitor and align executive remuneration with the entity’s stated climate metrics and targets, disclosing at a minimum:
  - a description of whether and how climate-related considerations are factored into executive remuneration
  - the percentage of executive management remuneration recognised in the current period that is linked to climate-related considerations
- expand disclosure requirements to include financed emissions and sustainable finance/funding targets to achieve the objectives of the Sustainable Finance Strategy
- designate the relevant requirements for assurance to a broader group of suitably accredited professionals, together with Audit and Assurance Standards Board (AUASB) and the Treasury
- collaborate with Australian Securities and Investments Commission (ASIC) to bring digital sustainable financial reporting to Australia as soon as ISSB finalises the IFRS Digital Financial Reporting
- signal clear next steps after mandatory disclosure and scenario analysis are implemented, as part of the broader Sustainable Finance Strategy
- work with government to implement capability-building and training programs focused on clarifying what entities need to do specifically to meet the standards.

Scenario analysis

Recommendation 1: Review wording in the Exposure Draft to clarify that scenarios used should be both ‘Paris-consistent’, and specific to Australia.

Climateworks supports AASB’s proposal that scenario analysis must include a 1.5°C-aligned scenario (Proposal in [draft] Australian Sustainability Reporting Standards (ASRS) 2 paragraph Aus22.1), aligning with the sustainability disclosures legislative instrument Exposure Draft from the Treasury and the goal set out in the *Climate Change Act 2022*.

Climateworks, like many leading climate organisations and institutions, regards limiting warming to 1.5°C as vital to preserving a safe and prosperous planet. Climateworks believes it is therefore best practice to use a 1.5°C-aligned scenario to assess transition risk as part of mandatory financial climate-risk disclosure. The use of a 1.5°C-aligned scenario is also in line with GFANZ and other international expectations. Climateworks does not have a view on the best scenarios to use for assessing physical risk to an entity.

In addition, Climateworks invites the AASB to review the wording and clarify that scenarios used should be both 'Paris-consistent', as defined by OECD (Pouille et al. 2023), and specific to Australia to guide entities and provide comparability and rigour to investors – such as Climateworks' Australia-specific modelling (Climateworks Centre 2023) or similar.

Credible transition plans

Recommendation 2: Set standards that include requirements for entities to prepare a credible transition plan as part of their mandatory climate disclosures.

The Sustainable Finance Strategy Discussion Paper dated November 2023, proposes that mandatory disclosure include transition plans and that the ISSB provides the framework for disclosure of transition plans. The Exposure Draft of the relevant legislation delegates setting the standards to AASB. This means that these AASB standards should provide the details on what climate disclosures should be reported.

Climateworks suggests that AASB sets standards that require entities to prepare a credible transition plan as part of their mandatory climate disclosures.

There is growing recognition (nationally and internationally) that 'credible' transition plans reinforce the reliability and rigour of climate-related financial disclosures. A credible transition plan may significantly lower a company's risk of greenwashing and provides a far greater level of transparency.

International best practice for transition plans includes the following criteria to ensure they are credible:

- developed according to a comprehensive framework to enable comparability and support stakeholder decision-making,
- show how the entity will achieve science-based decarbonisation targets for their activities
- are inclusive of wider impacts on nature and just transition.

In addition to providing clarity to investors on the business transition, credible transition plans also provide benefits to those preparing them. For best practice, the transition plan also should be the framework for the entity's internal reporting, governance, investment and stewardship activities.

International alignment driven by best practices

Recommendation 3: Propose to Treasury that every entity that has a material risk should have a credible transition plan, in line with international best-practice.

International alignment driven by best practices is required to ensure compatibility across peers, geographies and to promote international investment attractiveness.

The International Financial Reporting Standards' (IFRS) 2 accounting standard (14av and ASRS 2) includes requirements that entities show how they can reach their emissions reduction targets, but there is no requirement to disclose a fuller transition plan.

The United Kingdom Transition Plan Taskforce (TPT) has published guidance and aims to help entities develop, disclose, and deliver 'gold standard' climate transition plans. The TPT recommends corporations analyse all material interdependencies, including nature, workers, value chain and consumers. Developments such as these are expected to impact Australian businesses in the near term.

The proposed approach is not in line with best practices. Our belief is that this approach is insufficient and will make it harder for Australian companies to receive investment if our practices don't align with what the rest of the world is doing. The market demand for transition plans is moving fast, and investors expect that credible transition plans will be completed and disclosed.

Climateworks therefore recommends that every entity that has a material risk should have a credible transition plan. AASB should point this out to Treasury, highlighting the weakness of the approach.

Reporting methodology

Recommendation 4: Highlight to Treasury the weaknesses of relying solely on NGERs for methodologies for reporting data, especially as regards methane.

Recommendation 5: Include ACCUs in a separate category for a time limited period for the carbon credit used. Highlight with the government and the Clean Energy Regulator that the lack of serialisation of ACCUs means they do not meet ISSB standards for mandatory disclosure.

Climateworks recognises the advantages of applying existing methodology and that, in Australia, many entities that will be covered under mandatory disclosure are already covered under the *National Greenhouse and Energy Reporting Act* (NGER). However, as pointed out in the Climate Change Authority's (CCA) report on the NGER scheme, there are several weaknesses in NGER's methodologies, especially when accounting for methane (Climate Change Authority 2023). Climateworks is concerned that the credibility of mandatory disclosure will be weakened if it relies on out-of-date methodologies for reporting.

Climateworks recommends that the AASB highlight to the government that the weaknesses of NGERs methodology would be materially important for standards for mandatory climate risk disclosures. We also recommend that the AASB signals in the ASRS standards the differences with the methodologies/ regulations included in the IFRS S1 and S2 and note that NGERs methodologies are under review.

We also note that given Australian Carbon Credit Units (ACCUs) are not uniquely serialised they do not currently meet the carbon credits definition included in IFRS S2. In order to ensure the integrity and transparency of the framework and the alignment with international practice we suggest that this criteria remains, and instead AASB includes ACCUs in a separate category for a time limited period for the carbon credit used (ACCUs, serialised Carbon credits). We further suggest that given the government is currently responding to reviews of the integrity of ACCUs, that AASB highlights with the government and the Clean Energy Regulator that the lack of serialisation of ACCUs means that they do not meet how ISSB considers Carbon Credits for the purposes of mandatory disclosure.

Entities with non-material risks

In line with our recommendation to the Treasury's Exposure Draft consultation, we support the proposal from the AASB that entities with a non-material risk should be required to present why they should be exempted from reporting.

Standards for Commonwealth entities

Recommendation 6: Propose that the Department of Finance standards for Stream 1 and Stream 2 Commonwealth entities and Commonwealth companies are consistent with the transparency and ambition provided by the AASB standards for mandatory corporate disclosures.

It is proposed that AASB Standards, in line with Treasury-mandated climate-related financial disclosures, will apply to Stream 1 Commonwealth companies meeting specific thresholds. The Department of Finance has been tasked with developing separate standards for Stream 2 Commonwealth companies and entities (including Commonwealth Corporates and Commonwealth Non-Corporates) as part of the Commonwealth Climate Disclosures policy, in alignment with the AASB Standards outlined in the Exposure Draft. This is due to the different reporting requirements Stream 2 Commonwealth entities currently follow, compared to Stream 1 entities. Climateworks views mandating consistent and sustainable reporting which aligns with the transparency and ambition provided by the AASB standard as necessary to reach decarbonisation targets. It is also important for the government to show leadership in meeting the transparency standard and ambition being set for mandatory corporate disclosures.

Climateworks suggests that the AASB recommend that the Department of Finance develop standards for Stream 1 and Stream 2 Commonwealth entities and Commonwealth companies that align closely with the transparency and integrity provided by the AASB standards for Stream 1 entities. This should ensure that the ambition of mandatory disclosure is not compromised by the different reporting mechanisms that are proposed to apply to the streams.

Transparency of disclosures

Recommendation 7: Clarify the specific circumstances in which data can be withheld for commercially-sensitive reasons.

We recognise that entities with commercially sensitive information must be allowed some flexibility. However, this flexibility must not undermine the transparency of climate-related financial disclosures. We are concerned that labelling data as commercially sensitive could be overused.

Climateworks also notes the CCA's view on publishing comparable data through NGER. The authority was of the view that it is appropriate that companies continue to be able to request certain data be withheld from publication in specific and limited circumstances, i.e. when publication would unacceptably reveal the trade secrets or other commercially valuable information, as is provided for under existing tests (Climate Change Authority 2023). However, consideration should be given to clarifying the specific circumstances in which data can be withheld.

Executive remuneration

Recommendation 8: Monitor and align executive remuneration with the entity's stated climate metrics and targets, disclosing at a minimum:

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

The objective of climate-related financial disclosures on governance is so users of general-purpose financial reports understand the governance processes, controls and procedures an entity uses to monitor, manage and oversee climate-related risks and opportunities.

Climateworks recommends that executive remuneration be monitored, managed and aligned with the entity's stated climate metrics and targets. In our view, this is essential as we have seen how powerful remuneration can be as a lever for change. Explicitly linking executive remuneration to climate or other sustainability-related metrics would affect an entity's climate or sustainability-related performance .Remuneration is a key metric for investors to understand the level of ambition aligned to executive deliverables. Therefore clearly linking remuneration to reporting and achievement of climate performance metrics and targets strengthens transparency on climate-risk. We also consider that information about executive remuneration in relation to climate or other sustainability-related topics will directly influence users' investment decisions and stewardship activities.

Climate change poses significant risks to businesses, including physical, regulatory and reputational risks. Aligning executive remuneration with climate goals can encourage executives to adopt long-term strategic approaches to mitigate these risks and capitalise on opportunities associated with the transition to a 1.5°C-aligned net zero economy.

Climateworks notes that the AASB, in the joint AASB-AUASB response to the ISSB's Exposure Drafts on [draft] IFRS S1 and [draft] IFRS S2, has a different view.

We note the reference to AASB Staff Paper Review of Executive Remuneration Disclosure Requirements, which highlighted that Australia and many other nations already have detailed remuneration disclosure or reporting requirements that are heavily regulated and subject to audit or assurance, including requirements for a discussion of the relationship between the remuneration policy and the entity's performance.

Climateworks recommends that reporting on remuneration explicitly includes climate-related executive remuneration, and at a minimum, the following is disclosed:

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

Disclosure of financed emissions and sustainable finance targets

Recommendation 9: Expand disclosure requirements to include financed emissions and sustainable finance/funding targets to achieve the objectives of the Sustainable Finance Strategy.

Climateworks recommends that financed emissions be disclosed because they are material to the entity's exposure to climate risk and transparency on financed emissions is a vital part of achieving the objectives of the Sustainable Finance Strategy. This transparency will provide investors with more clarity about the climate risks the entity faces. At the very least, an 'if not, why not' approach should be applied to an entity not disclosing their financed emissions, rather than allowing the entities to decide the applicability of those disclosures.

Climateworks would also suggest that sustainable finance and funding targets be included for financial entities providing funding, with targets set by category and/or asset class. These targets should be aligned to the entities climate metrics, be included in the credible transition plans as well as in the executive remuneration reporting.

Third-party assurance

Recommendation 10: Designate the relevant requirements for assurance to a broader group of suitably accredited professionals, together with AUASB and the Treasury.

Climateworks welcomes the Treasury's approach to ensure sustainability report compliance through third-party auditors. However, this could be made difficult by limited numbers of appropriately qualified auditors.

Climateworks recommends the AASB, together with AUASB and the Treasury, instead designate the relevant assurance requirements to a broader group of suitably accredited professionals.

We understand that requirements, including quality control and management, will be set out in the AUASB's standards. In addition to broadening the group of suitably qualified people who can provide assurance, we recommend that 'professional competence' on sustainability and financial sustainability reporting be defined in the appropriate standards and guidance. This should include the necessary level of theoretical knowledge and the ability to apply such knowledge in practice. The Corporate Sustainability Reporting Directive in the European Union and the International Organization for Standardization ISO auditing standards (ISO 32210) provide useful examples.

Digital reporting and data interoperability

Recommendation 11: Collaborate with ASIC to bring digital sustainable financial reporting to Australia as soon as ISSB finalises the IFRS Digital Financial Reporting.

European Financial Reporting Advisory Group and ISSB are bringing uniformity and alignment to the financial approach to sustainability reporting internationally. The global trend for climate accounting and reporting is greatly increasing the amount of data being generated and reported. This increases the demand to compare, share, and use information across all geographies and jurisdictions – known as interoperability. Despite progress on alignment, data challenges persist partly because countries are still in the early stages of developing digital data systems for sustainability disclosures.

Climateworks welcomes the Treasury prioritising data and analytical challenges, per the November 2023 Sustainable Finance Strategy discussion paper, and calls for AASB to collaborate with the Australian Securities and Investments Commission (ASIC) to bring digital sustainable financial reporting to Australia as soon as ISSB finalises the IFRS Digital Financial Reporting, expected Q2 2024. Climateworks supports government efforts to increase data interoperability and encourages further work, including by AASB, to facilitate the identification of foundational data to help manage climate risks.

Since 2010, ASIC has voluntarily lodged digital financial reporting in accordance with the ASIC financial reporting taxonomy. The same system architecture could be used for sustainability reporting, once the IFRS Digital Reporting is available.

Timely implementation

Australia has been slow to adopt mandatory reporting standards relative to comparable economies and markets. Even while investors have been requesting information on climate risk since the Task Force for Climate-Related Financial Disclosures released their final recommendations in 2017. Group 1 entities have been preparing for mandated climate disclosure to start in July 2024 since the Treasury released its first mandatory disclosures consultation in June 2023 (at the same time IFRS S1 and IFRS S2 – the basis of ASRS 1 and ASRS 2 – were finalised). Climateworks therefore considers the Australian system ready for phased implementation of mandatory standards according to the timeline set out in the Exposure Draft legislation.

Decarbonisation action from large corporations can drive short- and medium-term emissions reduction required for Australia to meet its national and international climate commitments and its further ambition to become a renewable energy 'superpower'. Prioritising mandatory disclosure from both large and high-emitting corporations can influence other corporations and drive sector-wide emissions reductions.

Next steps

Recommendation 12: Signal clear next steps after mandatory disclosure and scenario analysis are implemented, as part of the broader Sustainable Finance Strategy.

Recommendation 13: Work with government to implement capability-building and training programs focused on clarifying what entities need to do specifically to meet the standards.

Improved reporting and transparency will result in climate-related financial information that is useful to users. Climateworks' view is that mandatory disclosure and scenario analysis is a first step in the broader Sustainable Finance Strategy and that the AASB must play a role in signalling future steps.

These future steps may include:

- expanding mandatory disclosure to also consider nature-related risks
- requiring disclose of transition plans as part of mandatory disclosure
- providing standards and guidance to develop credible transition plans in line with international best practices, including a timetable on when this guidance – such as how to align plans with 1.5°C scenarios or how to incorporate nature and social aspects within transition plans – will be issued.

Mandatory disclosure standards are complex, particularly in the way they relate to other reporting requirements. To ensure the ambition set by these standards can be met by entities, the AASB should work with government to implement capability-building and training programs. These should ideally focus on clarifying what entities need to do specifically to meet the standards.

Thank you for taking the time to consider our submission. We would welcome an opportunity to brief your team to explore our responses in further detail.

Yours sincerely,

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