Thursday, 11 April 2024

Senate Standing Committees on Economics
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Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024: Schedule 4 – Sustainability Reporting

As the representatives of over 300,000 professional accountants globally, Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia welcome the opportunity to provide feedback to the Senate Economics Legislation Committee in relation to Schedule 4 – Sustainability Reporting of the *Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024* ("Schedule 4").

We continue to support the Commonwealth Treasury's work and efforts towards the establishment of legislation for a framework for mandatory climate-related disclosures. We recognise the extensive outreach and engagement that Treasury undertook during the consultation period, and its careful policy consideration, particularly when it comes to the larger entities reflected in Groups 1 and 2 and their stakeholders, including retail and institutional investors. However, we are concerned that the smaller and medium sized entities (SMEs), including many private companies and not-for profits captured in Group 3 do not appear to have been commensurately considered or consulted in designing the package. Treasury itself anticipates that "only 5 per cent" of Group 3 entities will have material climate risks or opportunities, but the legislation as currently drafted imposes onerous and costly requirements on 100 per cent of these entities. This submission focuses on the issue of Group 3, problems arising as a result of this, and proposed solutions.

Internationally aligned and credible climate-related financial disclosures will be pivotal to maintain Australia's position within the global economy, particularly for those larger and public interest entities in Groups 1 and 2 whose stakeholders are increasingly demanding climate disclosures. However, it is important that a balanced approach is taken in Australia which considers the proportionality of decision useful disclosure information against resources required.

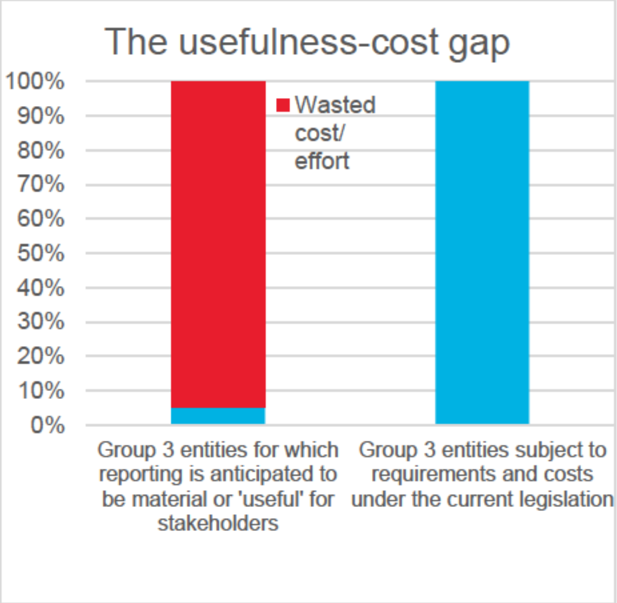
The issue

Treasury indicated in its Policy Impact Statement on Climate-Related Financial Disclosures (the Impact Statement), dated September 2023

> *we assume that only 5 per cent of Group 3 companies (278 entities) have material climate risk and would be required to report.*

The Impact Statement anticipates Group 3 will capture 7,098 entities, most of which could be categorised as private companies or not-for-profits.

Despite this expectation, the most recent legislative package imposes a requirement for 100 per cent of the entities in Group 3 to undergo an 'audit' if they have no material climate risks or opportunities.



The Impact Statement, and further engagement, reveals that this requirement appears to have been imposed on an assumption that the costs would be negligible or nil, or that it would be possible to 'lighten' the requirements of an audit with a locally developed standard. However, an audit, or 'reasonable assurance engagement', is a substantial process normally reserved for circumstances where the information involved is material and of consequence to stakeholders (Refer also *Understanding Audit: A plain English guide to audit* or *A guide to understanding auditing and assurance*). These engagements would involve costs likely to range between $20,000 to $50,000 on average for the thousands of Group 3 entities involved. The standards and framework for audit and assurance engagements are already established internationally and in Australia by the Australian Auditing and Assurance Standards Board (AUASB). Although new standards are being developed for sustainability assurance engagements, including with regard to climate, any departure from the framework or 'lowering of the bar' aimed at lessening the costs involved would be adverse to the credibility and integrity of Australia's auditing standards and international standing overall.

Other impacts

Further significant impacts caused by this issue include:

- **Capacity:** Although larger audit firms serving Groups 1 and 2 are substantially progressed toward the capacity needed to meet the demand for assurance arising from the legislation, the capacity to serve Group 3 is likely to be far more limited. While there is a growing cohort of small and medium audit practices (SMP auditors) building sustainability practices to serve this segment, the capacity available by 2027-2030 is not likely to be sufficient to service all of the entities in Group 3. Therefore the currently drafted legislation would result in a large skills and capacity gap. Although substantial capacity building efforts are underway within the profession, the inherent implication of the envisaged legislation that would result in a flurry of reporting and auditing activity within SMEs, where it is immaterial and of little consequence could be a major setback in achieving buy-in and commitment within the sector.

- **Pressure on SMP auditors:** The design of the legislative package effectively relies on auditors to achieve proportionality. Entities that are acknowledged by the Impact Statement to mostly have little or no benefit in climate reporting or assurance due to the immateriality of climate risks and opportunities would be vetted by auditors, rather than more targeted policy analysis and scoping. Establishing a more appropriate threshold in this instance would provide a vastly superior solution. This approach causes a significant predicament for SMP auditors, who will likely face great difficulty in obtaining the documentation, evidence and other support needed from the entities to perform an audit.

- **Audit quality:** Following on from the above point, a significant pressure on the quality of auditing arises in situations where audits are used as an alternative to more appropriate and focused scoping of the entities impacted at a policy/legislative level. This type of approach to policy-making concerningly often foreshadows a situation where SMP auditors may be strongly leant on by entities or other stakeholders to reduce their own costs and consequently quality.

The solutions

We recommend the committee urgently considers the following two options to mitigate the high risk of significant adverse impacts on Group 3 entities arising from the legislation:

1. Increasing the threshold for Group 3 entities to $100 million consolidated revenue and providing for an additional qualifier that would limit this group to entities that are *Public Interest Entities*[1] or alternatively, *Disclosing Entities*[2]. This would capture entities with stakeholders such as investors, lenders or others for which climate reporting is material with far greater precision and efficiency than the currently drafted settings, meaning resources and capacity building can be focused on where there is truly a need for reporting, rather than capturing a majority of entities whose stakeholders are not expected to have a material need for reporting.

<u>OR</u>

2. Removal, or limitation to *Public Interest Entities* or *Disclosing Entities*, of the audit requirement when there are no material climate risks or opportunities. The assessment of material climate risks and opportunities should be limited to a governance process for Group 3. Removing or limiting the audit requirement to *Public Interest Entities* or *Disclosing Entities* would better target assurance and avoid the significant and disproportionate costs associated with a significant additional assurance engagement where this is anticipated in most cases to be unnecessary.

Over the medium to longer term, we recommend it is essential for Government to monitor how implementation proceeds domestically, and relevant international experience, to frame a more refined and fit for purpose approach to climate-related disclosures amongst SMEs.

[1] As defined in APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)*.
[2] As defined in section 111AC of the Corporations Act 2001 (Corporations Act).

If you have any questions about our submission, please contact or Amir Ghandar (CA ANZ) at [redacted] or Tiffany Tan (CPA Australia) at [redacted].

Sincerely,

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