

Your ref: Consultation on climate related financial disclosure bill - April 2024
Our ref: Comments from GHD's climate assurance team

26 April 2024

Senate Standing Committees on Economics
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Additional information regarding Climate Disclosure Bill

Dear Senators, Members of the Committee

Thank you for the opportunity to give evidence to the public hearing on 23 April 2024 relating to the *Treasury Law Amendments (Financial Market Infrastructure and Other Measures) Bill 2024* (the Bill). As you know, GHD's climate assurance team provided a submission relating to Schedule 4 of the Bill in respect Sustainability Reporting, which contains proposed mandatory climate-related financial disclosures (climate disclosures) – with comments relating to the mandatory assurance requirements.

1. Additional information to questions asked

During the hearing a number of questions were asked that I think would benefit from further information in response to the questions. I provide this further information in this letter, for your consideration.

1.1 Regarding capability and capacity gap

Senator DEAN SMITH asked: *Thank you for your submissions. Noting the lack of capacity in assurance at present, how long do you expect that lack of capacity to exist in the Australian market?, and*

Senator DEAN SMITH asked: Can you perhaps give us an indication? Will it be rectified in the short-term, medium-term or the longer-term?

1.1.1 Additional information answering these questions

Reflecting further on these questions after the hearing, there are two key points of distinction in considering how long it may take to address:

1. **Addressing assurance scope that it is currently not technically feasible to assure** – as per our submission, and in responses at the hearing, we have clarified that there are aspects of the enduring (final) assurance scope¹ proposed in the Bill that is unlikely to be possible to assure. This includes proposed assurance of forward-looking statements relating to risks and opportunities. Such assurance currently has no substantive assurance standard, and it is unlikely there will be any in the medium-term – and it is also unlikely other jurisdictions will require assurance of such forward-looking statements.

¹ As set out in the Bill's proposed new Section 309A of the Corporations Act.

For these matters, the time it may take to address it is uncertain, but it is likely a long-term project and may ultimately never be possible to resolve. To address it in the medium term would likely require a change of the final (enduring) assurance scope to be different than the one the Bill proposes to be set by an Act of Parliament now – **accordingly, this suggest that the enduring (final) assurance scope set in the Bill’s proposed Section 309A of the Corporations Act should be amended.**

- 2. Addressing the capability and capacity gap in providing climate assurance** – where assurance is technically feasible the capability and capacity gap should be possible to address in the medium term, even if it is an ambitious assurance scope. This is because it will generally be a matter of resource investments to upskill assurance providers and team members. If sufficient investment goes into it, supported by the assurance fees paid by audited companies, then the timeframe set out in the Bill to achieve the final (enduring) assurance scope for the aspects that are technically feasible to assure should be appropriate.

However, two related aspects are worth considering:

- **Are there appropriate incentives for investing in addressing the capacity and capability gap?**

The answer to this is ‘No’ – this is because the Bill sets out that assurance must be led by the company’s financial auditor, whether competent or not at providing it at a fair fee. This implies that the Big-4 accounting firms will get probably at least 90-95% of the associated fees without having to compete for it. They will have an incentive to invest, but not any competitive pressure to invest to deliver the assurance scope innovatively or cost-effectively. Other providers will have limited or no incentive to invest, and therefore the capacity and capability gap will likely linger for longer and be more costly to address – translating into higher assurance fees payable by companies.

- **Will costs of driving an ambitious assurance scope exceed possible value?** This is unknown because Treasury’s impact assessment does not include any assessments of the costs and benefits of the enduring (final) assurance scope. We have offered some perspectives on this in our submission, but these are obviously speculative rather than definitive.

This suggests that the climate assurance framework as to who can or should deliver the assurance requires further consultation before being determined by an Act of Parliament as proposed by the Bill.

1.2 Regarding Treasury’s consultation on assurance

Senator DEAN SMITH asked: I want to ask about a couple of issues—and these are questions to you both. When you’ve put the propositions to Treasury that group 3 should be removed from their reporting obligations and suggested that the bill be amended to permit the auditor of the sustainability report not needing to be the same individual auditor, audit firm or audit company that performs the audit of the financial report, how have you engaged with Treasury through that process or with other regulators through that process? How ready have they been to accept the experience that you bring to these particular recommendations?

1.2.1 Additional information answering this question

During the hearing I never got an opportunity to answer this question appropriately. In summary, we would suggest that whilst Treasury has had significant public consultation on the climate risk disclosures, there has been insufficient public consultation on the proposed assurance framework.

For example, Treasury talks about having considered a range of options², but there appears to have been no public consultation on any of these options:

- **Treasury’s 1st public consultation included a few overarching generic questions relating to assurance** – but with no discussion of options provided and no questions asked relating to different options. This included no discussion or questions about the scope of assurance, and no discussion or questions about the framework for assurance delivery. The questions posed were at a higher scoping level not suitable for public consultation on specific options and models for climate assurance.

² Per response from Ms McCallum at the Hearing.

Feedback obtained appears to have confirmed that assurance is deemed important, that it should be performed by appropriately competent professionals that are appropriately independent and using appropriate assurance standards, and that reasonable assurance was highly preferred. Feedback also included many stakeholders expressing concerns about the capability and capacity of assurance providers, as well as concerns about the technical feasibility of assurance of certain aspects of the climate disclosures, including in relation to forward-looking statements.

– **Treasury’s 2nd public consultation presented the option for assurance that Treasury has determined as appropriate** – this included the following policy decisions made by Treasury:

- The enduring (final) assurance scope of all climate disclosures to be subject to reasonable assurance.
- That climate assurance should be led by the company’s financial auditor supported by technical climate and sustainability specialists when required.
- A fixed pathway to the enduring (final) assurance scope within a three-year period.

The following paragraph from the 2nd consultation paper encapsulates their policy position in respect of who delivers the assurance (emphasis added):

It is proposed that [the company’s] financial auditors would lead climate disclosure assurance engagements, supported by technical climate and sustainability experts, when required. While financial auditors will have both requisite professional qualifications and knowledge of assurance processes, they may not possess the skills or technical expertise to assure climate-specific elements. Delegation to third-party assurance providers increases the available pool of auditors and broadens the market, while maintaining professional, ethical, and quality controls. It is important that new players are encouraged to enter the market to build capacity and avoid entrenching a highly concentrated assurance market that inhibits competition.

There was no public consultation that we know of on the different options for the enduring (final) assurance scope, nor on the model for how assurance should be delivered – and by the time of the 2nd consultation, Treasury appears to have fixed its policy position on this. Treasury did not invite specific feedback on this policy position.

Noting the encouraging policy objectives of *increasing the pool of auditors, broadening the market, it being important that new players are encouraged to enter the market to build capacity and avoiding a highly concentrated assurance market that inhibits competition* – this sounds like an appealing policy position. However, the policy position actively works against these policy objectives – it narrows rather than broadens the market – the Big-4 accounting firms will likely control 90-95% of the climate assurance fees and are unlikely to delegate to third party assurance providers because it will not be in their self-interest to do so. They will delegate to and invest in their own specialists, thereby narrowing and concentrating the ‘market’ considerably – especially given they will be under limited competitive pressure to deliver climate assurance cost-effectively.

This in turn will discourage new players to enter the market to build capacity – which increases the capability and capacity gap, refer also above in section 1.1. Indeed, GHD’s climate assurance team, currently being one of Australia’s leading climate assurance providers, cannot see any meaningful role for us in this framework, despite that clearly appearing to be Treasury’s policy objective.

We also noted that Treasury’s policy decision is that climate assurance should be provided *while maintaining professional, ethical and quality controls*. We agree – however, Treasury used this to discard NGRS assurance providers as appropriate. However, this appears based on incorrect knowledge, as NGRS assurance providers effectively are subject to the same professional, ethical and quality control requirements as financial auditors (or Registered Company Auditors). It is a requirement to be registered with the Clean Energy Regulator and is subject to regular inspections by the Clean Energy Regulator.

We and several other stakeholders (including other NGRS assurance providers) provided this feedback to Treasury for both its 2nd and 3rd consultation. However, despite all this feedback Treasury has not responded – it appears that it simply fixed its policy decision on the assurance model and the enduring (final) assurance scope between the 1st and 2nd consultation without any public consultation

on the apparent range of options considered. On the enduring (final) assurance scope this is despite many stakeholders having expressed concerns across the consultations regarding the technical feasibility of it, as well as what it might cost – noting Treasury’s impact assessment does not assess the cost of the enduring (final) assurance scope (refer also our submission).

It should be acknowledged that following the 2nd consultation, Treasury responded with a longer timeframe to achieve the enduring assurance scope and delegating it to the AUASB to work out the pathway to achieve it. However, the same enduring (final) assurance scope of reasonable assurance of all climate disclosures set out in the Bill remains – which therefore is not something that can be determined through AUASB’s consultation – implying that to our knowledge there has never been any public consultation on the different options for the enduring (final) assurance scope that is included in the Bill.

1.3 Regarding international alignment

Senator DEAN SMITH asked: The other point that I was interested to read in your submissions is this. Much has been made of the importance of international alignment, of bringing Australia into line with other jurisdictions, and the importance of Australia being a good global citizen et cetera. But then your submission says that there is actually not international alignment at the moment. Can you expand upon that point?

1.3.1 Additional information answering this question

Reflecting further on these questions after the hearing, I would like to clarify two key points of distinction in considering international alignment:

1. **Who performs the assurance?** I mentioned the coming International Standard for Sustainability Assurance 5000 (ISSA 5000) – further to this standard, it is deliberately broadening who can lead sustainability (and climate) assurance – it does so because it is recognised internationally that this is necessary for credible assurance – that is, it is recognised that not only financial auditors need to lead this, other professionals need to as well.

Additionally, as mentioned at the hearing, it requires that the assurance engagement leader has sufficient knowledge about the matter to be assured.

Therefore, the proposed framework of *requiring* the company’s financial auditor to lead this assurance whether competent or not is not aligned with the coming international standard – indeed, it appears contrary to that standard, and it seems questionable whether that standard can be implemented in Australia under the framework to be enacted by the Bill.

It is also noteworthy to refer to how the EU is implementing its sustainability assurance requirements, especially as those are likely the leading requirements. They are setting up a separate accreditation for ‘sustainability auditors’. Financial auditors can obtain this accreditation provided they obtain further relevant professional competence. And whilst they see value in the company’s financial audit firm leading the assurance, they do not mandate they must do it – because of concerns of costs and concerns that it will lead to a narrowing and more concentrated market (i.e., aligned to the policy objectives that Treasury has despite following a policy that is contrary to achieving it).

2. **What should be assured?** As outlined at the hearing, there is no one that currently are looking to mandate assurance of all sustainability or climate disclosures – whether at limited or reasonable level of assurance. Indeed, it is highly unlikely that other jurisdictions will require assurance of forward-looking statements due to the technical challenges of provide assurance over these (refer section 1.1 above). Most jurisdictions are looking subsets of climate disclosures to assure rather than all the climate disclosures.

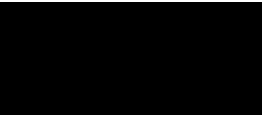
Climate assurance practice is lagging in clarity, standards and experience of climate disclosure. The voluntary assurance of climate disclosures that has been performed, in Australia and elsewhere, will have included assurance of only certain aspects of climate disclosures. It will not have performed assurance over most or all of the climate disclosures. That is, there is ample experience, in both Australia and elsewhere, in how to prepare these disclosures, but only limited experience in assuring them all.

Accordingly, whilst an ambitious assurance scope is appropriate, it is inappropriate to set the enduring (final) assurance scope in an Act of Parliament now – due to technical feasibility challenges, but also costs considerations and international alignment.

2. Thank you for considering our comments

Thank you again for the opportunity to comment and give evidence. Should you have any further questions or inquiries relating to our comments, please feel free to contact the undersigned.

Regards



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Copy to: GHD's climate assurance team's lead auditors.