Energy Efficiency Council submission to the Climate-related Financial Disclosure design consultation paper

21 July 2023

Summary

The Energy Efficiency Council (EEC) welcomes the opportunity to make a submission to the design consultation on climate related financial disclosures (CRFD). The EEC is Australia's peak body for energy efficiency, energy management and decarbonisation.

The EEC strongly supports the introduction of climate-related financial disclosure in line with the International Financial Reporting Standards Foundation's S2 standard. Adopting internationally consistent standards will help Australian business access expertise and capital globally that will be essential to help them decarbonise and become a prosperous part of the net zero economy.

The proposals in the discussion paper for a phased implementation of CRFD are appropriate and sensible. Australia is currently in the midst of a labour and skills shortage, and it will take some time to build a pool of suitably expert advisors to assist business in undertaking their climate risk analysis and transition planning activities. Allowing for a phased implementation reduces the risks of poor quality planning and disclosure, and allows liable entities to build confidence in the regime.

The EEC notes that the principles of CRFD could be extended more broadly, and encourages the Commonwealth to engage with state and territory governments to explore whether CRFD may be applicable to entities established under frameworks other than the *Corporations Act,* as well as adopting the principles of CRFD (including disclosure and transition planning) throughout its own operations. Similarly, the threshold for reporting and disclosure should include all NGERS-liable entities as soon as possible.

The EEC strongly supports the inclusion of requirements for transition planning in CRFD, and recommends that transition plans are informed by the guidance provided by the UK's Transition Plan Taskforce. The EEC also strongly welcomes the requirement for scenario-based analysis, and suggests that this exercise could be enhanced by more precisely defining a reference scenario.

The design consultation paper presents a feasible proposal, with a reasonable implementation period to build confidence and expertise in the regime. The EEC supports the introduction of enabling legislation at the earliest possible opportunity to ensure that clear policy signals are provided to industry to prepare for CRFD requirements, and to begin engaging more deeply with their emissions and transition plans.

1. Comments on specific proposals

1.1 Coverage and phased implementation

The paper's proposal to require all *Corporations Act* entities with annual revenue of $50 million or more; assets of $25 million or more, or 100 or more employees to make climate related financial disclosures is a reasonable and proportionate threshold. Companies of this size should have the resources to effectively foresee climate risk and to create transition plans. At this size, the conduct of the business operations affects a significant number of people, other businesses and organisations, creating a reasonable public interest in ensuring that investors - as well as wider community stakeholders - have sufficient information about the organisation's plans to respond to climate risk.

The paper's proposal to also include NGERS controlling corporations is sound and important. However, we recommend that *all* NGERS liable entities should be making climate related financial disclosures as soon as possible. Considering that 25 kt CO_2-e is greater than the entire emissions of the sovereign state of Tuvalu,[1] companies exceeding this threshold are both making a significant contribution to Australia's emissions, and present both climate and transition risks to investors, suppliers, customers, and the community at large. It is appropriate that these entities outline plans on how they will manage their emissions and address relevant risks.

The paper's proposal for phased implementation between FY25 and FY28 is appropriate and sensible. It will take some time to scale up industry resources to assist liable entities to report, and this task will be complicated by Australia's ongoing skills and labour shortages. A phased implementation with clearly signalled end markers helps industry scale up sustainably and reduces risks of poor quality reporting.

Government could also take a lead in CRFD by applying climate risk reporting across the Commonwealth's operations, in line with the Net Zero APS initiative. Leading government action has proven instrumental in catalysing development of skills and supply chains in other similar initiatives (such as NABERS), and could send a strong market signal that climate risk reporting is important across the entire economy, not just in the medium-to-large corporate sector.

Lastly, the EEC suggests that the principles of climate risk reporting and management are relevant not only to *Corporations Act* companies and NGERS liable entities, but also to organisations that may be incorporated or established under other legal frameworks. For example, local governments are likely to be on the front line of climate impacts, and some entities that are incorporated under state and territory law may have significant operations that face climate or transition risks. If these risks are unmanaged and undisclosed, this could cause the possibility of loss or damage to others. We suggest that the Commonwealth consult with state and territory governments on the applicability of climate risk reporting to a wider range of entities, with a view to forming a nationally consistent position.

Recommendations:

R1. All NGERS liable entities - including companies that do not currently meet NGERS publication thresholds - should be included in the coverage of climate risk and emissions reporting and disclosure as soon as possible.

R2. The Commonwealth should consult with state and territory governments with a view to applying climate risk reporting to all relevant organisations, including those not captured by the *Corporations Act*.

1.2 Reporting content

The EEC strongly supports reporting content requirements that align as closely as possible with the IFRS' S2 standard. Internationally consistent standards allow for Australia to leverage international capital markets to assist in our decarbonisation task, as well as permitting easier mobility of skilled expertise to assist companies in undertaking climate related risk analysis and reporting. Australian adaptation of the IFRS standards should mirror the international standard as closely as possible, except where local circumstances necessitate local variations.

[1] World Bank (2023), *Total greenhouse gas emissions (kt of CO2 equivalent) - Tuvalu*.

1.2.1 Phasing of reporting requirements

Introducing the new standards with a transitional period with less onerous requirements is supported by the EEC, noting constraints on labour markets and skilled advisors and expertise.

1.2.2 Materiality

The EEC supports the use of financial materiality as the threshold in the first instance. Corporate entities are familiar with financial materiality, making the transition to reporting financially material climate risks easier. The consultation paper's statement that *'it is increasingly understood that climate-related risks… would be material for most businesses.'* The EEC suggests that regulatory guidance should accompany this requirement indicating that companies reporting no material climate risks should detail the analysis leading to that conclusion.

It may also be necessary to consider expanding the conception of materiality in the future, particularly if climate risk reporting is expanded to entities that have missions that are expressed through a non-financial lens (e.g. local governments, incorporated associations etc.)

1.2.3 Governance

The EEC supports the proposal that information regarding governance processes, controls and procedures for monitoring and managing climate related risks and opportunities are reported from the commencement of CRFD requirements.

1.2.4 Strategy

The EEC strongly supports the use of multiple scenario analysis to underpin planning of climate risks, as well as resilience. The proposal to transition scenario analysis from qualitative in the first instance to quantitative by the end state is reasonable and will support sustainable scale up of capability and capacity.

The proposal that entities are required to disclose resilience assessment against two possible future states, with one being consistent with a global temperature goal set out in the *Climate Change Act* is reasonable, however there is a range of possible interpretations of that global temperature state. An assessment against a 1.5ºC average temperature increase is likely to be substantially different compared to an assessment against a 2ºC temperature increase. This means that different entities could be disclosing analysis against completely different scenarios, while still complying with this requirement.

The EEC suggests that Government consider specifying a precise 'reference' scenario consistent with the *Climate Change Act*. This would enable investors and other stakeholders to reliably compare the exposure and plans of different entities using a common baseline. We note that international finance is rapidly converging around a 1.5ºC assessment as a necessary part of CRFD reporting, and inclusion of 1.5ºC as a prescribed reference scenario could be productive.

1.2.5 Transition planning and climate-related targets

The EEC strongly supports the proposals in the discussion paper to:

- Require disclosure of transition plans, including information about offsets, target setting, and mitigation strategies
- Require disclosure about any climate targets, and progress towards those targets.

Requiring disclosure of these items is important both for investors, but also for Australia's broader climate change efforts. Where organisations have not considered climate risks, or how their business will transition to a net zero compatible state, investors or the community risk loss or damage as a result of unmanaged risks within organisations.

Target setting should be complemented by analysis of whether the target set is consistent with a fairly determined global carbon budget, and consistent with sectoral decarbonisation pathways. This will help investors determine whether a company's target is credible, and whether the company has fully engaged with climate risk.

The EEC strongly recommends that the requirement for transition plans is informed by the work of the United Kingdom's Transition Plan Taskforce – a poor quality or cursory transition plan will serve no purpose.

1.2.6 Risks and opportunities

The EEC supports the proposal for disclosure to include information about the process of identifying, assessing and managing climate risks and opportunities.

1.2.7 Metrics and targets

The EEC supports the inclusion of scope 1 and 2 emissions disclosure immediately, and phased implementation of scope 3 reporting. Scope 1 and 2 emissions are minimum basic information that is required in climate related financial disclosure. For many companies, risk and opportunity in the transition is likely to arise principally through their supply chain – making scope 3 emissions a practical and convenient lens to start analysis of these risks and opportunity. While it is true that calculation of scope 3 emissions is more complex than scope 1 and 2 emissions, a phased implementation should provide the necessary time for liable entities to build familiarity and expertise in scope 3.

There is likely to be a role for government in helping define authoritative benchmarks and parameters for scope 3 emissions, to ensure that scope 3 emissions reporting retains sufficient integrity and robustness to allow effective comparison.

The EEC also supports the inclusion of industry-based benchmark metrics where relevant and appropriate, to assist investor comparison between different companies' performance. In the future, industry benchmarks may be important for comparing the progress of a firm against the relevant sectoral Net Zero Plan.

Recommendations:

R3. A precise climate change 'reference' scenario – consistent with the targets *of the Climate Change Act* – should be determined through regulatory guidance, which climate related financial disclosures should be required to address.

R4. As far as possible, transition plans in disclosure should be informed by the work of the Transition Plan Taskforce's guidance on best practice transition plans.

1.3 Reporting framework and assurance

The EEC has no particular comments about these matters at this time, but generally supports the principles of transparent, regular reporting, supported by robust integrity measures, to inform businesses and the community, and to assist businesses in improving their performance in the transition to a net zero economy.