CPA Australia Ltd

Level 20, 28 Freshwater Place
Southbank VIC 3006
Australia

GPO Box 2820
Melbourne VIC 3001
Australia

Phone 1300 737 373
Outside Aust +613 9606 9677

Website cpaaustralia.com.au

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Committee Secretariat
Economic Development, Science and Innovation Committee
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Dear Economic Development, Science and Innovation Committee

CPA Australia's submission on the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill 2021

CPA Australia welcomes the New Zealand Parliament's proactive measures to address climate risks and opportunities. The proposed legislative amendments will undoubtedly create a significant step change in transparency regarding how climate-related risks and opportunities are addressed across listed issuers and other FMC reporting entities with a higher level of public accountability. CPA Australia represents the diverse interests of more than 168,000 members working in over a 100 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

In particular, we support reporting climate-related disclosures (CRD) by climate reporting entities in a climate statement in accordance with climate standards to be issued by the External Reporting Board (XRB), and which will be based on the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) framework. We also support assurance in relation to greenhouse gas (GHG) emissions reported in that statement under XRB auditing and assurance standards, conducted by qualified CRD assurance practitioners.

Implementation challenges

We note that climate-related disclosures are expected to be required for financial years commencing some time in 2022, although the date is not yet set. This will mean that governance, systems and processes will need to be in place soon in order for climate reporting entities to be ready for implementation within 6 to 18 months. However, the standards against which entities will need to report and qualified CRD assurance practitioners will need to assure, do not yet exist. We note that the TCFD framework encompasses a comprehensive suite of climate-related disclosures across governance, strategy, risk management, and metrics and targets, which are likely to be challenging for many entities to implement and which will take time to bed down. We recommend that the CRD reporting and assurance requirements not come into effect at least until after the standards for reporting and assurance, and requirements for recognition of CRD assurance practitioners, are all in place.

Figure 1 of the TCFD's June 2017 Final Report provides an illustration of categories of climate-related risks and their ultimate reflection in the core pillars of financial statements. The rapidly evolving landscape of climate-related disclosures spans not only emerging forms of sustainability reporting, but also deepening awareness, accompanied by heightened regulatory expectation, of recognition and presentation within IFRS and GAAP reporting. The formalisation of this understanding can be found in commentary and resources such as those of the AASB/ AUASB and from the IFRS Foundation, each driven by an appreciation of the materiality of climate risk from the perspective

of investor expectations for meaningful disclosure. In applying the additional powers granted to the XRB under the Financial Reporting Act 2013 to promulgate climate standards (the Bill Part 2 amendments to section 5 and 12 etc.), we urge such development to occur in lockstep with evolving financial accounting practice, regulatory requirements and standards in areas of significance such as impairment assessments, capital maintenance and presentation of a true and fair view.

The TCFD is structured around four pillars within which there are a total of eleven recommendations. Under *Metrics and Targets,* Recommendation (b) addresses disclosure of GHG emissions which, at present at least, appears to be the primary focus of those parts of a climate statement subject to assurance (refer Financial Markets Conduct Act proposed Part 7A sections 461N(1)(c) and 461ZD). We note however the capacity afforded by Financial Reporting Act 2013, amended section 5, for the XRB to widen its remit across a range of ESG subject matter. The following observations relate to some of the challenges of adapting the TCFD into a corporate disclosure regulatory environment, noting its justified pre-eminence as the de facto climate risk disclosure 'standard', at the present point in time.

- The accepted methodology of GHG accounting is contained in the WBCSD/ WRI's Greenhouse Gas Protocol which defines categories of Scope 1, 2 and 3 emissions. The Bill is silent on these distinctions. We suggest that this type of detailed expectation be formally detailed to align with the TCFD, either in statute or by regulation. Also, we suggest regulatory expectations be addressed, either immediately or in the longer term, as to the disclosure and assurance of Scope 3 emissions which increasingly are a part of both policy attention and net-zero pledges.
- An examination of the eleven TCFD Recommendation shows a combination of both narrative and metrics. It is noted in both the TCFD Final Report (pages iv and 33) and accompanying "Implementing of the Recommendations" (page 3), that the disclosures should be made in the preparer's mainstream financial filing. In other words, depending on jurisdictional requirements, they should be made in the annual reporting package which includes audited financial results. Particularly in relation to applying each of the two Governance recommendations and the first two of the three Strategy recommendations dealing with description of risk time horizons and impact on the organisation's business, CPA Australia suspects that close attention will need to be given to establishing a suitable platform of mandated disclosure analogous to what is broadly termed as management commentary.
- We observe, in relation to the extensive supplementary materials contained in the TCFD's "Implementing the Recommendations", the potential for the XRB drawing on these as the basis for the development of climate standards. Particularly relevant is the supplemental guidance spanning each of four financial and non-financial sectors (refer Figure 2 page 2) and, when it comes to specific metrics, the extensive cross-referencing to external standards such as those of the CDP, GRI and SASB. With respect to these sustainability framework developers and standards setters, along with the IIRC and CDSB, there is currently strong momentum towards convergence, and indeed, well advanced moves towards institutional merger amongst some of these key players. This, when overlaid by the now formalised intention of the IFRS Foundation to establish a Sustainability Standards Board to sit alongside the IASB, has created a high degree of dynamism within both the climate-related and wider sustainability disclosures environment. Doubtless the XRB will be aware of these major shifts. Therefore, we urge caution in the development of TCFD-based standards by the XRB, who should seek, where possible, a high degree of harmonisation.
- The TCFD supplemental materials mentioned above point to a potentially high degree of granularity in underlying data that would necessarily support aggregated public disclosures of climate-related risks and operational/strategic responses. The need for internal data capture and related management capacity building is highlighted throughout this submission. CPA Australia urges, where possible, allowance for incremental development.

- Neither the Bill nor the Explanatory Note makes mention of scenario analysis being required to be conducted by reporting entities (refer TCFD Strategy Recommended Disclosure (c)). It was intended by the Taskforce that scenario analysis be performed in order to align to the TCFD recommendations. Therefore, not including this requirement potentially undermines the overarching objective of the TCFD. Climate scenario analysis is a key tool which aids a company to model the financial impact of material risks and opportunities. Utilising climate datasets and financial modelling tools supports companies to better understand the potential impacts of the risk and financial modelling and translates risk into a business issue for increased internal attention. Scenario analysis is also critical to understand impacts in response to different global climate action trajectories. A company should do worst-case scenario modelling in order to understand the highest level of impact and to mitigate risks under this scenario. Failure to disclose scenario analysis methods and results may not provide investors with confidence that the effects of multiple discrete or compounding risks occurring together in time, have been considered by the organisation. Significant resources in these regards are the TCFD's *Guidance on Scenario Analysis for Non-Financial Companies* (October 2020) and the earlier 2017 guide which accompanied the Final Report.
- Stemming from this discussion of scenario analysis, we suggest that the proposals might not sufficiently reflect the distinction between, and interactions of, physical and transition risk as elaborated on pages 5 to 7 of the TCFD Final Report. Given physical risks and transitioning vary under different climate scenarios, it is very important to perform climate scenario analysis to ensure that entities are best informed on climate change. Further, without mandatory scenario analysis, there is a lower level of transparency on how companies are assessing risks and the key assumptions they are using. Assessments are likely to be more subjective and qualitative without mandatory scenario analysis.

Implementation timeline

Entities will need support and access to resources to develop systems and processes to implement and report against the framework. This will take time and refinement, along with upskilling of staff and development of additional capacity. Those systems and processes need to be in place at the commencement of the reporting period in order for reliable reporting to be achievable. As the likely implementation date is so soon there will be little time for entities to put those systems and processes in place. We suggest that this will necessitate the oversight body—which at this time is not clearly identified—to allow entities a period of transition during which that oversight body can focus on education and support, before pursuing compliance action.

Whilst we support the CRD requirements to extend to all FMC reporting entities with a higher level of public accountability, we suggest consideration be given to a staggered implementation timeline in order to build capability within reporters and amongst external consultants, as well as capacity amongst qualified CRD assurance practitioners and their teams.

Part 1 of the Bill giving effect to changes to Part 7A of the Financial Markets 2013, proposes, in section 461O, definitions of climate reporting entities with the subsequent sections 461P and461Q elaborating on size-based thresholds. A 'plain reading' of these sections and the Explanatory Note leaves some ambiguity as to the reach of the legislation to entities and market participants outside that of the financial sector. We suggest that section 461O(a) be expanded to both address any such doubt and to give more direct guidance on size thresholds for listed issuers rather than merely cross-referencing to section 351(1)(ab).

Exception from reporting requirements

We recommend that the proposed exceptions from reporting, under the new section 461ZA, Financial Markets Conduct Act 2013—that is, when the entity's activities are considered not to be materially affected by climate change—be removed. Reporting under TCFD recommendations allows for when no assessed climate-related risks and opportunities have been identified. However, in such circumstances the entity should also be expected to describe the governance processes which led to that conclusion. It would be preferable if the XRB addressed this

matter in the standards to be developed, so that all climate reporting entities conducted a robust assessment of climate-related risks and opportunities and reporting was consistent. Governance and risk management processes will need to be in place to properly assess the impact of climate change.

Even if the inclusion of an exception were appropriate, it focusses solely on the impact of climate change on the entity, but overlooks whether that entity's activities affect climate change. While we recommend that the exceptions be removed, if they are retained they should also be predicated on the entity not having any material impact on climate change.

Materiality

In preparing the climate statement entities will need to apply materiality so that less relevant or trivial matters do not clutter the report, and so that users can focus on the issues of greatest importance. The proposed amendments to Financial Reporting Act 2013 (s.19D(2)) include that the climate standard should require an entity to provide, in the climate statements, a description of the kind of information that has been excluded from the analysis and an explanation of why the entity has determined that information is immaterial to the analysis. This requirement for immaterial disclosures is contradictory to the purpose of applying materiality. Therefore, we recommend omission of this amendment.

Duplicative Reporting Requirements

The existing Emissions Trading Scheme (ETS) regulated by the Environmental Protection Authority requires emissions reporting by certain entities. As TCFD recommendations include reporting of emissions, it will be important to align the reporting requirements and metrics used under ETS with the climate standards to be developed by the XRB, in order to avoid duplicative reporting requirements. We also recommend streamlining of the ETS and climate statement lodgement requirements.

Criteria for Reporting and Assurance

In order to accurately and consistently report under the TCFD recommendations, detailed criteria need to be provided, which we expect the XRB will develop within the standards or guidance. With respect to GHG, detailed metrics will be needed for different industries. These metrics will also provide the criteria against which the CRD assurance practitioner assures the emissions reported and enables comparability with other entities. We note that the Environmental Protection Agency has metrics for some industries. In Australia, the Clean Energy Regulator, which is the independent statutory authority responsible for regulation of climate-related schemes, provides detailed methods for measuring emissions in different industries These methods may be of assistance, as a point of reference to the XRB, in developing the reporting requirements for GHG emissions.

Level of Assurance Required

The amendment Bill is silent on the type of engagement that the CRD assurance practitioner needs to conduct, whether it be a reasonable or limited assurance engagement, on the GHG emissions reported. This needs to be clearly communicated, either in the legislation, regulation or standards, although we suggest that this is best specified in legislation or regulation, as it is a matter of government policy. The metrics to be applied for quantification of emissions need to be sufficiently specific to enable assurance against those metrics. As emissions can be quantified, they can be subject to a reasonable assurance engagement. However, a reasonable assurance engagement becomes more challenging, and may not be suitable, if assurance is then extended to other parts of the climate statements, including forward-looking statements.

Qualified CRD Assurance Practitioners

The draft Bill requires the expertise, technical competence, and qualifications of qualified CRD assurance practitioners to be set by the auditing and assurance standards. As this is a new profession which will need to evolve over time, there is likely to be limited availability of practitioners with both the assurance skills required to

conduct engagements under the XRB Standards and with the technical competencies in emissions quantification. There will need to be some level of flexibility, at least in the initial years of climate statement reporting, regarding the competencies required by the individual CRD assurance practitioner and recognition that reliance can be placed on the competencies of the other assurance team members and any experts engaged.

To help build capacity, we strongly recommend that the regime for recognition of qualified CRD assurance practitioners accommodate overseas practitioners in order to leverage existing registration regimes in other jurisdictions. For example, Australia has a robust registration system in place for registered greenhouse and energy auditors (RGEA), which is operated by the Clean Energy Regulator, which oversees RGEAs and the “audits” (assurance engagements) they undertake. RGEAs could provide additional capacity for assurance on emissions, while the pool of qualified CRD assurance practitioners within NZ becomes established.

The draft legislation includes recognition of individuals and partnerships as qualified CRD assurance practitioners but omits companies within which qualified CRD assurance practitioners may operate. We suggest extending this recognition to companies with at least one director who is a qualified CRD assurance practitioner, with appropriate requirements for the other directors to be a fit and proper persons and be subject to an equivalent code of conduct as that of a CRD assurance body.

Oversight of CRD assurance practitioners

Consideration will need to be given to who will have responsibility for oversight of climate statement reporting and CRD assurance practitioners. Under the draft Bill, the FMA has a role in approving CRD assurance bodies, and the cancellation or suspension of CRD assurance practitioners or CRD assurance bodies. The CRD assurance bodies provide the code of conduct and a disciplinary process. However, these roles fall short of monitoring the quality of climate statement reporting or oversight of assurance engagements or CRD assurance practitioners. The body that will be responsible for this monitoring role needs to be clarified. Potentially, the manner in which CRD assurance practitioner oversight is conducted could draw on the work of the Clean Energy Regulator in Australia, which has a well-established oversight regime. An oversight body may also have a role to play in providing CRD assurance practitioners with guidance on the implementation of the XRB Standards.

If you require further information on the views expressed in this submission, please contact Dr. John Purcell, Policy Advisor ESG at john.Purcell@cpaaustralia.com.au or Claire Grayston, Policy Advisor Audit and Assurance at claire.grayston@cpaaustralia.com.au.

Your sincerely

Dr. Gary Pflugrath
Executive General Manager
Policy and Advocacy

Rick Jones
Country Head New Zealand

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