30 April 2021

Committee Secretariat
PO Box 6021
Parliament House
Canberra
Via email: jsctiq@aph.gov.au

Dear Committee Secretariat,

Inquiry into the prudential regulation of investment in Australia's export industries

CPA Australia and Chartered Accountants Australia and New Zealand (together 'the Major Accounting Bodies') welcome the opportunity to respond to 'the Inquiry' as named above. Together we represent over 280,000 professional accountants in Australia, New Zealand and around the world.

The Inquiry covers issues that are of great importance to the Major Accounting Bodies in respect of our members' responsibility to act in the public interest.

A critical element in investment decision-making is being aware of all factors that may impact that investment in the short, medium and long term, and members of the Major Accounting Bodies have a role to play in providing investors with reliable and accurate information. Of relevance to export industries is the effect of climate-related matters, including climate-related financial risks, on business. To this end, the attachment to this letter provides an overview of the current frameworks, principles and developments in this space that are most relevant to the Inquiry. This is provided with respect to points 2, 3 and 5 of the Inquiry's terms of reference.

Taken together, these developments illustrate a recognition both in Australia and internationally of 1) the growing demand in capital markets for robust and reliable climate-related financial information, and 2) the role that regulators play in providing a framework for this disclosure. These developments are further strengthened by regulators and standard setters who are providing greater clarity on the applicability of materiality to information related to non-financial matters.

If you require further information or elaboration on the views expressed in this letter please contact Karen McWilliams, CA ANZ [redacted] or Dr John Purcell, CPA Australia [redacted]

Yours sincerely

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ATTACHMENT

The domestic and foreign investment opportunities and challenges for Australia's export industries and their associated businesses, arising from changes in prudential standards and practices across banking, insurance and superannuation institutions, in addition to publicly-listed companies, with particular reference to:

> ***Term of Reference 2*** *- The investment guidance and advice provided by Australia's financial regulators, including the Australian Prudential Regulation Authority (APRA), the Reserve Bank of Australia (RBA) and the Australian Securities and Investments Commission (ASIC), to banking, insurance and superannuation institutions, and also to publicly-listed companies, in relation to investment in Australia's export industries;*

A critical element in investment decision-making is being aware of all factors that may affect the investment in the short, medium and long term. Of relevance to export industries is the effect of climate-related matters, including climate-related financial risks, on business. To this end, we provide the following overview of the current frameworks, principles and developments in this space that are most relevant to Australian businesses and the Inquiry.

Task Force on Climate-Related Financial Disclosures (TCFD)

In April 2015, the G20 asked the Financial Stability Board (FSB) to convene public and private sector participants to review how the financial sector could take account of climate-related issues. From there, the FSB established the TCFD in December 2015 with the instructions to develop a set of voluntary, consistent disclosure recommendations for use by companies in providing information to investors, lenders and insurance underwriters about their climate-related financial risks. To this end, the taskforce identified two types of risks – transition and physical - and published 11 recommendations on climate-related financial disclosures that could be applicable to all organisations, structured around Governance, Strategy, Risk Management, and Metrics and Targets.

Internationally and domestically the TCFD recommendations have been widely supported as outlined below (with emphasis on international developments that could affect Australian businesses in some way due to shareholding, location of operations or otherwise).

New Zealand

New Zealand was the first country to commit to mandating these disclosures with respect to banks, registered investment schemes, insurers, listed entities and the Crown's financial institutions.[1] The comply or explain regime has been developed by the Ministry for Business, Innovation and Employment (MBIE) with the Financial Markets Authority (FMA) set to be responsible for monitoring and enforcing. Further, the External Reporting Board (XRB) is developing relevant accounting standards and the Ministry for the Environment (MfE) will provide guidance on scenario analysis.

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[1] See https://www.mfe.govt.nz/climate-change/climate-change-and-government/mandatory-climate-related-financial-disclosures.

At the time of writing, the legislation has been introduced and is awaiting its first reading.[2] The relevant accounting standards are yet to be released but the Government has signalled that the disclosure requirements are likely to apply to financial years commencing 2022.[3] Assurance requirements will eventually be developed, first over greenhouse gas (GHG) emissions disclosures and then more broadly.

United Kingdom

In 2019, the Financial Reporting Council (FRC), Financial Conduct Authority (FCA), Prudential Regulatory Authority (PRA) and The Pensions Regulator (TPR) released a joint statement welcoming the Green Finance Strategy released by the Government.[4]

Since then, the FRC has undertaken reviews of climate-related considerations by boards, companies, auditors, professional bodies and investors. Following these reviews, the FRC concluded that corporate reporting needs to improve to meet the expectations of investors and other users on the urgent issue of climate change and, as such, a global reporting framework is needed (and supported by the FRC).[5] To this end, the FRC is also encouraging United Kingdom public interest entities to report in line with the TCFD and, with reference to their sector, using the Sustainability Accounting Standards Board (SASB) metrics.

From 1 January 2021, premium listed companies are required to make better quality disclosures consistent with the TCFD on a comply or explain basis.[6] The FCA has also indicated that further consultation will take place to assess whether these listing rules should apply to asset managers, life insurers and pension providers by 2022.[7] Further, the Chancellor has announced the intention to make TCFD aligned disclosures fully mandatory across the economy by 2025 – a development that is expected to capture over 1,600 companies and resulting in reporting within the non-financial section of the strategic report.[8]

United States

Recognising the increase in investor demand for climate change information, the Securities and Exchange Commission (SEC) is currently seeking input on its current disclosure rules and guidance as they apply to climate-related financial disclosures, and whether these should be modified.[9] The questions posed by this consultation are broad and high-level in nature, indicating that the SEC clearly intends to thoroughly assess what is needed for robust

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[2] See https://www.parliament.nz/en/pb/bills-and-laws/bills-proposed-laws/document/BILL_109905/financial-sector-climate-related-disclosures-and-other.

[3] For a summary of the elements of the legislation as it is currently drafted, see https://www.beehive.govt.nz/release/nz-becomes-first-world-climate-reporting.

[4] See https://www.frc.org.uk/news/july-2019/regulators-welcome-government-s-green-finance-stra.

[5] See https://www.frc.org.uk/news/november-2020/climate-pn and https://www.frc.org.uk/news/november-2020/frc-nfr-statement.

[6] See https://www.fca.org.uk/news/news-stories/fca-introduces-rule-enhance-climate-related-disclosures and https://www.fca.org.uk/publication/policy/ps20-17.pdf.

[7] See https://www.fca.org.uk/publications/policy-statements/ps20-17-proposals-enhance-climate-related-disclosures-listed-issuers-and-clarification-existing.

[8] See https://www.fca.org.uk/news/speeches/green-horizon-summit-rising-climate-challenge.

[9] See https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.

disclosure (notably, not *if* this disclosure is needed – this is now taken as a given) and how it can play a role in influencing the global capital markets.

Australia

Currently, Australia's corporate reporting and disclosure requirements can be found in three places – ASIC's Regulatory Guidance 247 *Effective disclosure in an operating and financial review* (RG 247), Regulatory Guidance 228 *Prospectuses: Effective disclosure for retail investors* (RG 228), and the Australian Securities Exchange's (ASX) Corporate Governance Principles and Recommendations.

RG 247 provides guidance for directors on providing useful and meaningful information to shareholders or unit holders when preparing an operating and financial review (OFR) in a directors' report.[10] RG 228 sets out guidance for effective disclosure for retail investors.[11] With respect to these regulatory guides, ASIC has included updates that make specific reference to climate-related financial disclosures.[12] To this end, ASIC is encouraging the inclusion of climate change risk in the OFR and consideration of these risks in prospectuses.

Similarly, principle 7.4 of the fourth edition of the ASX Corporate Governance Principles and Recommendations includes a requirement on listed entities to disclosure any "material exposure to environmental or social risks and, if it does, how it managers or intends to manage those risks".[13] The ASX recognises that "[h]ow an entity manages environmental and social risks can affect its ability to create long-term value for security holders", and as such, investors are calling for more rigorous and transparent disclosures in this area. However, the ASX notes that making disclosures does not necessarily require the publication of a separate 'sustainability' report (i.e., disclosures could be made within the annual report or in the notes to the financial statements). Entities are encouraged to consider whether they have any material exposure to environmental or social risks and to benchmark any resulting disclosures against those made by other organisations in the same industry.

Taken together, these reporting developments illustrate a recognition in Australia of 1) the growing demand in the financial markets for robust and reliable climate-related financial information, and 2) the role that regulators play in providing a framework for this information disclosure. Notably, both the ASIC regulatory guides and ASX's Corporate Governance Principles and Recommendations recognise the TCFD recommendations as one way of providing the market with the information requested.

Sustainability reporting and assurance

International developments

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[10] See https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-247-effective-disclosure-in-an-operating-and-financial-review/.

[11] See https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-228-prospectuses-effective-disclosure-for-retail-investors/.

[12] See https://asic.gov.au/about-asic/news-centre/find-a-media-release/2019-releases/19-208mr-asic-updates-guidance-on-climate-change-related-disclosure/.

[13] See https://www.asx.com.au/documents/regulation/cgc-principles-and-recommendations-fourth-edn.pdf.

In 2020, the Trustees of the International Financial Reporting Standards (IFRS) Foundation published a Consultation Paper to assess demand for global sustainability standards and, if demand is strong, to assess whether and to what extent the Foundation might contribute to the development of such standards (such as through the establishment of a board solely responsible for developing sustainability standards).[14]

The IFRS Foundation was established to develop a single set of globally accepted accounting standards. It is the organisation behind IFRS — the financial reporting standards that are used by more than 140 jurisdictions, including the UK, Australia and New Zealand. The Trustees are responsible for the strategic direction and governance of the Foundation as well as the oversight of the International Accounting Standards Board, which sets IFRS.

After receiving 576 responses,[15] the Trustees noted the growing and urgent demand to improve the global consistency and comparability in sustainability reporting, as well as strong recognition that urgent steps need to be taken with broad demand for the IFRS Foundation to play a role in this. The Trustees have noted that priority will be placed on the development of climate-related standards.

Since then, the Trustees have announced the formation of a working group to accelerate convergence in global sustainability reporting standards focused on enterprise value, and to undertake technical preparation for a potential international sustainability reporting standards board under the governance of the IFRS Foundation.

This announcement responds to a statement made by the International Organization of Securities Commissions (IOSCO) calling for the coordination of work to drive international consistency of sustainability-related disclosures with a focus on enterprise value creation.[16] To this end, the Trustees have indicated that the work completed will build on the illustrative prototype of a climate-related financial disclosure standard developed by the 'Group of Five'.[17] The prototype combines the TCFD recommendations and other sustainability frameworks, standards and platforms to create a skeleton of a climate-related financial disclosures standard.

The working group will be chaired by the IFRS Foundation and will include both the International Accounting Standards Board (IASB) and IOSCO as observers, as well as some members of the Group of Five. For reference, the Group of Five consists of CDP, the Climate Disclosures Standard Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB).

Notably, IOSCO's involvement is particularly important. In 2000, IOSCO completed an assessment of the existing accounting standards issued by the standard setter at the time and

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14 To find out more about the consultation, see https://www.ifrs.org/projects/work-plan/sustainability-reporting/.

15 The Major Accounting Bodies' submission can be found at http://eifrs.ifrs.org/eifrs/comment_letters//570/570_27234_LydiaTsenCAANZCPAAustralia_0_CAANZCPAAustraliaJointSubmission.pdf.

16 See https://www.iosco.org/news/pdf/IOSCONEWS594.pdf.

17 See https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Reporting-on-enterprise-value_climate-prototype_Dec20.pdf. See also https://www.ifrs.org/news-and-events/2021/03/trustees-announce-working-group/.

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confirmed that these standards were fit for use by multinationals worldwide. Within five years, harmonisation became more achievable as major jurisdictions adopted the standards. This widespread adoption took place due to IOSCO's reach and influence.

In the assurance space, the International Auditing and Assurance Standards Board (IAASB) has released guidance on applying the International Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historic Financial Information*, which seeks to increase the credibility of information regarding traditionally non-financial matters so that they can be trusted and relied upon by their intended users.[18]

[18] See https://www.iaasb.org/publications/non-authoritative-guidance-applying-isae-3000-revised-extended-external-reporting-assurance.

The domestic and foreign investment opportunities and challenges for Australia's export industries and their associated businesses, arising from changes in prudential standards and practices across banking, insurance and superannuation institutions, in addition to publicly-listed companies, with particular reference to:

> ***Term of Reference 3*** *- The approach and motivations of our financial institutions, including banks, insurers and superannuation funds, as well as publicly-listed companies, to their investment in Australia's export industries;*

As noted above, climate-related matters are relevant to investment decision-making. To this end, there is a need for rigorous climate-related risk management and reporting, as discussed below.

Risk management and reporting

Risk management and reporting lie at the heart of an organisation's governance and strategic activities. Regardless of the source (i.e., financial or non-financial), risks have a direct impact and influence on an organisation's profitability. Consequently, investors are demanding more information to inform their investment decisions, which in turns requires relevant and robust disclosures to be made on a range of risks.

In his annual letter to CEOs, Larry Fink, BlackRock, Inc. CEO, repeatedly calls for the pursuit of creating "enduring, sustainable value" for all stakeholders.[19] BlackRock, Inc. is an American multinational investment management company and the world's largest asset manager with around USD 8.67 trillion in assets under management as at the beginning of 2021. Fink has previously recognised climate-related risk as an investment risk, with investors currently grappling "to understand both the physical risks associated with climate change as well as the ways that climate policy will impact prices, costs and demand across the entire economy". [20]

This year's letter is no different and recognises that pursuing a just transition and "[a]ssessing sustainability risks requires that investors have access to consistent, high-quality and material public information". The global capital markets depend on the disclosure of such information, as is the case with the existing rigorous reporting of more traditional forms of financial data.

International developments

This need for robust and reliable data is recognised internationally. For example, Climate Action 100+,[21] an investor-led initiative established in 2017 by the United Nations environment programme, seeks to engage systemically important GHG emitters and other companies across the global economy that have significant opportunities to drive the clean energy transition and help achieve the goals of the Paris Agreement. The initiative comprises more than 570 investors who are responsible for over USD 54 trillion in assets under management and is coordinated by

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[19] For example, see the 2021 letter at https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

[20] See https://www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceo-letter.

[21] For more information, see https://www.climateaction100.org/.

regional investor networks.[22] Climate Action 100+ recognises the role that investors and financial markets play in supporting the just transition and pursuit of sustainability for all.

In a similar vein, the Principles for Responsible Investment (PRI) was launched to support a shift towards a more sustainable global financial system.[23] It provides an international network of investors (or signatories) with six principles for incorporating environmental, social and governance (ESG) in investment in practice. The Principles are based on the notion that ESG issues can affect the performance of investment portfolios and should therefore be considered alongside more traditional financial factors if investors are to properly fulfil their fiduciary duty.

The 2021 United Nations Climate Change Conference (COP 26) also includes a private finance initiative led by Mark Carney, former Governor of the Bank of England and former Chairman of the Financial Stability Board. The initiative recognises the importance of robust disclosures for real change. The objective of this initiative is to ensure that every professional financial decision takes climate change into account. Stakeholders will work together for improvements in the reporting, risk management, returns and mobilisation spaces.

With respect to reporting and risk management, the initiative seeks to improve the quality and quantity of climate-related financial disclosures (as well as internal risk management processes). Deliverables include the issuing of guidance, the provision of climate stress tests and the promotion of the use of scenario analysis and appropriate disclosures.

Local developments

In Australia, the Centre for Policy Development commissioned legal opinions from barrister Noel Hutley SC to assess the extent to which Australian corporate law requires company directors to respond to climate change risks (the Hutley opinion).[24] The most recent version of this opinion (which was first released in 2016) concludes that:

1. climate change risks are capable of being foreseeable risks to the interests of a company;
2. climate change risks may be relevant to a director's duty of care and diligence under s180(1) of the Corporations Act 2001 (Cth) to the extent that they interact with the interests of the company; and
3. company directors can and, in some cases, should be considering the impact of climate change risks on their business, or else risk breaching their obligation to exercise care and diligence.

While confined in scope to a director's duty of care and diligence, these conclusions confirm two matters: 1) all risks, regardless of source, can have an impact on the interests of a company and, 2) there exists, at the governance level, an obligation to assess the impact of a risk and act accordingly

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[22] The regional investor networks are the Asia Investor Group on Climate Change (AIGCC), Ceres, Investor Group on Climate Change (IGCC), Institutional Investors Group on Climate Change (IIGCC) and Principles for Responsible Investment (PRI). It is supported by a global Steering Committee.

[23] For more information, see https://www.unpri.org/.

[24] To find out more see https://cpd.org.au/2019/03/directors-duties-2019/.

Notably, ASIC has endorsed the conclusions reached in the Hutley opinion.[25]

The Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board (AUASB) have acknowledged the shift in investor focus towards emerging risks, including climate-related risks. In a joint bulletin (Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB/IASB Practice Statement 2) the two bodies address climate-related and other emerging risk disclosures, saying that organisations can "no longer treat climate-related risks as merely a matter of corporate social responsibility and may need to consider them also in the context of their financial statements".[26] The joint bulletin (Practice Statement 2) recognises the materiality assessment needed in determining whether to disclose climate-related financial information, as well as the assurance obligations that arise with respect to this information. That is, if climate-related risk has a significant impact on the entity, the auditor is expected to consider whether the financial statements appropriately reflect this in accordance with the applicable financial reporting framework.

Following the release of Practice Statement 2, the IFRS Foundation issued its own article IFRS Standards and Climate-related Disclosures.[27] In this article, the IFRS Foundation illustrated what already exists in the current requirements and guidance on the application of materiality, and how it relates to climate and other emerging risks. This is despite the lack of explicit mention of such matters in the standards themselves.

Following this the IAASB issued guidance on the consideration of climate-related risks in a financial statement audit.[28]

The above examples illustrate that international and domestic developments remain relatively aligned, occurring in response to the significant push from the global capital markets for robust and reliable climate-related financial disclosures. They also show these developments are further strengthened by regulators and standard setters who are providing greater clarity on the applicability of materiality to information related to non-financial matters.

25 See https://asic.gov.au/about-asic/news-centre/speeches/climate-change/.

26 See https://www.aasb.gov.au/admin/file/content102/c3/AASB_AUASB_Joint_Bulletin_Finished.pdf.

27 See https://cdn.ifrs.org/-/media/feature/news/2019/november/in-brief-climate-change-nick-anderson.pdf?la=en).

28 See https://www.iaasb.org/news-events/2020-10/iaasb-issues-staff-audit-practice-alert-climate-related-risks. For completeness, the International Public Sector Accounting Standards Board also released public sector standards related to climate change, but these are not relevant to Australia for the time being.

The domestic and foreign investment opportunities and challenges for Australia's export industries and their associated businesses, arising from changes in prudential standards and practices across banking, insurance and superannuation institutions, in addition to publicly-listed companies, with particular reference to:

***Term of Reference 5** - Any other related matter.*

Role of accountants in addressing climate change

In February 2020, 13 accounting bodies representing 2.5 million accountants globally, including the Major Accounting Bodies, supported a call to action in response to climate change.

The call to action contains seven actions which accountants, and the accounting bodies, are committing to take including:

- Providing sound advice and services as organisations, capital markets, and governments develop and implement plans for climate change mitigation and adaptation
- Using and implementing existing and developing reporting frameworks such as those from the International Integrated Reporting Council and the Task Force on Climate-related Financial Disclosures
- Contributing to the efforts of the organisations they work with to integrate climate change risk into organisational strategy, finance, operations, and communications
- Supporting sustainable decision making within the organisations they work for by allocating budgets and resources, and by developing high quality and timely information and insights through measurement and disclosure, built on robust and transparent accounting systems.

The call of action commits its signatories to:

- Providing our members with the training, support and infrastructure they need to apply their skills to the challenge
- Supporting relevant market-based policy initiatives and incentives, consistent and well-considered regulation, and more useful disclosure
- Providing sound advice to help governments to create the policy and regulatory infrastructure necessary for a just transition to a net zero carbon economy.

This announcement recognises that the accountancy profession can play a significant role in achieving both climate change mitigation and adaptation at individual business, industry sector and economy-wide levels. Accountants frequently use their skills and expertise to help deliver meaningful change. These skills can now be applied to the uncharted challenges that climate change present. Identifying material risks with financial consequences and providing the information needed to make decisions are the domain of the accountancy profession.

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