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9 February 2024

Climate-related financial disclosure: exposure draft legislation

As a leading professional services firm, KPMG Australia (KPMG) is committed to meeting the requirements of all our stakeholders – not only the organisations we audit and advise but also employees, governments, regulators – and the wider community. We strive to contribute in a positive way to the debate that is shaping the Australian economy and we welcome the opportunity to comment on Treasury's *Climate-related financial disclosure: exposure draft legislation* (ED).

KPMG has a team of experts that work with organisations to help them manage the risks and opportunities associated with climate change and GHG emissions, and to enhance all aspects of sustainability reporting and communication. We also provide assurance services over climate and other sustainability-related disclosures, as well as financials, to enhance the credibility of reported information. Our KPMG Law team help clients navigate the legal and regulatory implications arising from sustainability issues including increasing regulatory requirements and risks associated with "greenwashing".

KPMG provided submissions to the first and second consultations in February and July 2023 and we were pleased to see a number of our recommendations adopted in the ED. We strongly support the adoption of globally consistent disclosure of sustainability-related financial information. We believe that globally consistent sustainability disclosure standards are an imperative. Alignment of Australian sustainability disclosure standards with those issued by the ISSB, in a timely manner and with due process will strengthen the ability of Australian entities to participate on the international stage. This includes ensuring our standards are flexible enough to be able to encompass broader sustainability reporting in the future.

While KPMG is supportive of the proposals set out in the ED, we note that the AUASB will be setting out a pathway for phasing in assurance requirements over time, which would commence with limited assurance of Scope 1 and 2 emissions disclosures from years commencing 1 July 2024 onwards. We do have some concern with a delay in adopting the full assurance roadmap outlined in the last consultation paper.

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Industry needs strong guidance and certainty so it can invest in its people, processes and training to ensure that we have appropriately skilled people to meet the Government's policy intent of having reasonable assurance of all climate disclosures commencing 1 July 2030. The Second Consultation Paper also proposed that "*consultation on professional audit and assurance requirements is proposed to be conducted at a later stage*". We would appreciate guidance from Treasury as to whether this consultation process will be undertaken by the Auditing and Assurance Standards Board (AUASB) and if so, to set out the mandate to allow them to achieve this and any implications this may have on the proposed merger of the AUASB, the Australian Accounting Standards Board (AASB) and Financial Reporting Council in 2026.

We understand Treasury is seeking feedback on whether the ED meets the stated policy intent set out in the Policy Position Statement and whether it's understandable, readable and clear. We have outlined several areas that Treasury may need to review or amend at the Appendix of this letter and these comments relate to:

1. Intended scope of entities required to prepare sustainability reports;
2. Clarification on who must be appointed as auditor, the individual auditor or the audit firm;
3. Asset managers and the funds under management hurdle;
4. Flexibility around the production of the sustainability report and whether it must be a separate report;
5. Clarification of the interim modified liability framework;
6. Incorrect references to S292A(1)(c);
7. CCIVs – omission of requirement to keep financial records;
8. Consistency when referring to companies limited by guarantee;
9. Description of assurance in the ED;
10. Potential misalignment of liability for directors of reporting entities and assurance practitioners/firms; and
11. Matters that would benefit from inclusion in any explanatory material.

Lastly, KPMG considers that an industry campaign will be required to ensure enough assurers are qualified to meet the assurance requirements of the Climate-related financial disclosure regime. The campaign would benefit from clear industry targets to ensure a sufficient level of capacity in the market, including the consideration of any visa related changes to help support resourcing.

We would be pleased to discuss our comments with Treasury and we look forward to working with the Government and our clients on this important matter.

Yours sincerely,

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Appendix: KPMG Climate-related financial disclosure exposure draft legislation clarifications

1 Clarification on intended scope of entities required to prepare sustainability reports

It is our understanding from the policy statement that Treasury intend for sustainability reporting to be applicable to:

- Large entities that are required to prepare and lodge annual reports under Chapter 2M of the Corporations Act; and
- Entities subject to both the annual reporting requirements under the Corporations Act and emissions reporting obligations under the National Greenhouse and Energy Reporting Act 2007 (Cth) (NGER Act), regardless of size.

In contrast to the second Consultation paper, it appears from the proposed amendments to the Corporations Act 2001 included in the draft bill legislation that the drafting approach seeks to do the following:

- For “large entities’ the ED defines a reporting entity (excluding an entity registered under the NGER Act) as any entity (broadly defined under section 64A Corporations Act) which meets the minimum size thresholds (whether or not the entity is currently subject to statutory reporting under Chapter2M).

- Whilst those minimum thresholds correspond to the existing thresholds for determining what is a large proprietary company and therefore subject to Chapter 2M reporting, this approach has the effect of including entities which are not currently subject to Chapter 2M reporting which do meet the minimum size thresholds; and

- For an entity registered under the NGER Act the draft bill legislation provides that such an entity falls within the definition of reporting entity (whether or not the entity is subject to Chapter 2M reporting) which seems to run against the stated policy intent.

Given these inconsistencies, it would be helpful to clarify whether the policy intent is aligned with the ED legislation.

2 Clarification on who must be appointed as auditor, the individual auditor or the audit firm

KPMG recommends the legislation is made clearer on who must be appointed as auditor, the individual auditor or the audit firm. If Treasury were to adopt the approach taken for financial reports, it is the audit firm that is appointed, noting that the individual auditor signs the assurance report in their own name.

3 Clarification needed for Asset managers – funds under management hurdle

The current drafting and policy intention is not clear on whether a registered superannuation fund or registered scheme that meets both the size requirements for Group 1 and for Group 2 would be treated as a Group 1 entity and therefore would be required to have a first annual reporting period commencing on 1 July 2024.

Draft section 1705(1) and (3) seems clear that a registrable superannuation entity (as well as a registered scheme or fund manager) would be a Group 1 entity if it met at least 2 of the following minimum thresholds;

> i. the consolidated revenue for the FY of the registrable super fund and the entities it controls is $500m or more;
> ii. the value of the consolidated gross assets of the registrable super fund and the entities it controls is $1B or more; and/or
> iii. the registrable super fund and the entities it controls have 500 or more employees.

It is our understanding that not all entities have interpreted this requirement in the same manner and are potentially concluding that regardless of size they could only fall within Group 2.

In addition, the current drafting and policy intention is not clear on which approach to use in determining whether an entity is in scope or the new asset owner requirements. We recommend that this is clarified in the final legislation and associated explanatory materials (refer commentary that follows).

Per legislation S292A(7)

This subsection applies to an entity for a financial year if the <u>value of assets at the end of the financial year of the entity and the entities it controls (if any)</u> is the following amount or more:
a) the amount determined under subsection (8);
(b) if no amount is determined—$5 billion

Per policy statement:

Asset owners (such as registrable superannuation entities and registered schemes) will be considered large if funds under management are more than $5 billion

Funds under management of an entity are different to the assets recognised on the consolidated balance sheet under the accounting standards. Clarification is required of what the Treasury policy intention is. For example, does Treasury intend to capture entities based on the value of assets recognised in the entity's consolidated financial report or based on the value of assets which it has under management. The latter approach would increase the scope of entities within the sustainability reporting requirements.

This issue is illustrated by two examples:

1. An asset manager manages $20bn of funds on behalf of other investors. The asset manager is not considered to control these funds under the requirements of the Australian Accounting Standards. In applying S292A(7) and the $5bn asset threshold, clarification is needed to determine whether the asset manager should consider the total assets it reports in its consolidated balance sheet forming part of its financial statements (which is below $5bn) or whether it also considers the $20bn assets it manages on behalf of others, the value of which is not captured in the consolidated balance sheet of the asset manager.

2. An asset manager controls several funds under the definition of control in the Australian Accounting Standards. It does not consolidate them into its balance sheet due to an exemption in AASB 10 *Consolidated Financial Statements*. As a result, it recognises investment in the funds it controls at fair value of $3bn rather than consolidating and recognising the underlying controlled funds' gross assets of $10bn and gross liabilities of $7bn. In applying S292A(7) and the $5bn asset threshold, clarification is needed to determine whether the asset manager should consider the total assets reported by the asset manager in its consolidated balance sheet forming part of its financial statements (which is below $5bn) or whether it also considers the value of $10bn of gross assets held by the funds it controls, the value of which is not captured in the consolidated balance sheet.

4 Clarification of whether the sustainability report is required to be a separate report

The Policy position statement states that "entities should include an index table within their annual report that enables users to easily navigate the climate disclosures" yet the draft legislation is worded such that a separate "sustainability report" is required. The draft legislation requires the preparation of an "annual sustainability report" (section 292A). Draft section 296A then prescribes what the basic contents of the sustainability report are to consist of, including the prescribed climate statements for the year and any notes to those statements. Importantly the nature and scope of many of those

prescribed disclosures must be in accordance with the applicable sustainability standards and any further requirements of the Minister. Structurally this regime aligns with the existing regulatory regime for preparation of annual financial reports (see section 295).

It is unclear whether the Treasury policy intention is to require the sustainability report to form a separate and discrete report/section within the Annual report, or whether entities can integrate this information into other sections of their Annual Report, such as the directors' report and operating and financial review. We further note, that [draft] ASRS 1 paragraphs 60 – 63 contemplates flexibility in the location of the climate disclosures that form part of the annual report, including a separate report such as the sustainability report presently issued by some entities that encompass broader sustainability topics beyond climate.

To reduce duplication and to facilitate connected information, thereby making it easier for users to understand and navigate an entity's annual report, we recommend flexibility of reporting location be explicitly enabled within the legislation. We note any additional provision of flexibility would need to ensure that the modified liability regime would continue to apply to the required disclosures.

For the financial report, for example, s300(2) of the Corporations Act provides for certain information to not have to be included in the directors' report if it is included in the company's financial report for the financial year. A similar provision would be beneficial for sustainability report information.

5 Interim Modified liability framework

Under the proposed draft legislation (draft section 1705B(1)(b)), the scope of the proposed modified liability regime for the first 3 years of reporting applies only to disclosures regarding Scope 3 emissions (which in any event only apply from the second year for Group 1 entities) and scenario analysis which means that other forward-looking statements are not covered. In particular, in respect of transition plans, Scope 3 emissions and scenario analysis can be seen as logically connected elements, so the omission of transition plans is an important gap in modified liability coverage and risks tipping the proposed liability framework out of balance, resulting in underreporting or potential litigation risk in respect of a reporting entity's transition plans.

6 Incorrect references to S292A(1)(c)

Per legislation in subsections 9 (sustainability records), 86A(1)(c) and 296C(1) & (2) there is a reference to:
"…and statements mentioned <u>in paragraph 292A(1)(c)</u> ..."

Drafting recommendation:

Section 292A(1)(c) does not appear to exist. We expect this reference should instead be to S296A(1)(c).

7 CCIVs – omission of requirement to keep financial records

Per Division 4 Subdivision B subsection 1232A and B:
This section deals with obligations to keep and access financial records of CCIVS and sub funds.

Drafting recommendation:
We recommend that this be extended to include sustainability records as well.

8 Companies limited by guarantee – for consistency

Per legislation S316A heading:
"Annual financial reporting to members of companies limited by guarantee"

Drafting recommendation:
For consistency with other changes in legislation, recommend adding "and sustainability" after "annual financial".

Per legislation S316A(1):
A member of a company limited by guarantee may, by notifying the company (whether or not in writing), elect to receive the following reports:
(a) the financial reports;
(b) the directors' report(c) the auditor's reports

Drafting recommendation:
For consistency with other changes in legislation recommend adding:
(aa)The sustainability reports (if required to be prepared)

9 Description of assurance

We note that the draft legislation refers to the terms "audit" and "review". These terms have a specific meaning in the AUASB audit and assurance standards and only relate to engagements of historical financial information, for example, an audit of a financial report. Relevant AUASB standards for sustainability reports or disclosures use the defined term "assurance" which can be either reasonable or limited in scope. A solution would be to have a separate definition in the legislation referring to assurance rather than adding the sustainability report to the definition of audit. This will ensure consistency with the AUASB standards and prevent inefficiencies in needing to reword existing standards to be compliant with legislation, etc. It is terminology that is familiar to existing practitioners and is used in other jurisdictions which have introduced or proposed assurance over climate information.

Per legislation s9 *audit* means:

(a) an audit conducted for the purposes of this Act; or
(b) without limiting paragraph (a)—a review of the following conducted for the purposes of this Act:
    i. a financial report for a financial year or a half-year;
    ii. a sustainability report for a financial year.

Drafting recommendation – We recommend that the sustainability report for a financial year be removed from the definition of audit and inserted into the legislation as a new definition under assurance.

10 Modified liability for directors of reporting entities and assurance practitioners/firms

The exposure draft explanatory material paragraph 1.18 states that "*A modified liability approach will apply for a transitional period to ensure that reporting entities are allowed time to develop experience and practice to report to the required standards. After this period, the existing liability arrangements will apply."*
We note there may be unintended consequences of a misalignment of liability between directors and assurers, in addition providing a limited immunity to directors but not auditors would potentially undermine the effectiveness of this measure.

11 Matters that would benefit from inclusion in any explanatory material

It is our understanding that S292A(2) means that each individual entity that is otherwise required to prepare a sustainability report would not need to do so when the *ultimate* Australian parent prepares consolidated financial statements and elects to prepare a sustainability report for the consolidated entity covering those individual entities. We recommend any explanatory material confirm that this is the outcome even if an intermediate parent within the group is required to prepare separate financial statements but voluntarily elects to prepare consolidated financial statements (not ***required*** under Australian Accounting Standards*)*.

We recommend any explanatory materials explain that a company limited by guarantee only needs to meet the higher revenue thresholds when assessing whether it needs to prepare a sustainability report. Currently the explanatory memorandum wording [paragraph 1.24] could be read as the company needing to meet the revenue threshold of $1 million or more.

Section 296A(6) requires the directors declaration to include an explicit and unreserved statement of compliance with international sustainability reporting standards when such a statement is included in the notes to the climate statement. At present with the Treasury climate first approach, the proposed Australian Sustainability Reporting Standards are not aligned with the requirements of the International Sustainability Standards and as a result, many entities will not be in a position to make this

statement. We recommend that explanatory materials acknowledge this to avoid any confusion of requirements for preparers.

We note that the consultation papers do not refer to the CER register being used as an accreditation vehicle for climate-related disclosure audits and instead refers to an entity's financial auditor who will use 'technical climate and sustainability experts' where required. This change in policy position may need to be more clearly articulated to the sector in the EM or alternatively in another forum.