Mandatory climate reporting – status update

September 2023

Frontier Advisors

Introduction

Sustainability reporting – why has it become a priority?

Decisions, decisions…

- We know financial markets move in response to buy, sell and hold decisions.
- Rational customers and investors in financial markets base those decisions on the most accurate information available to them.
- Financial accounts (balance sheet, income statement, cash flows) are *'decision-useful' information* because they reveal a lot about the underlying fundamentals of a company/asset.
- The disclosure of financial accounts is regulated, e.g. mandatory annual reporting; specified accounting standards, meaning investors can *rely* on this information to be comprehensive and consistent between companies and across markets, and make decisions with confidence.
- This confidence facilitates the stability of financial markets, a key objective of governments and financial regulators.

Now, add ESG…

- Today, acceptance that *environmental, social and governance (ESG)* factors can and do impact the financial performance of companies/assets is mainstream.
- It follows that good disclosure of decision-useful ESG information that is comprehensive and consistent, will also support confidence and market stability.
- Until recently however, the reporting and disclosure of ESG-related information has lacked consistency, and within Australia at least, has not been mandatory.
- This is about to change, particularly with the Australian government expected to introduce *mandatory climate-related financial disclosures* from the 2025 financial year.

In this paper we provide an update on some of the key observations on these important developments.

"Without the right information, investors and others may incorrectly price or value assets, leading to a misallocation of capital."

– Taskforce for Climate Related Financial Disclosures (TCFD)

The ISSB - convergence and catalyst

Global efforts to *standardise* sustainability disclosures in financial markets

Sustainability disclosures are not new

- The need for decision-useful sustainability disclosures has been well understood since ESG came to prominence in financial markets in the early 2000s.
- In response, some voluntary reporting frameworks developed, usually in regional jurisdictions, advancing ESG disclosure at company and asset owner levels.
- But, because these developed within different regions and at different times, local requirements and nuances meant these frameworks were often inconsistent, compromising the usefulness of disclosures for the purposes of decision-making.

Establishment of the ISSB (2021)

- Market demand for global standards in sustainability disclosure ultimately led to the establishment of the *International Sustainability Standards Board (ISSB)* by the International Financial Reporting Standards Foundation (IFRS).
- The ISSB's establishment was announced at the 2021 UN Climate Change Conference of the Parties in Glasgow (better known as COP26).
- The ISSB's mandate was to develop a high-quality, comprehensive global baseline of sustainability disclosures focused on the needs of investors and the financial markets.

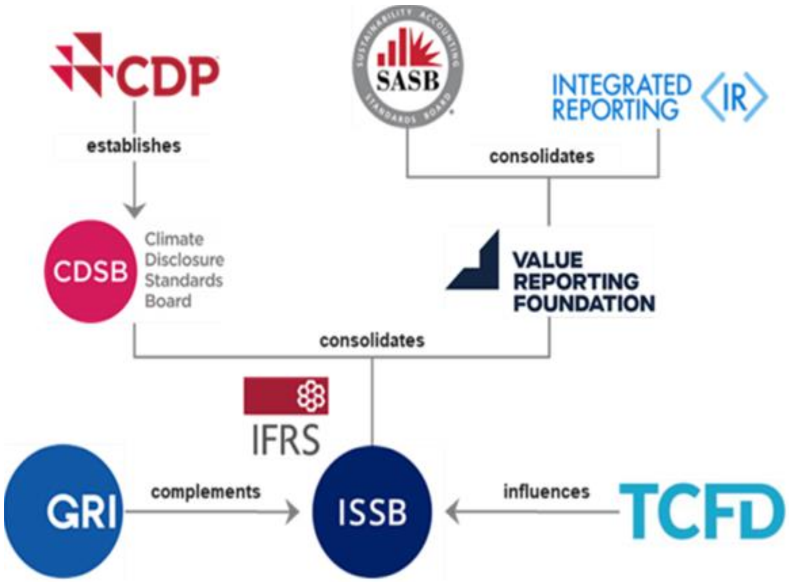
ISSB Standards issued (2023)

- Building on market-led, investor-focused reporting initiatives (see Figure 1), the ISSB issued two IFRS Sustainability Disclosure Standards in June 2023[1]:
  - **IFRS S1**: General Requirements for Disclosure of Sustainability-related Financial Information; and
  - **IFRS S2**: Climate-related Disclosures.

The ISSB has catalysed action globally, including mandated climate disclosures in Australia.

1. Further information on IFRS S1 and S2 is provided in the attachments.

Figure 1: Convergence of sustainability disclosure frameworks



Source: Kirkland & Ellis

"The ISSB is committed to delivering standards that are cost-effective, decision-useful and market informed."

- International Financial Reporting Standards Foundation (IFRS)

Australian Government prioritising climate reporting first

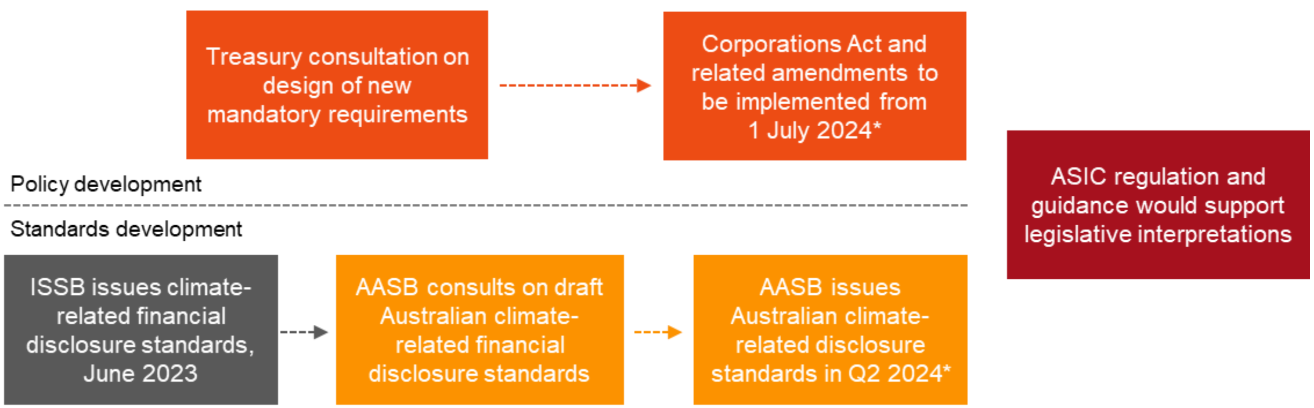
Mandatory climate-related financial disclosures expected from financial year 2024/25 onwards

Climate change is the highest priority ESG issue facing investors according to the Principles for Responsible Investment (PRI). Governments around the world have therefore typically prioritised climate change when developing policies on sustainability. Consistent with this trend, the Australian Government has also prioritised climate change in developing new sustainability reporting standards.

A work in progress

- Domestic policies, laws, regulations and guidance relating to climate change have increased significantly over recent years, e.g. national net zero targets, APRA's CPG229. These support Australia's commitments to addressing the impacts of climate change.
- Governments and regulators have been engaging with financial services entities as this industry has a vital role in meeting those commitments.
- Drawing on IFRS S2, Australian Treasury has led a consultation process since December 2022, specifically around developing a framework for climate-related financial disclosures (see Figure 2).
- Based on strong feedback through the consultation, a key objective for Treasury is developing climate-related standards quickly. Based on Treasury's proposed pathway, final climate-related disclosure standards will be issued by the Australian Accounting Standards Board (AASB) in Q2 2024, with mandatory reporting to begin from 1 July 2024 (with the first reporting date under this regime being 30 June 2025).
- Although investors are still awaiting AASB's draft standards some time in Q4 2023, it is well worth being aware of key elements of Treasury's proposed legislation and preparing for this new regulatory environment.

Figure 2: Pathway to mandatory climate-related financial disclosures



* Subject to passage of legislation

Source: Australian Treasury

"…ensuring large businesses and financial institutions provide Australians and investors with greater transparency and accountability when it comes to their climate-related plans, financial risks, and opportunities…"

- Australian Treasury (consultation paper)

Reporting entities and timing phases

Who will likely be covered by mandatory climate reporting and when?

Listed and unlisted companies, and financial institutions (including asset owners) will have mandatory reporting requirements

- Entities required to lodge financial reports under Chapter 2M of the *Corporations Act 2001 (Cth)* and who meet prescribed size thresholds will be covered.
- Treasury has proposed 'phasing' in coverage, starting with very large entities for FY25 and expanding over time.
- Phases are based on meeting two of out of three thresholds (1) assets, (2) revenue, and (3) number of employees – as shown in Table 1.

Table 1: Australian Treasury's proposed roadmap for mandatory disclosure requirements

Threshold as at end of FY	Group 1	Group 2	Group 3
Consolidated gross assets	A$1 billion or more	A$500 million or more	A$25 million or more
Consolidated revenue p.a.	$500 million or more	A$200 million or more	A$50 million or more
No. of employees	500+	250+	100+
Timing phase	**FY 2024-25 onwards**	**FY 2026-27 onwards**	**FY 2027-28 onwards**

It is important asset owners are prepared to meet their reporting requirements well ahead of time

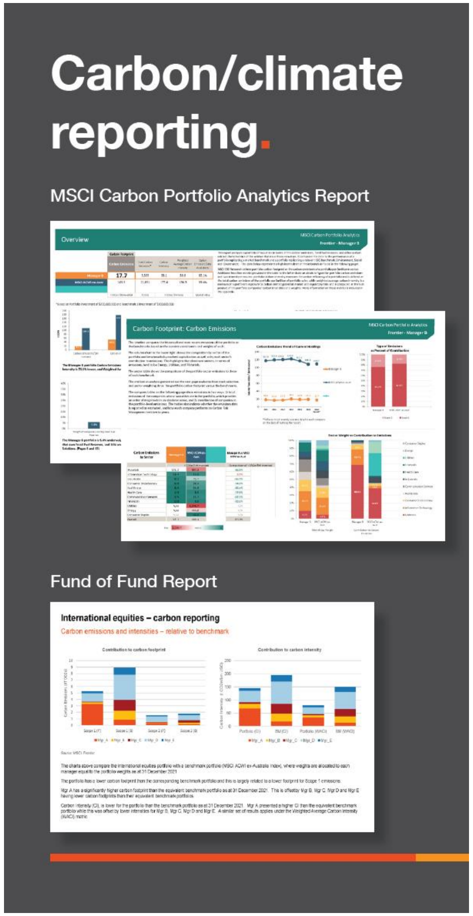
- While Treasury considers 'Group 1' to be a limited group of large entities (and likely to already be providing climate reporting of some kind), we note:
  - For asset owners, the Group 1 asset-based threshold is relatively low at A$1 billion.
  - The definition of consolidated revenue for the revenue-based threshold is to be clarified but may include contributions (as in the case for super funds) as well as investment returns and fee income.
  - Given the 'two out of the three' rule, even modestly sized asset owners may be included in Group 1 and come under mandatory requirements for FY25.
- Entities lower than Group 3 are encouraged to provide climate reporting on a *voluntary* basis.

Reporting content

Greenhouse (GHG) gas emissions reporting expected to be standard disclosure requirement

- Reporting content requirements will ensure disclosures are decision-useful for users
  - AASB is currently drafting Australian climate-related financial disclosure standards. Draft standards are expected to be made available in Q4 2023.
  - The disclosure standards are expected to closely align with the requirements in IFRS S2 *Climate-related Disclosures.*
  - Public consultation on the draft standards will form part of the process to finalise the standards by end of Q2 2024.
- The principle of materiality will inform what information an entity discloses.
- Standards are also expected to reflect TCFD, APRA's CPG229 and include:
  - Governance – arrangements to oversee and manage climate factors.
  - Strategy – to identify and address climate risks and opportunities, i.e. scenario analysis to demonstrate consideration of climate futures and decarbonisation targets and strategy such as net zero by 2050.
- Risks and opportunities - which are material or concentrated.
- Metrics and targets
  - Scope 1 and 2 emissions are expected to be required disclosure regardless of materiality.
  - Scope 3 emissions have been proposed for disclosure from an entity's second year of reporting.
  - For asset owners, Scope 1 and 2 for unlisted and alternatives asset classes may still prove challenging at this time, while availability of Scope 3 data across a diversified portfolio is limited.
- Some leeway will be afforded to reporting entities in terms of disclosures in the early stages of the new mandatory climate disclosure regime giving an opportunity for learning and development.

Frontier is ready to assist clients to meet their upcoming climate reporting requirements. Get in touch to learn more.



Frontier has partnered with MSCI to provide clients with concise, streamlined carbon reporting.

The final word

Mandatory climate reporting on the doorstep

- Much is still to be finalised in terms of climate reporting standards.
- Frontier believes investors should approach this new regime with authenticity and a growth mindset.
- Accepting the clear rationale and wide-ranging benefits of consistent and comprehensive sustainability disclosure and reporting will generate positive momentum within your organisation, rather than it being seen as a compliance and cost-minimisation exercise.

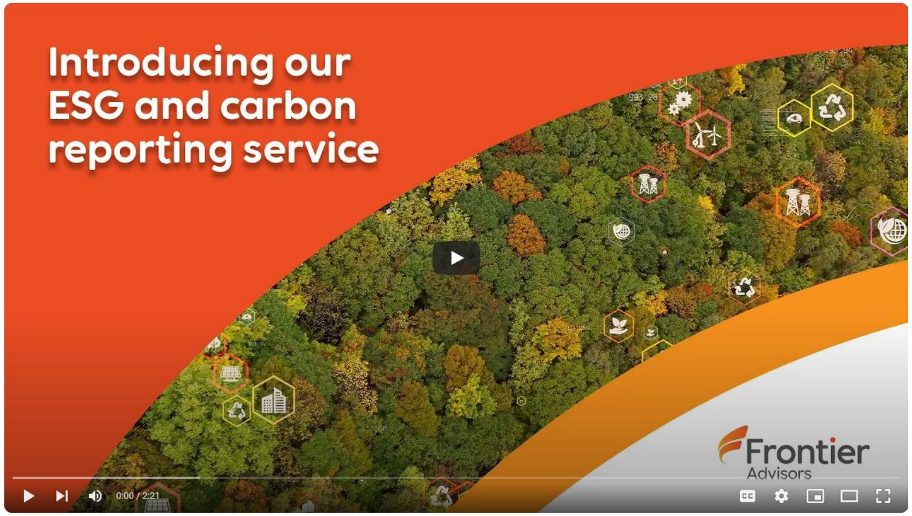
As further details on climate reporting standards become available, Frontier will provide additional updates to clients.

Resources:

[Learn about our reporting service >]

[Learn about ESG reporting >]

[Learn about carbon/climate reporting >]



Want to learn more?

Frontier continues to develop its support services for clients with respect to climate change and sustainability.

Contact a member of our Responsible Investment Group, or your client team to learn more.

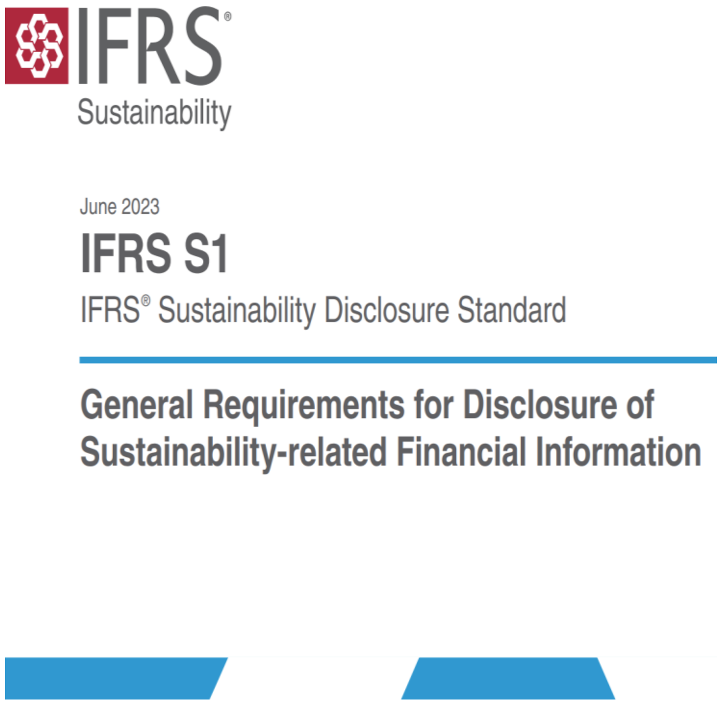
Attachment

International Financial Reporting Standards Foundation (IFRS) S1 and S2

IFRS sustainability standards

A new era in financial reporting is upon us

- By way of background, IFRS announced the formation of the International Sustainability Standards Board (ISSB) at COP26 in Glasgow in late 2021. The primary objective of establishing ISSB was to develop a comprehensive global baseline of sustainability disclosures.
- ISSB released the final versions of its Sustainability and Climate-related Disclosure Standards (“S1” and “S2” respectively) on 26 June 2023. The Standards (which include requirements such as the phased-in reporting of material Scope 3 emissions) are closely aligned to the recommendations of the TCFD and represent baseline sustainability reporting requirements for companies. The overall influence of the Standards will be dependent on jurisdictional adoption/alignment into mandatory and voluntary reporting regimes and greater standardisation of overlapping disclosure frameworks more generally.
- For companies adopting S1 and S2 (voluntarily or under mandatory reporting regimes), these Standards will be applicable for annual reporting periods on or after January 1, 2024. While the ISSB Standards pertain to company-level reporting (concurrent with traditional financial statements); we note that domestically, Treasury has proposed a wider coverage which includes asset owners and other financial entities. Revenue, personnel and size thresholds will determine when entities will be required to provide the prescribed disclosures.
- The Standards are expected to be incorporated into regulatory regimes in a number of jurisdictions, with Australia, the UK, Canada, China and Japan amongst those countries that have signaled their intention to adopt the Standards. Support has been received from a broad range of organisations, including the PRI, which has called for governments to align mandatory reporting regimes with the Standards.
- While full harmonisation may not be possible, we believe the development of the ISSB Standards represents an important step forward towards standardisation of corporate sustainability reporting globally and by extension for investor expectations and asset owners in Australia.


IFRS®
Sustainability

June 2023

IFRS S1

IFRS® Sustainability Disclosure Standard

General Requirements for Disclosure of Sustainability-related Financial Information

Source: IFRS

IFRS sustainability standards

ISSB S1 and S2

- ISSB S1 (sustainability-related disclosure requirements) and ISSB S2 (identification and measurement of climate related risks) build upon the existing SASB framework, to create a framework for broader sustainability-related exposures (S1), while going beyond the recommendations of TCFD as it relates to climate disclosures (S2). While TCFD recommendations have had a strong uptake in Australia and other regions, there remains scope for disclosures to vary in reporting across entities. The ISSB aims to bridge this gap.
- Deloitte notes that the ISSB standards require more specific climate-related disclosures than what is required under the TCFD recommendations. Additionally, sustainability considerations under S1 include the extent of a company's dependencies on both resources and the relationship with a broad range of stakeholders.
- It should be noted that there is an exemption from disclosing Scope 3 emissions for a year following the effective dates of IFRS S2. Unsurprisingly, the timing and assurance related to Scope 3 disclosure was the area of greatest pushback from respondents to the draft exposure standards, given measurement challenges.
- There is some irony that mandating Scope 3 disclosures is likely to put greater scrutiny on those sectors with otherwise small Scope 1 & Scope 2 emissions (when it comes to how a portfolio is actually tracking against its net zero targets for example, if Scope 3 inclusive).
- ISSB is also seeking feedback on the development of other sustainability standards in the coming years, such as biodiversity.

IFRS S1 & S2

	Proposed IFRS S1: General Sustainability Disclosures	Proposed IFRS S2: Climate-Related Disclosures
Objective	To provide information about **significant sustainability-related risks and opportunities** to assist primary users of general-purpose financial reporting when they assess enterprise value and decide whether to provide resources to the company.	To provide information about **exposure to climate-related risks and opportunities** to assist users in assessing effects on enterprise value, understanding use of resources, and evaluating strategy, business model, and operational adaptation abilities.
Key Disclosure Topics	• *Governance* — Processes, controls, and procedures to monitor and manage **sustainability-related** risks and opportunities. • *Strategy* — Approach for addressing **sustainability-related** risks and opportunities that could affect business model and strategy over the short, medium, and long term. • *Risk management* — Processes to identify, assess, and manage **sustainability-related** risks. • *Metrics and targets* — Information used to assess, manage, and monitor performance of **sustainability-related** risks and opportunities.	• *Governance* — Processes, controls, and procedures to monitor and manage **climate-related** risks and opportunities. • *Strategy* — Approach for addressing **climate-related** risks and opportunities that could affect business model and strategy over the short, medium, and long term. • *Risk management* — Processes to identify, assess, and manage **climate-related** risks. • *Metrics and targets* — Cross-industry metrics, **industry-based metrics**, and other metrics used to measure **progress toward targets**.

Source: Deloitte