21 February 2020

Australian Sustainable Finance Initiative
info@sustainablefinance.org.au

Via info@sustainablefinance.org.au

Dear Sir or Madam

Submission on the Progress Report of the Australian Sustainable Finance Initiative

As the representatives of over 200,000 current and future professional accountants in Australia, Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia (together referred to as both Accounting Bodies) welcome the opportunity to provide a submission to the Australian Sustainable Finance Initiative (ASFI) on its Progress Report titled *Developing an Australian Sustainable Finance Roadmap* (the report).

Appendix A provides our responses to the specific questions asked in the feedback survey.

We would like to express our interest to participate in further consultations and/or meetings with the ASFI. Contact details can be found at the conclusion of this submission.

Key points:

Both Accounting Bodies:

- are strong advocates for an appropriate sustainable finance system, and we appreciate and agree that the Australian financial services sector is faced with a range of challenges in its journey towards this system. As such, we commend the ASFI for leading the conversation in this space.

- suggest that the members of the ASFI first work towards implementing a sustainable finance focus within organisations that are part of the initiative to show that this outcome can be achieved, and influence their stakeholders (which could also include requesting that those parties begin adopting sustainable finance focuses). A sustainable finance focus needs to be embedded within the organisation, which can be achieved by providing key management personnel with sufficient and appropriate education.

- agree that there remains a perceived narrow interpretation of a director's or fiduciary's duty to act in the best interests of an entity. Before any possible solutions are proposed, we consider it important to understand the reality and reasons behind this interpretation.

- do not consider that additional mandatory disclosure is the best path forward. While regulation can sometimes provide a way to change behaviour, we caution against using this avenue to enforce compliance with organisations viewing sustainable finance as another 'tick the box' exercise. Rather, we consider the first step should be to better understand the reasons for a lack of disclosure of 'non-financial' information under the existing reporting frameworks, followed by regulatory monitoring and enforcement of the frameworks in place.

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- agree that there are gaps in availability of data and inconsistent frameworks to provide context for environmental and social considerations in decision-making. However, not all matters can be easily quantified, so a change is required in the way risk is assessed and valued, rather than continuing to rely on existing models.

- encourage ASFI to continue working collaboratively with the Government for consistency and harmonisation of frameworks, and for the purposes of identifying any concerns or conflicts within the legislation.

Should you have any questions about the matters discussed in this submission or wish to discuss them further, please contact either Karen McWilliams at karen.mcwilliams@charteredaccountantsanz.com or Dr John Purcell at John.Purcell@cpaaustralia.com.au.

Yours sincerely,

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Appendix A

General comments

We are strong advocates for an appropriate sustainable finance system, and we appreciate and agree that the Australian financial services sector is faced with a range of challenges in its journey towards this system. As such, we commend the ASFI for leading the conversation in this space.

The progress report provides an opportunity for a wider conversation about how best to address the challenges faced by the financial services sector. However, we caution against jumping to possible solutions until the challenges are fully analysed and assessed, in the context of the current policy framework.

1. Leadership, culture and institutional structures

Leadership and Capability

We agree that greater importance needs to be placed on non-financial matters at all levels of governance to align values and create organisational cultures that authorise commitment to these issues among leaders.

In this regard, we suggest that the members of the ASFI first work towards implementing a sustainable finance focus within organisations that are part of the initiative to show that this outcome can be achieved and influence their stakeholders (which could also include requesting that those parties begin adopting sustainable finance focuses).

For completeness, a sustainable finance focus needs to be embedded within the organisation, which can be achieved by providing key management personnel with sufficient and appropriate education. As such, ensuring that sufficient and appropriate education is provided to raise general awareness should be the first priority.

Remuneration and Culture

Financial incentives provide a useful method for encouraging the adoption of a sustainable finance focus alongside the typical finance metrics. However, while financial incentives can provide a way to encourage change, we caution against using only this method in the long run. The use of financial incentives needs to be balanced and should not attempt to force the appropriate behaviour and culture change.

Further, to support a sustainable finance focus, key management personnel need to comprise individuals who take a long-term view to value creation, and who recognise the importance of environmental and social inputs. These individuals will therefore need to have received appropriate training which also places emphasis on long term sustainable finance (which will itself emphasise accountability to all stakeholders). These individuals need to understand and acknowledge the interconnections and linkages with sustainable finance and long-term value creation, and why a sustainable finance focus makes good long-term business sense.

Fiduciary Duties

We note the observations as to a perceived narrow scope of directors' duties of care and diligence and related fiduciary responsibility in acting in the best interests of an entity. Before any possible solutions are proposed, we consider it important to understand the reality and causes of these interpretations which are the subject of ongoing legal debate around the notion of shareholder primacy. As part of this, there may be an opportunity for the ASFI to update and extend the director's opinion by Noel Hutley QC to apply to all matters of sustainable finance (i.e., beyond climate change). We point also as a useful reference the *work undertaken by the Commonwealth Climate Law Initiative* comparing climate change risk and potential for directors' liability across Australia, Canada, South Africa and the United Kingdom.

2. Community and consumer interests and expectations

As noted above, education and awareness raising activities are key in connecting consumer expectations and the financial services sector's response with regards to a sustainable financial system. Education of financial advisers and others who engage with consumers, is also crucial for the development of the necessary skills and capabilities expected by consumers.

3. Frameworks, tools and standards

Frameworks, tools and standards

We agree with the challenges identified in this section. Any framework or tool used should be principles-based and encompass forward-looking business risks (such as cyber-security, conduct and modern slavery) to further promote good governance by organisations. Taking a multi-capital approach and communicating how value is created via a suitable reporting framework (such as integrated reporting) is crucial for building trust between stakeholders and organisations and provides a way for claims to be validated. Further, while any framework or tool used should be globally aligned, it should also build on Australia's existing reporting framework (i.e., the Operating and Financial Review, the Australian Corporate Governance Council principles and recommendations). We also caution against placing too much focus on comparability as this does not necessarily lead to better information for users.

For completeness we note that work is being done at an international level, such as *the* *Corporate Reporting Dialogue's Better Alignment Project* (to align frameworks, tools and standards to facilitate a sustainable finance focus) and the *World Economic Forum's Consultation Draft Toward common metrics and consistent reporting of Sustainable Value Creation* (which proposes core metrics and disclosures to create comparability and consistency in ESG reporting). Further, the recent publication *Sustainable Development Goals (SDG) Disclosure Recommendations* establishes best practice for corporate reporting of contributions towards SDGs on a principles basis and leveraging existing reporting frameworks.

Reporting and assurance

Reporting

For reference, Australia's existing 'non-financial' reporting framework and guidance includes the following:

- Australian Accounting Standards Board (AASB) Practice Statement 2 *Making Materiality Judgements*, which notes that the application of materiality is mandatory to all information in financial statements (which are themselves subject to audit) and the AASB and Auditing and Assurance Standards Board (AUASB) joint bulletin, *'Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB/IASB Practice Statement 2'*, where the two Australian standard-setters address climate-related and other emerging risk disclosures in the context of financial statement materiality.
- Australian Securities and Investments Commission's (ASIC) *Regulatory Guide 247 Effective disclosure in an operating and financial review* which requires that all non-financial information be subject to materiality, and that the review itself forms part of the Board of Directors' report (itself required under the Corporations Act 2001).
- Australian Stock Exchange *Corporate Governance principles*, which operate on a comply or explain basis, and which include Recommendation 7.4 applicable to risk disclosures.

While there are multiple frameworks for various non-financial matters, these are more complementary in nature than conflicting. As noted above, reporting with respect to material 'non-financial' matters is, by all accounts, mandatory in nature.

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For example, while the phrase 'climate-change' does not feature in the Australian Accounting Standards, these standards still do address issues that relate to climate-change risks and other emerging risks. The accounting standards require companies to make materiality judgements in decisions about recognition, measurement, presentation and disclosure. Climate-related risks and other emerging risks are predominantly discussed outside the financial statements, but, qualitative external factors, such as the industry in which the company operates, and investor expectations may make some risks 'material' and may warrant disclosures in financial statements, regardless of their numerical impact.

Further, the AASB and AUASB joint bulletin (on the application of materiality to climate change in the context of financial statements) provides some guidance to support the inclusion of (and subsequent assurance of) climate-related disclosures in financial statements. This bulletin has been recognised by the International Accounting Standards Board (IASB). The guidance notes that climate-related risks could affect the general presentation of financial statements, impairment and fair value of both tangible and intangible assets, financial instruments, as well as provisions and contingent liabilities and assets.

We do not consider that additional mandatory disclosures is the best path forward. While regulation can sometimes provide a way to change behaviour, we caution against using this avenue to enforce compliance so as to avoid organisations viewing sustainable finance as another 'tick the box' exercise. Rather, we consider the first step should be seeking an understanding as to why disclosure is not taking place under the existing frameworks. This may be due to a lack of understanding of the actual issues, in which case, more mandatory reporting will not necessarily lead to better disclosure. Awareness raising and engagement, followed by regulatory monitoring and enforcement of the frameworks in place may result in better outcomes.

We also encourage members of the ASFI to use their positions in supply chains to encourage real change towards a sustainable finance focus.

Assurance

In terms of assurance, we note that as part of an audit of a general purpose financial report, an auditor must read the 'other information' (financial or non-financial information (other than the financial statements and the auditor's report thereon) included in an entity's annual report and consider whether there is a material inconsistency between the other information and (i) the financial statements; or (ii) the auditor's knowledge obtained in the audit. We consider that this requirement should remain in place with respect to all non-financial disclosures.

Further, the challenges around auditing non-financial information has been recognised by the International Auditing and Assurance Standards Board (IAASB) which is in the process of developing guidance in relation to applying International Standard on Assurance Engagements (ISAE) 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*. Similarly, the Parliamentary Joint Committee on Corporations and Financial Services is currently holding an inquiry into the regulation of auditing in Australia and, in response to this inquiry, CA ANZ has developed a 15 point plan which recognises that assurance is increasingly relevant to addressing non-financial risks such as those related to cyber-security, conduct and climate change. In its submission to the inquiry, CPA Australia notes the importance of understanding and clarifying financial report users' needs—that is, beyond financial information—and ensure that the audit scope better meets the expectations of users.

4. Decision-making and valuation

We agree that there remain significant gaps in availability of data and inconsistent frameworks to provide context for environmental and social considerations in decision-making. Not all matters can be easily quantified, so change is required in the way risk is assessed and valued, rather than continuing to rely on existing models. Collaborative initiatives such as ASFI are continuing to mature and develop, and members play a critical role in bringing investors and reporters together to pilot the approach to disclosure.

Disclosures are themselves meaningless if organisations are not considering these issues internally. In this regard and as commented earlier, we suggest that the members of the ASFI first work towards implementing a sustainable finance focus within organisations that are part of the initiative to show that this outcome can be achieved and influence their stakeholders (which could also include requesting that those parties begin adopting sustainable finance focuses). Implementing this focus will naturally require ensuring sufficient and appropriate education is provided to personnel in order to raise general awareness.

5. Unlocking sustainable finance and allocating capital to where it is needed

No specific comment.

6. Policy, regulation and supervision

Australian financial regulators and standard setters have already issued clear guidance on their expectations around climate-related and other risks (in line with our comments above). Regulators need to be adequately resourced to effectively monitor and enforce compliance with the existing 'non-financial' regulatory framework. Further, ongoing communication and education will be needed to ensure regulators' expectations are understood. Despite this, regulation will not address an organisation's internal adoption of a broader sustainable finance focus.

We encourage ASFI to continue working collaboratively with the Government for consistency and harmonisation of reporting frameworks, and for the purposes of identifying concerns or conflicts within the legislation. Further, members of the ASFI could advocate for a Wellbeing-focused budget and a living standards framework – similar to what has been developed in New Zealand – as a way to encourage the Government to fully incorporate a sustainable finance focus in policy, but also in their interactions with members of business (to begin driving real change).