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Submission to the Australian Government Treasury Consultation
Climate-related financial disclosure

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About the authors

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Summary

This submission draws on the authors' combined research and experience over a number of years in corporate climate risk disclosure and management in Australia and internationally, and the role of law and regulation in driving improved practice.

The authors support the introduction of standardised, internationally aligned regulation for climate risk disclosure in Australia for the following reasons:

- Disclosure is an important tool to underpin efforts to decarbonise corporate Australia, in pursuit of Australia's emissions reduction targets under the Paris Agreement, and to enhance corporate resilience to climate impacts.
- Existing legal obligations clearly require companies to disclose material financial risks. However, disclosure of climate-related risks in practice is highly variable and often lacking. As the consultation paper notes, a lack of internationally comparable disclosure can place Australian companies at a disadvantage. Investors and other stakeholders continue to call for more transparency on corporate climate risk exposure and management.
- Voluntary guidance and standards, such as the Taskforce on Climate-related Financial Disclosures (TCFD), have provided a pathway for companies to start their decarbonisation journey. While many Australian companies have made an initial commitment to adopt the TCFD framework, few companies are moving beyond the original commitment phase and implementing the full suite of recommendations. There are particular gaps in setting out climate risk management/transition plans and using targets and metrics to track progress in climate risk management.

Further comments are provided below on the reform principles and a selection of the key consultation questions.

Reform Principles

The reform principles provide a useful framework with which to develop climate risk disclosure requirements and respond well to current gaps and weaknesses in disclosure practice:

- Principle 1 recognises that climate-risk disclosure plays an important role in supporting Australia's climate change mitigation and adaptation targets and goals. If companies are required to disclose their exposure to climate-related risks, as well as their transition and adaptation strategies to manage these risks (using standardised approaches to targets and metrics that reference Australia's emissions reduction targets and Paris Agreement goals and reporting explicitly on greenhouse gas emissions), this will help to address current concerns regarding greenwashing and support companies to deliver on their net-zero commitments.

- Principle 2 acknowledges that improvements in the quantity, quality, and comparability of disclosures are needed. Our research underscores the highly variable nature of corporate climate risk disclosure practices across the ASX100 companies. While the quantity of climate disclosures has increased over time,[1] companies continue to take very different approaches to risk assessment, scenario analysis, and risk management strategies using relevant targets and metrics.[2] As a result, companies are not always providing decision-useful information, which allows for relevant stakeholders to assess their readiness and progress in addressing climate change and to make comparisons between companies. Further, climate disclosures are spread across annual reports, sustainability reports, climate-specific reports, and company websites, further hindering accessibility and transparency.[3]

- Principle 3 recognises that a clearer prescription of obligations and guidance is required to ensure all relevant stakeholders have a clear and common understanding. Currently, companies have legal obligations to disclose financial risks that are material to company interests,[4] with accompanying regulatory guidance explaining to some degree how

[1] Luisa Unda and Anita Foerster, 'Climate risk disclosure, compliance and regulatory drivers: a textual tone analysis' 39(1) (2022) *Company and Securities Law Journal*, 47-72; Phang, S. Y., Adrian, C., Garg, M., Pham, A. V., & Truong, C. 'COVID-19 pandemic resilience: an analysis of firm valuation and disclosure of sustainability practices of listed firms' (2023) 38(1) *Managerial Auditing Journal*, 85-128.
[2] Anita Foerster and Michael Spencer, 'Corporate Net Zero Pledges: A triumph of private climate regulation or more greenwash? (2022) *Griffith Law Review* (forthcoming)
[3] Ibid.
[4] Corporations Act 2001 (Cth), ss 295-7, 299A(1), 307-8. See also, Noel Hutley and Sebastian Hartford-Davis, *Climate Change and Director's Duties* (Memorandum of Opinion, Centre for Policy Development, 7 October 2016)

these climate-neutral disclosure rules apply to climate change where climate change poses risks to a particular company.[5] Regulatory guidance also points to the 'voluntary' TCFD standard as a source of best practice guidance on how to disclose climate risks.[6] Even though the climate risk disclosure practices of Australian companies have evolved considerably over the last 10 years, the existing combination of principle-based rules and regulatory guidance has not resulted in high quality and consistent disclosure of climate-related risks. This suggests a clear case for a more explicit prescription of obligations and more detailed and targeted regulatory guidance.

Q. 1, Q.2, Q.3 – What are the costs and benefits of Australia aligning with international practice on climate-related financial risk disclosure? Should Australia adopt a phased approach to climate disclosure? To which entities should mandatory disclosure apply initially?

Introducing mandatory climate risk disclosure will certainly result in some increased compliance costs for regulated entities. Therefore, a phased approach and strategic, initial targeting of obligations at larger listed entities is appropriate: these entities emit more greenhouse gases, have a large stakeholder group, and have the required financial resources to comply with the regulation.[7]

However, compliance costs should not be over-exaggerated and used as a reason to delay the introduction of these important reforms. Most larger listed companies are already signed up to report using TCFD standards or, indeed, producing TCFD-aligned reports. Investors and other market stakeholders have been explicitly seeking comprehensive information from investee companies on climate risk exposure and management strategies for some time.[8] Large listed companies are well-placed to adapt quickly to a mandatory disclosure regime.

Q. 4 – Should Australia seek to align our climate reporting requirements with the global baseline envisaged by the ISSB?

The development of the ISSB draft standard for climate risk reporting provides a timely opportunity for Australia to align reporting requirements with international best practices and support companies to meet their legal obligations to fully disclose climate-related risks. As the recent legal opinion prepared by Hartford-Davis and colleagues makes clear, adopting the ISSB standard would not impose additional legal obligations on Australian companies. Instead, it would help to clarify best practice expectations consistent with existing legal obligations for companies and their directors.[9]

Currently, corporate climate disclosure practices in Australia are only *weakly aligned* with the voluntary international TCFD standard. This is achieved through reference to TCFD in regulatory guidance provided by ASIC and APRA, such as *ASIC Regulatory Guide 247* (RG 247.64 & RG 247.66).

However, a considerable body of research now shows that while there is ostensibly high uptake of TCFD standards in Australia, in practice, companies only partly implement the TCFD recommendations, and there is considerable variation in approaches. The TCFD and others have identified weaknesses in the disclosure of the financial effects of climate risk, transition strategies, and relevant targets and metrics that can help measure and compare progress and performance.[10] **This highlights that more explicit reference to international standards in regulation is needed to achieve more consistent, higher quality disclosures.**

The draft standards for climate risk disclosure developed by the ISSB draw on the TCFD and other relevant standards in ways that will usefully address current gaps and weaknesses in Australian climate risk disclosure practices. For example:

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[5] Australian Securities and Investment Commission (ASIC), *Effective disclosure in an operating and financial review - Regulatory Guide 247* (August 2019). See also, Li, A., Michaelides, M., Rose, M., & Garg, M. 'Climate-related risk and financial statements: Implications for regulators, preparers, auditors and users' (2019) 29(3) *Australian Accounting Review*, 599-605.
[6] ASIC above n 5, RG 247.66; APRA, Prudential Practice Guide CPG 229 Climate Change Financial Risks (November 2021), 5, 18, 19,
[7] Over 50% of ASX-listed companies are small and loss making. Such companies have lower GHG emissions and lack financial resources to bear the high cost of compliance.
[8] Australian Accounting Standards Board (AASB) and Auditing and Assurance Standards Board (AUASB), *Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB/IASB* (Practice Statement 2, AASB and AUASB, April 2019).
[9] Sebastian Hartford-Davis and Kelly Dyon, *Advice regarding potential liability of directors under the ISSB Draft Standards for Forward Looking Statements* (2023).
[10] TCFD, *2021 Status Report: Taskforce on Climate-Related Financial Disclosures* (2021).

- The ISSB standards provide considerable detail on climate target setting and associated emissions reporting.[11] In Australia, there is currently no legal requirement for companies to set emissions reduction or other climate targets. Still, companies are increasingly setting these targets as part of their climate risk response. However, companies take a range of approaches to target setting. Some set absolute emissions targets; others set emissions intensity targets and some set targets for certain business lines only.[12] Targets for scope 3 emissions (a very significant source of climate risk for many entities) are not well developed. Clearer guidance is needed to support consistent practice and address greenwashing concerns and associated legal liability risks.[13]

Further, a significant benefit of aligning Australian climate reporting requirements with the global baseline envisaged by the ISSB is that the international community will be able to compare and benchmark Australian corporate disclosures with other organisations. For example, Australia has the required natural resources and geographical features to generate extensive green energy (e.g. solar, wind power, green hydrogen), but significant investment is required for commercialisation and to reduce the cost of production. Increased international comparability will help Australia become a more competitive investment destination and is particularly important in light of international developments to standardise investor approaches to green, low carbon investments (sustainable finance taxonomies).

Q. 5 – What are the key considerations that should inform the design of a new regulatory framework, in particular, when setting overarching climate disclosure obligations?

Current concerns about climate risk disclosure in Australia centre on the inconsistencies of corporate approaches and the poor quality of disclosures, particularly in providing quantified assessment of climate risk exposure, setting out credible climate risk management and decarbonization/transition strategies, and reporting transparently on progress in achieving these.

Incorporating overarching obligations for climate disclosure into legislation and developing the details of those obligations through standards or guidance (option 1 as set out in the Consultation Paper) would clearly signal the importance of climate risk disclosure and strengthen the application of existing legal obligations to disclose material financial risks posed by climate change. This would likely help address the above weaknesses in current practice and help build a clear and common understanding of what is required and expected (in line with Principle 3).

In particular, international best practice, as expressed through the ISSB Draft Standard, requires companies to go beyond disclosing their exposure to climate-related risks. Considerable emphasis is now also placed on companies setting out credible risk management strategies, including decarbonisation pathways that align with Paris Agreement goals and reporting on their implementation using relevant targets and metrics.

To appropriately reflect these best practice expectations, legislative provision for climate risk disclosure would be beneficial. As current practice shows, relying on the indirect legal obligation to disclose material financial risks in the annual report, with some guidance provided on how this applies to climate risk, has not yet led to sufficient shifts in disclosure practices.

It is important that any new statutory obligation is well supported by regulatory guidance, education, and outreach for regulated entities.

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[11] International Sustainability Standards Board (ISSB), *Exposure Draft IFRS S2 Climate-related Disclosures*, 40-43.

[12] Foerster and Spencer (above n 2)

[13] For example, litigation is currently underway against Santos Ltd alleging the company has engaged in misleading and deceptive conduct with regards to net zero targets and climate risk strategy: Environmental Defender's Office, 'World-first Federal Court case over Santos' 'clean energy' & net zero claims' (Webpage, 26 August 2021), https://www.edo.org.au/2021/08/26/world-first-federal-court-case-over-santos-clean-energy-net-zero-claims/

Q.6 Where should new climate reporting requirements be situated in relation to other periodic reporting requirements? For instance, should they continue to be included in an operating and financial review, or in an alternative separate report included as part of the annual report?

To meet existing legal obligations in relation to climate risk reporting, companies are advised to discuss climate-related risks and their impacts on company strategy in the Operating and Financial Review (OFR) of the Directors' Report,[14] as well as ensuring that climate risks are reflected in the financial statements where material to the company.[15]

While there has been a rapid and significant increase in the quantity of climate risk reporting in the OFR,[16] reporting climate risk in the financial statements or notes is still undeveloped in practice.[17]

Further, many companies also produce a separate climate report or report on climate risks in their sustainability report or on the company website. This additional information is typically not audited nor subject to the same degree of scrutiny as the Annual Report. As well as under-reporting and inconsistent reporting, our research has noted at times excessively verbose over-writing of vague or anecdotal climate commitments that can obscure actual commitments and performance.

To improve transparency and accessibility and drive quality improvements in climate risk disclosure, it is important that companies are required to report within the Annual Report so that stakeholders can find all the required information in a single source document. Climate risk should be discussed, where material and relevant, in the OFR and in the financial statements. However, an additional and separate section in the Annual Report should also be required to make it easier for users of Annual Reports. In this separate section of the Annual Report, companies can provide a more detailed discussion of their climate risk exposure and its impact on company strategy and set out climate risk management strategies and associated progress reporting in line with the ISSB standards.

Q. 7 – What considerations should apply to materiality judgements when undertaking climate reporting, and what should be the reference point for materiality?

As the Consultation Paper acknowledges, assessing materiality of climate and sustainability risks for reporting purposes is an evolving area.

Australian regulators and standard-setters have, however, clearly recognised the materiality of climate risk for entities in all sectors of the Australian economy and provide some guidance as to how existing standards and materiality thresholds apply to the treatment of climate-related risks.

One example is the AASB/AUSB Practice Note of 2019 which sets out the range of potential financial implications from climate change that may need to be disclosed in financial statements (asset impairment, changes in the useful life of assets, and changes in the fair valuation of assets) and provides guidance on reflecting these implications in financial statements.[18] As set out in *AASB Practice Statement 2 Making Materiality Judgements (APS 2),* qualitative external factors such as the industry in which the entity operates, and investor expectations may make climate-related risks 'material' and warrant disclosures when preparing financial statements, regardless of their numerical impact. *AASB 101 Presentation of Financial Statements* considers a piece of information material if omitting it or misstating it could influence decisions that users make on the basis of financial information of a reporting entity.[19]

One of the key challenges in this area is achieving clarity and consistency on the scenarios and assumptions on which materiality judgements are based, particularly given the high levels of uncertainty surrounding how the transition and physical risks posed by climate change will develop over time. **Without clear guidance on timeframes and other parameters for assessing climate**

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[14] Noel Hutley and Sebastian Hartford-Davis, *Climate Change and Director's Duties* (Memorandum of Opinion, Centre for Policy Development, 7 October 2016); Noel Hutley and Sebastian Hartford-Davis, *Climate change and directors' duties* (Supplementary Memorandum of Opinion, Centre for Policy Development, 26 March 2019).
[15] AASB and AUASB (above n 8).
[16] Unda and Foerster (above n 1).
[17] A review of climate-related content in 2018 annual reports conducted by ASIC (2018) and the AUASB (2018) has shown that climate-related risk is being considered by companies. However, this trend does not extend to financial statements or notes.
[18] Above n 13.
[19] If there is an assessed risk of material misstatement in the financial statements due to climate change, the auditor should respond appropriately to the risks of a material misstatement by applying *ASA 330 The Auditor's Responses to Assessed Risks*.

risk, it remains open to individual companies to take quite diverse approaches (e.g. select favourable scenarios) and also to disregard and discount the longer-term impacts of climate change on their business. There is certainly some evidence, and a strong perception among investors and other stakeholders that many companies highly exposed to climate risks continue to use short time frames and low ambition emissions reduction scenarios to guide their materiality assessments and reporting.[20]

Given the proposed reforms are intended to support the realisation of Australia's emissions reduction target under the Paris Agreement (Principle 1) and have real potential to underpin corporate decarbonisation, companies should be provided with clear guidance to support appropriate materiality assessments and development of climate risk management strategies that reflect this underlying principle. Both the TCFD and ISSB standards emphasise the importance of assessing risk and aligning strategy against Paris Agreement goals and associated emissions reduction pathways. There are various best practice standards emerging to guide companies in setting Paris-aligned targets (e.g., Science-based Target Setting Initiative). Investors are also calling for Paris-aligned emissions reduction scenarios to underpin corporate climate risk management.[21] **Developing guidance for companies on the use of Paris Agreement-aligned scenarios as part of their risk assessment should be prioritised.**

Q. 8 – What level of assurance should be required for climate disclosures, who should provide assurance, and should assurance providers be subject to independence and quality management standards?

Australian regulators have recently focused their attention on greenwashing practices in relation to climate risk disclosure.[22] This is also a focus for investors and advocacy groups, with litigation currently afoot alleging misleading and deceptive conduct in relation to climate risk reporting practices of a prominent Australian company.[23] Given the risks of greenwashing behaviours, ensuring credible assurance of climate-risk disclosures is an important aspect of the proposed reforms, and specific provision for this should be made.

Currently, the Directors' Report (including the OFR) is not subject to the same level of external assurance as the financial statements. Company auditors have limited obligations to review and provide assurance on such 'other information' that is disclosed outside of the financial statement and accompanying notes. While auditors do review information in the annual report beyond the financial statements, this review is undertaken for the purposes of identifying any material inconsistency with the financial statements or material misstatements of fact and is not taken to be an assurance of the other information within the annual report.[24]

The proposed reforms would see companies required to disclose their performance against a range of standardised metrics (including GHG emissions). This standardised approach to disclosure lends itself well to imposing an external audit requirement.

Demand for assurance engagements to enhance the confidence of the intended users of sustainability/ESG/non-financial reporting (or extended external reporting, EER) is growing. In the broader sense, a sustainability or environmental audit may include a very large 'scope', as it could involve, for example, examinations of emissions, water quality, resource constraints, community impacts or ecology.[25] There will be associated costs for companies, and audit firms will need to address current skills gaps in this area. However, these costs should not be prohibitive for the large, listed companies to which these obligations will attach. Indeed, comparative jurisdictions such as the United Kingdom, already require external assurance of disclosure of non-financial information in the annual report.[26]

In terms of assurance provider, a recent research report commissioned by the AUASB found that specialist providers have had a larger market share (58%) during the early years of sustainability reporting audit, compared to general audit and assurance

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[20] See e.g., Pablo Berutti, We need to talk about net zero bull sh*t, (Responsible Investor Website, 2 August 2021), https://www.responsible-investor.com/we-need-to-talk-about-net-zero-bullsh-t/

[21] See e.g. Climate Action 100+ 'Net Zero Company Benchmark', https://www.climateaction100.org/progress/net-zero-company-benchmark/ accessed 23 August 2021.

[22] Cathie Armour (ASIC), 'What is Greenwashing and what are its potential threats?' *Company Director* (July 2021), https://asic.gov.au/about-asic/news-centre/articles/what-is-greenwashing-and-what-are-its-potential-threats/

[23] The case brought by the Australasian Centre for Corporate Responsibility against Santos Ltd is noted above at n 11.

[24] Auditing and Assurance Standards Board, *Australian Auditing Standard 720: The Auditor's Responsibilities Relating to Other Information* (2015); ASIC RG 247.37.

[25] Pratt, Van Peursem, Garg, *Auditing Theory and Practice*, (2023, First Ed., Cengage Australia).

[26] *Companies Act 2006* (UK), ss 496, 497A.

services firm providers (42%).[27] This study found that companies appeared to be more willing to choose the assurance services from specialist providers if the subject assured is GHG emissions only. Audit and assurance services firm providers were also more likely to provide assurance at a limited level. In contrast, specialist providers are more likely to offer a reasonable level of assurance. As such, Australian listed companies could engage a combination of specialist providers and existing financial auditors, which should be consistent with the Board of Directors and Audit Committee policy and guidelines.

Q. 9 – What considerations should apply to requirements to reporting emissions including use of any relevant Australian emissions reporting frameworks?

Reporting GHG emissions and tracking emissions against targets is a critical part of climate risk disclosure. Given most large, listed companies will already be required to report their scope 1 and 2 emissions under the National Greenhouse and Energy Reporting (NGER) Framework, there is little additional burden to include this information in the annual report.[28] Indeed, most large companies appear to be already reporting scope 1 and 2 emissions in the annual report.[29] However, fewer companies provide accessible information on their progress in reducing emissions against targets.[30] This should be a key consideration in designing guidance for companies on climate risk disclosure. Companies should use emissions data to report on their progress against relevant targets (e.g., a roadmap to show a phased reduction in CO2 emissions).

As the Consultation Paper recognises, scope 3 emissions are an important indicator of climate risk exposure for many companies. International best practice standards now require reporting of scope 3 emissions and encourage companies to also set scope 3 targets. In Australia, scope 3 emissions reporting practice is in its infancy, even among large listed companies, with companies only providing limited, preliminary, or partial information.[31] Further, very few companies have set meaningful targets to reduce scope 3 emissions – existing targets are either heavily qualified or constrained to small parts of the company's value chain.[32] Companies are unlikely to progress in this important but challenging area of climate risk disclosure without a clear obligation and additional guidance and support.

The recent pilot of the Corporate Emissions Reporting Initiative (CERT) suggests that it is both valuable and feasible for large, listed companies to set out climate targets and use NGER data to report on progress against these targets.

Q. 10 – Should a common baseline of metrics be defined so that there is a degree of consistency between disclosures including industry-specific metrics?

Combining core, baseline metrics with industry-specific metrics, as proposed by the ISSB, is an appropriate approach to foster consistency but also ensure disclosure obligations are appropriate to the industry context.

For example, drought will have a direct impact on the profits and operations of companies in industries most reliant on water, such as food processing, agriculture, power generation, and automotive, and relevant metrics should reflect this industry-specific risk exposure.[33] If an entity has revised its financials due to climate change and has recognised significant write-downs, investors may publicly demand such information disclosure from entities in a similar industry (i.e. whether or not climate-related risks impacted the carrying value of the assets recognised in the financial statements). If a common baseline of metrics, including industry-specific metrics, is defined, it will facilitate a degree of consistency between disclosures by companies from the same industry. This will make comparison easier for stakeholders, thereby supporting their decision-making.

Development of industry-specific guidelines could be based on the Global Industry Classification Standards (GICS) with the identification of important industries relevant to the Australian economy.

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[27] AUAB, *AUASB Research Report 7: A Literature Review on the Reporting and Assurance of Climate-related and Other Non-financial Information* (2022).
[28] The National Greenhouse and Energy Reporting (Measurement) Determination 2008 outlines the requirements for measuring and reporting greenhouse gas emissions and energy consumption and provides information on fugitive emissions from coal mining.
[29] Foerster and Spencer above n 2.
[30] Ibid.
[31] Ibid.
[32] Ibid.
[33] Truong, C., Garg, M., & Adrian, C. (2020) 39(4) 'Climate risk and the price of audit services: The case of drought,' *Auditing: A Journal of Practice & Theory*, 167-199.

Q. 11 – What considerations should apply to ensure covered entities provide transparent information about how they are managing climate related risks, including what transition plans they have in place and any use of GHG emissions offsets to meet their published targets?

As previously noted, the most significant gaps in current climate disclosure practice are in setting out climate risk management strategies (transition plans, decarbonisation, and resilience strategies) and providing regular progress reporting on the implementation of these strategies in a standardised, comparable form. The ISSB standard provides a framework for the development of transition plans, setting of targets, and progress reporting. The CERT pilot also provides a model for progress reporting on the key metric of GHG emissions.

Net-zero claims: Given that many companies are responding to market pressure to commit to net-zero emissions and alignment with Paris Agreement, it would also be pertinent to provide regulated entities with guidance and resources to ensure these claims are only made on reasonable grounds, thereby help mitigate liability risk for greenwashing practices.

Important reference points for such guidance include the *Climate Action 100+ Net Zero Benchmark* (an investor-led initiative),[34] and the *Net-Zero Standard* developed by the Science-based Target Setting (an increasingly prominent industry standard).[35] These standards emphasise the importance of:

- Setting near, medium, and long-term emissions targets that align with the Paris Agreement for scope 1, scope 2, and (where relevant) scope 3 emissions.
- Setting absolute emissions targets, not emissions intensity targets (which can mask emissions increases for fast growing companies).
- Focusing on direct emissions reductions, with only a small proportion of residual emissions permitted to be offset or otherwise neutralised via negative emissions technologies.

Use of Offsets: The role of carbon offsets in reducing corporate emissions in Australia remains highly contested. In response to increasing market pressure, many Australian companies have voluntarily committed to net zero by 2050. There is already substantial reliance on offsets by Australian companies,[36] and increased demand for carbon offsets is expected, particularly from companies in hard-to-abate sectors.

While quality carbon offsets can play a role in corporate decarbonisation, the experience with offsets around the world points to serious integrity issues (e.g., additionality and permanence of emissions reduction and carbon sequestration, and validity of carbon accounting approaches). Concerns have been raised about the methods used to award Australian Carbon Credit Units under the Emissions Reduction Fund, and this scheme is currently under review.[37] Further, the use of the Australian Government Climate Active Carbon Neutral Standard (which accredits companies based on the use of Australian and international offsets to meet voluntary commitments) is highly controversial.

These concerns are also emphasised in the report of the United Nations High-Level Expert Group on the Net Zero Emissions Commitments of Non-State Actors released at COP 27.[38] As the Chair of the Group stated in her introduction: “Non-state actors cannot buy cheap credits that often lack integrity instead of immediately cutting their own emissions across the value chain.”[39] The report recommended credits only be used above and beyond efforts to achieve 1.5C aligned interim targets.

There is a pressing need to ensure that offsets relied on by Australian companies are appropriately certified and represent genuine emissions reduction or sequestration. The proposed mandatory climate risk disclosure regime can play a very important part in this by explicitly requiring disclosure about corporate reliance on offsets. The ISSB draft standard provides some useful categories to guide disclosure around the credibility and integrity of offsets, including the extent to which targets rely on the use of offsets, whether offsets are subject to third-party verification or certification, and the type of offset.

[34] Climate Action 100+ ‘Net Zero Company Benchmark’ https://www.climateaction100.org/progress/net-zero-company-benchmark/

[35] SBTi, *SBTi Corporate Net Zero Standard* (Version 1.0, Oct 2021), < https://sciencebasedtargets.org/resources/files/Net-Zero-Standard.pdf> accessed 31 July 2022.

[36] Foerster and Spencer above n 2.

[37] Australian Government Dept. of Climate Change, Energy, the Environment and Water, *Independent Review of Australian Carbon Credit Units*, https://www.dcceew.gov.au/climate-change/emissions-reduction/independent-review-accus

[38] United Nations’ High-Level Expert Group on the Net Zero Emissions Commitments of Non-State Entities (2022), *Integrity Matters: Net Zero Commitments by Businesses, Financial Institutions, Cities and Regions* (2022)

[39] Ibid p8.

Q 15 – How suitable are the 'reasonable grounds' requirements and disclosures of uncertainties or assumptions in the context of climate reporting? Are there other tests or measures that could be considered to ensure liability is proportionate to inherent uncertainty within some required climate disclosures?

In their recent legal opinion, Hartford-Davis and colleagues explain that adopting the ISSB standard as the basis for mandatory climate reporting in Australia would not actually impose additional legal obligations on Australian company directors. Instead, it would help to clarify best practice expectations consistent with existing legal obligations.[40] As such, the proposed reforms, would not create additional liability risk for company directors, who are already required to inform themselves of foreseeable risks to the company posed by climate change; to take proportionate measures to manage these risks; and ensure that company disclosures provide a true and fair representation of the company's financial position and appropriate discussion of material financial risks.[41]

Best practice climate risk disclosure necessarily involves making forward-looking statements on matters that are inherently uncertain. However, as Hartford-Davis and others point out, existing provision of a reasonableness standard operates as an appropriate safeguard that is consistent with best practice approaches. Company directors will only face liability where they lack a reasonable basis for making predictive statements: '*where disclosures are made with appropriate disclosure of assumptions, methodologies and uncertainties, the assessment of reasonableness will take into account those assumptions and disclosed uncertainties*.'[42]

Q. 17 – While the focus of this reform is on climate reporting, how much should flexibility to incorporate the growth of other sustainability reporting be considered in the practical design of these reforms?

Introducing mandatory sustainability (or ESG – Environmental, Social, and Governance) disclosures in Australia would align with international trends and help to achieve consistency and improved reporting of non-financial information that is increasingly important to stakeholders.

Sustainability disclosures are now mandatory in many comparative jurisdictions. For example, the EU *Non-Financial Reporting Directive* introduced in 2014, requires larger companies and corporate groups to provide sustainability disclosures on environmental, social, employee, human rights and bribery, and anti-corruption issues in the annual report and to quantify company performance against measurable performance indicators, including for the company value chain.[43] UK companies are also required to provide a non-financial statement that includes information on company performance on sustainability issues within the annual report, with these sections also subject to external assurance.[44]

While there is no direct legal obligation to provide a sustainability or ESG report in Australia and only a requirement to report on social and environmental issues where they pose material risks to company interests, many large and listed companies do provide additional sustainability/ESG disclosures. The uptake of ESG reporting by large Australian companies has increased significantly over time, and there have been marked improvements in its quality and some convergence of approaches. [45] An Australian study finds an increase in sustainability disclosure practices post the 2015 Paris Agreement, with investors assigning higher value to listed companies making more elaborate sustainability and climate change disclosures.[46]

Nonetheless, a number of weaknesses remain, which could be usefully addressed by mandatory reporting standards, which align with international best practice:

- Like climate-risk reporting, sustainability disclosures are spread across annual reports, company websites and standalone reports.

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[40] Hartford Davis and Dyon above n 7.
[41] Hutley et al above n 12.
[42] Hartford Davis and Dyon above n 7, 12.
[43] European Union, *Non-Financial Reporting Directive* (NRFD) (2014/95/EU)
[44] *Companies Act 2006* (UK), ss 414 CA and CB.
[45] These are other concerns are detailed in the annual reports on corporate sustainability reporting and corporate ESG reporting trends, prepared by the Australasian Council of Superannuation Investors. See e.g. ACSI, *ESG Reporting Trends – a detailed assessment of ESG reporting in ASX200 companies* (2022).
[46] Phang, S. Y., Adrian, C., Garg, M., Pham, A. V., & Truong, C. 'COVID-19 pandemic resilience: an analysis of firm valuation and disclosure of sustainability practices of listed firms' (2023) 38(1) *Managerial Auditing Journal*, 85-128.

- Companies adopt different standards to guide sustainability reporting (including the Global Reporting Initiative, the Sustainable Development Goals framework, and Integrated Reports).

- External verification or assurance of reported data is voluntary and limited, with internal control systems and data collection processes not as developed as comparable systems for financial information.

- Target setting is common, but it can be difficult to track progress against targets given a lack of standardised baselines, metrics and target categories.

- Lack of standardised metrics and reporting means parts of these documents can become the domain of marketing and public relations departments eager to present the company in the best possible light to stakeholders. Hence, there may be an inclination to ignore or gloss over bad news and amplify better news.

Q. 18 – Should digital reporting be mandated for sustainability risk reporting? What are the barriers and costs for implementing digital reporting?

eXtensible Business Reporting Language (XBRL) plays an important role in providing stakeholders with higher levels of data accessibility, accuracy, and reportability. Digital reporting and the use of XBRL allow for efficient extraction of reported information, making assessment and comparison of company performance easier and less costly for relevant stakeholders. Recent technological developments mean that the costs for companies to implement digital reporting have reduced significantly. The American Institute of CPAs (AICPA) and XBRL US have found that the cost of XBRL formatting for small reporting companies has declined 45 percent since 2014.[47]

Q 19 – Which of the potential structures presented would best improve the effectiveness and efficiency of the financial reporting system, including to support the introduction of climate related risk reporting?

Establishing a separate board for sustainability reporting standards in Australia would help to ensure that businesses within the country are held to a higher standard of environmental and social responsibility.

Australia should adopt a model similar to IFRS Foundation, which has established the ISSB. A separate board should be constituted as part of Financial Reproting Council, with the required mix of expertise and oversight. This board could work closely with the AASB and AUASB to facilitate the development of Australia-specific standards that meet economic, environmental and stakeholder needs.

A separate board would also provide a platform for Australian entities to share best practices and collaborate on sustainability initiatives internationally. Such an outcome can be facilitated more easily if the sustainability reporting board is independent of the AASB and the AUASB.

[47] AICPA, 'XBRL Costs for Small Companies have declined 45% according to AICPA study' (Webpage, 2018), https://www.aicpa.org/news/article/xbrl-costs-for-small-companies-have-declined-45-according-to-aicpa-study