CLIMATE-RELATED FINANCIAL DISCLOSURES: WHAT ARE THEY AND WHAT DO THEY MEAN?

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OVERVIEW

Background

The Australian Government recently released an exposure draft of the legislation to implement mandatory climate-related financial disclosures (Draft Legislation). This follows the release of draft Australian Sustainability Reporting Standards - Disclosure of Climate-related Financial Information (Draft ASR Standards) from the Australian Accounting Standards Board which were published on 23 October 2023 (as previously reported by K&L Gates).

What are Climate-Related Disclosures?

The Draft Legislation requires certain reporting entities under Chapter 2M of the *Corporations Act 2001* (Cth) (Corporations Act) to publish annual sustainability reports in accordance with the Draft ASR Standards (Sustainability Reports). The Sustainability Reports will be in addition to the currently required directors report, financial report and, where relevant, auditors report included in each reporting entity's annual report. See *below* for a summary of the requirements under the Draft ASR Standards and the Draft Legislation.

Who reports and when?

The requirement to prepare a Sustainability Report will be phased in for different cohorts over time as follows:

Financial year starting on or after	Entities which satisfy two of the following three criteria		
	Number of employees	Gross asset value	Consolidated revenue
Group 1 1 July 2024	>500	>AU$1 billion	>AU$500 million
Group 2 1 July 2026	>250	>AU$500 million	>AU$200 million
Group 3 1 July 2027	>100	>AU$25 million	>AU$50 million

There are also special implementation rules for certain entities:

- *Large asset holders* - the Draft Legislation has introduced a threshold of

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AU$5 billion or more for registered schemes or registerable superannuation entities which will be required to report from 1 July 2024. However, the financial services industry has identified significant anomalies and gaps with the current classification of large asset owners and has made submissions to Treasury to clarify the application to registered schemes, superannuation trustees and the consolidated groups of which they may be part. It is expected that further clarification of the application of the AU$5 billion threshold will emerge from these consultations.

- *NGER entities*:
  - An entity which is required to report under Chapter 2M of the Corporations Act, is a "controlling corporation" under the *National Greenhouse and Energy Reporting Act 2007* (Cth) (NGER Act) and meets the required publication threshold under the NGER Act must commence reporting with Group 1 entities; and
  - All other reporting entities under the NGER Act must commence reporting with Group 2 entities.
- *Charities* - charities which are registered under the *Australian Charities and Not-for-profits Commission Act 2012* (Cth) (ACNC) and are not ordinarily required to report under Chapter 2M of the Corporations Act will not be required to prepare Sustainability Reports. However, not-for-profit entities which are not registered charities under the ACNC and are required to report under Chapter 2M of the Corporations Act will be required to prepare a Sustainability Report.
- *Group 3 or smaller entities* - these entities (unless a large asset holder or NGER entity) that do not have any material climate-related financial risks or opportunities for a financial year need only make a statement to that effect in their Sustainability Report.

DIRECTORS' CONSIDERATIONS

Contents of Sustainability Reports

The core contents of Sustainability Reports will broadly include the following:

- *Governance* - the governance processes, controls and procedures the entity uses to monitor and manage climate-related risks and opportunities;
- *Strategy* - the approach the entity uses to manage climate-related risks and opportunities including qualitative (eventually moving to quantitative) scenario analysis and climate change resilience assessments;
- *Risk management* - the processes the entity uses to identify, assess, prioritise and monitor climate-related risks and opportunities;
- *Emissions* - Scope 1 and Scope 2 emissions, and Scope 3 emissions from the second year of reporting for all reporting entities;
- *Financial effects* - the impacts of climate-related risks and opportunities on the entity's cash flows, revenues and assets values in the relevant reporting period and anticipated future impacts over time; and

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- *Metrics and targets* - the entity's performance in relation to climate-related risks and opportunities, including progress towards any targets the entity has set or is required to meet by law or regulation.

These are set out in the Draft ASR Standards and are explored in greater detail below.

Director's Declaration

Notwithstanding the reduced audit and assurance requirements as noted below, each Sustainability Report must contain a positive director's declaration confirming compliance with the finalised ASR Standards.

Climate Change Risks and the Duty of Care and Diligence

Climate change risks may be relevant to a director's duty of care and diligence under section 180(1) of the Corporations Act to the extent that the risk is "foreseeable" and is not "far-fetched" or fanciful.

Directors' duty of care and diligence could relevantly extend to directors:

- Taking steps to inform themselves about climate-related risks to their business;
- Considering whether climate-related risks will impact the business adversely or favourably; and
- Considering whether anything can or should be done to address or alter their business' climate-related risks.

Due Diligence Processes

Whilst certain aspects of the Sustainability Report will require directors to implement and oversee conventional due diligence processes before finalising disclosures, the disclosure of metrics regarding Scope 1 and 2 emissions, and particularly Scope 3 emissions, will require the deployment of new systems, technology and people to collect, report and react to the significant volumes of data relevant to such emissions.

The Draft ASR Standards do stipulate that certain disclosures may be limited to that which is based on "reasonable and supportable information", including when assessing climate-related risks.

Modified Liability Under the Draft Legislation

The Draft Legislation proposes to limit civil liability during the period between 1 July 2024 and 30 June 2027 (Transition Period) for statements made in respect of the more uncertain parts of Sustainability Reports – namely, those about Scope 3 emissions or scenario analyses (collectively, the Uncertain Parts).

During this time, only the Australian Securities & Investments Commission (ASIC) would be able to commence misleading and deceptive conduct actions in relation to statements made in the Uncertain Parts of Sustainability Reports.

ASIC's Powers

However, the Draft Legislation proposes to amend ASIC's enforcement powers for civil actions during the Transition Period in respect of statements made in the Uncertain Parts of Sustainability Reports, such that ASIC will only be able to commence proceedings in respect of the following:

- *Civil actions with a fault element* - contraventions of civil provisions with a fault element, including false or misleading statements.

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- *All civil actions* - where ASIC is only seeking an injunction or declaration.
- *Criminal actions* - where the proceedings are criminal in nature.

If ASIC considers that any statement made in a Sustainability Report is incorrect, incomplete or misleading in any way, the Draft Legislation proposes to enable ASIC to, during the Transition Period, direct a reporting entity to:

- Confirm to ASIC that its Sustainability Report is correct or complete;
- Explain any statements made in a Sustainability Report to ASIC; and
- Correct, complete or amend any statements made in a Sustainability Report.

Directors' Guidance

As previously reported by K&L Gates, the Australian Institute of Company Directors published its guidance on mandatory climate reporting on 3 October 2023 (AICD Report). The AICD Report provides an overview of the current climate reporting landscape, sets out the legal duties and responsibilities of directors in respect of climate-related reporting and provides practical steps that directors can take to meet their obligations to report on climate-related risks and opportunities.

Audit and Assurance

The Draft Legislation proposes that auditing and assurance requirements will apply to Sustainability Reports in full for financial periods starting after 1 July 2030. During the period between 1 July 2024 and 30 June 2030, the following interim provisions will apply:

- *Audits* - Sustainability Reports will need to be reviewed by an auditor only in respect of statements relating to Scope 1 and 2 emissions.
- *Assurance* - the extent and level of assurance required to be provided by a reporting entity's financial auditor will be set out in assurance standards for climate disclosures to be published by the Auditing and Assurance Standards Board.

CONTENTS OF SUSTAINABILITY REPORTS

Draft ASR Standards sets out some additional details with respect to the proposed contents of the Sustainability Report.

Scope 1, 2 and 3 Emissions

The definitions of Scope 1 emissions, Scope 2 emissions and Scope 3 emissions are as set out in the NGER Act. The NGER Act is principally regulated by the Australian Clean Energy Regulator, which defines these terms as follows:

- *Scope 1 emissions* - these are “direct emissions” and include greenhouse gas (GHG) emissions resulting from activities conducted at an organisational level. These may include emissions from a manufacturing process, burning of fuel in motor vehicles and the production of electricity by burning coal or natural gas.

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- *Scope 2 emissions* - these are GHG emissions resulting from the indirect consumption of an energy commodity, such as an organisation's use of electricity which was produced by burning coal.
- *Scope 3 emissions* - these are indirect GHG emissions which are not otherwise Scope 1 or 2 emissions and that are generated in the wider economy. Some examples include the transportation of purchased fuels, use of sold products and services, and flying on a commercial airline by a person from another business.

Materiality

Draft ASR Standard 1 clarifies that “Information is material if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users of general purpose financial reports make on the basis of those reports.”

Draft ASR Standard 2 also clarifies that climate-related risks which are not material need not be disclosed, but if a reporting entity determines that there are no material climate-related risks and opportunities that could reasonably affect its prospects, it must disclose that fact and provide reasons for its determination.

Scope

The scope of climate-related financial risks and opportunities extends to:

- Climate-related physical risks (being the physical risks associated with rising aggregate global temperatures);
- Climate-related transition risks (being the transition risks associated with developments that may (or may not) occur in the process of adjusting towards a lower-carbon economy); and
- Climate-related opportunities available to the entity,

but expressly excludes disclosures in relation to emissions that are not GHG emissions.

Core Content

Further to the content of Sustainability Reports noted above, Draft ASR Standard 2 provides the following additional information:

Heading	Core content
Strategy and decision-making	The entity should disclose its resourcing, progress plans and how it has set, and plans to achieve, any climate-related targets.
Climate resilience	The entity must disclose its climate-related scenario analysis which assesses its climate resilience, as well as how and when that scenario analysis was undertaken.
Climate-related metrics	The ASR Standard 2 provides a list of relevant cross-industry metric categories and requires entities to disclose information relevant to Scope 1, Scope 2 and Scope 3 emissions (expressed as metric tonnes of CO2 equivalent).

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Climate-related targets	The entity must disclose the quantitative and qualitative climate-related targets it has set (whether by law or regulation) and provides a list of disclosure criteria in respect of those targets. The entity must also disclose its planned use of carbon credits (including any Australian Carbon Credit Units) to offset GHG emissions and help achieve its targets.

HOW CAN WE HELP?

While the Draft Legislation may change before enactment, directors of reporting entities should be seeking appropriate advice and taking action to set up the governance, strategy, systems and processes required to support the provision of these mandatory disclosures. Failure to do so in a timely manner may expose directors and reporting entities to adverse market and regulator scrutiny in addition to potential liability.

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