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The Treasury
Corporations Branch
Market Conduct Division
Langton Cres
Parkes ACT 2600

Via email:
climatereportingconsultation@treasury.gov.au

Dear Treasury

Consultation: Climate-related financial disclosure

Thank you for the opportunity to provide a submission on key considerations for the design and implementation of a climate related reporting regime in Australia.

The Australian Institute of Company Directors (**AICD**) welcomes the opportunity to comment on the development of this important policy. The AICD is the largest director institute in the world, with a mission to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. The AICD's membership of 50,000 reflects the diversity of Australia's director community, comprised of directors and leaders of not-for-profits, large and small businesses and the government sector.

The AICD supports the government's policy objective of establishing a climate reporting framework that facilitates high quality, comparable disclosures and supports the attainment of Australia's climate change goals. We agree that time is of the essence and that swift implementation is critical. Directors appreciate that market expectations have shifted and are committed to meeting that challenge.

The AICD strongly believes that any Australian climate-related framework should be aligned to the global baseline as envisaged by the ISSB climate standards To this end, in 2022 we made detailed submissions to both the International Sustainability Standards Board (ISSB) and the Australian Accounting Standards Board (AASB) in relation to the ISSB's Exposure Draft Sustainability (S1) and Climate (2) standards.

Relevantly, our submission to the AASB annexed legal advice obtained from Herbert Smith Freehills (HSF) detailing liability issues for companies and directors arising out of the ISSB Exposure Drafts (HSF Advice). We continue to believe that these issues will need to be addressed, in order to support the implementation of good faith climate reporting, and so that legal risks do not drive limited disclosures that fail to meet market expectations. Directors consistently report that they wish to provide fulsome disclosures but face a tension in managing complex legal risks. We have **re-attached** the HSF Advice as **Annexure A** to this submission for ease of reference. We also provide a table summarising the key liability issues (relevant to questions 15 and 16) in **Annexure B.**

Enclosed with this cover letter are our detailed responses to the consultation paper questions. These responses are informed by extensive engagement with members of the AICD's ASX Chairs Forum, APRA Regulated Entities Forum, Corporate Governance Committee, Reporting Committee, and Law Committee as well legal experts, other peak bodies and civil society groups.

Executive Summary

The AICD welcomes the current consultation and provides the following key comments:

1. The AICD strongly supports the policy objective of establishing a climate reporting framework that provides for high quality, useful disclosures which aligns with the ISSB as the global baseline on climate reporting, and which supports the attainment of Australia's climate change goals.
2. The move to ISSB-based mandatory reporting is a significant one, representing a major shift in current Australian market practice. This adjustment will require significant upskilling for both report preparers, assurance professionals and the directors who are ultimately required to sign off on the disclosures.
3. Because of the particularities of Australian law, including the lack of existing safe harbour provisions, Australian companies and directors have significantly more liability exposure than their international counterparts when making representations to the market, particularly forward-looking statements. In light of this, policy settings should be adjusted to incentivise good faith, fulsome disclosures on a best endeavors basis, without removing appropriate accountability.
4. Preserving the legal status quo creates a material risk that disclosures will fail to meet market expectations and undermine the desired policy objectives. In our view, policy settings must support the phase in of the standards and the major shift in reporting practices that a mandatory regime would entail. Proportionate liability and appropriate accountability will support more comprehensive and comparable climate disclosures.
5. We consider the initial tranche of reporting entities should cover those companies with the largest carbon footprint, namely the ASX 200, large private companies and public sector entities, emitters which report under the National Greenhouse and Energy Reporting Scheme (NGERS), and financial institutions with assets or assets under management (AUM) equal to or greater than $5 billion.
6. The impact of the climate reporting standards will be influenced by the extent to which disclosures can be assured. As such, the AICD supports the need for climate disclosures to be subject to the highest standard of assurance that is reasonably achievable, noting that current data and capability gaps are likely to mean that grades of assurance will need to be phased-in.

Next steps

We hope our submission will be of assistance to Treasury in this important and timely work. If you would like to discuss any aspects further, please contact [redacted], Head of Policy at [redacted] or [redacted], Senior Policy Adviser at [redacted].

Yours sincerely,

[redacted]

General Manager
Education & Policy Leadership

Australian Institute of Company Directors

Response to key consultation questions

Question 1

What are the costs and benefits of Australia aligning with international practice on climate-related financial risk disclosure (including mandatory reporting for certain entities)? In particular:

1.1 What are the costs and benefits of meeting existing climate reporting expectations?

1.2 What are the costs and benefits of Australia not aligning with international practice and in particular global baseline standards for climate reporting?

The AICD strongly supports the policy objective of establishing a climate reporting framework that provides for high quality, useful disclosures which aligns with the ISSB as the global baseline on climate reporting, and which supports the attainment of Australia's climate goals. To achieve this objective, the disclosure regime needs to incentivise companies to make fulsome disclosures on a good faith and best endeavours basis.

Costs of moving to mandatory ISSB-based climate reporting

The shift to ISSB-based mandatory reporting is a significant one and will require companies to disclose climate information to a level of granularity that is rarely found in current Australian reporting practices. By way of example, a December 2022 PwC report found that only 14% of the ASX200 undertook a comprehensive measurement of scope 3 emissions including operational, upstream and downstream scope 3 emissions,[1] with 24% disclosing only operational scope 3 emissions. Another study found that only 14% of ASX200 included scope 3 targets and milestones.[2] Whilst draft ISSB Climate Standard (**S2**) requires disclosure on the current and anticipated impact of climate risk, PwC found that only 18% of the ASX200 currently do so.[3]

These statistics clearly show the gap between current disclosure practices and ISSB-required disclosure, even amongst the largest corporate entities, let alone more broadly in the Australian market. Bridging this gap will require significant upskilling for report preparers and directors who are ultimately required to sign off on these disclosures and who carry significant liability risk as a result of Australia's comparatively stringent legal framework (discussed further below). Similarly, directors and companies will be looking for appropriate assurance to support them, necessitating a suitably skilled pool of both internal and external experts which is widely acknowledged as currently lacking.

Costs of not moving to mandatory ISSB-based global reporting

Ultimately, the costs of not aligning with global baseline standards for climate reporting outweigh the costs of alignment. Failure to align with the ISSB-set global baseline includes:

- decreased attractiveness of Australian companies as sources of investment by domestic and international investors, creditors and lenders;

[1] PwC, December 2022, 'ESG Reporting in Australia – Change afoot, but are companies ready?' Available at https://www.pwc.com.au/assurance/esg-reporting-in-australia-2022-v2.pdf at page 13.
[2] Australian Council of Superannuation Investors (ACSI), July 2022, 'Promises pathways & performance – Climate change disclosure in the ASX200'. Available at https://acsi.org.au/wp-content/uploads/2022/07/ACSI-Research-Climate-Change-Disclosure-in-ASX200-July-2022.pdf at page 5.
[3] PwC report as per n 1, at page 7.

- reputational risk to companies for perceived failures to manage climate risks; and
- missing the opportunity for Australian organisations to align with international better practice regarding climate risk management.

All of the above could ultimately impact the company's financial position, performance, and long-term sustainability.

Question 2

Should Australia adopt a phased approach to climate disclosure, with the first report for initially covered entities being financial year 2024-25?

In light of the significant gap between current disclosing practices and disclosure under the ISSB standards detailed in our response to **Question 1** above, we consider that 2024/2025 is the earliest year reporting could commence for the initial tranche of covered entities. Essentially this means that entities would only have the period from when any final legislation is passed (potentially mid-late 2023) until 1 July 2024 (the commencement of FY25) to have their data collection and other supporting internal processes in place.

2.1 What considerations should apply to determining the cohorts covered in subsequent phases of mandatory disclosure, and the timing of future phases?

In light of capability and data gaps (expanded on in our response to **question 13**) and the significant gap between current disclosing practices, disclosure under the ISSB and the capacity and current ability for ISSB-disclosures to be assured, it is difficult to specify future cohorts or phase-in times.

One option would be for the government to commence the initial reporting cohort and then to undertake a review of the regime within two years to consider the scope, content and timing of future cohorts, subject to any lessons learned from the initial cohort. Having this two-year initial period will give time for the market to mature and to allow directors, report preparers and information providers to refine their processes and resulting disclosures.

Question 3

To which entities should mandatory climate disclosures apply initially?

In our view, in order to create meaningful action on climate change, initial disclosure should be undertaken by those with the largest climate impact, which should include large emitters regardless of corporate structure (i.e. listed, public and private companies and public sector entities), as well as large financial institutions which provide capital to business throughout the economy (i.e. "financed emissions"). As such, we consider that the initial scope of the regime should cover all of the following:

1. ASX 200;
2. private companies and public sector entities which fall within the ATO definition of "large corporate group";[4]
3. any company which reports under NGERS; and
4. any financial institution (i.e. APRA or ASIC regulated) which has assets or assets under management (AUM) equal to or greater than $5 billion.

For clarity, we note that if an entity falls within the above thresholds and is part of a corporate group, the disclosure obligation should fall on the group, rather than on the individual entity.

Subject to a careful regulatory impact assessment, over time, the disclosing cohorts could be expanded with obligations proportionate to an entity's impact. For example, entities in the size bracket below the initial cohort, might be required to disclose scope 1 and 2, but not scope 3 emissions.

[4] Defined by the ATO as any corporate group with a turnover greater than $250 million. Given the thresholds being discussed, we would anticipate that the vast majority of companies would be part of a corporate group. Consideration may also need to be given as to how this test could be adjusted to cover stand-alone corporations.

However, as a note of caution, it should be recognised that expanding the number of entities captured by the reporting regime will necessarily dilute the surveillance and enforcement resources of regulators tasked with implementing and overseeing the new framework. In our view, it would be preferable if those resources were targeted at those entities that will make the most difference to Australia's climate footprint. Lifting reporting practices amongst *that* cohort should be the focus of the regime.

3.1 What size thresholds would be appropriate to determine a large, listed entity and a large financial institution, respectively?

Large listed entities

In our view, the appropriate threshold for initial disclosure for large, listed entities should be **ASX200** companies as they are the most significant entities trading on public markets, and a key part of the overall Australian economy.

We would caution against capturing entities beyond the ASX 200, in at least the initial disclosing cohort, given their likely lower maturity levels and emissions footprints. For those entities, it seems that the compliance costs and management effort (for example to disclose scope 3 emissions) may not be proportional to the expected transparency benefits. In this respect, we note that expanding the initial cohort to include the ASX 300 would capture a number of entities with no or minimal revenue. It is not apparent to us that including them within the reporting regime would yield significant public benefit.

Large financial institutions

Acknowledging that large financial institutions are a key source of capital in the economy, we support the need for those institutions to be within the initial cohort of disclosing entities. However, it is important not to set the threshold too low such as to capture small ADIs, investment managers and lenders which are likely to play a relatively limited role in the overall climate picture. As such, we propose that an appropriate disclosure threshold could be"

> *"any financial institution (i.e. APRA or ASIC regulated) which has assets or assets under management (AUM) equal to or greater than $5 billion. "*

In respect of APRA-regulated entities, our desktop analysis suggests this threshold would cover 42 RSE licensees, 55 ADIs, 6 General Insurers and 7 Life Insurers. In respect of ASIC-regulated entities, data from the 2022 report into the World's 500 largest asset managers[5] suggests that approximately 27 of Australia's largest investment managers would be captured (other data sources suggest that an additional 12 foreign incorporated investment managers who operate in Australia will also be captured[6], in addition to 3 additional investment managers).

3.2 Are there any other types of entities (that is, apart from large, listed entities and financial institutions) that should be included in the initial phase?

We consider that it is not enough to initially focus only on large, listed entities and financial institutions – the focus should be on capturing the bulk of Australia's emissions, which necessarily includes large private corporations, large public entities, heavy emitters and possibly those entities which are particularly vulnerable to climate impacts (albeit it is not currently clear to us what metrics should be used to identify these entities).

Large private companies

We believe that the regulatory settings should be structure agnostic – that is, not create an incentive to be either listed or unlisted, government or private sector held. Accordingly, we recommend that private companies (and public sector entities – see more below) disclose if they meet a set criteria. To the extent possible, criteria for private companies needs to be consistent with criteria applied to listed entities, for which we have suggested a threshold of ASX200. Whilst the ASX200 threshold is set by reference to market valuation, which is difficult to apply to private companies, our research suggests that the

[5] Thinking Ahead Institute (Willis Tower Watson, 2002, 'World 500 largest asset managers 2022'. Available at: https://www.thinkingaheadinstitute.org/research-papers/the-worlds-largest-asset-managers-2022/
[6] https://fundcomb.com/lists/largest/australia-office

companies towards the lower end of the ASX200 fall around the $250 million revenue mark. Similarly, a $250 million threshold is also consistent with the ATO definition of "large corporate group."

Large public sector entities

The Consultation Paper states that the Government will look to develop a separate comparable disclosure framework for public sector entities.

In our view, to the greatest extent possible, the proposed disclosure regime should encompass both private sector and public sector entities (recognising Commonwealth-State constitutional limitations). A separate disclosure regime that applies only to public sector entities may blunt incentives in the public sector to reduce emissions intensity, weaken comparability across all sectors and result in competitive neutrality implications if private sector entities face more rigorous disclosure requirements than government owned entities in the same sector.

These issues are particularly pronounced as public sector entities are significant participants in the financial system, including as investors. For instance, the Future Fund and the Commonwealth Superannuation Corporation collectively have over $400 billion in funds under management. The Future Fund and Exempt Public Sector Superannuation Schemes (EPSS) already have extensive disclosure obligations, including to APRA in the case of EPSS, and should be as well placed as similarly sized APRA regulated entities to meet the likely disclosure obligations.

For the avoidance of doubt, our view is that other Commonwealth and state-owned corporations or businesses that are significant participants in the economy, such as in telecommunications, energy or logistics sectors, should be within the scope of the proposed disclosure regime. We would have concerns about the impact on comparability and competitive neutrality if they were subject to a separate regime developed and implemented at a later point.

The AICD recognises there may be constitutional challenges with application of any disclosure regime to some State-owned financial corporations, such as TCorp (NSW) or the Victorian Funds Management Corporation. However, to ensure a robust comparable disclosure framework we would urge that these entities be brought within scope with the agreement of relevant State and Territory governments.

Heavy emitters

In identifying Australia's heaviest emitters, we recommend that policymakers look to already existing mechanisms– namely the *National Greenhouse and Energy Reporting Scheme* (NGERS), which currently captures approximately 913 corporations and covers approximately 60% of Australia's emissions. Additional consideration should be given to whether large emitters who currently fall outside the scope of NGERS, such as agriculture and forestry companies, should also be captured by the mandatory climate reporting regime.

Entities particularly vulnerable to the impacts of climate change

The AICD is conscious that whilst disclosing information on how a company contributes to climate change through emissions is a significant part of climate reporting, disclosure on the ***impact*** of climate change on organisations (and an organisation's resilience to such risks) is also important.

Organisations that may not have significant emissions may nevertheless be significantly impacted by climate change. This is particularly so for the physical effects of climate change. Consideration will need to be given as to how disclosure can capture the most climate-vulnerable entities, whilst ensuring that the cost of compliance is not prohibitive, particularly in respect of smaller entities.

Question 4

Should Australia seek to align our climate reporting requirements with the global baseline envisaged by the International Sustainability Standard Board?

1.1 Are there particular considerations that should apply in the Australian context regarding the ISSB implementation of disclosures relating to: governance, strategy, risk management and/or metrics and targets?

1.2 Are the climate disclosure standards being issued by the ISSB the most appropriate for entities in Australia, or should alternative standards be considered?

One of the key objectives of the formation of the ISSB was to remove the 'alphabet-soup' of sustainability and climate standards so as to promote consistency and comparability. In feedback provided to the AICD, directors have cited examples of multiple reporting frameworks applied to climate change and ESG material to meet the needs of different investors and users, and challenges with comparability and benchmarking from such frameworks. Australian directors expressed strong support for the ISSB objectives of greater harmonisation and consistency as part of lifting the quality and comparability of climate reporting.

As such, the AICD considers that the ISSB standards effectively satisfy the "global baseline"[7] for climate reporting. The ISSB is currently the most detailed in coverage and international reach, having consolidated three large frameworks and standard setting bodies around the world.[8] We note that originally the users of reports issued under ISSB's standards were investors only, although the ISSB did subsequently expand the definition of "users" somewhat by including creditors and other lenders. The ISSB has also made other changes to the content and phase-in settings of standards off the back of an extensive consultation process which included input from many Australian companies, industry, and peak bodies. We now understand that the ISSB intends to finalise those standards by June 2023.

Whilst we are satisfied that the ISSB standards are the preferred global baseline, we are cognisant of the fact that the ISSB standard has not yet achieve its intended goal of consolidating *all* major international climate frameworks (in particular the GRI). It also remains unclear how major national frameworks, such as the European Sustainability Reporting Standards and the forthcoming US sustainability standards will sit alongside them, notwithstanding broad public statements in favor of alignment.

Given many businesses operate across Australia and New Zealand, there is also a need for Australian policy makers to consider the Aotearoa New Zealand Climate Standards. We consider it is important that guidance is issued as to how such national frameworks and standards interact between themselves and the ISSB.

Question 5

What are the key considerations that should inform the design of a new regulatory framework, in particular when setting overarching climate disclosure obligations (strategy, governance, risk management and targets?

The AICD considers that the new regulatory framework should support internationally aligned and high-quality climate reporting. At a fundamental level, the AICD agrees with the reform principles set out on page 6 of Treasury's consultation paper (**Treasury's Climate Reform Principles**). In addition, we consider that the regulatory framework should:

- incentivise fulsome disclosure on a good faith, best endeavors basis without the fear of disproportionate liability risk (see detailed responses to **questions 15 to 16** below). Any penalties

[7] The ISSB defines "global baseline" as the provision of disclosures that (1) are designed to meet the information needs of investors, creditors and other lenders; (2) are subject to an assessment of materiality; and (3) can include information necessary to meet specific jurisdictional regulatory requirements, but that these additional disclosures should not obscure the ISSB disclosures. This definition was tentatively agreed at the ISSB's October 2022 meeting.

[8] Being the Integrated Reporting Framework, Sustainability Accounting Standards Board (SASB), and the Climate Disclosure Standards Board.

should be for conduct such as a failure to produce a report, submission of a materially false or misleading statement or clear failure to satisfactorily address all mandatory reporting criteria. Such enforcement will require a well-resourced regulator that prioritises monitoring and enforcement of climate-related reporting;

- reduce duplication with existing disclosure regimes such as to minimise compliance costs for disclosing entities and confusion for users; and
- be reliable, comparable and of a high quality. This can be achieved through ensuring the disclosures are capable of assurance (noting that there are current capability and data gaps impacting the fulfilment of this objective).

Question 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?

The positioning of ISSB-based climate reports within the current corporate reporting ecosystem is difficult in circumstances where the ISSB requires both narrative/qualitative and quantitative disclosures. Further, the disclosures required under S2 go to many of the same issues that, if deemed material, are required under Australian law to be included within existing reports such as the Financial Report or Directors Report.

In addition, for listed entities, ASIC's Regulatory Guide 247 (RG247) recommends that material risks, which may include climate change risk (as well as other ESG risks), be disclosed as part of the Operating and Financial Review (OFR) – a component of the Directors Report. It is important that the inclusion of climate disclosures ensures internal consistency throughout the various components of the financial reports. To address this, it is likely that significant cross-referencing will be necessary. In our view, the government should clarify how the climate reporting requirements will interact with existing periodic reporting requirements.

In addition to ensuring internal consistency and avoiding duplication as a result of multiple reporting requirements, there is also a need to ensure comparability across entities. To address these issues, we consider there are four possible solutions as to the location of climate disclosures:

1. **Climate disclosures set out within a single mandatory section of the Annual Report** with relevant cross-references to other section or reports within the Annual Report. The Corporation Act could be amended to include a climate report as a section (similar to the Directors' Report). The advantage of this approach is increased comparability, as well as elevating the status of climate reporting. Notwithstanding the benefits of this approach, timing constraints are likely to arise in circumstances where entities are reliant on disclosures of other entities within their value chain (such as with scope 3 emission disclosure). This has been acknowledged by the ISSB, which is considering whether to introduce transitional relief for a limited period to permit an entity to provide climate disclosures up to 3 months after the publication of its financial statements.[9]

2. **Climate disclosures produced in a report that is separate to the Annual Report** to resolve the timing issues set out above. The downside would be that there would be a lack of integration with the financial report which could jeopardise the holistic assessment by investors and other users of climate change's impact on a company.

3. **Climate disclosures to be provided in the Directors Report, specifically the OFR,** with the key advantage being that this approach is consistent with current ASIC regulatory guidance under RG247. We note that ASIC recommends that in respect of the OFR, preparers should cross-reference relevant other sections of the financial report). The disadvantage is that the Directors' Report is only mandatory for disclosing entities, public companies, large propriety companies and registered

[9] https://www.ifrs.org/content/dam/ifrs/meetings/2022/november/issb/ap3c-timing-of-reporting.pdf

schemes. Whilst this is a broad range of entities which will likely cover the initial scope of mandatory climate reporting, this could prove problematic in the event that the scope is eventually expanded. For clarity, subject to any future review of the policy's efficacy, such significant expansion of scope is not necessarily something that the AICD would consider necessary or desirable.

4. **Climate disclosures to be dispersed throughout the Annual Report depending on the nature of the metric**. A significant downside of this approach will be ease of comparability. We understand that this could be somewhat addressed through digital reporting proposals which will allow preparers to "tag" topics (such as climate change) and then use technology to generate a report which consolidates all disclosures tagged with this topic into a single report. Whilst certainly more helpful, in our mind this would still not be as user-friendly as simply flicking to a clearly designated mandatory section of the Annual Report. Further, as with any technology, there will be a significant lag in uptake as preparers and users adjust.

Question 7

What considerations should apply to materiality judgements when undertaking climate reporting, and what should be the reference point for materiality (for instance, should it align with ISSB guidance on materiality and is enterprise value a useful consideration)?

In respect of materiality, we were pleased to see that in October 2022 the ISSB tentatively amended its definition of "material" to make it consistent with the IFRS Accounting Standard definition,[10] which is also used by the Australian Accounting Standards Board (AASB). We note that the AASB and Auditing and Assurance Standard Board (AUASB) have previously produced guidance on the making of materiality assessments in periodic reports in the context of climate change and other emerging risks.[11]

In relation to the use of enterprise value as a touchstone to materiality, we note that this is a concept that is based on the Sustainability Accounting Standards Board (SASB) standards which have had limited uptake in Australia and are not well understood. We understand that as a result of submissions on this issue (including concerns that preparers may not have a strong understanding of what affects enterprise value particularly over the long term, and that users may find the definition too narrow[12]), the ISSB is currently reformulating its definition of "enterprise value." As such, we will refrain from comment until such a time as the revised definition is issued.

As a final point, we expect that there will be some entities subject to the reporting regime which might form the view that climate change risk is not material to their business. In those circumstances, rather than simply not reporting, we recommend that entities be required to publicly articulate their rationale for forming that judgment in a robust fashion.

Question 8

What level of assurance should be required for climate disclosures, who should provide assurance (for instance, auditor of the financial report or other expert), and should assurance providers be subject to independence and quality management standards?

The AICD considers that the utility of the standards will be informed by the extent to which disclosures can be assured. Assurance is critical to our members as it provides independent verification of information, which then supports disclosures approved by the board of directors. It is also important to investors and other stakeholders, as assured information is more reliable and therefore useful.

As such, the AICD supports climate disclosures being subject to the highest standard of assurance that is reasonably achievable, recognising current constraints. Presently, in light of the maturity of the market (data shows that only around 5% of listed companies' have climate-related data disclosed in their

[10] Tentatively agreed by ISSB Board at its October 2022 meeting.
[11] See https://www.aasb.gov.au/admin/file/content102/c3/AASB_AUASBJointBulletin.pdf
[12] See paragraph 31 of https://www.ifrs.org/content/dam/ifrs/meetings/2022/october/issb/ap3b-general-sustainability-related-disclosure-fundamental-concepts.pdf

Annual Report audited[13])and key data and capability gaps in regard to the ISSB standards, which we discuss in our response to **question 12**, we consider that most disclosures (to the extent that disclosures are capable of assurance) will be initially subject to limited assurance only. This will hopefully progress to reasonable assurance once data and capability gaps are filled. It should be noted that liability concerns (discussed in detail in our response to **questions 15 and 16**), will be more pronounced in the absence of reasonable assurance being obtainable.

Many of our members have reiterated to us that they take comfort from having external assurance when signing off on financial reports and making other representations to the market. The absence of assurance due to the difficulties set out above will intensify liability concerns for directors. Although some climate related disclosures are currently provided by companies with only limited or no assurance, they are largely of a qualitative nature and therefore markedly different to the reports expected by S2.

In respect of who should provide assurance, we note that assurance over climate and sustainability reporting is an emerging field, such that there is currently a relatively shallow pool of qualified personnel. It will take time for this capability to develop. This will take place either through the upskilling of current assurance professionals, or through the emergence of a new profession of sustainability and climate assurance practitioners. Data from the AASB and AUASB detailing assurance of climate-change disclosures in the annual reports of listed entities in the period 2018 to 2021 revealed that nearly all current assurance of climate-related disclosures is issued by the major audit firms, with 64% being issued by the incumbent audit firm for the company.[14]

Given climate disclosures contain a mix of qualitative and quantitative disclosures which go to both financial and non-financial matters, we do not currently see a need for assurance to be restricted to the auditor of the financial report, although clearly knowledge of financial audit requirements would be advantageous.

Regardless of who provides the assurance, the key criteria should be that the assurer has the relevant skills and expertise, and that they comply with the relevant quality and independence requirements, as set by the relevant standard-setting body. We expect that quality and independence requirements would be developed by the International Auditing and Assurance Standards Board (IAASB) and then domestic implementation considered by the AUASB.

Question 9

What considerations should apply to requirements to report emissions (Scope 1, 2 and 3) including use of any relevant Australian emissions reporting frameworks?

The AICD supports the required disclosure of Scope 1, 2 and 3 emissions under the draft ISSB standards.

However, **in respect of scope 3, disclosure presents both data availability and data quality challenges.**[15] Data availability challenges largely revolve around the dependency entities have on other entities within their value chain to provide input data which is then relied on to calculate scope 3 emissions. A failure of entities within the value chain to provide data within a reasonable time could inhibit the ability of entities upstream or downstream from disclosing their scope 3 emissions. Data quality challenges include a lack of clear measurement methodologies, the risk of double counting, and compromised data as a result of having different reporting periods as between entities within a value chain**.** Whilst efforts have been made to provide practical guidance on how scope 3 emissions (such as the Climate Leaders' Coalitions' Scope 3 roadmap[16]), there remains no definitive scope 3 methodology.[17]The disclosure of Scope 3 financed emissions is particularly complex.

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[13]AASB and AUASB (December 2022), 'Research Report: Climate-related disclosure and assurance in the Annual Reports of ASX-listed companies. Available at: https://aasb.gov.au/media/xu5leeby/aasb-auasb_rr_climaterelateddisclosures_12-22.pdf at page 19.
[14] Ibid.
[15] See https://www.ifrs.org/content/dam/ifrs/meetings/2022/october/issb/ap4b-climate-related-disclosures-scope-3-greenhouse-gas-emissions.pdf
[16] https://www.climateleaders.org.au/documents/Scope_3_Roadmap_PUBLISHED.pdf
[17] We note that the ISSB has committed to issuing guidance on how to measure scope 3 GHG emissions.

Reflecting these difficulties, as noted in response to **question 1**, a PwC study found that only 14% of the ASX200 undertook a comprehensive measurement of scope 3 emissions including operational, upstream and downstream scope 3 emissions,[18] with 24% disclosing only operational scope 3 emissions. In our view, these statistics highlight the shift in current practices that will be required by mandatory reporting in line with ISSB- based climate reporting standards.

In recognition of these data challenges, at its December 2022 board meeting, the ISSB board tentatively agreed to delay the requirement for mandatory scope 3 disclosure for a minimum of one year after the effective date of S2 (**ISSB Scope 3 phase-in**), and to conditionally allow an entity to measure its scope 3 emissions using information from entities in its value chain with reporting cycles that are not aligned with the entity's reporting period. New Zealand's climate disclosure regime similarly allows for a delayed phase-in for the disclosure of scope 3 emissions (amongst other things).

We strongly support that Australia align itself with the ISSB standards, including adopting the ISSB Scope 3 phase-in.

There are also material liability risks for entities disclosing scope 3 emissions. This is because under Australian law,[19] the subjective state of mind of the entity making the representation is irrelevant in cases alleging misleading or deceptive conduct. Rather, the conduct is objectively assessed by reference to whether the representation might lead a reasonable person in the position of the recipient into error.

In this regard, as set out in detail in the HSF Advice, Australia is an outlier relative to other jurisdictions. For instance, in the UK, liability for misleading or deceptive conduct only attaches where the person/entity *knew* or was *reckless* as to whether the information was false or misleading. In the context of scope 3 emissions disclosure, given the data issues, there is a risk that notwithstanding the best efforts of directors, information relied upon to formulate scope 3 emissions may be deficient or incorrect. Disclaimers may also not provide adequate protection, as the courts tend to interpret such clauses narrowly.[20]

Further, under s 79 of the Corporations Act, directors can be personally liable for misrepresentations if they are found to be 'involved in' the contravening conduct.[21] Australia's stringent liability settings and low procedural hurdles for commencing proceedings, particularly class actions, have made the jurisdiction attractive to shareholder class actions. Further, Australia has the second highest number of climate litigation proceedings globally.[22]

Whilst delaying phase-in may provide time for some of these data limitations to be addressed, that would run counter to the policy objective of swift implementation of the new reporting regime. Further, as a result of the strict liability settings for misleading or deceptive conduct, liability risks will remain.

Accordingly, **we consider some other form of targeted protection for entities and directors is required once mandatory scope 3 disclosure is required**. Other jurisdictions with less onerous liability settings, such as the US, have already proposed safe harbours for scope 3 disclosures. The ISSB staff also recommended to its board in December 2022 that language be added into S2's 'Basis for Conclusions' document stating that the risk of litigation may discourage Scope 3 emissions disclosures, and to note that the provision of safe harbour protection could assist in facilitating such disclosures.

More broadly, there are other liability risks that will need to be managed appropriately in order to support the implementation of the new reporting regime, and specifically high-quality disclosures under it (see our response to **question 15**).

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[18] PwC, December 2022, 'ESG Reporting in Australia – Change afoot, but are companies ready?' Available at https://www.pwc.com.au/assurance/esg-reporting-in-australia-2022-v2.pdf at page 13.

[19] s 1041H(1) of the Corporations Act, s 12DA of the ASIC Act and s 18 of the ACL.

[20] *Downey v Carlson Hotels Asia Pacific Pty Ltd* [2005] QCA 199; *Australian Competition and Consumer Commission* (ACCC) v T*elstra Corp Ltd* (2007) 244 ALR 470.

[21] A person is 'involved in' a contravention if they (i) aid, abet, counsel or procure the contravention; (ii) induce the contravention; (iii) in any way are knowingly concerned in or party to a contravention; or (iv) have conspired with others to effect the contravention. This requires that the person have knowledge of the essential matters giving rise to the contravention, to undertake a positive act (as distinct from an omission), , and for the conduct to cause the contravention or render it more likely.

[22] LSE Grantham Research Institute of Climate Change and the Environment (June 2022), 'Global trends in climate change litigation: 2022 snapshot'. Available at: https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2022/08/Global-trends-in-climate-change-litigation-2022-snapshot.pdf at page 9.

Question 10

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

Given the significant shift in corporate reporting required as a result of the implementation of ISSB-based mandatory reporting standards (see our response to **question 1** detailing this) we are concerned that requiring disclosure against additional industry-specific metrics will overwhelm entities, as well as increase costs and liability risks. As such, and consistent with our submission to the ISSB in July 2022, we do not support the imposition of additional industry-specific metrics, such as those set out in Appendix B of ISSB S2. In recognition of similar concerns expressed by stakeholders,[23] at its October and December 2022 meetings, the ISSB board tentatively agreed that disclosure against Appendix B metrics will initially not be mandatory, with a view to making it mandatory in the future, subject to further consultation.

It may be that disclosure on industry-specific metrics can be achievable in the future, once the market matures. However, currently the focus should be on disclosing as against the main body of the ISSB standard, and on getting the liability and enforcement settings appropriately calibrated.

Question 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 greenhouse gas emissions offsets to meet their published targets?

We consider that the ISSB requirements under S2 sufficiently cover the identification and management of climate change risks. In particular, we note that paragraph 13 of S2 requires disclosure of:

- changes to business model, strategy and resource allocation occasioned by the transition plan (such as demand or supply changes, capital expenditure adjustments, additional expenditure on operations or research and development, etc);[24]
- direct and indirect anticipated adaptation and mitigation activities;[25]
- climate-related targets necessary to achieve long-term decarbonization objectives;[26]
- the extent to which carbon credits will be used to achieve emissions targets, and information on the nature of the credits being used;[27] and
- resourcing of transition plans.[28]

Given the significance of the shift from current climate reporting to ISSB-based reporting (discussed in our response to **question 1**), we consider that the above provides a sufficient overview of entities' climate strategy and approach to risk management. There are also a number of data gaps (set out in our response to **question 13**) which make the confident disclosure of comprehensive transition plans difficult. In light of Australia's unique legal landscape (discussed in response to **questions 15 and 16**), these data gaps increase director concerns in respect of liability arising from transition plans and climate targets.

It may be the case that further guidance is needed from the ISSB on the disclosure of transition plans in due course. In the interim, guidance from international bodies such as the TCFD[29] and the UN's High level Expert Group on the Net zero emissions Commitments of Non-State Actors,[30] is available. We also note that the UK government is finalising its Transition Plan Taskforce Disclosure Framework[31] which seeks to assist UK corporations to prepare transition plans.

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[23] See the December 2022 and October 2022 papers on Appendix B presented to the ISSB Board.
[24] Paragraph 13(a)(i)(1).
[25] Paragraph 13(a)(i)(2) and (3).
[26] Paragraph 13 (b)
[27] Paragraph 13 (b)(iii).
[28] Paragraph 13(a)(ii).
[29] See the TCFD's 'Guidance on Metrics, Targets and Transition plans (October 2021) - https://assets.bbhub.io/company/sites/60/2021/07/2021-Metrics_Targets_Guidance-1.pdf
[30] https://www.un.org/en/climatechange/high-level-expert-group
[31] https://transitiontaskforce.net/#:~:text=The%20Transition%20Plan%20Taskforce%20(TPT,building%20on%20international%20disclosure%20standards.

The development of a sustainability taxonomy by the ISSB internationally, and domestic efforts to draft one specific to the Australian context, could also ensure that terms used in relation to transition plans such as "net zero", "Paris aligned", "carbon neutral" or "science-based" are accurately and consistently used, thereby decreasing the risk of greenwashing. We encourage the government to prioritise this related work stream to support the roll out of the climate reporting regime.

One area specific to Australia on which the government could provide guidance, is the extent to which companies should disclose reliance on **Australian Carbon Credit Units (ACCUs) and Safeguard Mechanism Credits (SGMs)** as part of their transition plans, and how disclosures under any Australian mandatory climate standard will intersect with disclosures to the Clean Energy Regulator as part of NGERs and the Safeguard Mechanism.

Question 12

Should particular disclosure requirements and/or assurance of those requirements commence in different phases, and why?

Although the AICD strongly supports the assurance of climate-disclosures, given that climate assurance is somewhat in its infancy and there is a limited pool of qualified professionals available, we do not consider it feasible to mandate assurance immediately. Further, it remains unclear what parts of the ISSB standards are capable of assurance,[32] and what assurance standards and methodologies should apply. For clarity on this, we await the finalisation of the ISSB standards and the publication of the IAASB's draft Standard for Assurance on Sustainability Reporting.

In light of these data and capability gaps, we consider that the better approach is to delay the phase-in of mandatory assurance until some of these gaps have been filled, and to then stagger assurance depending on the disclosure topic. This staged approach has been adopted by New Zealand. After commencing mandatory reporting on 1 January 2023, New Zealand is waiting until November 2024 to bring in mandatory limited assurance of greenhouse gas emissions only.

Question 13

Are there any specific capability or data challenges in the Australian context that should be considered when implementing new requirements?

Key areas of capability and data challenges include: (1) scope 3 emissions; (2) transition planning and target setting; and (3) assurance.

Scope 3 disclosures

As set out in our response to **question 9** above, scope 3 disclosure presents both data availability and data quality challenges. In measuring their scope 3 emissions, entities must identify and measure scope 1 emissions from those within their value chain. Where value chains are long, complex and involve international elements, this can be very difficult.

Financed emissions in particular are extremely challenging to measure, without agreed industry-wide methodologies. There are also capability challenges, with many companies lacking the internal expertise to accurately measure scope 3 emissions. Externally, there are also relatively few service providers who have such expertise, with demand for their services likely to exceed capacity when this reporting regime commences.

[32] We note that its submission to the ISSB, the International Auditing and Assurance Standards Board (IAASB) identified those provisions within the ISSB standards which it considered would give rise to assurance challenges, including references to SASB standards and Greenhouse Gas Protocol Corporate Standards, the meaning of "significant climate-risks and opportunities," the relationship between ISSB Sustainability Standard S1 and S2, scalability, proportionality and statement of compliance, materiality, application to Corporate Croups, Joint Ventures, Associates and investments, definition of "value chain" and time horizons (short, medium and long term), scenario analysis, location of disclosures, use of comparative data, and definition of "general purpose financial reporting,"

Transition planning, scenario analysis and target setting

The lack of an agreed taxonomy has meant that there is no clear definition of terms such as "Paris-aligned," "science-based," "carbon neutral," or "net zero." Further, the fragmentation of scenario analysis and transition pathways has meant that entities are disclosing against a plethora of different transition pathways and scenarios, which vary in their assumptions, methodologies, or allowances.

Common points of disagreement include the manner in which reliance on offsets is allowed, the required pace of decarbonisation, the extent to which there can be reliance on unproven technology, and assumptions made in respect of economic and physical conditions, amongst others. All this means that it is very difficult for users to assess the viability of transition plans, or to compare transition pathways and climate resilience across sectors and entities.

Further, conducting scenario analysis and developing a transition plan is complex and resource intensive (in terms of both personnel/expertise and cost). To assist those entities who may lack these resources, and aid comparability, we support the government issuing standardised climate scenarios against which all entities are required to disclose (see our answer to **question 14**).

Assurance

We refer to the data and capability challenges arising out of assurance, as set out in our response to **question 12.**

13.1 How and by whom might any data gaps be addressed?

It is clear that the shift to ISSB-based mandatory climate disclosure will require significant upskilling to address data and capability gaps. In respect of specific ways of addressing data and capability gaps arising from:

- **Scope 3 emissions** – please see our response to **question 9**.
- **Transition Planning and target setting** – please see our responses to **questions 11 and 14.**
- **Assurance** – please see our response to **question 8.**

13.2 Are there any specific initiatives in comparable jurisdictions that may assist users and preparers of this information in addressing these challenges?

To the extent that we have identified practices or initiatives in comparable jurisdictions which can assist address data and capability challenges, we have referred to them in our responses to the above.

Question 14

Regarding any supporting information necessary to meet required disclosures (for instance, climate scenarios), is there a case for a particular entity or entities to provide that information and the governance of such information?

As noted in our response to **question 13**, the fragmentation of scenarios used for scenario analysis and transition pathways has created confusion amongst both users and preparers of climate disclosures. Further, scenario analysis and transition planning are resource-intensive activities, and many smaller entities are unlikely to have the expertise or financial resources to undertake these processes. To address this issue, we support the provision of a set of standardised climate scenarios or transition pathways issued by a government entity.

However, we do not consider that such standardised scenarios/pathways should be exhaustive, and consider that organisations who have invested considerable resources into developing their own bespoke models should be entitled use them in addition to the mandatory scenarios.

Question 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?

Based on our engagement with directors, we know that significant time and effort is spent on considering appropriate disclosures, informed by legal and other expert advice. Often the tension point is a desire to provide as much useful information as possible, at the same time as the obligation of a diligent director to carefully consider legal advice which warns about the risks associated with comprehensive disclosure. This notwithstanding, directors appreciate that investors' disclosure expectations have shifted materially, and are working to meet those expectations.

It is widely recognised, including by the ISSB itself,[33] that there are a number of provisions within the ISSB standards which require the disclosure of information which is based on inherently uncertain inputs and assumptions. These issues are explored in detail in the HSF Advice. The AICD is primarily concerned with two categories of such statements contemplated by the draft standards, namely:

1. forward looking statements (including about an entity's transition plans); and
2. scope 3 emissions disclosure (see comments in response to **question 9**).

For clarity, we note that under Australian law the 'reasonable grounds' test applies to forward looking statements only. Outside of the continuous disclosure context, statements made as to current or past matters, which includes scope 3 emissions, are subject to the general prohibition on misleading and deceptive conduct, which looks to whether the conduct or representation might lead a reasonable person in the position of the recipient into error (the subjective state of mind or intention of the person making the representation is irrelevant).

Because of the inherent uncertain inputs on which such representations are made in the context of ISSB reporting requirements, both types of statements present material liability risks to companies and directors.

We also provide a table summarising the key liability issues in **Annexure B.**

Further discussion of the challenges associated with the forward looking statements contemplated by the proposed standards is outlined below. In addition, we have recommended some potential solutions to these issues with the goal of supporting comprehensive, good faith reporting.

1 - Forward looking statements

A significant range of forward looking statements is contemplated by S2 including:

- identifying future climate-related risks and opportunities on organisational strategy and decision-making, including transition plans;
- determining the anticipated effects on an entity's future performance, position and cash flows;
- applying climate-related scenario analysis; and
- disclosing the anticipated amount and percentage of assets or business activities which are likely to be vulnerable to transition and physical risks, and which are aligned with climate-related opportunities.

As Treasury is aware, under Australian law, persons who make representations as to future matters will be liable for misleading or deceptive conduct unless the representations are made on reasonable grounds. The subjective belief of the person at the time that the representation was made is immaterial, even if it was honestly held.

[33] The ISSB acknowledged in its January 2023 board meeting that certain provisions of the S1 and S2 involved a high level of measurement or outcome uncertainty, thereby tentatively introducing the standard of "reasonable and supportable information that is available at the reporting date without undue cost or effort" into the standards.

The Australian legal position is contrary to a number of comparable common law jurisdictions. In the UK for instance, liability only applies where representations are made fraudulently or recklessly. Further, penalties in the UK for non-compliant climate reporting under its mandatory climate regime (which notably is based on TCFD rather than ISSB) are extremely mild.[34] In Canada and the US, liability does not attach to forward looking statements where meaningful cautionary language is applied.

The lack of such legal safe harbours makes Australia an outlier, meaning that Australian companies and directors have significantly more liability exposure relative to their international counterparts when making representations to the market.

It is noteworthy that liability issues are significant enough to warrant large investors, who are both users of climate reporting as well as expected disclosing entities, to express concerns. For example, the world's largest institutional investor, BlackRock, in its 2022 submission to the SEC on climate disclosures, stated the following:

> ***Protections from liability***: *the liability attached to climate-related disclosure should be commensurate with the evolving nature of that disclosure to encourage rather than discourage higher quality disclosure.* ***We urge regulators to adopt a liability framework that provides meaningful protection from legal liability for disclosures provided in good faith while standards continue to evolve, and that gives companies the flexibility they need to develop their disclosures without imposing a chilling effect*** *[emphasis added].*[35]

It is important to highlight that Blackrock's comments were made in an US environment with significantly less disclosure risk than the Australian market (as discussed above).

Coming back to the Australian market, the nation's largest superannuation fund, Australian Super, called, during the recent AASB consultation, for discussion on the implementation of climate disclosure requirements of a forward-looking nature, including "the expectations and ability of entities to make these disclosures in the current Australian legal environment, and development of the related scope of assurance."

1.1 - Material liability risks even where disclosure is on a good faith, best efforts basis

AICD members have expressed concern that, because of the inherent uncertainty in making climate-related future estimates or projections, they could be held liable even if, at the time of disclosure, they undertook good faith disclosure on a best-efforts basis. There is also concern that entities that had previously made disclosures under the TCFD voluntary framework could be held to have misled or deceived after making the more substantive and detailed mandatory ISSB disclosures.[36]

Alternatively, companies that previously formed the view that climate risk was not material and did not disclose, and are now subsequently made to disclose under the mandatory regime, could be held liable on the basis that their materiality assessment was incorrect and/or that they should have disclosed earlier. Difficult questions as to the point at which entities became aware, or ought to have become aware, of the materiality of climate change risk are likely to arise.

Whilst we do not condone poor disclosure practices, it is important that these matters be considered in the policy design phase so that the market can move forward with confidence, without undue fear of litigation.

Notably, the HSF Advice concluded that establishing reasonable grounds for some of the ISSB-mandated representations will pose considerable difficulties, given the inherent uncertainty of dependencies such as market dynamics, energy transition challenges and the development of new technologies.

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34 In the event of noncompliance, the Conduct Committee of the Financial Reporting Council has the authority to seek a court order compelling a company to revise its climate disclosure report. The court may order the company directors to personally pay for the costs associated with preparing a revised report.

[35] BlackRock submission to the SEC: Enhancement and Standardization of Climate-Related Disclosures for Investors (File Number S7-10-22), 17 June 2022, available here.

[36] For instance, shareholders may argue that it was a breach of s 299A if the pre-ISSB Directors Report failed to include detailed information on climate change in the Directors Report such as to satisfy the requirement for a Director's Report to include any information which shareholders would reasonably require to make an informed assessment of the corporation's business strategies and prospects for future years.

Based on our engagement with the AICD's Law Committee, and other legal experts, we understand that the HSF Advice is an orthodox view and largely accords with the position taken by other major law firms advising large, listed Australian companies on the risks associated with climate related disclosure. This notwithstanding, we appreciate that contrary positions have been expressed, such as those contained in the barristers' opinion commissioned by the Australian Council for Superannuation Investors (ACSI), the Investor Group on Climate Change (IGCC) and Responsible Investment Association Australasia (RIAA) released on 6 February 2023 (**Investor Legal Opinion**).

1.2 Contemplated climate related forward looking statements are novel and well beyond market practice

Whilst under current Australian law, companies need to make representations as to uncertain future matters in their financial statements, such as the forecasting of revenues and profits or the making of provisions, impairments and contingent liabilities, these future representations are subject to long-established, well understood accounting principles, and are subject to full external audit. In contrast, as set out in our response to **question 1**, the ISSB standard requires very granular and complex disclosures in circumstances where assurance options are currently limited, and where current market practice is to not disclose such information.

Whilst these barriers are likely to decrease over time, as the market matures in its understanding of climate-related risks, **currently there remains a large gap as between current climate-disclosure (most often under the TCFD, which is *not* a reporting framework, and still not universally applied[37]) and the ISSB's very specific and granular disclosure requirements. Therefore, the assertion in the Investor Legal Opinion that there is no material change in the liability risks facing companies arising from a transition to the ISSB framework seems incorrect**.

1.3 Consensus that the test for reasonable grounds is unclear in the climate context

Ultimately, while legal opinions on the extent of the liability risk may differ, there is agreement (explicitly acknowledged in the Investor Legal Opinion[38]) that there is a lack of clear information as to the processes that preparers need to undertake to ensure they are making future representations on reasonable grounds.

Whilst the Investor Legal Opinion suggests that this information/guidance should come from the ISSB and ASIC[39], in the AICD's view, a robust test for 'reasonable grounds' should be legislated such that preparers of financial reports (including directors) are reasonably comfortable that if they adhere to the legal requirements and make good faith, bests efforts disclosure, they will not be exposed to unreasonable litigation risk – a risk that is material given the relative ease with which shareholder claims can be brought in Australia, and the active class action market.

ASIC's view on what constitutes "reasonable grounds" is their opinion only, rather than having any force of law,[40] and may differ from other (activist) groups which may take strategic litigation to test the bounds of the law. Further, from a rule of law perspective, it is preferable that such significant policy issues are considered through a robust parliamentary process, rather than regulatory guidance which is developed subject to much more limited public accountability mechanisms.

Finally, the reality must be acknowledged that current legal settings have not produced the desired outcomes for the market – that is, investors continue to bemoan the quality of climate reporting, and directors continue to be unsure as to how and what to report. Simply requiring companies to disclose much more information than is current market practice, without the benefit of reasonable external assurance, is very unlikely to improve reporting if one of the underlying concerns (legal risks) is left unaddressed.

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[37] For instance, a KPMG report that 24% of the ASX100 considered that they had not reported climate risks in line with TCFD recommendations. Of those that did disclose in line with TCFD, the vast majority of disclosure take place in separate sustainability reports. KPMG found that only 38% of the ASX200 are reporting on their progress in implementing the TCFD recommendations in their primary report to shareholders. For more detail see KPMG (June 2022), 'Corporate Reporting Trends 2022: Integration of ESG, critical to enterprise value reporting - A review of ASX200 Corporate Reporting Trends in the year to 30 June 2022. Available at: https://assets.kpmg.com/content/dam/kpmg/au/pdf/2022/asx200-corporate-reporting-trends-2022.pdf

[38] See paragraph 57 of the Investor Legal Opinion: "In our experience, an important and valid concern of directors is that they lack precisely the guidance about processes and disclosures which it is the purpose of the ISSB Draft Standards to assist in providing."

[39] See paragraph 60 (h) of the Investor Legal Opinion.

[40] Part 5 of the *Acts Interpretation Act* 1901(Cth).

2 - ISSB recognition of liability risks

It should be noted that in light of the number of stakeholders raising concerns in submissions to the ISSB, the ISSB itself has taken some limited steps to address these liability risks. In respect of future representations, the ISSB has amended the standard of disclosure to require only "use of reasonable and supportable information that is available without undue cost or effort,"[41] and allowing entities with limitations in skills, capabilities and resources to provide less onerous disclosures in respect of scenario analysis [42] and in respect to the current and anticipated effects of climate-related risks and opportunities on its financial position, performance and cash flows over the short, medium and long term. [43]

The ISSB is also considering mechanisms for addressing liability issues arising from the disclosure of scope 3 emissions, including by adding language into S2's 'Basis for Conclusions' document stating that the risk of litigation may discourage Scope 3 emissions disclosures, and to note that the provision of safe harbour protection could assist in facilitating such disclosures.

3 - Need for Australian solutions to Australian legal risks

In our view, if liability settings remain unchanged, there is a real risk that disclosures will be disappointing, such that they fail to meet market expectations and the policy objective of the proposed reforms, thereby delaying a clear picture of how the economy is tracking towards the government's climate commitments.

As stated above, at a minimum, there needs to be clear legislative clarification of the test for 'reasonable grounds' for forward looking statements in the climate context. Further, given the proposed ISSB Standards will require considerable reliance on technical and specialist advice (e.g. methodologies for calculating greenhouse gas emissions or advice on the viability of technologies which might then feed into public climate commitments and transition plans), there needs to be legislative clarification on the extent to which s 189 of the Corporations Act (Reliance on information or advice provided by others) may apply in the context of climate reporting (discussed in our response to **question 16** below).

In addition, the AICD proposes that the below solutions be considered, with the focus being on modifying enforcement and liability settings rather than on changing the substance of the disclosure obligations, or delaying their operation. In our view, addressing these issues will support the swift implementation of the new reporting regime, whilst a failure to address them will hold back comprehensive, good faith adoption.

The AICD's proposed solutions are as follows:

1. **Option A**: a safe harbour for forward looking climate-related statements generally, where such statements are supported by suitably qualified external advice, and made following reasonable steps by the disclosing entity;
2. **Option B**: the above safe harbour confined to scope 3 disclosures specifically; and

[41] This amendment is intended to provide guidance to organisations as to the type of information that entities must consider and the efforts to which organisations must go to obtain information that must then be disclosed. The standard clarifies that entities are only required to look for and consider information that is reasonably available, including information that it already has (and it cannot disregard known information) and available at the reporting date. It also must ensure that it has a reasonable basis for relying on the information it uses to draft disclosures. The ISSB has clarified that it does not require entities to undertake an exhaustive search for information needed for disclosure. The objective is to avoid placing a disproportionate burden on entities (especially smaller, less resourced entities) to obtain hard-to-find, expensive information. It applies in respect of only certain disclosures, including identifying climate-related risks and opportunities, applying value-chain requirements including those regarding the scope of the entity's value chain and measurement of scope 3 emissions, determining anticipated effects on an entity's financial performance, position and cash flows, scenario analysis, and calculating the amount and percentage of assets or business activities vulnerable to transition risks, physical risks and aligned with climate-related opportunities.

[42] When considering whether cost or effort is "undue," the ISSB states that entities must consider (1) the degree of the entity's exposure to climate-related risks and opportunities; and (2) the skills, capabilities and resources available to the entity to conduct climate-related scenario analysis. In respect of scenario analysis, the ISSB recognised that *"even if an entity determines that it has significant exposure to climate-related risks or opportunities, it may be challenged to use a quantitatively complex or technically sophisticated approach to climate-related scenario analysis."*

[43] The amendment allows entities that have limitations in skills, capabilities, and resources to substitute quantitative disclosures for qualitative disclosures.

3. **Option C**: limiting enforcement action based on deficient disclosure to the regulator only, with the focus being on heavily penalising those that fail to disclose, or where disclosure is of a clearly poor standard, accompanied by an intensified market surveillance program.

We acknowledge that penalties and enforcement options were not explicitly canvassed in this consultation and will no doubt be the subject of detailed consideration by government. Further, we note that although ASIC has issued infringement notices against four separate entities since October 2022, it has yet to initiate court proceedings against any entity for alleged greenwashing or broader climate disclosure.

Whilst each of the above options, in our view, has merit, we consider that Option C may best support the desired policy objectives and balance the competing perspectives of stakeholders. Specifically, if such an approach was taken, most directors would feel comfortable that litigation would only be brought where poor conduct was identified, and litigation deemed in the public interest, rather than actions brought by plaintiffs, such as activists, for alternative motives.

Further, such an enforcement approach could be introduced for a transitional period of say two years, to provide time for companies to upskill to the mandated standards, for regulators to provide guidance on their expectations and observance of market practices, and for well-acknowledged assurance challenges to be addressed.

Specifically on assurance, it would seem unreasonable to expect directors to sign off on a wide range of forward-looking climate disclosures, as contemplated by S2, in circumstances where there is a limited pool of assurance professionals, and where mandatory assurance may well be phased in over time (as has been the case in New Zealand). Without reasonable assurance being provided, it would be difficult for directors to satisfy themselves that they possess "reasonable grounds" for the detailed disclosures required.

Finally, we would note that if Option C was pursued in isolation of legislative clarification of the reasonable grounds test, and reliance on others provisions, there is a risk that private litigation would resume in earnest, exploiting existing weaknesses in Australian law.

Question 16

Are there particular considerations for how other reporting obligations (including continuous disclosure and fundraising documents) would interact with new climate reporting requirements, and how should these interactions be addressed?

As noted in the response to **question 6**, it is currently unclear how the disclosure requirements under the proposed ISSB standards will intersect with existing periodic and continuous disclosure reporting requirements (partly as it is unclear where such obligations will reside in the overall reporting architecture). Liability implications from this interplay will need to be carefully considered and are discussed below, along with the more specific obligations of directors with respect to reporting.

1 - Directors' duties

As a matter of Australian law, the AICD endorses the view that the management of climate change-related risks are relevant to directors' fiduciary, statutory and common law duties.

In 2021, an AICD-commissioned legal opinion by Bret Walker SC and Gerald Ng examined the current formulation of a director's duty to act in good faith and in the best interests of the corporation and the extent to which broader stakeholder interests can be factored into decision making.[44]

The opinion confirmed that while shareholders/members' interests are central, directors can consider a range of stakeholder interests, including the environment, and that taking a short-term view of where the company's interests lie is not required. The AICD's accompanying Practice Statement further encouraged directors to consider broader stakeholder interests in their decision-making given is it is often

[44] *The Content of Directors' "Best Interest" Duty,* Memorandum of Advice, Bret Walker SC and Gerald Ng (accessible here).

necessary to protect an organisation's reputation and ensure its sustainability over the long-term.[45]

The AICD also supports the view that a director must actively consider the impacts of climate change-relate risks on their operations and strategy as part of their duty of care and diligence under s 180 of the Corporations Act.[46] However, in the context of climate change being an emerging area of risk, the standard of competence that would be exercised by a diligent director acting reasonably is not yet clear, and is highly dependent on the materiality of the risk to the organisation.

1.1 - Narrow application of the business judgment rule – compliance matters excluded

A unique aspect of Australia's director liability framework is the narrow application of available defences, notably the limitations with the statutory 'business judgment rule' in s180(2) and ability to rely on information or advice provided by others in s 189.

Australia's business judgment rule was introduced to protect directors who undertake reasonable and informed commercial decision-making from claims that a director breached their s 180 duty of care and diligence. However, analysis from Allens Linklaters has found it to be of limited use compared to its effectiveness in other jurisdictions.[47]

In particular, Australian courts have excluded decisions relating to matters of compliance (e.g. continuous disclosure) from the protection of the rule, even though commercial considerations and business judgments will typically underpin such decisions.[48]

This is of particular relevance to the current consultation, where complex decisions by a board of directors as to what to disclose, may not benefit from any statutory protection as they may be deemed compliance rather than commercial decisions.

1.2 - Reporting breaches may trigger breach of director's duty

Importantly, it is well established that directors may be found to have breached their statutory duty of care and diligence for being involved in a company making misleading statements to the market[49] or if they sign off on deficient financial reports.[50]

The emergent doctrine of stepping-stone liability[51] has the potential to further expand the ambit of director conduct that may be subject to public enforcement. Under this doctrine, essentially a director may be found personally liable for a failure to prevent contraventions of the law by their corporation (for example a disclosure obligation).

1.3 - Clarification on section 189 (reliance on information or advice from others)

The consistent feedback from the director community has been widespread support of the ISSB standards as a mechanism for providing useful and comparable disclosures to users.

All directors consulted consider climate change to be a serious issue, and they wish to engage with it in a fulsome and substantive manner, recognising the capability lift that is required. To understand the impact of climate change on their businesses, directors seek and rely on advice from subject matter experts, including amongst others, lawyers, and assurance providers. Accordingly, the HSF advice is that there is "likely to be an unprecedented need for directors to rely on s 189 of the Corporations Act."

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[45] *Directors' "best interests" duty in practice,* AICD Practice Statement (accessible here).
[46] *Climate Change and Directors' Duties,* Memorandum of Opinion, Noel Hutley SC and Sebastian Hartord Davis (accessible here).
[47] See AICD-commissioned research by Allens regarding the "business judgment rule" (accessible here).
[48] *ASIC v Fortescue Metals Group Ltd* [2011] FCAFC 19 at [197]-[198] (appeal dismissed on other grounds: *Forrest v ASIC* [2012] HCA 39). This point was applied in *ASIC v Vocation Ltd (In Liq)* [2019] FCA 807 at [739].
[49] *Resource Equities Ltd v Garrett* [2009] NSWSC 1385; *ASIC v Vocation Ltd* (in liquidation) [2019] FCA 807.
[50] *ASIC v Healey (*2011) 278 ALR 618; [2011] FCA 717.
[51] The term 'stepping stone' originates from Keane CJ's judgment in ASIC v Fortescue Metals Group (2011) 190 FCR 364, 370 [10]. The "Stepping stone approach" has been subsequently adopted by ASIC and has two steps: (1) a breach of the Corporations Act 2001 (Cth) by the company; and (2) a finding of a breach of director's duty under the Corporations Act on the basis that they failed to protect the company from criminal procedure, civil liability or reputational damage. Key cases include *Resource Equities Ltd v Garrett* [2009] NSWSC 1385; *ASIC v Cassimatis* (No 8) [2016] FCA 1023; and *ASIC v Vocation Ltd (in liquidation)* [2019] FCA 807.

As such, clarification of the circumstances in which a director can rely on s 189 would assist the implementation of the proposed reporting regime. We understand that to date, the provision has only been pleaded successfully twice since it was introduced.[52] If there has been a reporting or disclosure failure, the obligation on directors to make an independent assessment of the information or advice on which they relied will be assessed in hindsight and may fail. Further, the section is limited to reliance on specific information or advice. It is not available, for example, when directors rely on someone who has been given responsibility for doing something and has failed to do it.

2 - Fundraising documents

Sections 710(1) and 1021E(8) of the Corporations Act provide that a prospectus must contain all the information that investors and their advisers would reasonably require to make an informed assessment of assets and liabilities, financial position and performance, profits and losses and prospects of the company. Therefore, if an entity considers that climate change is material, it is required to disclose on climate in the prospectus. However, we note that the Corporations Act does not specify the content of disclosures, which is different to S2 requirements.

3 - Continuous disclosure obligations

One example of incongruence with S2 is in respect to climate-target setting. S2 requires that entities revise targets and explain where there has been a significant change that will impact progress and performance against these targets on a periodic basis. Because of the fast pace of change in this area, there is a concern amongst the legal profession that the effect of these requirements could be to turn periodic disclosure documents (to which S2 is intended to apply) into sources of ongoing continuous disclosure obligations. This is because the ASX Listing Rules, given force of law by the Corporations Act, require listed entities to immediately correct or prevent a false market, which could arise where an existing announcement subsequently becomes incorrect in a material respect.

Should a reporting entity become aware that an announced climate target can no longer be met (for example, due to a change in external factors), or the assumptions underlying those targets have changed, there will be a heightened expectation on companies to issue updates to the market or otherwise risk liability.

Continuous updating is not generally required under the ISSB standards, so this is a uniquely Australian outcome (especially given continuous disclosure has force of law unlike some other jurisdictions) that will impact entities and directors and should be addressed as part of the consultation.

Further, under current Australian periodic reporting requirements, HSF advises that these are principally backward-looking in nature, which affords reporting entities a considerable degree of certainty over their disclosure and carries comparatively lower levels of liability risk. Notably, current Australian securities laws and ASIC policy guidance (ASIC Regulatory Guide 170) discourage statements involving speculation and supposition, as opposed to information that can be positively demonstrated to have a reasonable basis and that is based on reasonable assumptions, rather than hypothetical projections.

As noted above, many disclosures required under S2 require estimation or prediction as to the impacts of risks and opportunities for the reporting entity, notwithstanding that those impacts are inherently unknowable, and are forward-looking by their very nature.

While legislative clarification of a 'reasonable grounds' test will provide some comfort to support directors to make forward-looking statements, it is widely acknowledged that very few ESG disclosures are currently assured (particularly to a reasonable assurance standard). This is not going to change in the short term, meaning that liability risks will remain challenging to navigate.

[52] *ASIC v Mariner Corp Ltd (2015) 106 ACSR 343; ASIC v Mitchell (No 2)* (2020) 146 ACSR 328.

4 - Periodic reporting

If the proposed climate reporting requirements form part of the annual directors' report, inconsistencies in the various statutory liability tests may arise. Currently, s 344 of the Corporations Act states that directors are in contravention of periodic disclosure requirements if they fail to take all reasonable steps to comply with, or to secure compliance with, the disclosure requirements including the directors' report.

That is an objective "reasonable person" standard which is higher than the present continuous disclosure requirement, whereby the standard is actual knowledge or reckless or negligent failure to disclose (s 674A(2)(d)).

4.1 Potentially inconsistent legal tests in the Corporations Act

Further, it may be possible that a plaintiff could seek to allege that a climate-related statement made in the annual directors' report was misleading or deceptive under s1041H – a provision where the applicable test is one of strict liability, requiring no intention or indeed negligence by the director or company (as discussed above).

Accordingly, we urge alignment across the various statutory tests such that fault, specifically negligence as a minimum, is required to ground liability.

4.2 True and fair view sign off

Finally, for the reasons outlined elsewhere, should the proposed climate obligations form part of periodic financial reporting, the HSF Advice notes that directors would face "considerable difficulty" in providing a 'true and fair view' sign-off as part of their directors' declarations under ss 297 and 305 of the Corporations Act. This provides greater impetus for clarification of the reasonable grounds and reliance on others statutory provisions in the context of climate reporting.

Question 17

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

There is increasing recognition that traditional assessments of company value based purely on financial position and performance do not address the social, cultural and environmental impact of corporate activities and behaviour. Whilst climate reporting is the first "cab off the rank," it is important to note that S2 sits alongside a broader sustainability standard (S1). This latter, overarching standard seeks to cover sustainability issues that are broader than climate, recognising that more specific standards on particular topics (e.g. biodiversity) are likely to follow over time (S3, S4 etc).

In line with the government's policy objectives of scalability and the AICD's proposed design consideration (see response to **question 5**), we support the position that, to the extent possible, the basic framework of the climate-reporting regime should be flexible enough to allow the eventual inclusion of other sustainable reporting topics.

This should be done recognising that their potential domestic adoption will need to be considered on their individual merits. In particular, efforts should be made to ensure cross-referencing across sustainability reporting topics where there are points of convergence, such as between any mandated climate, nature and biodiversity reporting.

Question 18

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

We are aware of proposals in regard to the use of digital reporting to increase comparability of reports (see our response to **question 6**), which we support in principle, but are unable to comment on in detail.

Question 19

Which of the potential structures presented (or any other) would best improve the effectiveness and efficiency of the financial reporting system, including to support introduction of climate related risk reporting? Why?

As stated in our recent submission to Treasury (on draft legislation empowering the AASB to produce sustainability standards), in light of the AASB's work on the ISSB standards to date, we support the AASB's role as the entity initially responsible for the development of climate and sustainability disclosure standards (i.e. Option 1). We also support the recent appointment of sustainability experts to the respective boards of the AASB and AUASB given the expanding scope of those bodies, including with respect to climate reporting. Given the early stages of the mandatory climate-reporting project, we are uncertain as whether the AASB is bet placed to have a more permanent responsibility for this issue, or whether Options 2 or 3 are better long-term options.

We consider these questions would be better addressed at a future time when there is more information on the efficacy of the climate-reporting regime. Regardless of which option is ultimately selected (whether it be option 1,2, 3 or another option altogether), it is imperative that those bodies responsible for climate-reporting have the relevant resources and expertise to fulfil their mandates, and that their respective roles are clear as between themselves and the market more broadly.

HERBERT SMITH FREEHILLS

Liability risks associated with the proposed ISSB Standards

1. About this advice

The recent release of the International Sustainability Standards Board's (**ISSB**) consultation drafts of new sustainability- and climate-reporting standards[1] is a welcome development towards harmonised global reporting standards. However, in light of Australia's existing legal framework on financial reporting and directors' duties, the Australian Institute of Company Directors (**AICD**) has requested advice to seek to understand potential areas of liability or heightened risk for directors with respect to the ISSB Standards given the scope of the disclosures proposed.

In the still-developing ESG litigation environment, the ISSB Standards' requirements for forward-looking statements that are dependent on inherently uncertain matters (such as future technologies and market dynamics) are anticipated to create significant risk exposure for reporting entities and their directors in the absence of a 'safe harbour' for such statements. This advice outlines key areas of tension between the proposed ISSB Standards and directors' liability risks in the context of Australia's current legal framework for public corporate disclosures.

2. Executive summary

The proposed ISSB Standards will subject Australian reporting entities and their directors to a greater level of legal risk compared to their counterparts in other jurisdictions given the way in which forward-looking statements are regulated in this country.

Australia's current periodic reporting requirements are principally backward-looking in nature, which affords reporting entities a considerable degree of certainty over their disclosure and carries comparatively lower levels of disclosure risk. By contrast, the new ISSB Standards would require reporting entities to make an extensive range of forward-looking statements.

Under Australian law, forward-looking statements will be deemed to be misleading unless supported by reasonable grounds. Given the subject-matter of the disclosures proposed under the ISSB Standards, establishing 'reasonable grounds' is likely to pose considerable difficulty for directors in a number of areas, given the inherent uncertainty of dependencies such as market dynamics, energy transition challenges and the development of new technologies.

While the existing liability regime for public disclosures in Australia is well understood by reporting entities and their directors, the development of ESG-related litigation is embryonic, with the *ACCR v Santos* test case[2]

[1] IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* (**IFRS S1**) and IFRS S2 *Climate-related Disclosures* (**IFRS S2**) (together, **ISSB Standards**).

[2] *Australasian Centre for Corporate Responsibility v Santos Limited*, Federal Court of Australia case NSD858/2021, filed on 25 August 2021.

HERBERT SMITH FREEHILLS

likely to provide impetus for further litigation if the applicant is successful in establishing that Santos lacked reasonable grounds for the statements about its 'net zero' roadmap in its 2020 Annual Report. Compounding the litigation risk faced by Australian reporting entities and their directors is Australia's facilitative class action regime, where disclosure breaches may result in a reporting entity becoming vulnerable to securities class actions.

This area of tension arises because, unlike a number of other jurisdictions, Australia lacks a 'safe harbour' defence for forward-looking statements made in good faith. In jurisdictions where safe harbour defences exist, it is comparatively easier for reporting entities and directors to disclose sustainability matters alongside forward-looking information on their expected impacts for the business and the business' proposed actions in response. In the context of the current regulatory regime in force in Australia, it seems likely that reporting entities and their directors would be subjected to a comparatively higher level of risk as compared to their international peers when disclosing against the ISSB Standards.

The proposed ISSB Standards also interact with existing Australian law in other ways that will need to be carefully considered by the authorities responsible for implementing them in Australia. For example, in the context of the proposed materiality threshold, there may be a narrowing of the difference between information requiring immediate disclosure under Australia's continuous disclosure regime and the broader sustainability reporting contemplated by the new regime. There are also complexities which will need to be addressed relating to whether compliance with the new standards will be mandatory under the *Corporations Act 2001* (Cth) (**Corporations Act**), whether expanding the scope of financial reporting to cover sustainability- and climate-related issues may require 'true and fair' sign-offs by directors, and whether directors' duties will adjust to reflect the heightened levels of reliance directors will need to place on technical and specialist input underpinning the proposed reporting.

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3. Nature and regulation of periodic reporting in Australia

Schedule 1 provides an overview of key periodic reporting obligations in Australia.

Currently, periodic reporting in Australia is largely focused on a backward-looking review of the previous reporting period. Relatively few of the reporting requirements under the Corporations Act, the ASX Listing Rules and the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (**ASX Recommendations**) are forward-looking, with a notable exception being s 299A of the Corporations Act (the operating and financial review (**OFR**) requirements).[3]

Forward-looking statements carry a higher level of disclosure risk than backward-looking statements. Under s 769C of the Corporations Act, where a person makes a representation with respect to any future matter

[3] Relevantly, s 299A does also include a carve-out to disclosure which allows entities to omit material that would otherwise be included relating to their business strategies, and prospects for future financial years, if it is likely to result in unreasonable prejudice to the entity or consolidated group (e.g. likely to give third parties such as competitors or suppliers a commercial advantage, resulting in a material disadvantage to the entity).

HERBERT SMITH FREEHILLS

(including the doing of, or refusing to do, any act), the representation will automatically be taken to be misleading if the person does not have reasonable grounds for making the representation. The subjective belief of the person at the time that the representation was made is immaterial, even if it was honestly held.

Similar provisions are included in s 12BB of the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**) and s 4 of the *Australian Consumer Law* (**ACL**) and, in the case of the ACL in particular, the person making the representation is also deemed **not** to have reasonable grounds unless they adduce evidence to the contrary. Accordingly, forward-looking statements place an evidential burden on the person who makes the representation to adduce evidence that there were reasonable grounds for making it.[4]

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4. 'Forward-looking' information required by proposed ISSB Standards

As currently drafted, the proposed ISSB Standards would require reporting entities to make an extensive range of forward-looking statements, which is likely to enhance disclosure risks for reporting entities and their directors. This risk is more pronounced given the disclosures contemplated are relatively novel or unusual in the Australian market.

Scope of forward-looking information to be disclosed

A non-exhaustive list of the forward-looking requirements under the ISSB Standards is set out at **Schedule 2**. At a thematic level, they require disclosures of the following:

- **Significant sustainability- and climate-related risks and opportunities.** The overarching purpose of the ISSB Standards is to require the disclosure of information about significant sustainability- or climate-related risks and opportunities to enable users of general purpose financial reporting to assess the effects of such risks and opportunities on the reporting entity's enterprise value.[5] This would require a description of any significant sustainability- and climate-related risks and opportunities that could reasonably be expected to affect the reporting entity's business model, strategy, cash flows, access to finance and cost of capital over the short-, medium- and long-term.[6]
- **Effect of those risks and opportunities on business model and value chain.** A reporting entity would be required to disclose information about its assessment of the current and anticipated effects of significant sustainability- or climate-related risks and opportunities on its business model. This would include a description of the current and anticipated effects of such risks and opportunities on its value chain, and a description of where in its value chain such risks and opportunities are concentrated.[7]
- **Effect of those risks and opportunities on strategy and decision-making.** The ISSB Standards require a reporting entity to disclose

[4] *Australian Competition and Consumer Commission v Woolworths Limited* [2019] FCA 1039, 37 [113].

[5] IFRS S1 [1], IFRS S2 [1].

[6] IFRS S1 [16], IFRS S2 [9].

[7] IFRS S1 [20], IFRS S2 [12].

HERBERT SMITH FREEHILLS

information about the effects of significant sustainability- and climate-related risks and opportunities on its strategy and decision-making.[8] Compared to IFRS S1, IFRS S2 calls for more extensive forward-looking disclosures, including information about a reporting entity's transition plans, current and anticipated changes to its business model (e.g. changes in strategy and resource allocation, direct and indirect adaptation and mitigation efforts), and how these plans will be resourced.[9]

- **Effect of those risks and opportunities on financial position, financial performance and cash flows.** The ISSB Standards require a reporting entity to disclose information that enables users to understand the anticipated effects of significant sustainability or climate-related risks on its financial position, financial performance and cash flows over the short-, medium- and long-term, including how such risks and opportunities are included in its financial planning.[10] This would include, among other things, information about risks and opportunities for which there is a significant risk that there will be a material adjustment to the carrying amounts of assets and liabilities, and how the reporting entity expects its financial position and financial performance to change over time.[11]
- **Resilience.** IFRS S1 requires a reporting entity to disclose information that enables users to understand its capacity to adjust to the uncertainties arising from significant sustainability-related risks.[12] IFRS S2 sets out more extensive forward-looking disclosure requirements. Among other things, it requires a reporting entity to disclose information about the resilience of its strategy (including its business model) to climate-related changes, developments or uncertainties. Further, a reporting entity would be expected to use climate-related scenario analysis, and would be required to disclose the results of its climate resilience analysis to enable users to understand the implications of its findings for its strategy, and its capacity to adjust or adapt its strategy and business model over the short-, medium- and long-term.[13]
- **Targets.** IFRS S1 would require the disclosure of targets (which are, by definition, forward-looking) that a reporting entity has set to assess its progress towards achieving its strategic goals (including milestones or interim targets).[14] IFRS S2 would require a reporting entity to disclose its targets to mitigate or adapt to climate-related risks or maximise climate-related opportunities.[15] Compared to IFRS S1, IFRS S2 requires the disclosure of a broader range of details for each target.[16] Further, a reporting entity would need to disclose information regarding targets for its transition plan, including the

[8] IFRS S1 [21], IFRS S2 [13].

[9] IFRS S2 [13].

[10] IFRS S1 [22], IFRS S2 [14].

[11] IFRS S1 [22], IFRS S2 [14].

[12] IFRS S1 [23].

[13] IFRS S2 [15].

[14] IFRS S1 [32].

[15] IFRS S2 [20(d)].

[16] IFRS S2 [23].

HERBERT SMITH FREEHILLS

amount of its emissions target to be achieved through emission reductions within its value chain, and the intended use of carbon offsets in achieving those targets.[17]

5. Challenges with respect to establishing reasonable grounds

Many aspects of the proposed ISSB Standards require estimation or prediction of the impacts of risks and opportunities for the reporting entity, notwithstanding that those impacts are inherently unknowable and the relevant disclosure would be relatively speculative[18] – and for that reason, likely to be questioned as not being based on reasonable grounds (and therefore misleading). This appears at odds with Australian regulators' current expectation for companies' public disclosures to be supported by clearly demonstrable reasonable grounds.[19]

An example of a matter in respect of which it is likely to be challenging (and potentially impossible) for a reporting entity to establish reasonable grounds is the required disclosure of the 'anticipated effects [of climate-related risks] over the short, medium and long term' (IFRS S2 [14]), including:

- 'how [the reporting entity] expects its financial position to change over time, given its strategy to address significant climate-related risks and opportunities, reflecting its current and committed investment plans and their anticipated effects on its financial position (for example, capital expenditure, major acquisitions and divestments, joint ventures, business transformation, innovation, new business areas and asset retirements)'; and
- 'how [the reporting entity] expects its financial performance to change over time, given its strategy to address significant climate-related risks and opportunities (for example, increased revenue from or costs of products and services aligned with a lower-carbon economy)',

given the speed and breadth with which market dynamics are changing, challenges with respect to energy transition, policy uncertainty and dependence on the development of breakthrough technologies.

Additionally:

- while it has become reasonably common for companies to undertake (and publish the findings of) scenario analysis for climate impacts under different climate change scenarios, it is notable that those disclosures are typically bound by issue (i.e. climate) and do not require the reporting entity to present its granular view on anticipated outcomes (i.e. they are presented as possible scenarios rather than probabilities). The scale of analysis implied by the proposed ISSB Standards is considerably more ambitious given the broad application to sustainability-related risks and opportunities and the requirement for the estimation / prediction and disclosure of their *anticipated effects* for the reporting entity;

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[17] IFRS S2 [13(b)].

[18] See e.g. IFRS S1 [79], which provides that '[a]n entity shall identify metrics it has disclosed that have significant estimation uncertainty, disclosing the sources and nature of the estimation uncertainties and the factors affecting the uncertainties.'

[19] See e.g. ASIC Regulatory Guide 170.

HERBERT SMITH FREEHILLS

- while listed companies are already required to make forward-looking statements as part of their OFR, there is neither a legal requirement nor regulator expectation for granular disclosures in relation to inherently uncertain future matters; and
- while all companies need to include uncertain matters in their financial statements (e.g. provisions, impairments and contingent liabilities), these are subject to well understood accounting principles that are generally applicable to all reporting entities and have the benefit of full external audit, while the ISSB Standards call for highly company-specific disclosures which are usually only able to be subjected to limited external assurance (e.g. of data and performance).

6. Implications of additional disclosure for reporting entities and their directors

Misleading statements and lack of safe harbour for forward-looking statements

Under s 1041H(1) of the Corporations Act, a person must not engage in conduct in relation to a financial product or a financial service that is misleading or deceptive or is likely to mislead or deceive. This prohibition applies to the making of public statements by a company, as such statements could affect the value of its shares (and would hence be 'conduct in relation to a financial product').[20] Similar prohibitions are contained in s 12DA of the ASIC Act and s 18 of the ACL.

Litigation in this area is commonplace in Australia.[21] Further, directors and other persons could become personally liable to pay compensation for statements that are found to be misleading or deceptive, as s 1041I(1) of the Corporations Act provides that a person who suffers loss or damage by a contravention of s 1041H may recover against any person who is 'involved in' the contravention.

As outlined in **Section 3** above, a person is taken to make a misleading statement about a future matter in a periodic report or other disclosure if they do not have reasonable grounds for making it. This requirement extends beyond 'good faith' disclosure and creates potential liability risks for directors in the context of the extensive forward-looking disclosure required under the proposed ISSB Standards. Even where a reporting entity and its directors consider that their forward-looking representations are supported by 'reasonable grounds', this may be challenged in court with an allegation of 'greenwashing'. For example, proceedings were recently commenced by shareholders associated with the Australasian Centre for Corporate Responsibility (**ACCR**) against Santos, in which the ACCR is alleging (among other things) that the 'net zero representations' in Santos' 2020 Annual Report were misleading, and is challenging Santos' implied representation that it had a reasonable basis for making them.

Compared to their counterparts in certain other jurisdictions, reporting entities and officers in Australia are particularly exposed to this risk, because in Australia, there is no 'safe harbour' exemption which allows for the exclusion of liability by identifying a statement as a forward-looking

[20] See e.g. *Australian Securities and Investments Commission v Narain* (2008) 169 FCR 211.

[21] See e.g. *TPT Patrol Pty Ltd v Myer Holdings Ltd* [2019] FCA 1747.

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statement and including a proximate cautionary statement.[22] By way of comparison:

- in the US, a safe harbour exemption may be secured through identifying a statement as forward-looking and using meaningful cautionary statements which identify important factors that could cause the actual results to differ materially from those in the forward-looking statement. The safe harbour only applies to private civil suits and does not apply to civil and criminal enforcement actions brought by the Securities and Exchange Commission or other regulatory agencies, among other specific exceptions that apply; and
- in Canada, a person or company is not liable for a misrepresentation if the document or public oral statement containing the forward-looking information contained, proximate to that information:
    - reasonable cautionary language identifying the forward-looking information as such, and identifying material factors that could cause actual results to differ materially from a conclusion, forecast or projection in the forward-looking information; and
    - a statement of the material factors or assumptions that were applied in drawing a conclusion or making a forecast or projection set out in the forward-looking information.

Meanwhile, the position taken by the Australian Securities and Investments Commission (**ASIC**) is that the use of warnings and other cautionary language in respect of prospective financial information 'will not always be sufficient to prevent particular information being misleading and importantly will not, of itself, affect the requirement for there to be reasonable grounds to state the information'.[23]

Class action risk

A further source of potential risk for Australian reporting entities and officers is securities class action risk. Securities class actions are the most prevalent type of class action litigation in Australia, where the core allegations relate to asserted disclosure failures with respect to forward looking statements (such as guidance). The two primary factors contributing to the sustained growth in securities class actions in the last decade are:

- first, the procedural hurdles for commencing class actions in Australia are relevantly low, and therefore easy to meet; and
- second, an apparent surplus of capital willing to fund securities class actions, with both litigation funders and plaintiff law firms willing (and tending) to provide financial support to prosecuting securities class action claims.

Directors' duties

Directors and officers owe a duty of care, skill and diligence in relation to the performance of their duties, including with respect to the adoption and

[22] See Herbert Smith Freehills' article on the AICD's website at: https://www.aicd.com.au/board-of-directors/duties/engagement/class-actions-freehills.

[23] ASIC Regulatory Guide 170 *Prospective financial information* (April 2011) [RG 170.94].

approval of financial statements[24] and other types of reporting. Expanding the scope of financial statements to include sustainability- and climate-related matters would broaden the range of matters that directors would need to consider in order to discharge that duty.

A failure to discharge that duty may result in a civil penalty up to the greater of:

- 5,000 penalty units (currently $1.11 million); or
- three times the value of the benefit derived and detriment avoided because of the contravention (if the value can be determined by a court).

In contrast with the position in certain other comparable jurisdictions (including, notably, the US and the UK) which rely relatively heavily on private litigants to enforce directors' duties (barring egregious breaches justifying criminal prosecution), Australian directors are subject to greater exposure to enforcement proceedings, as directors' duties in Australia are principally enforced by the publicly funded ASIC.

A further source of potential liability for Australian directors is that, for any breach of a legal requirement by a *company* (such as the making of misleading or deceptive statement in public reporting), it is possible that the company's *directors* may be found to have failed to discharge their own duty of care and diligence by failing to prevent the company's breach. ASIC has pursued directors for 'stepping stone liability' in this way on a number of occasions.[25]

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7. Additional areas of complexity with proposed ISSB Standards

There are a number of other areas of complexity for Australian directors with respect to the proposed ISSB Standards.

Status of the ISSB Standards and related sign-offs

Under the ISSB Standards, an entity is required to 'disclose information required by IFRS Sustainability Disclosure Standards as part of its general purpose financial reporting'.[26] This requirement applies to both sustainability-reporting under IFRS S1 and climate-reporting under IFRS S2.[27]

While the Australian Accounting Standards Board (**AASB**) is proposing to introduce the ISSB Standards as sustainability standards, separate to the Australian Accounting Standards (i.e. not as part of the current reporting regime under which reporting entities are mandatorily required to comply), it is consulting on whether as an alternative model, sustainability-related financial reporting requirements should be developed as part of existing Australian Accounting Standards (i.e. as part of an entity's general purpose financial statements).

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[24] *Australian Securities and Investments Commission v Healey* [2011] FCA 717 at [21].

[25] See e.g. *Australian Securities and Investment Commission v Cassimatis (No 8)* [2016] FCA 1023 (affirmed by the Full Bench of the Federal Court of Australia in 2020); *Australian Securities and Investments Commission v Vocation Limited (in liq)* [2019] FCA 807.

[26] IFRS S1 [72].

[27] Even though this requirement is located in IFRS S1, it is relevant to both IFRS S1 and IFRS S2 because both sets of standards are 'IFRS Sustainability Disclosure Standards'.

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While it is unclear to us whether the AASB currently possesses the power to implement sustainability disclosure requirements via the Australian Accounting Standards, we expect that (if able to be implemented) this would result in:

- disclosure against the proposed ISSB Standards (or other relevant 'sustainability-related financial reporting requirements') becoming mandatory under s 296 and 304 of the Corporations Act; and
- directors being required to provide a 'true and fair' sign-off in respect of the sustainability- and climate-related disclosures as part of their directors' declarations under ss 297 and 305 of the Corporations Act.

Given the volume of disclosures being required under the ISSB Standards, their complexity, and the uncertainty of some of the data that would need to be disclosed (e.g. anticipated effects of significant sustainability- and climate-related risks and opportunities on financial position, financial performance and cash flows over the short-, medium- and long-term), Australian reporting entities would face considerable difficulty in putting their directors in a position where they would be able to confidently provide a 'true and fair' sign-off on the reporting.

Directors' duties and reliance on others

Another point of uncertainty at present is whether (and if so, how) the scope of directors' duties in relation to financial reporting might adjust to encompass sustainability- and climate-reporting. While there is existing case law on directors' non-delegable duties with respect to considering financial reports (encompassing both their duty of care and diligence but also their statutory obligation with respect to the approval of the financial report)[28], it remains to be seen whether Australian courts would take a similar approach towards sustainability- and climate-related reporting and extend directors' non-delegable duty to these additional areas of reporting.

Relevantly, the proposed ISSB Standards will require considerable reliance on technical and specialist advice (e.g. methodologies for calculating greenhouse gas emissions, advice on the viability of technologies). In this context, there is also likely to be an unprecedented need for directors to rely on s 189 of the Corporations Act (*Reliance on information or advice provided by others*) with respect to the basis for Board approvals of reporting.

Inconsistency with existing reporting standards

The proposed ISSB Standards use concepts which are not currently reflected in the Australian reporting regime and which would need to be clarified or adapted to facilitate relevant reporting.

Materiality

As foreshadowed in **Section 3** above, many Australian entities are currently subject to limited requirements to include forward-looking statements in the OFR section of their directors' report. A difference between the ISSB Standards and the OFR requirements is the materiality threshold for reporting. The existing OFR requirements under s 299A of the Corporations Act require the disclosure of information that

[28] E.g. *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291.

HERBERT SMITH FREEHILLS

shareholders would reasonably require to make an informed assessment of the reporting entity's operations, financial position, business strategies and prospects for future financial years. With respect to the prospects for future years, in Regulatory Guide 247 at [62], ASIC provides:

> 'It is important that a discussion about future prospects is balanced. It is likely to be misleading to discuss prospects for future financial years without referring to the material business risks that could adversely affect the achievement of the financial prospects described for those years. By 'material business risks', we mean the most significant areas of uncertainty or exposure, at a whole-of-entity level, that could have an adverse impact on the achievement of the financial performance or outcomes disclosed in the OFR. Equally, it may be appropriate to disclose factors that could materially improve the financial prospects disclosed.'

Additionally, ASX Recommendation 7.4 provides that an ASX-listed entity should disclose whether it has any material exposure to environmental or social risks, and if it does, how it manages or intends to manage those risks.[29] 'Material exposure' in this context means 'a real possibility that the risk in question could materially impact the listed entity's ability to create or preserve value for security holders over the short, medium or longer term'. In practice, many listed entities would satisfy this requirement either in their OFR or in a separate sustainability report.[30]

Unlike the OFR requirement and ASX Recommendation 7.4 (which are grounded by 'impact' on the achievement of stated outcomes), the proposed ISSB Standards call for much more granular disclosure of 'material information' about 'significant sustainability-related risks and opportunities'.[31] Materiality of information is expected to be determined by reference to whether 'omitting, misstating or obscuring that information could reasonably be expected to influence decisions that the primary users of general purpose financial reporting make on the basis of that reporting'.[32]

This appears more similar to the Australian test for continuous disclosure, under which information that 'would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of … securities'[33] is taken to be information that a reasonable person would expect to have a material effect on the price or value of securities (and hence needs to be immediately disclosed).

In the absence of clarification or adaption, there may be an unhelpful narrowing of the difference between materially price sensitive information requiring immediate disclosure to ASX, and information relating to entities' sustainability and climate-related risks and opportunities which – while important – is unlikely to have the same significance.

Lack of carve-out for commercially sensitive information

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[29] The ASX Recommendations are not mandatory. In the event of non-compliance, a listed entity is required to explain the non-compliance (i.e. 'if not, why not').

[30] As is contemplated under Commentary to ASX Recommendation 7.4.

[31] ISSB S1 [2]. The same materiality threshold applies under ISSB S2 (see ISSB S2 [B5]).

[32] ISSB S1 [56].

[33] Corporations Act s 677(1).

HERBERT SMITH FREEHILLS

The OFR requirement under s 299A allows a reporting entity to omit information from the directors' report that would otherwise need to be included under s 299A(1) if the information is likely to result in unreasonable prejudice to the reporting entity.

However, the ISSB Standards do not provide for a carve-out for any material information about significant sustainability- and climate-related risks and opportunities that would be unreasonably prejudicial to the reporting entity. This is an issue that needs to be carefully considered by Australian standard-setters in order to appropriately balance investors' interest in the disclosure of those risks and opportunities on the one hand, and the protection of reporting entities' legitimate commercial interests on the other.

Need to monitor progress and assumptions

The ISSB Standards require the disclosure of climate-related targets,[34] and in relation to those targets, reporting entities are expected to disclose their performance against them, an analysis of trends or significant changes in their performance, revisions to those targets, and explanations for such revisions.[35]

The provision of periodic progress updates against publicly announced targets is not a new concept for corporate Australia. For example, under ASX Recommendation 1.5, ASX-listed companies are required to report on their progress against gender diversity targets. However, compared to those targets, the targets mandated by the ISSB Standards (e.g. targets set to mitigate or adapt to climate-related risks or maximise climate-related opportunities) are inherently subject to more uncertainty. This would in turn require a greater level of monitoring by reporting entities to ensure that their targets remain appropriate.

A further issue is the forward-looking nature of targets. By definition, forward-looking matters are subject to uncertainty – and sustainability and climate are areas that are subject to rapid change. For Australian listed companies, this could have the (perhaps unintended) effect of turning periodic disclosure documents (which the ISSB Standards are intended to apply to) into sources of ongoing continuous disclosure obligations. This is because the ASX Listing Rules require listed entities to immediately correct or prevent a false market, which could arise where an existing announcement subsequently becomes incorrect in a material respect. Should a reporting entity become aware that an announced sustainability or climate target can no longer be met (for example, due to a change in external factors), or the assumptions underlying those targets have changed, careful consideration would need to be given to the materiality of such information and whether there may be a false market in the entity's securities.

* * *

[34] IFRS S2 [23].

[35] IFRS S1 [33].

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Schedule 1

Overview of directors' responsibilities under current reporting regime

Core reporting obligations

Under s 292(1) of the Corporations Act, all disclosing entities, public companies, large proprietary companies and registered schemes must prepare and lodge audited annual financial reports and directors' reports. In addition, s 302 requires disclosing entities to prepare and lodge audited or reviewed half-year financial reports and directors' reports.

Financial reports

The annual and half-year financial reports are intended to provide information about an entity's financial position and performance and are required to include financial statements, notes to the financial statements and a directors' declaration about the statements and notes (ss 295, 303). They are also required to:

- comply with the Australian accounting standards and any further requirements in the *Corporations Regulations 2001* (Cth) (ss 296(1), 296(2), 304); and
- provide a true and fair view of financial position and performance (ss 297, 305).

Directors' reports

The annual and half-year directors' reports are intended to provide information about the entity's operations and activities, with the level of disclosure required depending on the specific type of reporting entity. At a high level, for listed entities, the directors' report would typically be required to include:

- 'general' information on the entity's operations and activities (s 299);
- additional 'general' information that members of the listed entity would reasonably require to make an informed assessment of the operations, financial position, and the business strategies, and prospects for future financial years, of the reporting entity (s 299A) (referred to as the OFR); and
- specific information about the entity (s 300) and, for listed entities which are companies, the remuneration of the entity's key management personnel (s 300A).

Notably, the objectives of the OFR requirements are to provide shareholders with a narrative and analysis to supplement the financial report and assist shareholders in understanding the operations, financial position, business strategies and prospects of the reporting entity. ASIC has published *Regulatory Guide 247 Effective disclosure in an operating and financial review* (August 2019) to assist companies in applying the relevant disclosure obligations underpinning the OFR.

Additional ASX requirements

Additional periodic reporting requirements are imposed on ASX listed entities under the ASX Listing Rules, and also, the ASX Recommendations, with the latter to be complied with on an 'if not, why not' basis. Those requirements are not detailed in this advice.

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Directors' duties with respect to periodic reporting

Under Corporations Act s 180, directors and officers owe a duty of care, skill and diligence.[36] This reflects a similar duty that directors owe at common law.

This duty encompasses directors' ultimate responsibility for adopting and approving a reporting entity's financial statements, and would equally require directors' care, skill and diligence with respect to other types of periodic reporting as well.

In practice, a reporting entity's financial statements would have the assurance of an external audit, while any non-audited periodic disclosures would be subject to a verification process to ensure its integrity.[37] Further, directors are 'entitled to delegate to others the preparation of books and accounts and the carrying on of the day-to-day affairs of the company'.[38] However, the *Centro* case confirmed that each director is ultimately responsible for the financial statements, and that this responsibility is non-delegable.

The Corporations Act imposes a further requirement that a financial report must include a declaration by the directors as to (among other things) whether, in their opinion, the financial statements and notes are in accordance with the Corporations Act, including the requirements referred to above.[39]

[36] A director or officer must exercise their powers and discharge their duties with the care and diligence that a reasonable person would exercise if they were a director or officer of a corporation in the corporation's circumstances and occupied the office held by, and had the same responsibilities within the corporations as, the director of officer.

[37] In the case of ASX-listed entities, the verification process should be disclosed under Recommendation 4.3 of the ASX Recommendations.

[38] *Australian Securities and Investments Commission v Healey* [2011] FCA 717 ('***Centro* case**').

[39] See ss 295(4)(d), 303(4)(d).

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Schedule 2

Overview of the ISSB Standards

Background to the ISSB Standards

In recent years, the number of international sustainability-related disclosure standards has grown significantly. In an effort to harmonise sustainability disclosures globally, the International Financial Reporting Standards (**IFRS**) Foundation announced in November 2021 the establishment of the ISSB as a 'sister' board to the International Accounting Standards Board (**IASB**). In the same way that the IASB is the body that creates international financial reporting standards, the ISSB is envisioned as a body that sets international sustainability- and climate-related reporting standards.

In March 2022, the ISSB published two exposure drafts of international sustainability and climate-related reporting standards:

- IFRS S1, which sets out draft standards for disclosing information that enables investors to assess the effect of significant sustainability-related risks and opportunities; and
- IFRS S2, which sets out reporting standards in relation to the identification, measurement and disclosure of an entity's significant climate-related risks and opportunities.

In a similar way that the IASB's IFRS are implemented in Australia through the AASB's Australian Accounting Standards, once the ISSB's IFRS S1 and S2 are in place, they are proposed to be implemented in Australia by the AASB with Australia-specific adjustments. AASB is currently consulting on the ISSB Standards to inform any possible future development of a separate suite of Australian sustainability reporting standards by the AASB.

Overview of forward-looking information required under the ISSB Standards

Set out below is a non-exhaustive overview of the key heads of information required under the ISSB Standards which may be forward-looking in nature.

IFRS S1
Objective
[1] The objective of [draft] IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* is to require an entity to disclose information about its significant sustainability-related risks and opportunities that is useful to the *primary users of general purpose financial reporting* when they assess *enterprise value* and decide whether to provide resources to the entity. ... [5] Enterprise value reflects expectations of the amount, timing and certainty of future cash flows over the short, medium and long term and the value of those cash flows in the light of the entity's risk profile, and its access to finance and cost of capital. Information that is essential for assessing the enterprise value of an entity includes information that is provided by the entity in its financial statements and sustainability-related financial information.
[2] A reporting entity shall disclose material information about all of the significant sustainability-related risks and opportunities to which it is exposed.
[6] Sustainability-related financial information is broader than information reported in the financial statements and could include information about: … (b) decisions made by the entity that could result in future inflows and outflows that have not yet met the criteria for recognition in the related financial statements; (c) the entity's reputation, performance and prospects as a consequence of the actions it has undertaken, such as its relationships with people, the planet and the economy, and its impacts and dependencies on them; and …

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Core content
[11] Unless another IFRS Sustainability Disclosure Standard permits or requires otherwise, an entity shall provide disclosures about: … (b) strategy—the approach for addressing sustainability-related risks and opportunities that could affect the entity's business model and strategy over the short, medium and long term; … (d) metrics and targets—information used to assess, manage and monitor the entity's performance in relation to sustainability related risks and opportunities over time.
Strategy
[14] The objective of sustainability-related financial disclosures on strategy is to enable users of general purpose financial reporting to understand an entity's strategy for addressing significant sustainability related risks and opportunities. [15] To achieve this objective, an entity shall disclose information about: (a) the significant sustainability-related risks and opportunities that it reasonably expects could affect its business model, strategy and cash flows, its access to finance and its cost of capital, over the short, medium or long term (see paragraphs 16–19); (b) the effects of significant sustainability-related risks and opportunities on its business model and value chain (see paragraph 20); (c) the effects of significant sustainability-related risks and opportunities on its strategy and decision-making (see paragraph 21); (d) the effects of significant sustainability-related risks and opportunities on its financial position, financial performance and cash flows for the reporting period, and the anticipated effects over the short, medium and long term—including how sustainability-related risks and opportunities are included in the entity's financial planning (see paragraph 22); and (e) the resilience of its strategy (including its business model) to significant sustainability-related risks (see paragraphs 23–24).
[16] An entity shall disclose information that enables users of general purpose financial reporting to understand the significant sustainability-related risks and opportunities that could reasonably be expected to affect the entity's business model, strategy and cash flows, its access to finance and its cost of capital, over the short, medium or long term. Specifically, the entity shall disclose: (a) a description of significant sustainability-related risks and opportunities and the time horizon over which each could reasonably be expected to affect its business model, strategy and cash flows, its access to finance and its cost of capital, over the short, medium or long term; and …
[20] An entity shall disclose information that enables users of general purpose financial reporting to understand its assessment of the current and anticipated effects of significant sustainability-related risks and opportunities on its business model. Specifically, an entity shall disclose: (a) a description of the current and anticipated effects of significant sustainability-related risks and opportunities on its value chain; and (b) a description of where in its value chain significant sustainability related risks and opportunities are concentrated (for example, geographical areas, facilities or types of assets, inputs, outputs or distribution channels).
[22] An entity shall disclose information that enables users of general purpose financial reporting to understand... the anticipated effects [of significant sustainability-related risks and opportunities on its financial position, financial performance and cash flows] … Specifically, an entity shall disclose: … (b) information about the sustainability-related risks and opportunities identified in paragraph 22(a) for which there is a significant risk that there will be a material adjustment to the carrying amounts of assets and liabilities reported in the financial statements within the next financial year; (c) how it expects its financial position to change over time, given its strategy to address significant sustainability-related risks and opportunities, reflecting: (i) its current and committed investment plans and their anticipated effects on its financial position (for example, capital expenditure, major acquisitions and divestments, joint ventures, business transformation, innovation, new business areas and asset retirements); (ii) its planned sources of funding to implement its strategy; and (d) how it expects its financial performance to change over time, given its strategy to address significant sustainability-related risks and opportunities.

HERBERT SMITH FREEHILLS

[23] An entity shall disclose information that enables users of general purpose financial reporting to understand its capacity to adjust to the uncertainties arising from significant sustainability-related risks.
…

Metrics and targets

[32] An entity shall disclose the targets it has set to assess progress towards achieving its strategic goals, specifying:
(a) the metric used;
(b) the period over which the target applies;
(c) the base period from which progress is measured; and
(d) any milestones or interim targets.

IFRS S2

Objective

[1] The objective of [draft] IFRS S2 *Climate-related Disclosures* is to require an entity to disclose information about its exposure to significant climate related risks and opportunities, enabling users of an entity's general purpose financial reporting:
(a) to assess the effects of significant climate-related risks and opportunities on the entity's enterprise value;
(b) to understand how the entity's use of resources, and corresponding inputs, activities, outputs and outcomes support the entity's response to and strategy for managing its significant climate-related risks and opportunities; and
(c) to evaluate the entity's ability to adapt its planning, business model and operations to significant climate-related risks and opportunities.

Scope

[3] The draft Standard applies to:
(a) climate-related risks the entity is exposed to, including but not restricted to:
(i) physical risks from climate change (physical risks); and
(ii) risks associated with the transition to a lower-carbon economy (transition risks); and
(b) climate-related opportunities available to the entity.

Strategy

[8] To achieve this objective, an entity shall disclose information about:
(a) the significant climate-related risks and opportunities that it reasonably expects could affect its business model, strategy and cash flows, its access to finance and its cost of capital, over the short, medium or long term (see paragraphs 9–11);
(b) the effects of significant climate-related risks and opportunities on its business model and value chain (see paragraph 12);
(c) the effects of significant climate-related risks and opportunities on its strategy and decision-making, including its transition plans (see paragraph 13);
(d) the effects of significant climate-related risks and opportunities on its financial position, financial performance and cash flows for the reporting period, and the anticipated effects over the short, medium and long term—including how climate-related risks and opportunities are included in the entity's financial planning (see paragraph 14); and
(e) the climate resilience of its strategy (including its business model) to significant physical risks and significant transition risks (see paragraph 15).

[9] An entity shall disclose information that enables users of general purpose financial reporting to understand the significant climate-related risks and opportunities that could reasonably be expected to affect the entity's business model, strategy and cash flows, its access to finance and its cost of capital, over the short, medium or long term. Specifically, the entity shall disclose:
(a) a description of significant climate-related risks and opportunities and the time horizon over which each could reasonably be expected to affect its business model, strategy and cash flows, its access to finance and its cost of capital, over the short, medium or long term.
…
[10] In identifying the significant climate-related risks and opportunities described in paragraph 9(a), an entity shall refer to the disclosure topics defined in the industry disclosure requirements (Appendix B).

HERBERT SMITH FREEHILLS

[12] An entity shall disclose information that enables users of general purpose financial reporting to understand its assessment of the current and anticipated effects of significant climate-related risks and opportunities on its business model. Specifically, an entity shall disclose:
(a) a description of the current and anticipated effects of significant climate-related risks and opportunities on its value chain; and
(b) a description of where in its value chain significant climate-related risks and opportunities are concentrated (for example, geographical areas, facilities or types of assets, inputs, outputs or distribution channels).

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[13] An entity shall disclose information that enables users of general purpose financial reporting to understand the effects of significant climate-related risks and opportunities on its strategy and decision-making, including its transition plans. Specifically, an entity shall disclose:
(a) how it is responding to significant climate-related risks and opportunities including how it plans to achieve any climate-related targets it has set. This shall include:
(i) information about current and anticipated changes to its business model, including:
about changes the entity is making in strategy and resource allocation to address the risks and opportunities identified in paragraph 12. Examples of these changes include resource allocations resulting from demand or supply changes, or from new business lines; resource allocations arising from business development through capital expenditures or additional expenditure on operations or research and development; and acquisitions and divestments. This information includes plans and critical assumptions for legacy assets, including strategies to manage carbon energy- and water-intensive operations, and to decommission carbon-energy- and water-intensive assets.
information about direct adaptation and mitigation efforts it is undertaking (for example, through changes in production processes, workforce adjustments, changes in materials used, product specifications or through introduction of efficiency measures).
information about indirect adaptation and mitigation efforts it is undertaking (for example, by working with customers and supply chains or use of procurement).
(ii) how these plans will be resourced.
(b) information regarding climate-related targets for these plans including:
…
(ii) the amount of the entity's emission target to be achieved through emission reductions within the entity's value chain:
(iii) the intended use of *carbon offsets* in achieving emissions targets. In explaining the intended use of carbon offsets the entity shall disclose information including:
the extent to which the targets rely on the use of carbon offsets;
whether the offsets will be subject to a third-party offset verification or certification scheme (certified carbon offset), and if so, which scheme, or schemes;
the type of carbon offset, including whether the offset will be nature-based or based on technological carbon removals and whether the amount intended to be achieved is through carbon removal or emission avoidance; and
any other significant factors necessary for users to understand the credibility and integrity of offsets intended to be used by the entity (for example, assumptions regarding the permanence of the carbon offset).

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[14] An entity shall disclose information that enables users of general purpose financial reporting to understand... the anticipated effect [of significant climate-related risks and opportunities on its financial position, financial performance and cash flows] … Specifically, an entity shall disclose:
…
(b) information about the climate-related risks and opportunities identified in paragraph 14(a) for which there is a significant risk that there will be a material adjustment to the carrying amounts of assets and liabilities reported in the financial statements within the next financial year;
(c) how it expects its financial position to change over time, given its strategy to address significant climate-related risks and opportunities, reflecting:
(i) its current and committed investment plans and their anticipated effects on its financial position (for example, capital expenditure, major acquisitions and divestments, joint ventures, business transformation, innovation, new business areas and asset retirements);
(ii) its planned sources of funding to implement its strategy;
(d) how it expects its financial performance to change over time, given its strategy to address significant climate-related risks and opportunities (for example, increased revenue from or costs of products and services aligned with a lower-carbon economy, consistent with the latest international agreement on climate change; physical damage to assets from climate events; and the costs of climate adaptation or mitigation); and
...

[15] An entity shall disclose information that enables users of general purpose financial reporting to understand the resilience of the entity's strategy (including its business model) to climate-related changes, developments or uncertainties—taking into consideration an entity's identified significant climate-related risks and opportunities and related uncertainties. The entity shall use climate-related scenario analysis to assess its climate resilience unless it is unable to do so. If an entity is unable to use climate-related scenario analysis, it shall use an alternative method or technique to assess its climate resilience. When providing quantitative information, an entity can disclose single amounts or a range. Specifically, the entity shall disclose:
(a) the results of the analysis of climate resilience, which shall enable users to understand:
(i) the implications, if any, of the entity's findings for its strategy, including how it would need to respond to the effects identified in paragraph 15(b)(i)(8) or 15(b)(ii)(6);
…
(iii) the entity's capacity to adjust or adapt its strategy and business model over the short, medium and long term to climate developments in terms of:
the availability of, and flexibility in, existing financial resources, including capital, to address climate-related risks, and/or to be redirected to take advantage of climate-related opportunities;
the ability to redeploy, repurpose, upgrade or decommission existing assets; and
the effect of current or planned investments in climate-related mitigation, adaptation or opportunities for climate resilience.

Metrics and targets

[20] To achieve this objective, [the objective of climate-related financial disclosures on metrics and targets] an entity shall disclose:
…
(d) targets set by the entity to mitigate or adapt to climate-related risks or maximise climate-related opportunities.

[21] An entity shall disclose information relevant to the cross-industry metric categories of:
…
(b) transition risks—the amount and percentage of assets or business activities vulnerable to transition risks;
(c) physical risks—the amount and percentage of assets or business activities vulnerable to physical risks;
(d) climate-related opportunities—the amount and percentage of assets or business activities aligned with climate-related opportunities;
(e) capital deployment—the amount of capital expenditure, financing or investment deployed towards climate-related risks and opportunities;
...

[23] An entity shall disclose its climate-related targets. For each climate-related target, an entity shall disclose:
(a) metrics used to assess progress towards reaching the target and achieving its strategic goals;
(b) the specific target the entity has set for addressing climate-related risks and opportunities;
(c) whether this target is an absolute target or an intensity target;
(d) the objective of the target (for example, mitigation, adaptation or conformance with sector or science-based initiatives);
(e) how the target compares with those created in the latest international agreement on climate change and whether it has been validated by a third party;
(f) whether the target was derived using a sectoral decarbonisation approach;
(g) the period over which the target applies;
(h) the base period from which progress is measured; and
(i) any milestones or interim targets.

Annexure B

Overview of liability issues from Australian implementation of ISSB-based mandatory climate reporting

Category	Current legal requirement	Examples of relevant ISSB disclosure	AICD comments
Misleading or deceptive conduct – future representations	**s 769C Corporations Act (CA), s 12BB ASIC Act and s 4 Australian Consumer Law (ACL):** a person who makes a representation as to a future matter without reasonable grounds is liable.	• Quantitative and qualitative disclosures on the anticipated changes to an entity's business model,[i] resource allocation[ii] and financial position and performance in the short, medium and long term[iii] given its strategy to address significant climate-related risks and opportunities.[iv] • Scenario analysis. • Transition plan and climate-related targets.	• Difficulty in establishing reasonable grounds given inherent uncertainties of subject matter of disclosures. • Lack of legislative guidance on what constitutes "reasonable grounds" in the climate change context. • Lack of legislative guidance on the extent to which directors can rely on s 189 CA. • **Liability risks hold back current reporting practices:** ▪ Only 18% of the ASX200 currently report on anticipated impacts of climate change risk[v] ▪ Only 21% of ASX200 undertook physical risk scenario analysis[vi] ▪ More than 50% of the ASX200 have not set absolute emissions reduction targets[vii]
Misleading or deceptive conduct	**S 1041H CA:** A person must not engage in conduct in relation to a financial product or service that is misleading or deceptive or is likely to mislead or deceive. **S 12DA ASIC Act:** A person must not, in trade or commerce, engage in conduct in relation to financial services that is misleading or deceptive or likely to mislead or deceptive. **S 18 ACL:** A person must not, in trade or commerce, engage in conduct that is misleading or deceptive or likely to mislead or deceive.	• Absolute Scope 3 upstream and downstream GHG emissions. • The percentage of executive remuneration linked to climate. • Internal carbon prices. • The amount and percentage of assets or business activities currently vulnerable to physical and transition risk and aligned with climate-related opportunities. • The amount of capital, financing or investment deployed towards climate related risks and opportunities.	• Strict liability test means directors can be liable even when making good faith, best endeavors disclosures based on inherently uncertain inputs and poor quality or unavailable data. • **Liability risks hold back current reporting practices:** ▪ Only 14% of the ASX200 undertake a comprehensive measurement of scope 3 emissions including operational, upstream and downstream scope 3 emissions, with 24% disclosing only operational scope 3 emissions. ▪ Only 33% of the ASX100 have climate related disclosures in their remuneration reports.[viii] ▪ Only 15% of ASX200 (29 out of 200) disclosed an internal carbon price. 27 of these were in the ASX100.

Periodic disclosure obligations	**S 297 CA:** Financial statements and notes must give a true and fair view of the company's financial position and performance. Directors must make a declaration to this effect (**s 295(4) CA**). **Ss 298 – 300B CA**: Directors' report to set out the likely developments of the entity's operations in future financial years and the expected results of those operations. Listed entities must provide information that shareholders would reasonably require to make an informed assessment of the business strategies and prospects for future years of the entity. Directors must sign off on the report (**s 298(2)**). Directors who fail to take all reasonable steps to comply with, or to secure compliance with disclosure requirements, including the directors' report, will be liable (**s 344 CA**).		• Lack of clarity as to whether the ISSB disclosures will form part of the Financial Reports and be subject to periodic disclosure requirements. • If part of periodic disclosure requirements - difficulty for directors to establish reasonable grounds meaning directors are reluctant or unable to sign off on Financial Reports, especially in the absence of reasonable assurance. • Lack of legislative guidance on the extent to which directors can rely on s 189 CA (Reliance on others).
Continuous disclosure obligations	**S 674(2) CA:** A listed company must immediately disclose to the ASX if it becomes aware of information concerning it where (1) the information is not publicly available; and (2) a reasonable person would expect that the information, if it were generally available, to have a material effect on the price or value of its ED securities.	Updated disclosures required for value chain disclosures when there is a significant event or change of circumstances. Updates also required for changes in estimation techniques or significant assumptions when disclosing emissions.	• Lack of clarity as to whether and/or when continuous disclosure obligations are triggered. • Higher liability threshold due to introduction of fault element could lead to incongruent legal outcomes.
Director's duties – care and diligence	**Duty of care and diligence (s 180(1) CA):** A director must exercise their powers and discharge their duties with the care and diligence that a reasonable person would exercise if they were a director or officer of the company. Business Judgment Rule (BJR) provides a defence but does not extend to "matters of compliance."	Potentially all ISSB disclosures could be used as the basis for an allegation that directors failed in their duty.	• Well-established that directors can be personally liable under s 180 CA for non-compliant market disclosures. • Business judgment rule (section 180(2)) has limited application in practice - will likely not apply to climate disclosures as a result of them being a "compliance matter" rather than a "commercial decision". • Lack of legislative guidance on the extent to which directors can rely on s 189 CA in the context of climate disclosures, including what directors must do to establish that they undertook an independent assessment of the information or advice.

[i] S2, paragraph 12(1)(a)
[ii] See paragraph 13(a)(i)(1).
[iii] S2, paragraph 14(c) and (d).
[iv] S2, paragraph 15.
[v] PwC, December 2022, 'ESG Reporting in Australia – Change afoot, but are companies ready?' Available at https://www.pwc.com.au/assurance/esg-reporting-in-australia-2022-v2.pdf at page 7.
[vi] Ibid at page 6.
[vii] Ibid at page 7.
[viii] AASB and AAUSB, December 2022, Climate-related disclosures and assurance in the Annual Reports of ASX-listed companies.' Available at: https://aasb.gov.au/media/xu5leeby/aasb-auasb_rr_climaterelateddisclosures_12-22.pdf at page 14.