QUT Digital Media Research Centre

Exposure Draft Legislation Submission

Climate-related Financial Disclosure: Exposure Draft Legislation | 9 February 2024

Imogen Forster, Lauren Bellamy, Professor Anna Huggins

School of Law/Digital Media Research Centre, Queensland University of Technology*

Overview

We thank the Treasury for the opportunity to make a submission in response to the climate-related financial disclosure exposure draft legislation and explanatory materials. Our submission addresses the alignment between the exposure draft legislation and the policy position statement, specifically focussing on the reporting content and liability framework. We welcome the opportunity to make comments on the standard of information for forward-looking statements about climate-related risks, scope 3 emissions liability, and the extent to which the legislation facilitates digital implementation and compliance.

We broadly support the exposure draft legislation, which will align Australia with the international position on climate-related financial disclosures. In particular, we support the current position incorporating modified liability for forward-looking statements within scope 3 emissions and scenario analysis, to allow industry to effectively develop their disclosures over the coming years with reduced liability exposure.

In relation to the reporting content and liability framework, we make the following points:

1. There is a need to clarify the standard of information required to be relied upon for forward-looking statements about climate-related risks, opportunities and forecasts. The ISSB's IFRS 2 standard and draft Australian Sustainability Reporting Standards provide a proportionality standard of 'reasonable and supportable information', which may operate in tension with the requirement in s 728(2) of the *Corporations Act 2001* (Cth) that forward-looking statements must be made on 'reasonable grounds'.
2. In relation to scope 3 emissions, as information is currently low quality and will require entities to rely on estimations for their calculations, additional clarity regarding the standard of information required for forward-looking statements incorporating scope 3 emissions is needed.
3. We reiterate the need to recall digital by design principles to inform the design of legislative and regulatory guidance materials for climate-related financial disclosures.

1. Forward-looking statements and the standard of information

When considering the broader landscape of this proposed legislation alongside the exposure draft Australian Accounting Standards Board ('AASB') standards and the International Sustainability Standards Board IFRS S2 Climate-related Disclosures ('IFRS S2') standards, there are concerns about the standard of information relied upon, specifically for forward-looking statements. Building on the requirements from IFRS S2, entities are required to use 'reasonable and supportable information that is available to the entity at the reporting date without undue cost or effort' to identify scope 3 emissions, as well as reporting on the anticipated financial effects of climate-related risks and opportunities that may affect the entity's prospects.[1] This IFRS S2 position has been incorporated into the draft AASB sustainability standards ('AASB ED SR1'),[2] and we note that inherent in these disclosures is the need to make forward-looking statements.

Forward-looking statements and forecasts under s 728(2) of the *Corporations Act 2001* (Cth) ('*Corporations Act*') must be based on 'reasonable grounds', otherwise they will be considered to be misleading. Forward-looking statements currently made under existing financial reporting are guided by ASIC and other regulatory guidance. For example, ASIC's regulatory guide 170 Prospective Financial Information clarifies factors that may indicate reasonable grounds. We are yet to see similar guidance established for forward-looking statements as they relate to climate-related risks and opportunities. More specifically, we are concerned about the interaction between the ISSB and the AASB ED SR1 standard that disclosure needs to be based on 'reasonable and supportable information that is available to the entity at the reporting date without undue cost or effort', and the standard under s 728(2) of the *Corporations Act* that statements must be made on 'reasonable grounds.'

We acknowledge the opinion of Sebastian Hartford-Davis and Kellie Dyon, who note that the requirement for forward-looking statements to be made on a reasonable basis is 'capable of being sensitive to the inherent uncertainties in the scope, distribution, impacts and timing of the impacts of climate change'.[3]

---

[1] International Sustainability Standards Board, *IFRS S2 Climate-Related Disclosures* (June 2023) ('IFRS S2') para 11.
[2] Australian Accounting Standards Board, 'Draft ED SR1 *Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information*' (Exposure Draft, 2023) ('AASB ED SR1') para 37, B6(a); IFRS S2 paras 18, 11.
[3] S.H. Hartford-Davis and K. Dyon, *Australian Council Of Superannuation Investors Limited Advice Regarding Potential Liability Of Directors Under The ISSB Draft Standards For Forward Looking Statements* (Opinion, 2022) <https://igcc.org.au/wp-content/uploads/2023/01/Advice-on-ISSB-Draft-Standards-Final.pdf>

We build upon this statement to further suggest that the concern lies with the two standards of information required to be relied upon by Australian entities, and specifically how directors can resolve any inconsistency that exists between them.

This inconsistency is noted within the AICD Guide for Directors, where it is identified that the ISSB's 'proportionality test' is not a legal test in Australia, and that it is unclear how the 'tension between the accepted level of uncertainty under the ISSB Standards, and the level of reliability required for financial statements will be reconciled in Australia'.[4] This tension may expose directors to the risk of claims that their forward-looking statements are misleading, if relying on information that is 'reasonable and supportable' does not qualify as 'reasonable grounds'. In this respect, we support the proposed modified liability for forward-looking statements. However, we believe that there is a need to clarify, or more precisely define, the relationship between the standard supported by the ISSB and AASB, and the legal test for 'reasonable grounds' under s 728(2) of the *Corporations Act.*

1. Potentially, the standard supported by the ISSB and AASB may have the same practical impact as what is required under the *Corporations Act*. In this case, we suggest this should be clarified within the legislation or the accompanying explanatory material. This may tie climate disclosures to an existing legal test of 'reasonableness' to provide greater certainty to disclosing entities.

2. If based on the policy intent, these standards may lead to different standards of information, we propose that further guidance should be issued for reporting entities to better understand their reporting obligations and better clarify the operation of disclosure requirements. This clarity is particularly important when directors could be subject to claims of making misleading statements after the modified liability period expires.

3. At a minimum, we propose that the regulator should update their guidance for forward-looking statements to provide specific guidance for climate-related forecasts during the period of modified liability. We make this recommendation as group 2 and 3 entities are subject to a much shorter period of liability protection for forward-looking statements and, therefore, may require additional support to make statements that comply with requirements under the *Corporations Act*.

---

[5].

[4] Australian Institute of Company Directors, 'A Director's Guide to Mandatory Climate Reporting' (2023) <https://www.aicd.com.au/risk-management/framework/climate/a-directors-guide-to-mandatory-climate-reporting.html>.

2. Standards of information for scope 3 emissions disclosures

We support the inclusion of scope 3 emissions into the phased-in approach to climate-related financial disclosures, which will allow modified liability (also known as limited immunity) for statements about scope 3 emissions.[5] However, we note that there is an inconsistency in the time frame for modified liability, with the policy position statement noting that liability is modified between 1 July 2025 and 30 June 2028, whereas the exposure draft legislation (at s 1705B) states that the modified liability period is between 1 July 2024 and 30 June 2027.[6] Thus, clarity is needed about the relevant time frame for limited immunity, as this may have a substantial impact on Group 3 entities which begin reporting in 2027. Furthermore, before the expiration of this modified liability period, guidance is required due to challenges surrounding the low quality of information available, which exposes entities to a risk of liability for misleading and deceptive conduct.

Guidelines for collecting information, and the methodology to quantify and report information from the Greenhouse Gas Protocol ('GHG Protocol'), including the additional guidance for scope 3 emissions, are useful for companies to develop their scope 3 emissions disclosures.[7] However, scope 3 emissions targets and emissions disclosures are still limited and variable in Australia.[8] The GHG Protocol identifies in their Corporate Value Chain (Scope 3) Accounting and Reporting Standard that in the initial years of disclosure, limited data availability may mean that companies may need to rely on low quality data.[9] Furthermore, building on IFRS S2, the AASB recognises that 'an entity's measurement of Scope 3 greenhouse gas emissions is likely to include the use of estimation rather than solely comprising direct measurement'.[10] Thus, we suggest that a lack of available high-quality information may raise challenges for directors when attempting to disclose scope 3 emissions once the limited immunity period expires.

Issues can arise in relation to the standard of information received from entities along the value chain. Firstly, Group 1 entities will need to begin reporting on scope 3 emissions before or as organisations in

---

[5] https://treasury.gov.au/sites/default/files/2024-01/c2024-466491-policy-smt.pdf p.4.
[6] https://treasury.gov.au/sites/default/files/2024-01/c2024-466491-leg.pdf.
[7] Greenhouse Gas Protocol, 'Corporate Value Chain (Scope 3) Accounting and Reporting Standard' (2001) <https://ghgprotocol.org/sites/default/files/standards/Corporate-Value-Chain-Accounting-Reporing-Standard_041613_2.pdf>.
[8] Anita Foerster and Michael Spencer, 'Corporate Net Zero Pledges: A Triumph of Private Climate Regulation or more Greenwash?' (2023) 32(1) *Griffith Law Review* 110, 132.
[9] Greenhouse Gas Protocol (n 7) 84.
[10] AASB ED SR1 (n 2) B38.

later groups are required to start making disclosures. This may mean that there is variable quality of information for Group 1 entities to rely on to make calculations surrounding their scope 3 emissions. Secondly, scope 3 emissions may be difficult to verify sufficiently so that directors can be confident that the disclosure will not be misleading. For example, information in the value chain may come from organisations that are not subject to mandatory reporting, as well as organisations that are overseas and not subject to the same reporting standards. Furthermore, the use of general information, particularly information about downstream emissions (e.g., from consumers and users) may pose challenges for verification. Lastly, as noted above, there is a significant degree of estimation involved in scope 3 emissions calculations, and directors therefore risk exposing themselves to claims of misleading and deceptive conduct if they make disclosures, and the information they reported leads to calculations that do not provide a true picture of emissions.

In identifying scope 3 emissions, the IFRS S2 states that 'to determine the scope of the value chain, which includes its breadth and composition, an entity shall use all reasonable and supportable information that is available to the entity at the reporting date without undue cost or effort'.[11] This position has similarly been adopted in the proposed AASB ED SR1 under B39, and is reflected in the policy position statement, which requires scope 3 disclosures to be based on 'information that is available at the reporting date without undue cost or effort'.[12] However, section 189 of the *Corporations Act* suggests that a director's reliance on information will be 'taken to be reasonable' only if it was made in good faith and after 'making an independent assessment of the information'.[13] The ability to make independent assessments of the information may be difficult to achieve in this context, as the quality of disclosures is likely to be low for some time and estimations are frequently relied upon. Thus, there may be disparity between the information that can be relied upon under the *Corporations Act* and the IFRS S2/AASB ED SR1.

Thus, whilst the IFRS S2 and AASB standards may provide some flexibility for organisations to use the information they have available to them to assess and measure emissions in their value chain, the implications of making estimates and relying on low quality data raises concerns. This reliance may put directors at risk for making misleading and deceptive statements, as it is difficult to make independent assessments of the information under s 189 of the *Corporations Act*. As alluded to above, despite the modified liability period buying some time for organisations to make disclosures without the risk of

[11] IFRS S2 (n 1) B36.
[12] Ibid B38.
[13] *Corporations Act 2001* (Cth) s 189.

misleading and deceptive conduct liability in relation to scope 3 emissions, this may be insufficient for Group 2 and 3 entities.

Group 2 entities may only experience one year of modified liability, and Group 3 may not be subject to modified liability, if the limited immunity period expires on 30 June 2027. Furthermore, there is no guarantee that the abovementioned issues about data quality will be resolved after the three-year period, and thus directors may be exposed to liability for these disclosures. We suggest that exposing directors to a perceived risk of liability may create further issues for thorough identification and disclosure of scope 3 emissions, as directors may be hesitant to make full and meaningful disclosures unless the information has been assured. This lack of disclosure may influence the quality of information available to entities (as discussed above), meaning that the time frame for effective scope 3 emissions disclosure is pushed further into the future.

One option to address this concern is to provide extended modified liability so all three disclosing groups are given the three-year time frame to adopt scope 3 emissions disclosures. An alternative approach to respond to these challenges is to extend the modified liability period until there is capacity in the market to provide full assurance on this information. We are of the view that more thorough disclosure will better align with the policy aims of the proposed legislative reform, as compared to narrowed down disclosures for fear of liability. However, we acknowledge that extended modified liability does not solve the issue regarding disclosure by international entities or entities who are not subject to mandatory disclosure, as these may never reach the same standard of disclosures as reporting entities in Australia. Additionally, modified liability has the capacity to remove checks and balances surrounding the accuracy of information included in disclosures, despite information improving in quality over time. Thus, if extended modified liability is not adopted, we suggest that at the least, greater guidance should be provided about the quality of information that should be used in scope 3 emissions accounting. This is especially important if, as noted above, the standard of 'reasonable and supportable' is not comparable to existing legal tests in Australia.

Scope 3 emissions and forward-looking statements

Furthermore, it is unclear how scope 3 emissions will contribute to forward-looking projections and risk disclosures. It is possible that scope 3 emissions will be relied on to make some required forward-looking statements. If low quality information is relied upon to make a forward-looking statement, it is important to consider whether it will meet the requisite standard of 'reasonable grounds' as discussed in our first point above. We note that this may generate liability risks and discourage directors from making projections that incorporate scope 3 emissions data, thus narrowing the breadth of forward-looking disclosures. This result could undermine the policy aims where transparent and useful disclosures are the priority.

Therefore, along with our above proposals, we believe it is important to clarify the standard of information required for making forward-looking statements when scope 3 emissions are being incorporated. It should be clear whether the preferred approach is the 'reasonable grounds' standard under the *Corporations Act*, or if the AASB ED SR1/ IFRS standard needs to be differentiated as a unique test. Alternatively, if the standards are intended to have the same effect, this should be clarified. This is of particular importance in this context of scope 3 emissions, which may be uncertain and rely on estimates for the initial years of collection.

3. The Importance of Digital by Design Principles for Regulatory Design

We refer to our previous submission on 17 February 2023, in which we highlighted the importance of incorporating 'digital by design' ('DBD') principles into the regulatory framework. As previously noted, despite rapid digital transformation over the past few decades, the cost of administering and complying with regulatory requirements continues to place a significant burden on Australian businesses.[14] This burden is particularly pertinent to small and medium sized entities which have less capacity to ensure effective compliance with complex regulation (i.e., Group 2 and 3 entities). Thus, whilst we support the introduction of legislation mandating climate-related financial disclosure, we note the importance of ensuring that the broader regulatory environment incorporates DBD principles, to reduce compliance burdens and promote the flexible and scalable digital implementation of climate-related financial disclosure obligations.

A DBD approach to climate-related financial disclosure could take various forms, and we emphasise that it is a method of regulatory design rather than a coded output. DBD involves a consideration of digitisation from the beginning of the policymaking cycle, and is intended to allow entities to easily digitise and automate their disclosure obligations. We suggest that there should be a particular focus on incorporating DBD principles into prescriptive regulatory standards and guidance for climate-related financial

[14] See, for example, Deloitte, *Get out of Your Own Way: Unleashing Productivity* (Report No. 4, 2014) <https://www2.deloitte.com/au/en/pages/building-lucky-country/articles/get-out-of-your-own-way.html>.

disclosure, including the draft AASB standards. Furthermore, we reiterate three key DBD principles, which we suggest are of particular relevance to the design of regulation and guidance material in this space, namely:

1. Focus on reusing existing concepts and data to allow for interoperability and consistency across policies;
2. Incorporate multidisciplinary teams into the design process to keep pace with the evolving IT landscape and ensure a range of expertise and perspectives are captured; and
3. Draft clear rules in concise, simple and precise language, where appropriate, to allow for digitisation in the more limited vocabulary of computer code.[15]

We hope that our submission assists the Treasury. For further information, please contact Professor Anna Huggins at a.huggins@qut.edu.au.

* About QUT's Digital Media Research Centre

The Digital Media Research Centre ('DMRC') at the Queensland University of Technology is a leading research centre in digital humanities and social science research with a focus on communication, media, and the law. This submission is based on research supported by the Australian Research Council project entitled 'Optimising Digital Compliance Processes in the Financial Services Sector' (project LP210301088).

[15] Monica Palmirani et al, *Legal Drafting in the Era of Artificial Intelligence and Digitisation* (Report, 2022) 96, 63.