Wildflower on Oak Creek by Remy Taylor

BREAKING NEW GROUND:

ASX50 SUSTAINABILITY REPORTING AND GOVERNANCE IN 2023

June 2024

KING & WOOD MALLESONS
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INTRODUCTION

With mandatory climate reporting imminent, the contents of this publication are poised to become business-critical to more of corporate Australia than ever before.

Mandatory climate reporting has loomed since we released the first of these reports, looking at reporting back in 2020. Now, it's set to be incorporated into the heart of the Corporations Act, capturing a broad range of entities and requiring far more detail than we could have then foreseen.

Our previous reports on best practice amongst the ASX50[1] have tracked the key developments which have led to this point, highlighted emerging trends and provided valuable tips on preparing for the dual regulatory storm of mandatory climate reporting and greenwashing enforcement action.

This report builds on our cumulative knowledge, continuing to arm you with information on best practice and the latest developments, with a focus on how those supporting boards can help them to not only avoid greenwashing, but also clearly communicate the information required as part of mandatory reporting.

'With the real-world impacts of climate change becoming evident at a pace faster than initially predicted, it is encouraging to see such a high proportion of the ASX50 embracing dedicated climate disclosures, not least because it will soon become mandatory.

While the detail required of climate disclosures can appear daunting, ultimately, the preparation of climate disclosures will aid companies to better understand their risks and opportunities, aid decision making and strategic planning, and attract new investors by preparing credible strategies for ensuring long-term business resilience.'

MICHAEL MAZENGARB
SENIOR CLIMATE ADVISER, OWL ADVISORY BY KWM

1 Entities in the S&P/ASX 50 Index as of 22 November 2023 (ASX50). Although year-on-year comparisons have been used in this report, the report does not necessarily provide a direct entity-for-entity comparison due to, for example, movements in the composition of the ASX50 between calendar year 2022 and calendar year 2023. All figures have been rounded to the nearest whole number. In preparing this report, we have relied on public disclosures of, and relating to, the ASX50 and have not independently verified those disclosures.

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1 REPORTING TRENDS AND MANDATORY CLIMATE REPORTING DEVELOPMENTS

1.1 Reporting trends

OVER 90% TCFD THE NORM

Almost all of the ASX50 (over 90%) reported in accordance with the TCFD recommendations or confirmed that they are in the process of aligning their reporting with the TCFD recommendations. That compares to nearly 75% of entities in the S&P/ ASX 200 Index reporting or committing to the TCFD recommendations.[2]

While the TCFD has now fulfilled its remit and disbanded, mandatory climate reporting is expected to be based on the TCFD recommendations (which have formed the basis of the international sustainability standards). So practically these percentages will grow with mandatory climate reporting.

OVER 80% SEPARATE SUSTAINABILITY REPORTS

Of those that prepared TCFD disclosures, most (over 80%) included those disclosures in a separate climate/sustainability report. Over half of the ASX50 (66%) disclosed climate-related risk factors in their operating and financial review in their annual report.

Mandatory climate reporting is expected to require disclosures in a 'sustainability report', which may form part of an annual report or be a separate report (with appropriate cross-referencing).

OVER 76% SCENARIO ANALYSIS

More than three quarters of the ASX50 (76%) disclose scenario analysis. Of those, roughly half disclose against 3 scenarios, with the remainder disclosing against 2, 4, 6 or, in one case, 8, scenarios. Most disclose against a 1.5°C scenario, with the remainder including a 2°C or below scenario.

Mandatory climate reporting is expected to require disclosures against at least 2 relevant possible future states, one being a global temperature goal of 1.5°C above pre-industrial levels.

58% NATURE RELATED DISCLOSURES

More than half of the ASX50 (58%) are aligning with the TNFD recommendations, with a number having indicated they will adopt the TNFD recommendations for FY2024.

It is expected the mandatory climate reporting regime will give the Minister power to require disclosure of statements relating to financial matters concerning environmental sustainability more broadly (i.e., not just relating to climate).

Despite the concerns raised on this discretionary power in submissions on the mandatory climate reporting bill, the senate economics legislation committee considered it 'appropriate to give the Minister flexibility to ensure that Australia can continue to align with international standards as they develop.' The international standard setters are looking next at nature/biodiversity, and human capital.

2 ACSI, Promises, Pathways & Performance: Climate Change Disclosure in the ASX200 (August 2023), p4.

1.2 Mandatory climate reporting developments

The legal framework for the Australian mandatory climate reporting regime is nearly finalised, with the earliest start date now scheduled for 1 January 2025.

- **June 2023** — Treasury's second consultation paper on mandatory climate reporting released
- **October 2023** — Exposure draft Australian sustainability reporting standards released
- **January 2024** — Exposure draft mandatory climate reporting legislation released
- **20 March 2024** — AUASB consultation paper on assurance over climate and other sustainability information released (subsequently re-released with minor amendments on 4 April)
- **27 March 2024** — Bill proposing to introduce mandatory climate reporting (Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024) (Bill) introduced into Parliament
- **3 May 2024** — The Senate Economics Legislation Committee recommended the Bill be passed in its current form
- **1 January 2025** — Earliest start date for mandatory climate reporting, if the legislation comes into effect on or before 2 December 2024

While there is broad support for the Bill,[3] there have been concerns over the possible short timeframe between the finalisation of the Australian sustainability reporting standards (which is unlikely to occur before August 2024) and the proposed 1 January 2025 commencement date.[4] Additionally, Coalition Senators have issued a dissenting report recommending changes to several provisions of the Bill and amendments have been proposed by the crossbench to reduce or remove the limited immunity. It is possible this could result in a delay to the adoption of the Bill and accordingly, the start date of the proposed regime.

We've prepared a handy explainer on key elements of the Bill, including which entities are in scope. See also sections 2.2 and 2.3 for tips on preparing for the director declarations that will be required as part of mandatory climate reporting.

3 The Senate Economics Legislation Committee, Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024 [Provisions] Report – May 2024, paragraph 1.4.
4 As above, paragraphs 2.34 and 2.35.

2 GOVERNANCE TRENDS AND DIRECTOR PREPAREDNESS

2.1 Governance trends

‘The objective of climate-related financial disclosures on governance is to enable users of general purpose financial reports to understand the governance processes, controls and procedures an entity uses to monitor, manage and oversee climate-related risks and opportunities.’

EXPOSURE DRAFT AUSTRALIAN SUSTAINABILITY REPORTING STANDARDS (ARSR 1, PARAGRAPH 26)

82% REFLECT ESG RESPONSIBILITY IN CHARTERS

82% of the ASX50 refer to ESG responsibilities in their board or board committee charters (a significant increase of 16% from last year).

This is unsurprising given mandatory climate reporting is expected to require entities to disclose how climate-related responsibilities are reflected in charters and other related policies/documents.

NEARLY 50% SUSTAINABILITY EXECUTIVES

Nearly half of the ASX50 have now appointed a senior executive responsible for sustainability matters (up from almost a third last year).

That makes sense given mandatory climate reporting is expected to require disclosure of management’s role in the governance process, including whether that role is delegated to a specific management-level position or committee.

And it’s notwithstanding that accountability regimes such as the Financial Accountability Regime don’t yet include sustainability as a responsibility that must be undertaken by a senior executive.

36% ESG BOARD COMMITTEES

36% of the ASX50 have an environment/ sustainability board committee, sometimes combined with other matters such as health and safety, which is separate to their audit and/or risk committee (roughly consistent with last year).

Mandatory climate reporting is not expected to require particular governance structures to be set up, but the requirement to disclose information about the governance body(s) responsible may see some entities reconsidering their structures.

Prudential requirements don’t currently mandate a standalone sustainability board committee (or equivalent). Further, it’s not recommended under the ASX Corporate Governance Council’s Corporate Governance Principles and Recommendations. The draft 5th edition of those Principles and Recommendations also don’t mandate or recommend such committees although there’s explicit acknowledgement in the consultation draft that such a committee can have a role in climate, sustainability and related reporting. We expect there’ll be a growing trend for more companies to consider establishing such a committee, particularly with increasing nature reporting as flagged above and potentially increasing social reporting with the Task Force on Inequality-related Financial Disclosures.

78% LINK EXECUTIVE REMUNERATION

78% of the ASX50 link executive remuneration to climate or sustainability performance (similar to last year, which was a significant increase on 46% in 2021 and 40% in 2020). In some cases the relevant key performance indicators (KPIs) relate to delivery of the company’s sustainability strategies, while others link directly to emissions reduction.

This makes sense, given mandatory climate reporting is expected to require disclosure of how climate-related considerations are factored into remuneration of key management personnel, including the percentage of remuneration linked to climate-related considerations. That’s notwithstanding concerns raised about duplicating remuneration reporting requirements already in Australian law.

The little guidance available from proxy advisers seems to support including ESG KPIs to supplement financial KPIs.[5]

82% SUPPLIER EXPECTATIONS

82% of the ASX50 include some form of requirement or expectation relating to climate in their supplier code of conduct (or similar document).

Again, that’s unsurprising given mandatory climate reporting is expected to require disclosure of greenhouse gas emissions that are a consequence of the activities of the entity, but occur at sources owned or controlled by other entities in the value chain, including suppliers (i.e. scope 3 emissions).

Interestingly, Peter Dutton recently suggested in his budget reply speech that the opposition would wind back scope 3 reporting. That would be consistent with the approach taken in the US, which does not require scope 3 reporting.

The rationale for requiring scope 3 reporting is that they are emissions that are a consequence of the entity’s emissions, so even though they don’t own or control the sources that give rise to them, they can influence them.

OVER 66% INDEPENDENT ASSURANCE

Over two thirds of the ASX50 now obtain independent assurance on aspects of their climate reporting (up from just over half last year).

Mandatory climate reporting will initially require sustainability reports to be reviewed or audited to the extent required by auditing standards. Those standards are expected to require a greater level and extent of assurance over time. Under the Bill, full audits will be required for financial years commencing on or after 1 July 2030.

5 See the Australian Council of Superannuation Investors Limited Governance Guide at p18.

2.2 Director declarations on mandatory climate reporting

The phased declaration

The proposed mandatory climate reporting regime requires directors to make a declaration on the entity's sustainability report. In particular, directors will need to:

- **for a 3 year transition period:** declare whether, in their opinion, the entity has taken reasonable steps to ensure the sustainability report complies with the Corporations Act; and
- **following the transition period:** declare whether, in their opinion, the sustainability report is in accordance with the Corporations Act, which is a higher standard.

The 3 year transition period aligns with the 3 year 'limited immunity' expected to apply to statements about scope 3 emissions, scenario analysis and transition plans. During that time, only criminal proceedings or proceedings brought by ASIC will be able to be brought. See further our explainer on key elements of the Bill.

Reason for phasing

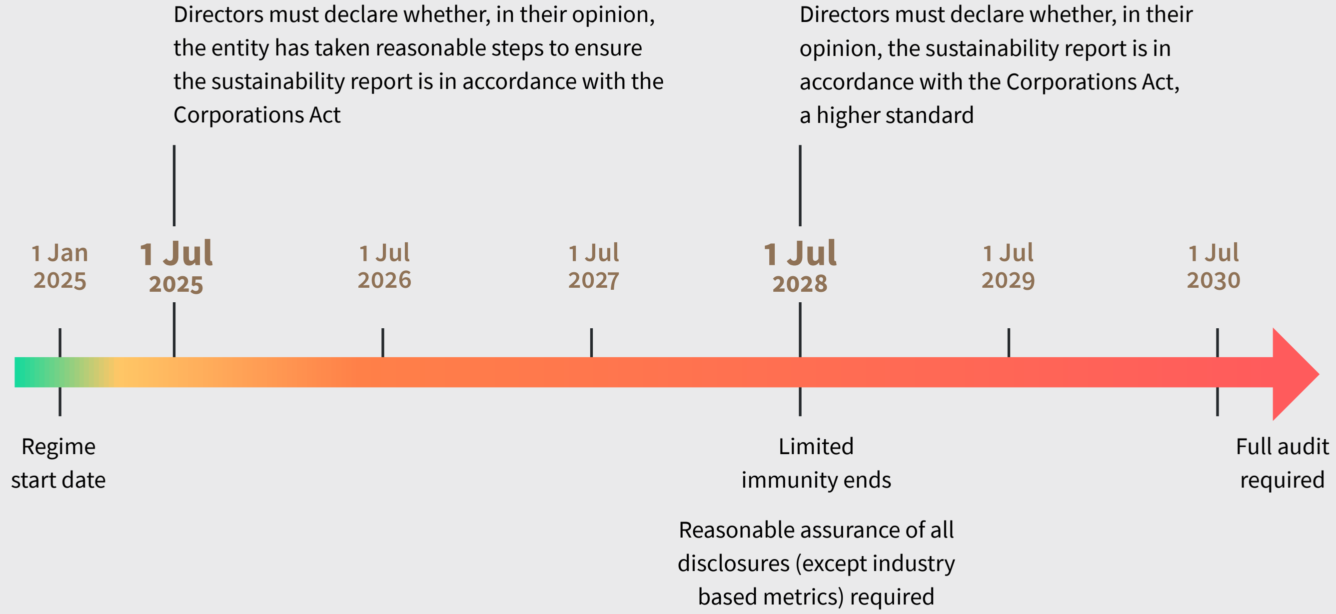
The proposed regime currently does not require CFO and CEO declarations in support of the directors' declaration (as is required for the financial reports of listed entities under the Corporations Act and recommended in the current ASX Corporate Governance Council's Corporate Governance Principles and Recommendations).

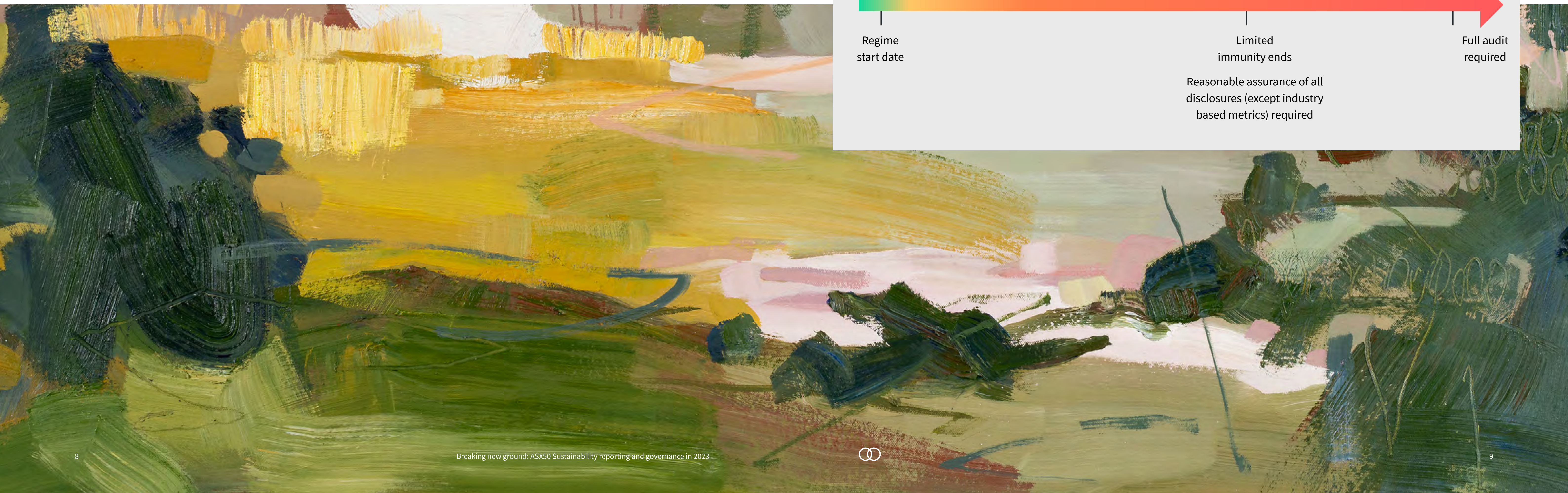
It also tasks the Australian Auditing and Assurance Standards Board (AUASB) with developing the auditing standards that will specify the extent to which the sustainability report must be assured until financial years commencing on or after 1 July 2030. After this date, a full audit will be needed, as noted above. The AUASB's policy position is to develop assurance standards in line with the International Auditing and Assurance Standards Board (which are expected to be finalised in September 2024). In the meantime, the AUASB has been consulting on possible phasing in of assurance requirements, commencing with limited assurance of scope 1 and 2 emissions in the first reporting year and moving to reasonable assurance of all disclosures (except industry-based metrics) by an entity's fourth reporting year.

A number of submissions on the proposed regime have argued that the above factors may expose non-expert directors to material risks and give rise to a fairness issue whereby these directors will have personal responsibility for the contents of mandatory sustainability reports for which no expert review, independent or otherwise, is required. We expect this is why the lower standard for directors' declarations has been introduced for the 3 year transition period.

Timeline for director declarations

The diagram below illustrates the directors' declaration requirements for relevant financial years for an entity required to report from the commencement of mandatory climate reporting. It assumes a 30 June financial year end, that the regime commences on 1 January 2025 and that the assurance phasing model in the AUASB's consultation paper is adopted.





2.3 Tips for avoiding greenwashing and supporting boards to make the declarations required for mandatory climate reporting

1 Ensure appropriately senior/skilled input, and contribution from all relevant teams (e.g. sustainability/finance/legal/comms/etc), in preparing and verifying sustainability reports. This is important to ensure disclosures are accurate and demonstrate reasonable steps have been taken, which could help in the event of any enforcement action. In case you missed it, we elaborated on this further in last year's report.

2 Ensure a greenwashing review of reporting (and marketing) materials is undertaken before they are published, having regard to recent ASIC and ACCC guidance, and cases before the courts. This is to ensure disclosures don't fall foul of 'hot button' issues and take into account key areas of focus for regulators and the courts.

Use (without clarification) at your own risk!	Omit at your own risk!
'Net zero', 'carbon neutral' 'clean', 'green', 'sustainable' **and other vague terms**	Key assumptions
Visual elements **(e.g. logos, trust marks, green-coloured packaging)**	Use of offsets
	Metric limitations
	Claim conditions and qualifications
	Material sustainability-related information **(i.e. 'greenhushing')**

3 Ensure appropriate procedures are in place for judgment calls made for the purpose of the sustainability reporting standards, including appropriate escalation processes so that a sufficiently senior body is making the decision with appropriate information and comfort provided.

4 Confirm there continue to be reasonable grounds supporting targets, and ensure appropriate processes are in place for all forward-looking statements.

This includes regularly reassessing targets and the assumptions on which they are based, with appropriate internal reporting (i.e. not a 'set and forget' approach). It's particularly important this is done before statements are repeated or reaffirmed, and where events (such as a major transaction) has occurred which may have an impact on a previously published target.

5 Consider other protections such as limiting the use of 'absolute' statements, footnoting source documents where you are relying on third party information/opinions, including assumptions/limitations/qualifications where relevant, and using an appropriately worded and prominent disclaimer.

6 Front-load preparation for mandatory reporting now, while there's time to set up efficient and effective processes and systems.

3 TARGETS

The objective of climate-related financial disclosures on metrics and targets is to enable users of general purpose financial reports to understand an entity's performance in relation to its climate-related risks and opportunities, including progress towards any targets the entity has set, and any targets it is required to meet by law or regulation.

EXPOSURE DRAFT AUSTRALIAN SUSTAINABILITY REPORTING STANDARDS (ARSR 1, PARAGRAPH 45)

96% EMISSIONS REDUCTION TARGETS

Almost all of the ASX50 (96%) have set long term emissions reduction targets. 90% have set a net zero target (an increase of 12% from last year) and one entity has a net positive target.

Consistent with last year, about two thirds of net zero targets have a 2050 deadline (including the net positive target) and almost all of the rest have an earlier deadline.

Most of the ASX50 (76%) have set interim targets, generally for between 2025 and 2035.

Mandatory climate reporting isn't expected to require entities to set emissions reduction targets where they aren't otherwise required to. However where targets have been set, it is expected detailed disclosures in relation to those targets will be required, including any milestones and interim targets, and how the Paris Agreement, and Australian commitments arising from it, have informed the target.

OVER 82% DISCLOSE PROGRESS TOWARDS TARGETS

The vast majority of the ASX50 (over 82%) report their progress against previously set targets (an increase from 64% from the previous year).

We expect this will also increase with mandatory climate reporting, which is expected to require detailed disclosure of an entity's progress towards any targets it has set, including the metrics used to monitor progress towards reaching the target and an analysis of trends or changes in the entity's performance against its targets.

OVER 50% INCLUDE SCOPE 3 EMISSIONS

Just over half of the ASX50 include scope 3 emissions in their reduction and net zero targets. Of those that don't, 86% provided comments on a path forward in respect of mapping or reducing scope 3 emissions.

Where entities have set targets, mandatory climate reporting is expected to require disclosure of which scopes are covered by those targets. It isn't expected to require targets to include scope 3 emissions.

76% DISCLOSE OFFSETS

76% of the ASX50 include disclosure on offsets, and how they will rely on them to achieve their climate-related targets, up from about 66% last year.

We expect this will increase with mandatory climate reporting, which is expected to require detailed disclosure of an entity's planned use of carbon credits to offset emissions to achieve net emissions targets.

58% DISCLOSING ASSUMPTIONS

58% of the ASX50 disclose that their targets are subject to assumptions (e.g. relating to technology) or qualifications (an increase from 50% last year).

We expect this will continue to increase, with ASIC guidance reiterating the importance of clearly explaining any assumptions relied on when setting targets, or measuring progress.

Mandatory climate reporting is expected to require entities to disclose key assumptions used in developing their transition plan, including their targets, and dependencies on which the plan relies, as well as assumptions regarding the permanence of carbon credits used to achieve net emissions targets.

36% SCIENCE-BASED TARGETS

The number of ASX50 entities that have set targets, or committed to setting targets, in line with the Science Based Target's Initiative (SBTi) (36%) has almost doubled in the last year. Nearly two thirds of those ASX50 entities have also committed to setting science-based net zero targets.

Mandatory climate reporting isn't expected to require targets to be validated by third parties. However it is expected to require entities that have set targets to disclose whether they have been validated by a third party, such as the SBTi.

OVER 50% NATURE-RELATED TARGETS

Over half of the ASX50 have set nature-related targets. Many of these relate to waste and water management, while others relate more broadly to having a net zero or net positive impact on biodiversity, rehabilitation and land and water stewardship.

We expect the number of entities setting nature targets, and breadth of targets set, may increase in correlation with the increase in adoption of the TNFD recommendations.

4 GREENWASHING DEVELOPMENTS

Greenwashing (aka misleading and deceptive conduct in relation to ESG matters) remains an enforcement priority of both ASIC and ACCC:

ASIC

July 2023

ASIC launches court proceedings against an investment manager for alleged greenwashing in relation to claims made about certain ESG exclusionary screens applied to investments in the fund

August 2023

ASIC commences court proceedings against a superfund for alleged greenwashing in relation to claims made that it was an ethical and responsible superfund

November 2023

ASIC announces that greenwashing continues to be an enforcement priority in 2024

March 2024

ASIC wins its first greenwashing case (being the case launched in July 2023 against the investment manager)

May 2024

ASIC confirms it has been active when it comes to greenwashing, having issued in total 17 infringement notices, totalling more than $230,000, won its first greenwashing civil penalty action (as mentioned), with two civil penalty proceedings underway in the Federal Court

ACCC

November 2023

ACCC accepts court-enforceable undertaking from a food manufacturer following an investigation into its '100% ocean plastic' representations

December 2023

ACCC publishes guidance on environmental and sustainability claims

March 2024

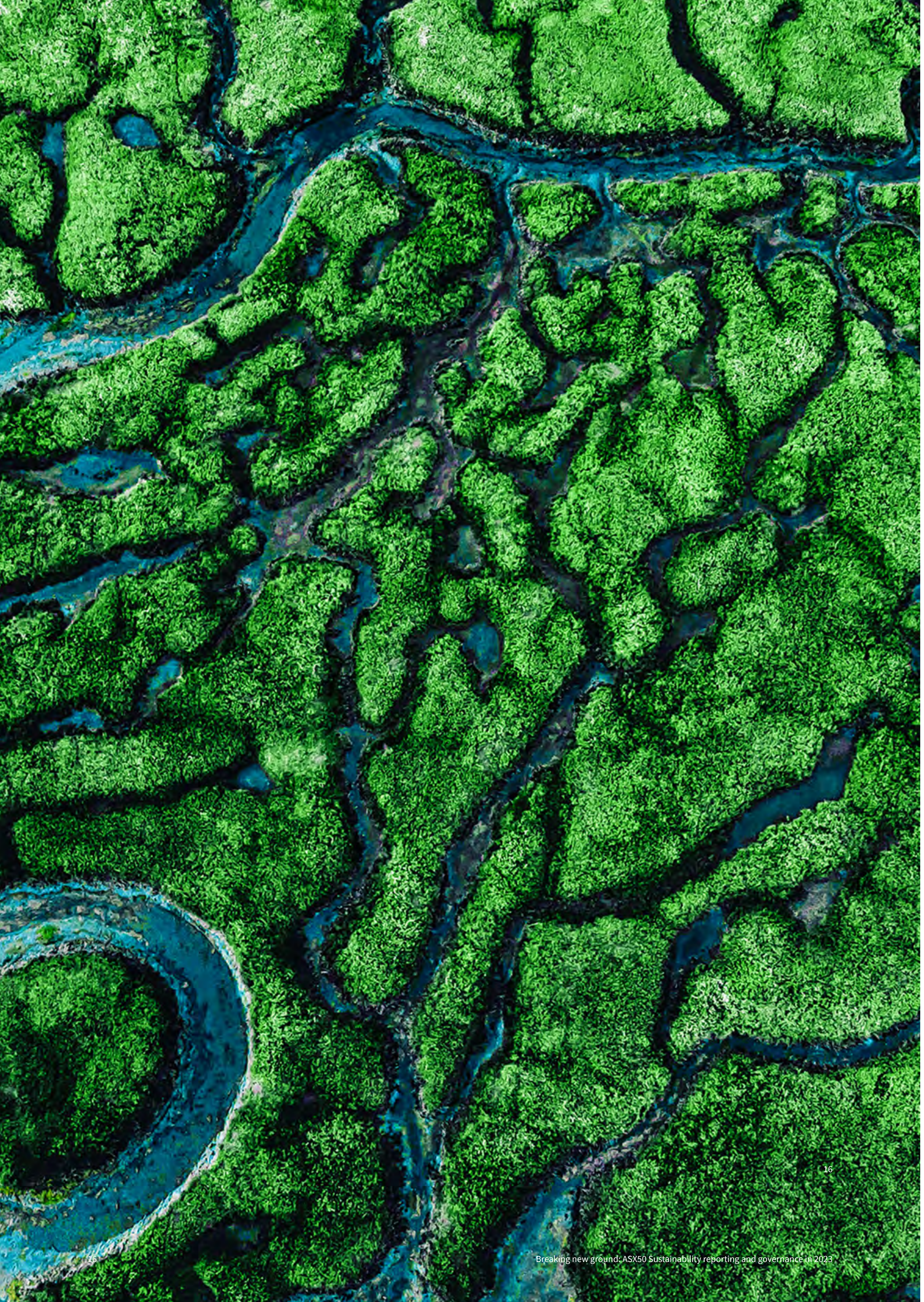
ACCC indicates that greenwashing will continue to be an enforcement priority in the coming years

Meanwhile:

- the Commonwealth Government is consulting on major changes to its 'Climate Active' carbon neutral certification scheme – to scrap the 'carbon neutral' language, tighten the use of offsets and require gross emissions reductions targets aligned with Australia's nationally determined contributions; and
- private actions for greenwashing brought by shareholder advocacy and environmental activists continue.

5 STAKEHOLDER ACTIVISM TRENDS

- Climate remains a hot topic for stakeholders, with one ASX50 entity holding as many as 110 meetings a year with stakeholders to discuss their climate reports.
- Climate issues often come to the fore at AGMs, with votes against director re-elections, votes against climate strategies, and physical protests at AGMs then also prominently reported in the media. In 2023 we observed less entities targeted, but those that were saw greater support for protest votes. In this regard, as we reported in our annual Deep dive into ASX200 AGMs, we observed less shareholder-requisitioned climate resolutions in 2023, but higher average support votes for them.
- It continues to be the case that questions on climate/ESG matters took up a significant portion of time at some AGMs, covering topics like renewable energy, environmental damage, links between executive remuneration and ESG measures, investments in fossil fuel projects, how the entity is tracking in preparation for mandatory climate reporting, adequacy of climate transition plans/commitments, financial risks from climate change, etc.



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WE ARE VERY GRATEFUL TO:

Steven Su, Gemma Chris, Linda Le, Tiffany Chan, Rhian Mordaunt, Lucy AB Johnson and our seasonal clerks for their help in preparing this report.

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