

An aerial photograph of a dense urban landscape, likely New York City, showing a multitude of skyscrapers and buildings. A semi-transparent white rectangular box is overlaid on the left side of the image, containing the main text. In the top-left corner of the image, there is a solid red square.

Are your finance & governance teams ready?

Responding to
heightened expectations
on climate risk assurance
& disclosure



'Climate change is a foreseeable risk facing many listed companies ... in a range of different industries. Directors and officers ... need to understand and continually reassess existing and emerging risks (including climate risk) that may affect the company's business – for better or for worse.'

ASIC Commissioner John Price, September 2018



The situation

As we charge deeper into FY20, financial report preparers are grappling with new expectations concerning the disclosure of financial impacts associated with climate change.

Climate change as rapidly mainstreamed as a financial risk issue in Australia, driven by institutional investors and market regulators. Corporations now have little option but to apply the governance, strategy, risk metrics and disclosure framework set out in the 2017 Recommendations of the Bloomberg Taskforce on Climate-related Financial Disclosures (TCFD) in their narrative disclosures, following updated Regulatory Guidance from the Australian Securities & Investments Commission (ASIC). Financial statements are also likely to be the subject of increased scrutiny, following the release of a joint bulletin by the Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board's (AuASB) on the relevance of climate risk assumptions to accounting estimates.

As a consequence, report preparers, assurers and auditors must approach climate change-related issues with the same degree of rigour as any other financial variable. A failure to do so may leave corporations and their directors increasingly exposed to claims for breach of duty and/or misleading disclosure under the Corporations Act.



The problem

Finance and governance professionals may feel they lack capacity on climate-related financial risks, and are ill-prepared to deal with this issue in the assurance process. As climate-related financial risk reporting moves swiftly into the audit mainstream, how can you prepare?



The way forward ...

In this primer, MinterEllison's Climate Risk Governance team set out a number of recent developments relevant to financial report preparation that are critical to the provision of a true and fair view of financial position, performance and prospects, and to the management of misleading disclosure risks under the Corporations Act.

BACKGROUND

Climate change as a key governance and disclosure issue

Leading market stakeholders – from large institutional investors, to credit ratings agencies and prudential regulators – now recognise climate change as a significant economic and financial risk (and opportunity) over both the long- and shorter-term. Such risks and opportunities arise not only from the physical or ecological impacts of climate change, but associated economic transition risks (such as capital market dynamics, including technological developments, and shifting investor, insurer and customer views), and litigation exposures (both regulatory and private).

Transition to net zero emissions

The catalyst for this evolution in mainstream market concern is often attributed to the Paris Agreement (2015). That Agreement commits 196 signatory countries to:

- limiting the 'increase in the global average temperature to well below 2°C above pre-industrial levels';
- shifting the global economy to an emissions platform of net zero in the second half of this century.

With global average temperature increases already exceeding 1.1°C, investors are pressuring investees to develop and disclose Paris Agreement-aligned emissions reduction strategies, and to show how they plan to withstand business disruption during the transition to a low-carbon economy.

Recognising risks of global transition in financial reporting

Baseline disclosure expectations around climate-related financial risks have been elevated accordingly. The 'voluntary' disclosure Recommendations of the Bloomberg Taskforce on Climate-related Financial Disclosures (2017) (TCFD Recommendations) are rapidly moving from 'best practice' to standard, with specific reference in ASIC Regulatory Guides. And the bar is set to be raised further, with the Australian Accounting Standards Board and Auditing and Assurance Standards Board's joint guidance on materiality assessments regarding climate-related assumptions within financial statement accounting estimates.



1. ASIC REGULATORY GUIDANCE ON NARRATIVE DISCLOSURES AND THE TCFD

Financial statements must provide true and fair view of financial position and performance (s 297 Corporations Act). Compliance with accounting standards is required (s 296), but additional information must be provided where that is necessary to provide a 'true and fair view' (note to s 297).

The accompanying director's report must contain information reasonably required by shareholders to make an informed assessment of operations, financial position, business strategies and prospects for future financial years (s 299A).

Within that legislative context, ASIC has recently updated its Regulatory Guidance on market disclosures for both prospectuses (RG228) and annual report operating & financial reviews (**OFR's**) (RG247) to incorporate the types of climate change risk developed by the G20 Financial Stability Board's Taskforce on Climate Related Financial Disclosures (**TCFD**). The TCFD Recommendations provide a framework on the kind of information that must be analysed and disclosed in order to truly and fairly represent (and enable assessment of) the impact of climate-related risks on financial positions and prospects, in a consistent form that is decision-useful for investors, lenders and insurance underwriters. The TCFD contemplates not only the disclosures themselves, but the risk metrics and targets, strategy and governance processes within which climate risk issues are managed.

TCFD focus: stress testing and scenario planning

A central plank of the TCFD Recommendations relates to the conduct, and disclosure, of stress-testing and scenario planning of business strategies against a plausible range of climate futures – including a 'sub-2°C' emissions pathway consistent with Paris Agreement targets.

Despite its importance to investors, financial report preparers, directors and auditors often struggle with the concept of stress-testing and scenario planning, concerned that disclosure on a 'forward-looking' basis may expose them to litigation.

Whilst understandable, such concerns often misapprehend the function of climate risk stress-testing: not as a prediction of likely outcomes, but as a risk management tool to consider the spectrum of strategic challenges it presents, which are without historical precedent. In addition, ASIC's updated RG247 explicitly emphasises ASIC's general view that there is minimal risk of directors being found liable for a misleading or deceptive forward-looking statement in an OFR provided the statements are based on the best available evidence at the time, have a reasonable basis and there is ongoing compliance with continuous disclosure obligations.

How MinterEllison can help

- TCFD capacity building for finance and governance teams
- Board oversight: due care and diligence assurance and advisory
- Annual reports: disclosure assurance and advisory
- Investor relations and executive remuneration consultancy
- Climate risk litigation advisory and defence.



2. MATERIALITY OF CLIMATE RISK ASSUMPTIONS IN FINANCIAL STATEMENT ACCOUNTING ESTIMATES

TCFD-related disclosures are ordinarily focused within the narrative portions of annual reports, such as the OFR (subject of ASIC's updated RG247, discussed above). That focus is set to expand to financial statements, with the Australian Accounting Standards Board and Australian Auditing and Assurance Standards Board's recent issue of joint guidance on the relevance of climate-related risks to accounting estimate materiality assessments (from asset fair values, impairments and changes in useful life assumptions to onerous contract provisions).

With narrative reports ordinarily falling beyond the scope of the financial audit engagement, the AASB/AuASB Guide is particularly significant in its repositioning of climate-related risks squarely within the scope of external audit scrutiny.

How MinterEllison can help

- Capacity building for finance, audit, governance and executive teams
- Annual report disclosure assurance and advisory (narrative and financial statements)
- Climate risk litigation advisory and defence.



3. LITIGATION by SHAREHOLDERS and REGULATORS

Challenges to climate-related misrepresentations (or omissions) under misleading disclosure laws – on the same basis as any other element of financial performance, position or prospects – are far from theoretical. Shareholder class actions alleging a misrepresentation of climate related financial risks, and/or a breach of directors' duties for a failure to govern for those risks, have already been filed in the US and Europe. In Australia, actions have been brought against large listed companies and superannuation funds. And ASIC and APRA have indicated they are monitoring companies' climate-related financial disclosures.

How MinterEllison can help

- Capacity building for audit and executive teams
- Annual report disclosure assurance and advisory (narrative and financial statements)
- Climate risk litigation advisory and defence.



4. CAPACITY BUILDING BY FINANCIAL REPORT PREPARERS and AUDIT TEAMS IS CRITICAL

The speed with which climate risk reporting norms have developed has caught many report preparers unprepared. This places reporting corporations and their directors at significant risk. The imperative to rapidly develop climate-related financial risk literacy is clear – to prepare for new lines of inquiry from auditors, to satisfy heightened investor information demands, and to guard against the very real risk of litigation.

How MinterEllison can help

- Unique multi-disciplinary approach to climate-related financial risk management
- Climate risk through a commercial law lens
- Governance oversight: due care and diligence assurance and advisory
- Annual report disclosure assurance and advisory (narrative and financial statements)
- Climate risk litigation advisory and defence.

MinterEllison's Climate Risk Governance Team



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MinterEllison's Climate Risk Governance team is led by one of the world's foremost experts on climate change governance, investment and liability, **Sarah Barker**.

Internationally, Sarah's expertise is called upon by governments and institutions across Europe and North America, from the Bank of England to the United Nations Principles for Responsible Investment. She is Australia's representative on the cross-jurisdictional Commonwealth Climate and Law Initiative, sits as an academic visitor at Oxford University's Smith School, and teaches sustainability in corporate governance for Cambridge University's Institute for Sustainability Leadership. In Australia and New Zealand, Sarah provides climate change liability risk management and disclosure advisor to state, federal and local government entities, and a range of large corporations in the banking, insurance, asset management, superannuation and infrastructure and development sectors. She was the instructing solicitor on a brief to Mr Noel Hutley SC that is widely cited as authority on directors' duties with regard to climate change risk in Australia (including by ASIC, APRA and the RBA).

Sarah has been an examiner, lecturer and course materials author for the Australian Institute of Company Directors for more than 15 years, and is the only lawyer represented on the Steering Committee of the Australian Sustainable Finance Initiative. Sarah brings an overtly practical, governance-focused perspective to her advice from her own experience on government and private sector boards. She is known for her ability to communicate complex legal and economic concepts in a pragmatic way, to both lawyers and non-lawyers.



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MinterEllison's Climate Risk Governance team is an integral part of our Responsible Business practice.

We lead the market in advising on climate change through a corporate law lens. Our unique multi-disciplinary team of lawyers and auditors works closely with scientists, economists, financiers and international regulators to ensure that our clients have the benefit of global thought leadership in this dynamic risk area. Our subject matter expertise is combined with deep sectoral experience to provide an unrivalled commercial lens across climate-related risk, governance and disclosure law issues.

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