Climate Risk and ESG Reporting: Reshaping the Future of Sustainability

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Introduction

The warming of the earth is inevitable. As we adapt to our new future, businesses must adjust their business practices to address the realities of climate change.

A warming planet will trigger a range of impacts for businesses globally. This includes both known and unknown impacts resulting from changes to our climate and environmental conditions. As the effects of climate change cannot be fully anticipated, organisations must review their approach to risk management and adopt an increasingly flexible approach to conducting business.

In addition to assessing and managing climate-related risks, it is important for organisations to assess their own impact on the climate. Reducing the corporate sector's environmental footprint will contribute to the reduction of climate risk on a global scale. It is also important that businesses meet changing consumer expectations in relation to sustainability and environmental harm.

This whitepaper introduces the concept climate risk and outlines how the growing popularity of Environmental, Social and Governance (ESG) reporting is reshaping the future of transparency in the private sector.

Climate Risk in Context

Climate risk describes an organisation's exposure to harm in relation to climate change. The risks posed by climate change are vast and varied.

Different organisations will face different types of climate risks, depending on the individual circumstances of the business, including its size, industry, and location of its operations. For example, businesses in the agricultural sector in Australia are preparing to manage the impacts of rising temperatures and unseasonal weather events on crop yield and worker productivity.

Not all climate risk will arise directly from global warming. Organisations must consider the impact of the 'knock-on effects' that may result from changes in the environment. This may include resource shortages, supply chain issues, market instability, increased regulation, labour shortages, and changes in consumer demand and preferences.

Failing to address climate risks may have serious financial ramifications for businesses. An organisation's capacity to be adaptable and resilient is key to managing the impacts of climate change. As demonstrated by the impacts of COVID-19 on global business, knock-on effects can have a devastating impact on businesses that do respond to change in a timely and responsive manner.

Inaction on climate change is also increasingly unpopular with consumers. Organisations that do not address climate risk may face reputational damage, loss of competitive advantage, shareholder activism and investor divestment.

Finally, businesses need to be aware of the growing regulatory environment in relation to climate issues. For example, many Australian businesses have obligations under the National Greenhouse and Energy Reporting Act 2007 (Cth) to make disclosures about the company's carbon emission, energy use and energy production.

Businesses may also have indirect obligations to report on climate risk. All listed entities in Australia are expected to comply with the continuous disclosure obligations. This means disclosing any information that shareholders might reasonably need to make informed investment decisions, including information relating to climate risk. It is also recommended by the Australian Securities and Investments Commission (ASIC) that listed companies with exposure to climate risk disclose climate-related financial information.

As legal requirements grow, organisations must take care to comply with all applicable local and international laws, regulations, and contract provisions. Businesses may face penalties and other forms of loss for failing to meet their legal obligations.

Organisations must consider the impact of the 'knock-on effects' that may result from changes in the environment.

An illustration: Farming apparel manufacturing in Australia

Consider a large-scale apparel company operating in Australia that produces protective leather products (aprons, utility belts, gloves) and livestock equipment (saddles, halters, whips) for the farming industry.

There are a range of climate-related risks that may befall a business in the apparel industry. Apparel manufacturers are known to have complex supply chains, some of which are so complicated that the complete chain of actors is not fully traceable.

The company may import leathers from Pakistan, metal hardware from Italy, and cotton from India. The leathers are treated and cut in Asia before arriving in Australia where the company assembles its products and performs quality checks before distributing them to its retailers.

Businesses that utilise a global network of resources and human labour are highly susceptible to climate-related impacts. One possible impact will be a reduction in the availability of workers. For instance, the decreasing liveability of certain areas is expected to cause mass migration across the world. Pakistan is predicted to be one of the first places to experience extreme temperatures.

In the case of our apparel manufacturer, the supply of leather, the essential component in its products, may be halted by labour shortages stemming from migration away from overheated urban areas like those in Pakistan. By extension, extreme conditions may also impact the cost and availability of water, an essential resource for preparing land tanning hides.

It is well known that delays in the release of products can have significant consequences for a brand's reputation and longevity. Similarly, businesses that fail to assist climate-effected workers to transition into new roles may be judged harshly by increasingly socially aware consumers. Recent push back against 'fast fashion' has already put a spotlight on the apparel industry globally to take greater responsibility for their impact on people and the planet, and to be more transparent in their attempts to improve their processes.

Businesses that fail to foresee supply chain issues may suffer significant financial and reputational damage. While changes to the supply of resources and labour are not new challenges for many businesses, climate change is likely to impact supply in two significant ways: disruptions to the supply chain will be harder to predict and will be more immediate and more frequent than before.

In our changing world, businesses that establish robust frameworks for identifying risk and opportunity will be best positioned to meet the challenges of climate change. Businesses will need to be responsive, nimble, and increasingly well-prepared. They must be willing to set meaningful climate goals, embrace a culture of transparency and accountability, and report truthfully on their progress.

Implementing an ESG Reporting System

ESG (Environmental, Social and Governance) reporting is a form of financial and non-financial disclosure. An ESG report discloses the organisation's performance in relation to its environmental, social and governance impact through qualitative and quantitative measures. The report evaluates the risks, strategies and opportunities that exist in relation to ESG matters.

ESG reporting is generally optional. However, there is increasing momentum to formalise and regulate ESG reporting, and certain aspects of ESG reporting have become mandatory in some countries. For example, ESG reporting will be required for select public interest companies in the EU from 2022.

The information that may be disclosed in an ESG report will vary substantially from organisation to organisation.

ESG impacts that are commonly addressed in an ESG report include:

- Greenhouse gas emissions
- Climate change
- Biodiversity
- Waste
- Human rights
- Labour conditions
- Privacy
- Community engagement
- Organisational governance and ownership
- Board composition
- Regulatory compliance
- Business ethics, and
- Responsible investment

Implementing an ESG reporting system can bring numerous benefits. These include:

- Encouraging the organisation to establish and work toward its sustainability goals
- Providing greater accountability and transparency for stakeholders, including shareholders, business partners, and consumers
- Clarifying the extent and nature of its ESG impacts and highlighting areas that may require attention
- Enhancing the organisation's credibility and reputation as a leader on sustainability issues
- Improving access to finance because of accurate and verifiable disclosures
- Greater employee engagement and commitment to business goals
- Enhanced ease of doing business within the supply chain based on sustainability goals and disclosures

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Selecting an ESG Framework

Many ESG reports reference or apply an ESG reporting framework. Frameworks provide structure for measuring and communicating an organisation's ESG impacts.

Multiple organisations have created frameworks for reporting on ESG matters, these include: the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), and the International Integrated Reporting Council (IIRC).

Some organisations also utilise other benchmarks or standards such as the UN Sustainable Development Goals (SDGs) or the Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

There is a considerable difference amongst the different ESG frameworks. For example, some frameworks are industry-specific while others can be applied to all sectors. Some frameworks may emphasise environmental factors over an organisation's social or governance impacts. The organisation will need to determine which framework or frameworks (if any) are best suited to the business.

Mandatory Reporting

While discussions about mandatory ESG reporting are well underway in Australia, ESG reporting remains voluntary for Australian companies.

However, there are a range of existing statutory requirements that require disclosures to be made in relation to certain ESG issues. Non-financial disclosures are currently required under federal statute, including under the Modern Slavery Act 2018 (Cth), the Workplace Gender Equality Act 2012 (Cth), and the National Greenhouse and Energy Reporting Act 2007 (Cth).

There is also an increasing push toward ESG disclosure for listed Australian companies. In 2014, the ASX Corporate Governance Council published a new recommendation in its Principles and Recommendations, requiring listed entities with material exposure to environmental social risk disclose how they intend to manage those risks.

The Australian financial services industry is also seeing a gentle nudge toward ESG disclosure with the publication of an ESG Reporting Guide by the Financial Services Council (FSC) and the Australian Council of Superannuation Investors (ACSI), and the Prudential Practice Guide on CPG 229 Climate Change Financial Risk by the Australian Prudential Regulation Authority (APRA). The ASIC Information sheet (INFO 271) How to avoid greenwashing when offering or promoting sustainability-related products highlights increasing regulatory interest in ESG reporting and disclosures.

Australian businesses that conduct business internationally are wise to maintain awareness of the regulation of ESG disclosures aboard. The regulation of ESG reporting is significantly more advanced in other nations, including in New Zealand, Singapore, Hong Kong, and the EU, where regulation is largely geared toward large corporations and financial institutions. A signal to where Australia's regulatory environment may expand in the future.

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Organisational Culture

ESG reporting requires an organisation-wide commitment. Organisations that publish an ESG report must establish a workplace culture that promotes the organisation's ESG goals. This commitment to improvement on ESG matters must be upheld at all levels, from entry level to senior management.

Fostering an organisational culture that prioritises risk awareness and ESG compliance will place the business in the best position to deliver meaningful ESG reports and maintain a competitive edge amongst its peers.

Reshaping the Future of Sustainability

ESG reporting represents more than best practice for climate-conscious businesses. It is a yardstick against which stakeholders and the public can measure a company's long-term commitment to sustainability and to the reduction of environmental and social harm.

Organisations that do not complete ESG reports, should consider the risk reduction benefits and opportunities that come with the establishment of a verifiable ESG reporting system. Organisations that already partake in ESG disclosures should ensure that their reporting approach and framework are suitable, effective, and up to date.

About the Expert

Dr Rachel Baird

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Dr Rachel Baird is an experienced environmental professional with a unique understanding of the interplay between state, commonwealth and international laws. Her major project experience provided a valuable practical lens to her legal skills and experience with social impact. Her research (Masters and PhD) addressed international environmental law including marine resource management, regional and high seas fisheries, and marine pollution.

Rachel has lectured international environmental law covering topics such as climate change, resource management, and transboundary pollution. She has authored many articles and books addressing sustainability topics and is a regular expert reviewer for LexisNexis®.

Rachel currently facilitates a Sustainability Law course run in partnership by Pearson and Oxford University and has provided ESG workshops/presentations for the CEO Institute, Governance Institute of Australia, Women on Boards and the Malaysian Institute of Accountants. Having now built a practice in governance advisory, Rachel has a particular interest in ESG and draws upon years of practice and academic research to advise boards and management teams on organisational sustainability strategies.

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