

CLIMATE-RELATED FINANCIAL DISCLOSURE

Summary

Treasury has released the Exposure Draft legislation on Climate-related financial disclosure which is open for consultation until 9 February 2024. The new framework mandates disclosure of sustainability reports by applicable entities that are reporting entities under Chapter 2M of the Corporations Act and meet at least one of three new thresholds based on specified size criteria, entities reporting under Australia's national greenhouse gas (GHG) reporting legislation or asset owners with \$5 billion or more assets under management.

The sustainability reports are to include 'climate statements' based on Australia's proposed adoption of the International Sustainability Standards Board (ISSB) IFRS S2 Climate-related disclosures. Under the proposed amendments, the Australian Securities & Investments Commission (ASIC) will have an express power to issue directions to test the veracity of statements made by entities in their sustainability reports. The proposed amendments coincide with Sarah Court, Deputy Chair of ASIC, confirming earlier this month that ASIC will pursue actions against entities that market 'net zero' or 'carbon neutral' claims without the requisite substantiation of those claims.¹

The introduction of sustainability reporting is proposed to be phased with the largest entities to commence the reporting process during the period starting on or after 1 July 2024. This start date is subject to the outcome of the current public consultation process under which Treasury is taking submissions on whether a deferral to 1 January 2025 would improve the quality of sustainability reporting.

Action required

To the extent entities have not already done so, entities will need to start preparing to determine whether they trigger the reporting threshold. If so, which reporting group they fall within and when the reporting process is to commence including the deadline for submission of their reports.

This process will include assessing whether the entity's existing reporting processes collect and document the necessary data and assessments to be able to prepare the sustainability report and where there are gaps, how those gaps are to be addressed. The Explanatory Memorandum accompanying the Exposure Draft legislation clarifies that entities will also be expected to report on their governance or risk management processes, controls and procedures relating to material climate-related financial risks and opportunities the entity faces and any metrics and targets of the entity related to climate (including scope 1, 2 and 3 GHG emissions).

As part of the requisite governance, entities will need to ensure that the company board is appropriately briefed and understands how the new regime will impact the company, including the liability framework and penalties for non-compliance.

Entities that trigger the mandatory reporting requirements will need to give consideration to their audit and assurance team with supporting expert technical climate and sustainability experts where appropriate, both internal and external. Technical assistance will be required including on the preparation of climate resilience assessments and scope 1, 2 and 3 GHG emissions reporting. Furthermore, legal advice is likely to be required in respect of the disclosures as part of preparations for any post-disclosure dealings with ASIC, interested persons such as shareholders and investors, or third parties in respect of the disclosures.

We set out below an overview of the key provisions of Australia's sustainability disclosure requirements.

Given the breadth of the proposed new requirements not every requirement is listed below. Key new concepts are shown in bold for ease of reference.

1 Who are the reporting entities?

Under the Exposure Draft, amendments are proposed primarily to the *Corporations Act 2001* (Cth) (**Corporations Act**) but also to related legislation. **Applicable entities** must prepare a **sustainability report** for a financial year if that entity reports under Chapter 2M of the Corporations Act and meets at least one of the three thresholds identified in the table below. The requirement to submit a sustainability report is to be phased commencing with the earliest reporting period for the largest applicable entities (ie. Group 1).

	THREE THRESHOLDS FOR SUSTAINABILITY REPORTING				
First annual reporting periods starting on or after	Large entities and their controlled entities meeting at least <u>two</u> of three criteria:			National Greenhouse and Energy Reporting (NGER) Reporters	Asset Owners
	Consolidated revenue ⁱⁱ	EOFY ⁱⁱⁱ consolidated gross assets	EOFY employees		
1 July 2024 Group 1	\$500 million or more	\$1 billion or more	500 or more	Above the NGER publication threshold ^{iv}	N/A
1 July 2026 Group 2	\$200 million or more	\$500 million or more	250 or more	All other NGER reporters	\$5 billion assets under management or more
1 July 2027 Group 3	\$50 million or more	\$25 million or more	100 or more	N/A	N/A

The above table is a modified version of the table prepared by Treasury in its Policy Position Statement which has been annotated to provide additional clarifications in blue text and endnotes.

Applicable entities are defined in the Exposure Draft legislation as 'a company, disclosing entity, registered scheme or registrable superannuation entity' (s1705). Subject to the outcome of the current public consultation process and any final legislative amendments, if an applicable entity falls within one or more of the thresholds in Group 1, then it will need to report in the first reporting period commencing on or after 1 July 2024 regardless of whether it also falls within Group 2.

2 What must a Sustainability Report address?

The **sustainability report** for a financial year will consist of:

- the **climate statements** for the year (which are those required by the **sustainability standards**); and
- any **notes to the climate statements** (see 2.1 in the table below); and
- any statements required by the Minister pursuant to a legislative instrument on matters concerning **environmental sustainability**; and
- the **director's declaration** about the statements and notes (s296A(1)).

Sustainability records must be kept for 7 years that correctly explain and record the preparation of (a) to (c) above. These records include documents and working papers that explain the methods, assumptions and evidence that form the basis for the statements disclosed. Failure to keep sustainability records is considered an offence that may attract a fine or up to two years imprisonment.

In relation to (a), the Explanatory Memorandum and Treasury's Policy Position Statement confirm that the Australian Accounting Standards Board (**AASB**) is responsible for preparing the final sustainability standards. Furthermore, the proposed standards are intended to adopt the ISSB's *IFRS S2 Climate-related Disclosures*, with necessary amendments for the Australian context. Treasury provides the examples of amendments to incorporate Australia's national GHG estimation methodologies and international climate change commitments (see **Next Steps** in Section 6 below).

As for (c), any such statements are to be set out in a future legislative instrument. We note the concept of 'environmental sustainability' is not defined in the draft legislation. In our view, it would be clearer for reporting

entities if there is a definition particularly given the requirements in 2.1 below in respect of reporting on notes to climate statements.

2.1 Notes to climate statements (s296A(4))	2.2 Climate statement disclosures (s296D)
<p>A sustainability report must include the following notes to climate statements:</p> <p>(a) any disclosures required under a legislative instrument (to be made by the Minister in relation to the preparation of the climate statements; or anything included in the climate statements; or other matters concerning environmental sustainability);</p> <p>(b) any notes required by the sustainability standards in relation to:</p> <p>(i) the preparation of the climate statements; or</p> <p>(ii) anything included in the climate statements; or</p> <p>(iii) other matters concerning environmental sustainability;</p> <p>(c) notes containing any other information necessary to ensure that the climate statements and notes together make the disclosures required by section 296D (see 2.2 in the opposite column).</p>	<p>The climate statements for a financial year, and the notes to the climate statements, must together disclose all of the following:</p> <p>(a) the material climate risks the entity faces and the material climate opportunities the entity has for the financial year (if any);</p> <p>(b) any metrics and targets of the entity for the financial year related to climate that are required to be disclosed by the sustainability standards, including metrics and targets relating to scope 1, 2 and 3 emissions of GHG;</p> <p>(c) any governance policies of the entity related to the matters in (a) and (b) above (if any) that are required to be disclosed by the sustainability standards;</p> <p>(d) the quantity of scope 3 emissions for the entity for:</p> <p>a. the period specified in the sustainability standards (if specified); or</p> <p>b. otherwise, the financial year.</p>

The concept of '**materiality**' in the context of material climate risks and opportunities is to be determined in accordance with the sustainability standards (s296D(2)).

The requirement to disclose the quantity of scope 3 emissions of an entity does not apply for the first financial year for which the entity is required to prepare a sustainability report (s296D(3)). Scope 3 emissions is defined to have the same meaning as in the Corporate Value Chain (Scope 3) Accounting and Reporting Standard developed by the World Resources Institute and World Business Council for Sustainable Development (**WBCSD**). That is, '*all indirect emissions of GHG (not included in scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions*'¹⁵.

3 What must a director's declaration address?

A director's declaration must declare:

- whether, in the director's opinion, the climate statements, any statements required by the Minister on matters concerning environmental sustainability, and the notes to the climate statements are in accordance with the Corporations Act (including the proposed new s296C (compliance with sustainability standards etc) and s296D (climate statement disclosures); and
- if the entity has included in the notes to the climate statements '*an explicit and unreserved statement of compliance with international sustainability reporting standards*' (in compliance with the sustainability standards) – that this statement has been included in the notes to the climate statements (s296A(6)).

The declaration must be made in accordance with a resolution of the directors, specify the date on which the declaration is made and be signed by a director (s296A(7)).

4 What are the Auditing and Assurance requirements?

The sustainability report is to be audited by an auditor of the financial report supported by technical climate and sustainability experts where appropriate. An auditor who conducts an audit of the sustainability report for a financial year must form an opinion about whether the sustainability report is in accordance with the Corporations Act and whether the auditor has been given all information, explanation and assistance necessary for the conduct of the audit (s307AB).

According to the Explanatory Memorandum, the Auditing and Assurance Standards Board (**AUASB**) will develop assurance standards in line with the final International Auditing and Assurance Standards Board (**IAASB**) standard. The assurance requirements will be phased – assurance of scope 1 and 2 emissions disclosures is required from 1 July 2024 and assurance of all climate disclosures required from 1 July 2030 onwards.

5 What is the liability framework?

It is important for directors and entities to be aware of the liability framework. Breaches in respect of the climate-related financial disclosures may result in civil and/or criminal legal proceedings.

The proposed amendments to the Corporations Act include a transitional period for the financial years commencing 1 July 2024 to 30 June 2027 (**Transitional Period**). During the Transitional Period there is a temporary suspension of some (but not all legal actions) that can be brought regarding statements in respect of scope 3 GHG emissions and scenario analysis (see summary table below of the proposed s1705B). The Explanatory Memorandum clarifies that statements regarding scope 3 GHG emissions and scenario analysis are *'the most uncertain parts of a climate statement'* thus attracting a limited temporary immunity for these statements. However, this immunity is only a partial immunity and does not limit the actions set out in the Exceptions below and in our view would not limit other regulators. After the Transitional Period ends, the existing liability arrangements will apply.

Limited immunity during the Transitional Period	Exceptions
<ul style="list-style-type: none">No legal action may be brought against a person or entity in relation to statements about scope 3 emissions or scenario analysis made in a sustainability report (subject to the Exceptions)	<ul style="list-style-type: none">Civil actions brought by ASIC relating to breaches with a fault element and/or where ASIC only seeks a remedy of an injunction or declaration.Criminal proceedings

During the Transitional Period, if ASIC considers that a statement in a sustainability report is *'incorrect, incomplete or misleading in any way'*, ASIC may issue a direction to the entity to respond to either confirm the statement is correct or complete, provide an explanation of the statement and/or correct, complete or amend the statement in accordance with the direction (s1705C). A penalty applies for a failure to comply with a direction from ASIC.

There is an important procedural fairness requirement that ASIC must comply with before issuing any such direction. That is, before issuing a direction ASIC must hold a hearing with the entity and provide a reasonable opportunity to the entity to make oral or written submissions to ASIC on whether the direction should be issued.

6 Next steps

We set out in the introduction an overview of some of the key actions required in response to the Exposure Draft legislation.

Furthermore, as indicated above, Treasury is taking submissions on the Exposure Draft legislation until 9 February 2024 including on whether a commencement date of 1 January 2025 for Group 1 entities *'would improve the quality of reporting during the transition year'*. Given the final sustainability standards and assurance standards are yet to be released by the AASB and AUASB respectively, this may support a deferral of the commencement date for entities expected to commence the reporting process within the next five months subject to the outcome of the public consultation process. Separately, we consider there to be a need for the Treasury to clarify the meaning of the concept of 'environmental sustainability' given the existence of other Australian laws that contain State and Commonwealth definitions of 'environment' and 'sustainability', for instance in the context of 'ecologically sustainable development'.

Finally, the AASB is taking submissions on its *Exposure Draft ED SRI Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information (ED SRI)* until **1 March 2024**.

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ⁱ N Fildes, 'Australian regulator steps up greenwashing crackdown', Financial Times, 7 January 2024

ⁱⁱ For the financial year, determined in accordance with accounting standards in force at the relevant time.

ⁱⁱⁱ End of Financial Year determined in accordance with the accounting standards.

^{iv} The applicable entity is (1) a registered corporation under the *National Greenhouse and Energy Report Act 2007* (Cth) (**NGER Act**) at the end of the financial year or required to make an application to be registered in relation to meeting a threshold under s12(1) of the NGER Act; and (2) its group meets a threshold for the financial year within the meaning of s13(1) of the NGER Act. The thresholds in s13(1) for a controlling corporations group relate to (a) the total amount of GHG emitted from the operation of facilities under the operational control of entities that are members of the group with a specified carbon dioxide equivalent; or (b) the total amount of energy produced from the operation of facilities under the operational control of entities that are members of the group which meets specified levels; or (c) the total amount of energy consumed from the operation of facilities under the operational control of entities that are members of the group which meets specified levels.

^v Greenhouse Gas Protocol, *Corporation Value Chain (scope 3) Accounting and Reporting Standard*, World Resources Institute and WBCSD, accessed 25 January 2024: [Corporate-Value-Chain-Accounting-Reporting-Standard_041613_2.pdf](#) (ghgprotocol.org)