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Australia soon to introduce a mandatory climate-related financial disclosure regime

The Australian government is in the process of finalising legislation relating to its proposed mandatory climate-related financial disclosure regime, following the completion of a one-month consultation process on the draft legislation in February 2024. Whilst a target date for the enactment of the legislation has not been announced, some of the proposed changes may apply as early as 1 July 2024. In this article, we provide an overview of the key features of the proposed legislation and how entities should be preparing for the new regime.

THE CHANGES IN BRIEF

The proposed changes will amend parts of the *Corporations Act 2001* (Cth) and the *Australian Securities and Investment Commission Act 2001* (Cth) to create additional reporting obligations for certain listed and unlisted entities relating to climate risks. The central requirement is to prepare an annual 'sustainability report', which will sit alongside the annual financial report. At present, it is proposed that this report will cover a range of climate-related matters however, the legislation has been structured to allow the sustainability report to be extended to other sustainability-related matters (that is, topics other than climate) relatively easily in due course.

The precise content of the sustainability report will be governed by a set of "sustainability standards" to be published by the Australian Accounting Standards Board (**AASB**). These are intended to align with standards published by the International Sustainability Standards Board (**ISSB**), with necessary amendments for the Australian context, including to support the emissions reduction targets set by the Australian government. The AASB aims to finalise these standards by the end of August.

Under the draft sustainability standards, entities must provide a wide range of information relating to their climate-related risks and opportunities, is currently proposed that entities will need to take a 'single materiality' approach to their reporting, whereby they must address the impacts and risks of climate change to their own business. In time, the standards may evolve to include a 'double materiality' approach, which will require information on how the entity's activities affect the surrounding environment.

The proposed disclosures are novel in the Australian context, particularly as to the amount of "forward-looking" information they require. The government acknowledges that entities are likely to need some time to adjust to the new regime. Accordingly, it is proposed that the reporting obligations will be introduced in phases (beginning with larger entities), and a reduced liability regime will apply for an initial period. We outline the key features of the proposed legislation in some further detail below.

The Australian government acknowledges that many large entities are already producing climate-related disclosures. This has occurred against the backdrop of an increasing awareness of the relevance of climate change to economic outcomes, and the need for company directors to turn their minds to climate-related risks and opportunities as part of their directors' duties. However, the intention through these reforms is to improve the consistency and quality of the disclosures for the benefit of investors and regulators, and to align Australia's approach with international best practice.

Corporates that are already familiar and complying with the ISSB's International Financial Reporting Standards S1 General Requirements for Disclosure of Sustainability-related Financial Information (**IFRS S1**) and S2 Climate-related Disclosures (**IFRS S2**) and the Task Force on Climate-Related Financial Disclosure (**TCFD**) guidelines are likely to be well positioned to meet the requirements under the new Australian regime. This will likely already be the case for multinational corporations with operations in jurisdictions where TCFD reporting obligations are already mandatory (such as the European Union and the United Kingdom). However, certain aspects of the Australian regime will require additional focus such as the director's declaration, record keeping and audit requirements.

THE KEY FEATURES OF THE PROPOSED REGIME

	Proposal
Who will be required to lodge sustainability reports?	Ultimately, entities currently required to lodge reports under Chapter 2M of the Corporations Act and meeting at least one of the following descriptions will need to prepare sustainability reports: (1) The entity satisfies at least two of the following criteria by the end of the relevant financial year: consolidated revenue of at least A$50m, consolidated gross assets of at least A$25m, 100 or more employees (aggregated with the entities it controls); (2) The entity is a registered corporation under the *National Greenhouse and Energy Reporting Act 2017* (Cth) (**NGER Act**)[1]; or (3) The entity is an asset owner (e.g. fund manager) with assets worth at least A$5b at the end of the financial year. This will capture both listed and unlisted entities incorporated in Australia as well as registered investment schemes and registrable superannuation entities, provided they meet the size thresholds set out above. However, the requirement is proposed to be phased in gradually over the next four years, beginning with larger entities and moving on to smaller entities (see below). Entities in the final "phase in" group (that is, "medium" entities in the table below) also have more limited disclosure obligations. They will only need to produce detailed climate disclosures if they face material climate related risks or opportunities in the relevant financial year. If they determine that they do not face such risks, they will only need to include a statement to that effect to fulfil their reporting obligations. Entities who prepare consolidated financial statements can also prepare sustainability reports on a consolidated basis.
When will entities need to start reporting?	**Commencement of reporting obligations** Reporting obligations will be triggered at different times for different cohorts of entities, based on size. In its current form, the legislation proposes three start dates for different groups of entities, outlined below (where the "proposed start date" refers to the commencement of the financial year when the obligations will be triggered). Whilst the current proposal is for "very large" entities to begin reporting from 1 July 2024, there has been widespread feedback in the consultation process to defer this date to 1 July 2025. It remains to be seen if this will be adopted.

Proposed start date	Entities
1 July 2024	"Very large" entities (i.e. entities meeting at least two of the following criteria at the end of the financial year: consolidated revenue of A$500m, consolidated assets of at least A$1b, 500 or more employees) "Large" reporters under the NGER Act
1 July 2026	"Large" entities (i.e. entities meeting at least two of the following criteria at the end of the financial year: consolidated revenue of A$200m, consolidated assets of at least A$500m, 250 or more employees) All other reporters under the NGER Act Asset owners with at least A$5b of assets
1 July 2027	"Medium" entities (i.e. entities meeting at least two of the following criteria at the end of the financial year: consolidated revenue of A$50m, consolidated assets of at least A$25m, 100 or more employees)

Lodgement of sustainability report

Sustainability reports will need to be provided to members within the time frames applicable to financial reports (and directors' and auditors' reports) under section 315(1) of the Corporations Act, being the earlier of 21 days before the next AGM after the end of the financial year or 4 months after the end of the financial year. So, for example, based on the current proposed timeline "very large" entities will need to provide their first sustainability report after the conclusion of the financial year commencing on 1 July 2024. There is no requirement to provide half-yearly reports.

1 There is no size threshold for these entities, on the basis that climate-related reporting is appropriate for all of these entities in light of the risks they face.

	Proposal
What needs to be done?	The central requirement is for entities to prepare a sustainability report, to be provided to members. In addition, entities will need to keep records relating to the preparation of the sustainability report and arrange for the report to be audited. Further detail on these requirements is outlined below.

SUSTAINABILITY REPORT

An entity's sustainability report must contain (i) the "climate statements" for the year, (ii) notes to the climate statements, (iii) any other statements required under a legislative instrument and (iv) a director's declaration about the climate statements and the notes.

Climate statements and notes

The precise contents of the climate statements will be governed by the sustainability standards to be published by the AASB (**Sustainability Standards**). The overarching requirements (to be enshrined in the Corporations Act) are that the climate statements and the accompanying notes must disclose:

(a) the "*material climate risks the entity faces*" and the "*material climate opportunities the entity has*" for the financial year (if any);

(b) any metrics and targets for the financial year relating to climate that are required to be disclosed by the Sustainability Standards;

(c) any governance policies relating to the above that are required to be disclosed by the Sustainability Standards; and

(d) from the second year of reporting onwards, the quantity of "Scope 3 emissions" for the period specified in the Sustainability Standards (or, if none is specified, the financial year).

The draft Sustainability Standards are extensive and require the disclosure of various information, including:

(a) the climate-related risks and opportunities that could reasonably be expected to affect the entity's prospects, where climate-related risks encompass both "physical risks" (i.e. risks resulting from climate-related events or longer term shifts in climatic patterns) and "transition risks" (i.e. risks arising from efforts to transition to a lower-carbon economy);

(b) the governance processes the entity has in place for monitoring and managing climate-related risks and opportunities;

(c) the current and anticipated effects of climate-related risks and opportunities on the entity's business model, value chain, and financial position;

(d) the entity's absolute gross Scope 1 and Scope 2 emissions and (from the second year of reporting onwards) Scope 3 emissions generated during the preceding financial year;

(e) the entity's transition plans and any climate-related targets the entity has, the progress towards those targets and how the entity plans to achieve those targets; and

(f) two "scenario analyses" to assess the entity's "climate resilience". It is currently proposed that one scenario will be specified (being a scenario where global temperatures increase by 1.5 degrees Celsius), whilst the entity will be able to select the other scenario (ideally, a scenario that is relevant to the entity).

However, as noted above the contents of the standards have not yet been finalised and the AASB is presently confirming the details around these requirements.

The notes to the climate statements must cover any notes relating to the preparation and contents of the climate statements, or other matters concerning environmental sustainability, where required by the Sustainability Standards.

Directors' declaration

The directors of the entity must provide a declaration as to whether, in their opinion, the climate statements and notes are in accordance with the Corporations Act (which includes a requirement to comply with the Sustainability Standards). The declaration must be made in accordance with a resolution of the directors, dated and signed.

RECORDS

Entities must keep records which correctly explain and record the preparation of the sustainability report for 7 years. This includes all documents and working papers explaining the methods, assumptions and evidence on which the statements are based. Failure to keep such records will be an offence, mirroring those relating to the requirement to keep financial records.

AUDIT REQUIREMENTS

Climate disclosures will ultimately be subject to similar assurance requirements as financial reports. That is, entities will need to obtain an auditor's report relating to their sustainability reports from their financial auditor, under which the auditor will need to form an opinion on whether the sustainability report is in accordance with the Corporations Act and the Sustainability Standards and whether they have been given all information necessary to conduct the audit. This audit may be supported by technical climate and sustainability experts where relevant. However, this requirement is proposed to be phased in over time, as follows:

(1) From 1 July 2024 until 1 July 2030, entities will need to obtain an audit of the content in their sustainability reports relating to Scope 1 and Scope 2 emissions only.

(2) From 1 July 2030, the audit will need to cover all of the content in the sustainability report.

The extent of assurance required will be set out in a set of assurance standards for climate disclosures. These will be developed by the Auditing and Assurance Standards Board based on international standards developed by the International Auditing and Assurance Standards Board.

LIABILITY AND PROPOSED 'GRACE PERIOD'

As with financial reports, an entity's directors will bear ultimate responsibility for the contents of sustainability reports, and will face potential liability where incorrect or misleading information is included in the reports (for example, via breaches of their directors' duties or their obligations under Chapter 2M of the Corporations Act). Entities also face potential liability in connection with these reports – for example, under the statutory misleading and deceptive conduct regimes.

The proposed regime brings new challenges for entities and their directors, particularly in light of the requirement to include information on matters that are forward-looking and uncertain.

In light of this, the government is proposing to apply a reduced liability regime for an initial period. In the Exposure Draft, the scope of the immunity is narrow. The immunity will only apply to actions brought by persons other than ASIC concerning content relating to Scope 3 omissions or scenario analyses, included in sustainability reports prepared for financial years commencing prior to 30 June 2027. After this, there will be no special protections in place and the normal liability regime will apply.

During this initial period, ASIC will still be permitted to bring actions for fault-based contraventions relating to statements which would otherwise attract limited immunity (for example, actions based on misleading and deceptive conduct). However, in this period ASIC may only seek relief in the form of a declaration of contravention or an injunction, not compensation or penalties. If ASIC considers a statement in a sustainability report to be incorrect, incomplete or misleading in any way, it will also have the power to request the entity to explain and, if necessary, correct the statement (which the entity must action).

As part of the consultation process, there were numerous calls to broaden the scope of this immunity. It remains to be seen whether this will occur, and if so what form it will take.

HOW SHOULD BOARDS PREPARE FOR THESE CHANGES?

Below, we outline some practical next steps boards may wish to take in preparation for the introduction of the new regime (to the extent they are not already being carried out):

1 Take steps to thoroughly understand the scope of the new requirements (including the Sustainability Standards) once they have been finalised.

2 Assuming the content requirements of the sustainability report broadly takes the form set out in the draft legislation, take steps to ensure that processes are in place to:

- accurately record the monitor Scope 1, 2 and 3 emissions;
- assess and describe the material climate-related risks and opportunities for the entity;
- with regard to the 'scenario analyses' required under the Sustainability Standards:
  - (i) assess the impact (on the entity) of an increase in global temperatures of 1.5 degrees Celsius; and
  - (ii) consider what other possible 'future state' would be appropriate and relevant to report on, and how the entity's climate resilience in that scenario can be assessed; and
- monitor climate-related developments and update their scenario analysis as and when appropriate.

This may require developing new processes and hiring personnel with relevant expertise.

3 Ensure the entity's staff are appropriately trained (and briefed on the contents of the Sustainability Standards) to carry out these processes.

4 Ensure that the entity has robust corporate governance and risk management processes in place in relation to climate-relate risks.

5 Allocate sufficient resources and time to allow for the preparation, verification and approval of the contents of the sustainability report, taking into account the novel aspects which may require additional time or specific procedures to adequately brief directors.

6 Ensure that all records relating to the preparation of the sustainability report are maintained and stored in a logical manner and made available to directors for the purposes of allowing them to understand and become comfortable with the contents of the report.

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