Governance Institute of Australia

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Climate Disclosure Unit
Market Conduct Division
The Treasury
Langton Crescent
PARKES ACT 2600

RE: Climate-related financial disclosure: exposure draft legislation (consultation material)

Who we are

Governance Institute of Australia (GIA) is a national membership association that advocates for a community of governance and risk management professionals, equipping over 8,000 members with the tools to drive better governance within their organisation. Our members have primary responsibility for developing and implementing governance frameworks in public listed, unlisted, and private companies, as well as the public sector and not-for-profit organisations. They have a thorough working knowledge of the operations of the markets and the needs of investors.

We regularly contribute to the formation of public policy through our interactions with Treasury, ASIC, APRA, ACCC, ASX, ACNC and the ATO. We are a founding member of the ASX Corporate Governance Council. We are also a member of the ASIC Business Advisory Committee, the ASX Business Committee and the ACNC Sector Users Group.

Summary of issues

Our members are concerned about the delay in release of the draft legislation given the proposed commencement date of 1 July 2024 for Group entities. The limited period for consultation on an issue of this magnitude during a period when many key stakeholders are on leave is unhelpful. They support delaying the commencement date of the legislation to the later of either 1 July 2025 or the next financial year commencing after the new Australian Accounting Standards Board (AASB) standards have been published. This will allow entities captured by the new regime the opportunity to prepare to meet both the disclosure requirements under the proposed legislation as well as the AASB standards, assist with minimising compliance costs for reporting entities and provide auditors with time to upskill on the new requirements to meet the increased demand for sustainability-related assurance services in the market.

Our members consider it is critical that the proposed reporting regime enables Australian entities to align their disclosures with requirements under the International Sustainability Standards Board (ISSB) Standards and with the National Greenhouse Energy Reduction Act (NGER) scheme requirements. They also encourage Government to continue to acknowledge, and consider, the international reporting obligations that some Australian entities will have due to non-ISSB aligned reporting structures, for example, the European Union. The standards should also align with the Greenhouse Gas Protocol: A Corporate Accounting and Reporting

Standard (2004) in allowing an entity to use either the equity share or the control approach when measuring greenhouse gas emissions. This aligns with approach taken in the NGER scheme.

Our members also note the inconsistencies between the Policy Statement, the Exposure Draft and the draft legislation. Given the complexity of this area and the significant 'step-up' for many reporting entities, this must be addressed as a priority. We have not commented in detail on the legislative drafting but note there are many areas where there is a disconnect between the stated policy and the legislation. We also recommend close review of the final legislation, policy statement and the Explanatory Memorandum to ensure they are consistent.

Our members consider that, as currently drafted, the regulatory burden of the proposals on Group 3 entities is disproportionate to the benefits of requiring these entities to make climate-related financial disclosures, given many of them currently have no external reporting obligations. The reporting threshold should be adjusted to $100M with a corresponding adjustment to turnover. Not-for-profits should also be excluded from the reporting requirements. There should also be a reduced disclosure regime for these entities given they are currently eligible to produce simplified financial disclosures. Assurance requirements should be appropriate for the size of these entities.

As currently drafted, the terminology in the draft legislation is potentially confusing. The term for the new report should be revised. Alternatively, climate-related financial disclosures should be located within existing reports and cross referencing enabled. The legislation should not contain the detailed content of the new report. This detail should be determined by the AASB and located in the relevant Standard. Alternatively locate climate-related financial disclosures in existing reports and enable cross referencing.

The detailed content of the new report (section 296D) should be determined by the AASB and set out in the applicable Standard rather than in the legislation, as is currently the case for financial reports. Entities should also be able to incorporate further disclosures by reference to an online resource such as a dedicated corporate website.

Subsidiaries within corporate groups should be able to rely on the consolidated parent entity reporting rather having to reproduce disclosures at the subsidiary entity level child entity can rely on the consolidated parent disclosures, where it makes sense to do so.

Our members consider that directors should be required to declare that, in their opinion, they have taken reasonable steps to comply with, or to secure compliance with, the Sustainability Standards and the Corporations Act noting that the scope of the ASRS is limited to climate-related disclosures and the International Standards cover a broader range of matters. If necessary, this form of declaration could be time limited to align with the term of the limited immunity.

Our members are concerned that the limited immunity in the consultation material is narrower in scope than the proposals previously consulted on. The limited immunity should be extended to all forward -looking statements and to entities in all Groups for the first three years of reporting. If the commencement date for the legislation is deferred the timeframe during which the limited immunity is available should be correspondingly adjusted.

Enshrining a broad Ministerial discretion of the type proposed in the consultation material into the Corporations Act only proceeds further down the path of obfuscation and obscurity, identified by the Australian Law Reform Commission in its recent report on that Act. Our members consider that any discretion should be limited to matters relating to climate-related financial disclosure, clearly linked to the Sustainable Finance Strategy.

Our members remain concerned that there has been no adjustment to the continuous disclosure regime because of the interaction between periodic climate-related financial disclosures and the continuous-disclosure regime for ASX-listed companies. They continue to advocate that the most appropriate option

for addressing these concerns would be to adapt the changes introduced during COVID-19 to the continuous disclosure regime.

Further details about our members' key concerns in relation to the consultation material is set out below.

1. Commencement date and reporting requirements

The Policy Statement seeks feedback about whether amending the legislation to require a 1 January 2025 commencement date for Group 1 entities would improve the quality of reporting during the transition year.

Our members consider the commencement date of the legislation should be deferred to the later of either 1 July 2025 or the next financial year commencing after the new AASB standards have been published, with a corresponding adjustment for Group 2 and Group 3 entities and provision for interaction between NGER reporting and climate-related financial reporting.

This is because:

- The delay in releasing the consultation material means that a proposed 1 July 2024 commencement date would give Group 1 entities a matter of months to prepare for release of their first reports under the new reporting regime. Even for entities currently reporting on climate-related matters at a sophisticated level this would create a significant burden
- On current advice the international assurance standard is unlikely to be released until September 2024 meaning the corresponding Australian Standard is unlikely to be released until late 2024, at best. If the legislation were to commence on 1 July 2024, Group 1 entities would be required to prepare reports with no assurance standard in place
- If the commencement date is delayed there should be a corresponding adjustment of the reporting requirements for Group 2 and Group 3 entities, and
- There is no provision for interaction between the NGER reporting requirements and the proposed climate-related financial disclosures. NGER reports are due in 31 October each year while most entities produce financial reports as at 30 June each year. This means that some entities may not be in a position to provide the required data by 1 July each year and/or will need to create a second set of data in order to meet the new reporting requirements. This issue needs to be addressed.

Governance Institute recommends deferral of the commencement date of the legislation for Group 1 entities to the later of either 1 July 2025 or the next financial year commencing after the new AASB standards have been published, with a corresponding adjustment for Group 2 and Group 3 entities and provision for interaction between NGER reporting and climate-related financial reporting.

2. Scope of legislation and liability – Group 3 entities, not-for-profits and materiality assessments

As noted in our previous Submissions, our members still consider that the consolidated revenue threshold for Group 3 is too low.[1] They consider $100M consolidated revenue is a more appropriate threshold which would align the climate-related financial disclosure regime with other regimes with which entities are familiar including: the Payment Times Reporting Scheme, the Modern Slavery reporting requirements and the Corporate Tax Transparency Code. The consolidated gross assets threshold should also be appropriately adjusted. The Policy Statement (page 1) refers to providing Australians and investors with 'greater

[1] See *Climate-related financial disclosure – consultation paper*, Governance Institute of Australia, 24 February 2023 and *Consultation paper - Climate-related financial disclosure June 2023*, Governance Institute of Australia, 28 July 2023.

transparency and more comparable information. The Statement also observes that … 'A rigorous, internationally aligned and credible climate disclosure regime will support Australia's reputation as an attractive destination for international capital and help draw the investment required for the transition to net zero'.

If one of the chief aims of the regime is to provide information to investors to attract capital investment our members question capturing entities of this size given their level of outside investment is low. They also question whether requiring these entities to make public disclosure of climate information is useful.

Our members welcome clarification that ACNC registered charities are excluded from the regime, however they question the inclusion of non-charitable not-for-profits such as other companies limited by guarantee, given the rationale for the regime is to provide information for investors and make Australia attractive to international capital investment. While the policy analysis indicates there is no impact on community organisations, many sporting and community organisations are companies limited by guarantee. In addition, companies limited by guarantee have members rather than investors. These entities should not be required to report under the legislation.

We also note that some entities required to report under Chapter 2M which are impacted by the legislation are eligible to use the 'Simplified Disclosures' Tier 2 financial reporting framework which came into effect on 1 July 2022. Given the desire to leverage existing reporting frameworks our members consider there should be a corresponding simplified climate-related financial disclosure regime for these entities to mirror the financial reporting regime with with assurance requirements appropriate to their size.

The consultation material indicates that Group 3 entities would only be required to make climate-related financial disclosures, if they face 'material' climate-related risks or opportunities for the financial reporting period and where they assess that they do not have material risks or opportunities, they would only be required to disclose a statement to that effect. This in effect creates an 'if not, why not' reporting obligation for Group 3 entities which potentially exposes them to liability. They also question how this interacts with the draft ASRS concept of materiality. The current draft of the legislation indicates it is intended to override the AASB's requirement for **all** entities to carry out a materiality assessment and requires Group 1 and 2 entities to make disclosure, without any materiality assessment. The legislation needs to be adjusted to refer to the materiality assessment required by the standards.

Governance Institute recommends:

- The consolidated revenue threshold for Group 3 entities should be $100M to align with other reporting requirements applicable to these entities
- Excluding not-for-profits such as other companies limited by guarantee from the requirements
- A simplified climate-related financial disclosure regime for entities eligible to use the Simplified Disclosures Tier 2 financial reporting framework to align with that Framework, particularly for Group 3 unlisted entities and assurance requirements appropriate to the size of these entities, and
- Adjusting the draft legislation to clarify that entities in all Groups must make materiality assessments in accordance with the ASRS.

3. 'Sustainability reports'

Terminology

There is a disconnect between the Policy Statement, the Explanatory Memorandum, the legislation and the Australian Sustainable Finance Strategy. Government is on record as 'consistent with global practice … adopting a climate first' approach.[2] The Policy Statement also refers explicitly to mandatory climate-related

[2] See for example *Sustainable Finance Strategy Consultation Paper*, Treasury November 2023 at page 5.

financial disclosure. On the other hand, the legislation refers to an obligation to produce a 'sustainability' report (for example, Exposure Draft sections 292, 292A and 296A).

Our members consider the term 'sustainability report' is likely to cause significant confusion. While many entities currently produce sustainability reports they are not currently mandatory. These reports typically cover a range of issues in addition to climate change and other environmental matters and many of our members report that their investors engage closely with these 'sustainability reports'.

Using the term 'sustainability report' in the legislation is problematic because while on the face of it the term used in the draft legislation relates to climate matters, as a practical matter entities and their investors generally consider a sustainability report as covering a broader field. Using a term which generally has a broader meaning in a narrow context in the legislation also potentially implies that 'sustainability reports' are mandatory. This seems contrary to the stated intention of a climate first approach and the consistent references in the Policy Statement and the Explanatory Memorandum 'to climate-related financial disclosures'. Entities also approach reporting on climate issues in a variety of ways and the legislation needs to be sufficiently flexible to accommodate a range of practices. One possible solution would be to adopt the term 'climate report' which clearly indicates that the report relates to climate-related financial disclosures and would provide better alignment with the directors' declaration as currently drafted (s296A(6)). An alternative would be to locate these disclosures in existing reports and enable cross referencing, noting the difficulties in relation to assurance referred to above.

Content and location of disclosures

The legislation contains significant detail about the contents of the 'sustainability report' (section 296D). Our members consider the bulk of detailed content of the report should be in the relevant Standard not in the legislation. The contents of these reports should be determined by the AASB as they are currently for financial reports. It will be important to achieve a balance between clearly setting out the reporting requirements, including the entities required to report, in the legislation and providing further detail in the Standard.

A further issue is whether entities will be able to incorporate material into the new report by reference to their annual report or to material on a website. As a matter of practice, it is likely that many annual reports containing climate-related financial disclosures will be available online. Our members consider entities should have the option to incorporate further disclosures by reference to an online resource such as a dedicated corporate website as many entities no longer produce hard copy sustainability reporting. Our members also continue to question the imposition of an additional requirement to make publicly available climate disclosures on entities which have no other public reporting requirements such as Group 3 entities.

Our members also consider that subsidiaries within a corporate group should be able to rely on the consolidated parent entity reporting rather having to reproduce disclosures at the subsidiary entity level child entity can rely on the consolidated parent disclosures, where it makes sense to do so. This would be particularly the case in relation to matters such governance structures, risks and strategies, metrics and targets. This is particularly important for Australian groups with foreign parent companies which under the current proposals would not be able to rely on their parent's reporting notwithstanding it will be more meaningful for investors, particularly in relation to targets and strategy. They would welcome clarification about whether a subsidiary entity which needs to prepare reports under Chapter 2M of the Corporations Act is required to prepare a climate/sustainability report absent any other criteria?

Governance Institute recommends:

- Replacing the term 'sustainability report' by the term 'climate report' in the legislation and the Explanatory Memorandum as this is more consistent with Government's stated policy intent to adopt a 'climate first approach' consistent with global practice. Alternatively locate climate-related financial

disclosures in existing reports and enable cross referencing. The legislation should clearly set out the reporting requirements, including the entities required to report, with further detail in the Standard.
- The detailed content of the new report (section 296D) should be determined by the AASB and set out in the applicable Standard as is currently the case for financial reports rather than in the legislation
- It should be clear in the legislation that entities should have the option to incorporate further disclosures by reference to an online resource such as a dedicated corporate website, and
- Subsidiaries within corporate groups should be able to rely on the consolidated parent entity reporting rather having to reproduce disclosures at the subsidiary entity level child entity can rely on the consolidated parent disclosures, where it makes sense to do so.

4. Directors' sign off

The proposed new Section 296A(b) contains a requirement for the sustainability report to include a directors' declaration.

Our members have several concerns about the breadth of this declaration:

- Full audits of reports are not currently scheduled to be required until 2030. However, directors, few of whom are likely to be climate experts, will be required to make a declaration that reports for years prior to 2030 comply with the Corporations Act and the accounting standards without the benefit of independent assurance. This potentially exposes directors to significant personal liability even with the benefit of the limited immunity. The legislation also refers to 'international sustainability reporting standards' a term which is not defined
- Many of the matters the subject of the directors' declaration are by their nature uncertain and should be subject to a 'reasonable grounds' test, and
- Given they are not experts, directors will of necessity be required to rely on the expert opinions of others. The extent to which the defence under section 189 of the Corporations Act will be available to assist them in situations where they have relied on climate experts' opinions remains unknown.

Our members consider that directors should be required to declare that, in their opinion, they have taken reasonable steps to comply with, or to secure compliance with, the Sustainability Standards and the Corporations Act, noting that the scope of the ASRS is limited to climate-related disclosures and the International Standards cover a broader range of matters. This repeats the wording in section 344 of the Corporations Act and is well understood. This form of declaration is also more appropriate given the absence of reasonable assurance and the fact that climate disclosures are a rapidly moving, emerging area. If necessary, this form of declaration could be time limited to align with the term of the limited immunity.

Governance Institute recommends that directors should be required to declare that, in their opinion, they have taken reasonable steps to comply with, or to secure compliance with, the Sustainability Standards and the Corporations Act noting that the scope of the ASRS is limited to climate-related disclosures and the International Standards cover a broader range of matters. If necessary, this form of declaration could be time limited to align with the term of the limited immunity.

5. Ministerial discretion

Our members are concerned at the breadth of the Ministerial discretion in the proposed section 296A(3) which gives the Minister power to require a sustainability report to include statements relating to matters concerning 'environmental sustainability' by legislative instrument. This power is extremely broad and could conceivably be used to in relation to matters that do not relate to climate-related financial disclosure. Our members consider this discretion should be limited to matters relating to climate-related financial disclosure.

The latest report by the Australian Law Reform Commission (ALRC), *Confronting Complexity: Reforming Corporations and Financial Services Legislation*, found the *Corporations Act* is no longer fit for purpose, unnecessarily complex, shrouded in obfuscation, obscure, convoluted, and like a maze – 'anything could be anywhere'. The proliferation of powers, including Ministerial instruments, was identified as a particular problem. Enshrining a broad Ministerial discretion of this type into the Corporations Act only proceeds further down the path of obfuscation and obscurity. Our members consider that any discretion should be limited to matters relating to climate-related financial disclosure, clearly linked to the Sustainable Finance Strategy.

Governance Institute recommends limitation of the proposed Ministerial discretion to matters relating to climate-related financial disclosure only and clearly linked to the Sustainable Finance Strategy.

6. Liability

Our members are concerned that the limited immunity in the consultation material is narrower in scope than the proposals previously consulted on.

They have identified the following specific concerns:

- The immunity only applies to statements made in relation to Scope 3 emissions, scenario analysis and transition plans **in** the report (in prior proposals immunity was in relation to all forward -looking statements). There is no immunity for other forward-l ooking statements required by the regime outside the report or in other locations such as disclosures under Recommendation 7.4 of the ASX Corporate Governance Principles and Recommendations. Our members consider this is likely to have the effect of limiting disclosure and to contribute to 'green hushing' due to concerns around liability, particularly noting the concerns in relation to the directors' sign off referred to above
- The immunity expires before the first reports are due for Group 2 entities and prior to the date for full assurance – this means that Group 2 and Group 3 entities will not have the benefit of the immunity. Group 3 entities are due to make their first reports at a time when the three-year modified liability regime is about to or has expired. Group 3 is the group least prepared for the significant uplift involved in the new reporting requirements and has the least resources. The limited immunity should apply to entities in all Groups for the first three years of their reports, and
- Continuous disclosure obligations will continue to apply in their current form without the benefit of the limited immunity – see below.

Governance Institute recommends:

- The extension of the limited immunity to all forward -looking statements and to entities in all Groups for the first three years of their reporting, and
- If the commencement date for the legislation is deferred a corresponding adjustment to the timeframe during which the limited immunity is available.

7. Continuous disclosure

Our members remain concerned that there has been no adjustment to the continuous disclosure regime because of the interaction between periodic climate-related financial disclosures and the continuous-disclosure regime for ASX-listed companies. As noted in our earlier submissions, some entities currently issue periodic sustainability reports or disclosures which include information they do not consider will have a 'material effect' on the price or the value of their securities from the perspective of continuous disclosure. These entities may, at a later point, change a pathway towards achieving net zero because the pathway becomes blocked or if it fails to reach an interim target and it has disclosed the pathway or target in a periodic report. Given the difficulty of assessing the point at which a path becomes blocked and, while this information may be important to some stakeholders, it may not necessarily be market sensitive.

There are inherent uncertainties in relation to, for example, some of the data and the technologies underpinning emissions reductions which involve significant complexity and the application of judgement.

Our members continue to advocate that the most appropriate option for addressing these concerns would be to adapt the changes introduced during COVID-19 to the continuous disclosure regime. This would mean that reporting entities and their directors only attract civil liability if there is evidence that they knew or were reckless or grossly negligent with respect to reporting. An alternative option may be to adopt a modified business judgement rule where directors and/or entities are taken to have made a business judgement with sufficient care and diligence if there is evidence that they:

- made the judgement in good faith and for a proper purpose
- informed themselves about the subject matter to the extent they reasonably believed was appropriate
- rationally believed that the judgement was in the best interests of the entity, and
- rationally believed that the judgement was reasonable in the circumstances.

Governance Institute recommends:

- Adapting the changes introduced during COVID-19 to the continuous disclosure regime which would mean that reporting entities only attract civil liability if there is evidence that they knew or were reckless or grossly negligent with respect to reporting, or
- Alternatively, adopting a modified business judgement rule where directors and/or entities are taken to have made a business judgement with sufficient care and diligence if there is evidence that they:
    - made the judgement in good faith and for a proper purpose
    - informed themselves about the subject matter to the extent they reasonably believed was appropriate
    - rationally believed that the judgement was in the best interests of the entity, and
    - rationally believed that the judgement was reasonable in the circumstances.

If you have any questions in connection with this Submission, please contact me or Catherine Maxwell, General Manger, Policy and Advocacy.

Yours faithfully,

Megan Motto
CEO