# THE BOTTOM LINE

Issue 17

HLB MANN JUDD
ADVISORY AND ACCOUNTING

**Welcome to this Sustainability Special Edition of our financial reporting publication. It is dedicated to sustainability reporting and the recent and fast-moving developments in this space.**

The reality is climate change is no longer a side issue. And businesses, large and small, have a pivotal role to play in tackling this global priority and doing their bit to decarbonise the global economy.

An effective way to do this is by making transparent, comparable and verifiable disclosures about the entity's impact on the planet. Cue the first two international sustainability disclosure standards (one of which focuses on climate) and the Australian Government's proposals to mandate climate-related financial disclosures here at home in the very near future.

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# The inaugural ISSB sustainability disclosure standards have landed

Since the formation of the International Sustainability Standards Board (ISSB) in late 2021, things have moved at an unprecedented pace. The ISSB has since developed, exposed and issued its first two sustainability-related disclosure standards, marking a significant step towards elevating the prominence of sustainability reporting to match that of financial reporting.

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## THE ISSB

In response to a global push for more consistent, comparable and verifiable sustainability-related information, the ISSB was established by the IFRS Foundation in November 2021.

To leverage off existing (and non-mandatory) sustainability reporting frameworks, standards and materials, the formation of the ISSB saw the consolidation of the Climate Disclosure Standards Board (CDSB) as well as the Value Reporting Foundation which governed materials from the Sustainability Accounting Standards Board (SASB) and the International Integrated Reporting Council (IIRC). Furthermore, the ISSB sought to build on the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

Like the International Accounting Standards Board (IASB), the ISSB is overseen by the IFRS Foundation making them 'sibling' standard-setters. This will allow close cooperation between the two bodies, ensuring connections between IFRS accounting standards (IASB) and IFRS sustainability disclosure standards (ISSB).

The objective of the ISSB is to establish a global baseline of sustainability-related financial disclosures to meet the needs of investors. This will simplify the sustainability reporting landscape by removing the need to consider and choose from several voluntary sustainability reporting frameworks that currently exist.

While the ISSB is responsible for developing IFRS sustainability disclosure standards at the international level, it will be up to local jurisdictions to decide whether, when and how to incorporate these standards into their local reporting regimes.

## IFRS SUSTAINABILITY DISCLOSURE STANDARDS

The ambition of the ISSB is to develop a complete suite of standards that will facilitate the disclosure of information about the financial impact of sustainability-related risks and opportunities on entities so that investors can make better-informed decisions.

The construct of the standards is based on the internationally recognised TCFD framework which consists of four pillars, namely governance, strategy, risk management, and metrics and targets.

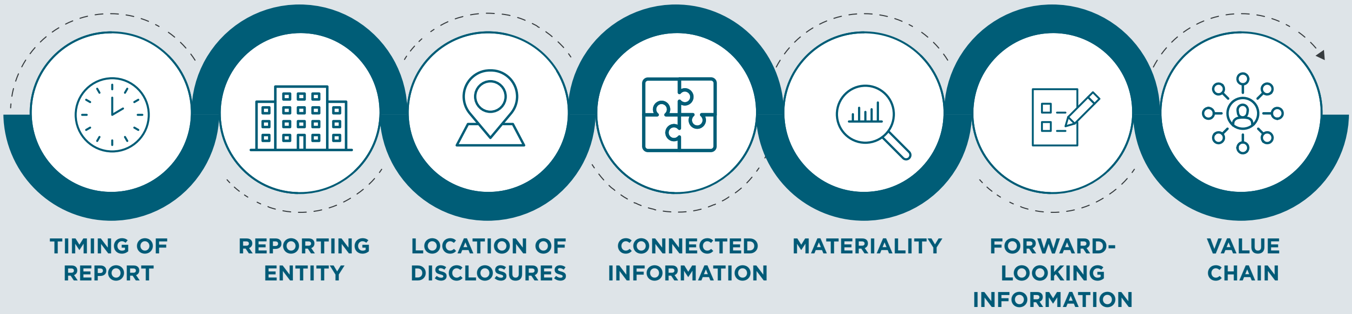
Key features of the ISSB's sustainability disclosure standards to be aware of:

- **Time of reporting** - Reporting under IFRS sustainability disclosure standards will occur at the same time, and for the same period, as the financial statements.
- **Reporting entity** - Sustainability-related financial disclosures are provided for the same reporting entity as the financial statements. This means that each element of an entity's general purpose financial report (which includes both the financial statements and sustainability-related financial disclosures) provides information about the same consolidated group or reporting entity.
- **Location of disclosures** - Sustainability-related information must be provided alongside financial statements, as part of the same reporting package. However, it will be up to local jurisdictions to decide on the exact location of this information within general purpose financial reports.
- **Connected information** - Information provided should allow users to assess the connections between various sustainability-related risks and opportunities, and to assess how information about these are linked to the related financial statements.
- **Materiality** - Similar to the concept of materiality applied in applying accounting standards, sustainability-related information is material if omitting, misstating or obscuring that information could reasonably be expected to influence decisions made by investors.
- **Forward-looking information** - Disclosures need to provide forward-looking insight about the impact of sustainability-related risks and opportunities on the company's strategy, business model and financial statements over the short, medium and long-term.

- **Value chain** - An entity is required to disclose material information about sustainability-related risks and opportunities throughout its value chain. The value chain is the full range of interactions, resources and relationships related to the entity's business model and the external environment in which it operates.

Furthermore, data and assumptions used in preparing sustainability-related financial disclosures must be consistent—to the extent possible—with the corresponding data and assumptions used in preparing the related financial statements.

## KEY FEATURES OF ISSB'S SUSTAINABILITY DISCLOSURE STANDARDS




Already, the ISSB has issued its first two sustainability disclosure standards, being:

- IFRS S1 *General Requirements for Disclosures of Sustainability-related Financial Information* (IFRS S1); and
- IFRS S2 *Climate-related Disclosures* (IFRS S2).

### *IFRS S1*

IFRS S1 can be viewed as a base standard, setting the foundation for how entities should disclose sustainability-related financial information as well as the requirements for providing a complete set of such disclosures.

Many of the concepts that underpin IFRS S1 are rooted in the IASB's *Conceptual Framework* as well as certain IFRS accounting standards such as IAS 1 *Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors*. Preparers of financial statements should therefore be familiar with many of the concepts and general requirements found in IFRS S1.

IFRS S1 requires entities to disclose material information about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects. The key takeaway here is that the standard does not require disclosure of *every* sustainability-related risk and opportunity, only those that could reasonably be expected to affect the entity's cash flows, access to finance or cost of capital over the short, medium or long term. The focus is on investors and disclosure of sustainability-related information that could influence the decisions they make about allocating resources to the entity.

As a high-level summary, IFRS S1:

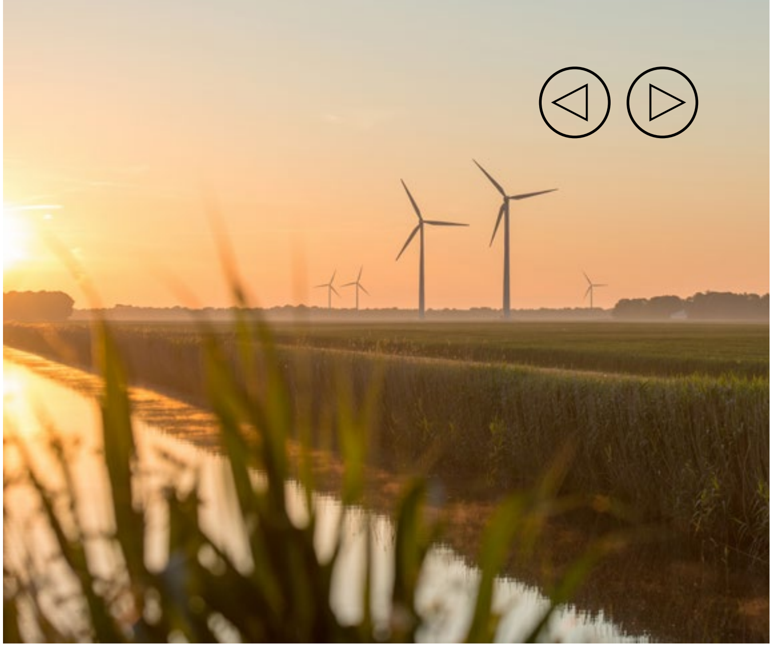
- Is 'GAAP agnostic' meaning entities can apply IFRS S1 (and other ISSB standards) whether their financial statements are prepared in accordance with IFRS accounting standards or other generally accepted accounting principles (GAAP)
- Is designed to be applied in conjunction with sustainability disclosure standards that address a specific sustainability topic (such as IFRS S2 that deals with climate-related disclosures)
- Requires disclosure of material information about sustainability-related risks and opportunities across an entity's value chain to meet the needs of investors
- Explains the general features that underpin useful sustainability-related disclosures
- Requires disclosure of sustainability-related information that cuts across the areas of governance, strategy, risk management, and metrics and targets (consistent with the TCFD framework)
- Specifies sources of guidance that entities must or can refer to when identifying their sustainability-related risks and opportunities and the appropriate information to disclose about them
- Requires disclosure of information related to significant judgements and uncertainties underlying sustainability disclosures, and explains the required treatment of previously reported errors
- Requires disclosures that allow investors to understand the connections between and within the various sustainability-related risks and opportunities, as well as the connections between sustainability-related financial disclosures and the related financial statements.

*IFRS S2*

IFRS S2 focuses on climate-related disclosures. As alluded to above, it must be applied together with IFRS S1.

The standard requires entities to disclose material information about their climate-related risks (both physical and transitional) and opportunities that are decision-useful for users of their general purpose financial reports.

IFRS S2 establishes a structure for entities to provide climate-related information across the TCFD’s four core content areas as follows:



**GOVERNANCE**

Information that enables users to understand the governance processes, controls and procedures the entity uses to monitor, manage and oversee climate-related risks and opportunities.

**STRATEGY**

Information that enables investors to understand the entitiy’s strategy for monitoring climate-related risks and opportunities. This includes information about the resilience of the entity to climate-related changes, developments and uncertainties.

**RISK MANAGEMENT**

Information that enables users to understand the processes the entity uses to identify, assess, prioritise and monitor climate-related risks and opportunities.

**METRICS & TARGETS**

Information that enables investors to understand the entitiy’s performance in relation to its climate-related risks and opportunities. This includes information about the entity’s Scope 1, 2 and 3 greenhouse gas emissions.

Within IFRS S2, under each of the headings above, there are a number of prescribed disclosures, including (but not limited to):

- Information about, including the identity of, the body or individual(s) charged with oversight of climate-related risks and opportunities
- The current and anticipated effects of identified climate-related risks and opportunities on the entity’s business model and value chain
- The effects of climate-related risks and opportunities on the entity’s strategy and decision-making, including information about its climate-related transition plan
- The resilience of the entity’s strategy and its business model to significant physical and transition risks. This includes how climate-related scenario analysis is used to inform climate resilience
- Information about climate-related metrics (including Scope 1, Scope 2 and Scope 3 greenhouse gas emissions) used to mitigate and adapt to climate-related risks, or maximise climate-related opportunities
- Information about climate-related targets to monitor progress towards achieving the entity’s strategic goals
- Whether carbon off-sets will be used to achieve climate-related targets

*Effective date*

Both IFRS S1 and IFRS S2 are effective for annual reporting periods beginning on or after 1 January 2024, however, it will be up to local jurisdictions to determine whether, how and when to integrate these standards (and future sustainability disclosure standards) into their local reporting requirements. Entities can choose to apply the standards voluntarily.

*First year transition reliefs*

There are various reliefs available to entities in the first year of applying IFRS S1 and IFRS S2.

*Climate-first approach*

The most significant relief allows entities to adopt a climate-first approach. This means information about sustainability-related risks and opportunities other than those related to climate is not required in the first reporting period. Entities that make use of this relief will need to disclose this fact.

*Comparative information*

Entities are not required to disclose comparative information in the first annual reporting period in which IFRS S1 and IFRS S2 are applied.

*Timing of reporting*

Under this relief, entities are permitted to report their sustainability-related financial disclosures after they publish their related financial statements.

For interim reporters, their first sustainability-related financial disclosures will be provided at the same time as the next second-quarter or half-year financial reports.

Where entities do not report at interim, their first annual sustainability-related financial disclosures must be reported within nine months after the end of the reporting period.

*Greenhouse gas emissions*

Disclosures of Scope 3 emissions are not required for the first annual reporting period in which an entity applies IFRS S2.

Furthermore, entities are permitted to continue to use their existing methodologies to measure their Scope 1, Scope 2 and Scope 3 greenhouse gas emissions instead of the GHG Protocol Corporate Standard for the first annual reporting period in which IFRS S2 is applied.

If an entity takes advantage of either of these reliefs, the entity is permitted to continue using that relief for the purposes of presenting that information as comparative information in subsequent reporting periods.

# Time to embrace mandatory climate reporting in Australia

To keep pace with international sustainability reporting developments, the Australian Government is in the process of legislating mandatory climate-related financial disclosures. Very large entities will be impacted first, as soon as 2024/2025, with the scope of the new climate reporting requirements extending to progressively smaller entities over a two-year period.

Since December 2022, Treasury has issued two consultation papers seeking feedback on key elements of its proposals to implement requirements for disclosure of climate-related financial risks and opportunities by entities in Australia. The proposals are based on the ISSB's IFRS S2 *Climate-related Disclosures* (IFRS S2) that was issued in June 2023.

While IFRS S2, and IFRS S1 *General Requirements for Disclosures of Sustainability-related Financial Information* (IFRS S1), have an international effective date of 1 January 2024, local jurisdictions (such as Australia) need to decide whether, when and how to formally adopt and integrate these requirements into their reporting regimes. This is what the Australian Government is currently undertaking, applying a climate-first approach as allowed under the transition relief afforded under IFRS S1.

In this article we look at some of the key aspects of Treasury's proposals.

## PHASED APPROACH OF REPORTING REQUIREMENTS

A three-phase approach will be used to implement mandatory reporting of climate-related financial disclosures, starting with the largest entities and then expanding to cover progressively smaller entities over a period of two years. This will allow entities on the smallest end of the spectrum to build capability in the lead up to the new reporting requirements becoming mandatory for them.

Entities reporting under Chapter 2M of the Corporations Act will be caught by the reforms where they meet two of the three thresholds, as indicated below:

| | | MEETS TWO OF THE THREE THRESHOLDS: | | |
|---|---|---|---|---|
| GROUP | FIRST REPORTING YEAR | EMPLOYEES | CONSOLIDATED ASSETS | CONSOLIDATED REVENUE |
| 1 | 2024/2025 | More than 500 | $1 billion or more | $500 million or more |
| 2 | 2026/2027 | More than 250 | $500 million or more | $200 million or more |
| 3 | 2027/2028 | More than 100 | $25 million or more | $50 million or more |

As can be seen from the table on the previous page, from 2027/28, all entities that are 'large' under the Corporations Act will have to comply with the mandatory climate reporting requirements. Where an entity drops below the Group 3 threshold for a particular year, it would no longer be subject to these requirements. Such entities would need to consider continuing to report on a voluntary basis, especially where they anticipate being large again in the future.

Group 1 and Group 2 also include entities required to report under Chapter 2M that are 'controlling corporations' under the *National Greenhouse and Energy Reporting Act* (NGER) and meet the NGER publication threshold used by the Clean Energy Regulator (CER) to determine which emissions data to report publicly.

Group 3 extends to entities required to report under Chapter 2M and that are 'controlling corporations' under the NGER whether or not they meet the NGER publication threshold.

## ASSURANCE REQUIREMENTS

The credibility of climate-related financial disclosures will be undermined in the absence of assurance over these disclosures. However, the Government acknowledges that significant capability uplift in terms of skills, capacity and processes is needed in the climate-related assurance space. It has therefore proposed scaling assurance requirements, starting with limited assurance in the first year of reporting and progressively moving to an end state of reasonable assurance over all climate disclosures by the fourth year of reporting. Refer to Diagram 1: Proposed scaling and extent of sustainability assurance requirements.

## REPORTING

### *Materiality*

Treasury's proposed approach to materiality aligns with the ISSB's position on materiality. That is, climate-related financial information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports (i.e., existing and potential investors, lenders and other creditors) make on the basis of those reports.

### *Location and timing*

In line with current financial reporting practices in Australia, climate disclosures would be required to be published in an entity's annual report. Entrenching climate disclosures in annual reporting processes will encourage Australian entities to integrate climate more deeply into their strategic decision making.

Charities that are registered with the Australian Charities and Not-for-Profits Commission (ACNC) are not captured by the proposals since these entities are not subject to Chapter 2M of the Corporations Act. However, not-for-profit entities that are not ACNC-registered and are required to report under Chapter 2M of the Corporations Act may be captured. This should be clarified when Government finalises its proposals.

Diagram 1: Proposed scaling and extent of sustainability assurance requirements

Climate disclosure requirements would be incorporated into Part 2M.3 of the Corporations Act and would be required as part of both the directors' report and the financial report.

Listed entities would include their climate disclosures in the Operating and Financial Review (OFR) within the directors' report.

In terms of timing of reporting, lodgement deadlines for annual financial reports (which includes climate disclosures) would remain the same as current requirements. That is, disclosing entities and registered managed investment schemes must lodge complete financial reports within three months after the end of financial year. All other companies are required to lodge their financial reports within four months after the end of the financial year.

For NGER entities, the statutory reporting deadline is 31 October for the preceding reporting year of 1 July to 30 June. To ensure consistency, entities should report the same emissions and energy data in their financial reports as they do in their NGER reporting.

*Content*

A key principle underlying the climate reporting reforms in Australia is close alignment with international reporting practices. Accordingly, Treasury's proposals are based on the ISSB's sustainability disclosure standards, with a climate-first approach being adopted.

The Australian Accounting Standards Board (AASB) has been charged with the responsibility to develop Australian climate disclosure standards, the content of which will be based on IFRS S2 and adapted for the Australian context.

Treasury's proposals set out the disclosures expected to apply from commencement of the climate reporting regime. These relate to:

- Governance
- Qualitative scenario analysis (moving to quantitative scenario analysis by end state)
- Climate resilience assessments against two possible future states, one of which must be consistent with the global temperature goal set out in the *Climate Change Act* 2022
- Transition plans
- Climate-related targets and progress towards these targets
- Information about material climate-related risks and opportunities
- Scope 1 and Scope 2 emissions

In terms of Scope 3 emissions, it is proposed that these be disclosed by in-scope entities from their second year of reporting onwards. Scope 3 emissions disclosures made could be in relation to any one-year period that ended up to 12 months prior to the current reporting period.

*Continuous disclosure and fundraising documents*

Treasury's consultation notes that climate-related disclosure obligations would extend to continuous disclosure and fundraising document obligations, and no modifications to or exclusions from those obligations are proposed. ASIC has previously noted that, depending on the circumstances, climate-related risk disclosure may already be required by law, for example within a prospectus or continuous disclosure announcement.

### LIABILITY AND ENFORCEMENT

Under the proposals, the Government intends to introduce civil penalty provisions into the Corporations Act so that a failure to disclose, or inadequate disclosure, would attract a civil penalty. Furthermore, ASIC will be able to issue infringement notices for non-compliance with the new requirements, which will operate alongside existing legal frameworks including directors' duties, misleading conduct and representation provisions, as well as current reporting requirements.

To balance the importance of disclosing decision-useful information with appropriate protections for reporting entities, it is proposed that for the first three years of the climate reporting regime (i.e., from 1 July 2024 to 30 June 2027), elements of mandatory disclosure including Scope 3 emissions, scenario analysis and transition planning would be shielded from misleading and deceptive conduct, false or misleading representations, and similar claims brought by private litigants. Regulators (such as ASIC) could still take action during the fixed three-year period, where appropriate.

### NEXT STEPS

Treasury is currently considering feedback it received on its latest consultation that closed in July 2023. Where legislation is required to give effect to the new requirements, such draft legislation will be exposed before being implemented in line with the initial commencement date of 1 July 2024.

In terms of standard-setting, and to support Treasury's proposals discussed in this article, the AASB has recently released an Exposure Draft, ED SR1 *Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information*. The proposals in the ED are based on the ISSB's IFRS S1 and IFRS S2, setting out the climate-related disclosures in-scope entities would be required to make. The Exposure Draft is open for comment until 1 March 2024.

# Sustainability reporting an opportunity for SMEs

The days of businesses operating without detailed consideration of their greenhouse gas emissions and sustainability impacts are quickly expiring.

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Consistent with many global economies, the Australian government is taking an active approach to addressing global climate change. In 2022, the government committed to reduce greenhouse gas emissions across the Australian economy to 43 per cent below 2005 levels by 2030. Australia's whole-of-economy long-term emissions reduction plan is to achieve net zero emissions by 2050.

This has and will drive significant investment and change throughout our economy and presents significant opportunities for all businesses, no matter their size or industry.

In support of these initiatives, the Australian Treasury released a proposal in June 2023 for implementing mandatory climate-related reporting disclosures. The current proposal would require certain entities (subject to size thresholds) to provide climate-related disclosures from as early as 1 July 2024.

The Australian reporting standards for climate-related disclosures will be substantially aligned to the climate disclosure standards set by the International Sustainability Standards Board (ISSB). The ISSB sustainability disclosure standards incorporate some of the established sustainability measurement and reporting guidance in the market, including the Taskforce on Climate-Related Financial Disclosures (TCFD).

Reporting entities will be obliged to delve into the TCFD's four pillars outlined on page 4.

### WHAT THE 'SCOPES' REALLY MEAN

Scope 1, Scope 2 and Scope 3 greenhouse gas emissions describe the sources of emissions expressed in kilotonnes of carbon dioxide equivalence.

- Scope 1 emissions are the emissions an entity directly controls and owns, such as those produced by their business-owned vehicles.
- Scope 2 emissions are the indirect emissions linked to purchased or acquired energy, electricity, heating or cooling consumed by the entity itself.
- Scope 3 emissions are the broadest class and stem from activities not controlled or owned by the entity but are a result of the entity's value chain, including upstream and downstream emissions.

When an entity reports on Scope 3, it opens a vast array of emissions data from upstream and downstream partners in its value chain. This means supplier or customer activities might find their way into another organisation's emissions calculations.

In response, reporting entities will likely show a preference for suppliers who not only measure their emissions but can also prove they're cutting down their emission intensity.  This has and will drive real changes in customer/supplier relationships.

### IMPACT ON SMALL AND MEDIUM-SIZED ENTERPRISES

While the mandatory reporting requirements will initially impact on the largest entities in the economy, there will be rapid flow on impacts to every organisation.

Small and medium-sized enterprises (SMEs) will undergo a major transformation due to mounting pressure from supply chain partners and customers who are directly impacted by stakeholder requirements to capture and measure the greenhouse gas emissions within their enterprise activities.

As the pressure mounts on reporting entities to reduce their carbon footprint, a greater number of SMEs will find themselves on the path to decarbonisation or risk being shut out from valuable customer opportunities.

As such, now is the time for SMEs to consider their impact on supply chain greenhouse gas emissions and calculate their carbon footprint – a vital first step on the journey towards decarbonisation.

While emissions measurement and reporting requirements may seem onerous, there are rapidly developing solutions available to assist SMEs. If not prepared, businesses could potentially run the risk of losing existing clients or being excluded from new client tender opportunities if they cannot provide relevant emissions related information when required.

## OPPORTUNITIES

Being aware of the sustainability impacts of the business will add value and potentially provide a competitive advantage.

There are many ways SMEs can harness benefits from investing in ESG and sustainability. Businesses can differentiate their market position if they are progressive in adopting an emission reduction target, which may add value to their proposition within the supply chains of larger businesses.

As companies develop a robust, sustainability reporting ecosystem, they can monitor their progress as they roll out a strong ESG strategy. This should help them to drive value and crucially, make them attractive to customers, suppliers, employees and financial providers.

## PERSONAL RISKS FOR DIRECTORS

While it's important and valuable for entities to establish an emissions related strategy, directors must be conscious that many aspects of climate-related disclosures are inherently forward-looking. Under the Corporations Act, forward-looking statements made without reasonable grounds may be taken to be misleading.

ASIC has provided guidance that it is actively alert to the risk of 'greenwashing' claims made by organisations. To minimise risk, directors need to actively ensure the content of climate-related disclosures are based on high quality information and can be substantiated.

As businesses progress towards mandatory climate-related disclosures, HLB Mann Judd is ready to assist business owners and managers commence their emissions measurement and reporting strategy journey.

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