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A guide for boards: ESG governance and reporting

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Directors bear an increasing responsibility to uplift their company's environmental, social and governance (***ESG***) standing amid intensifying stakeholder pressures, ESG regulatory reform and regulatory oversight.

Relevant to all sectors of the economy, this guide highlights the current expectations around ESG governance and reporting. It poses key questions for directors to consider in relation to ESG risk management, directors' duties and next steps. The guide is also a resource to legal leaders and teams looking to better understand the current issues and governance implications surrounding ESG.

Overview

ESG objectives for boards

Balancing ESG matters with other business priorities is a delicate and challenging role for directors. Boards that are leading the way are tackling this challenge by:

- Establishing the firm's ESG strategy and achieving set objectives;
- Overseeing risk and compliance issues as they evolve across a range of ESG areas;
- Monitoring stakeholder engagement as investors seek to understand how companies address and manage risks and opportunities;
- Navigating regulatory reform in relation to ESG issues;
- Appropriately disclosing and reporting on ESG objectives and performance; and
- Understanding the nexus of ESG with other business priorities.

In our assessment, as boards and their business seek to stay ahead of the curve, increasing attention will need to be given to reviewing ESG commitments, standards, policies, and their associated implementation. With ever-changing international and domestic guidelines and best practices—this is no mean feat amidst an already dynamic business environment and full board agenda.

Setting the ESG board agenda

ESG is a broad area of governance that includes, but is not limited to the below areas, which this guide will explore in turn. You'll also find a reporting duties and checklist at the end of this guide.

- Overseeing mandatory, climate-related financial reporting
- Monitoring diversity, equity and inclusion-related developments, including implications for reporting
- Board requirements to approve modern slavery statements
- Reviewing, approving and monitoring the organisation's position on biodiversity risk
- Human rights due diligence and a company-wide commitment to identifying and addressing human rights issues
- First Nations rights and understanding the touchpoints a company has with First Nations people
- Compliance with anti-money laundering and counter-terrorism financing requirements
- Overseeing management of psychosocial health in the workplace
- Appendix: reporting duties and checklist

Mandatory climate-related financial disclosure

By Jillian Button, Hannah Biggins, Victoria Costa, Tiana Macleod, Alex Batsis

12 September 2024

Overseeing a major change in corporate reporting

Boards should be taking steps now to understand the implications of the *Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Act 2024* (Cth) (the ***Act***) for their organisations, which was recently passed by the Federal Parliament on 9 September 2024 and received royal assent on 17 September 2024.

The new legislation represents a significant shift in corporate reporting. For many companies, mandatory climate-related financial reporting will mean navigating new and unfamiliar territory. As recently remarked by ASIC Chair Joseph Longo, 'the growing interest in ESG issues is driving the biggest changes to financial reporting and disclosure standards in a generation'. Boards will play an essential role in responding to these changes and overseeing management to ensure their organisations respond appropriately and adequately to climate-related risks and opportunities.

The new climate-related financial disclosure regime

The Act implements standardised, internationally aligned, mandatory climate-related financial disclosure requirements for large listed and unlisted entities. Such disclosures are intended to provide comparable, transparent and decision-useful information to stakeholders.

This information assists stakeholders to understand and assess:

- the climate-related financial risks and opportunities of reporting entities; and
- how entities manage, plan for and adapt to these risks and opportunities (see our recently published *Insight* for further details on the new regime).

Reporting entities are now required to provide relevant disclosures in a new 'sustainability report'. The sustainability report will form part of an entity's annual reporting obligations.

The new regime will be implemented principally under the *Corporations Act 2001* (Cth). Similar to the directors' declaration currently provided as part of the company's financial report, directors will be required to make a declaration regarding the sustainability report.

Under the Act,[1] directors will be required to declare that (among other things), in their opinion, the substantive provisions in the sustainability report are in accordance with the Corporations Act (eg that they are compliant with the sustainability standards etc). However, a lower threshold will apply for declarations in respect of financial years commencing before 1 January 2028, with directors required to declare that, in their opinion, the entity has **taken reasonable steps** to ensure the substantive provisions of the sustainability report are in accordance with the Corporations Act. As is the case with other financial reporting, directors must exercise their duty of care and diligence when reviewing and approving the sustainability report.

Given the interaction of these requirements and duties with the new regime, and with the first cohort of reporting entities to commence reporting for annual reporting periods commencing on or after 1 January 2025, boards should be taking steps now to understand the implications of the new regime for their organisations.

Steps boards should take to prepare for the new climate-related financial disclosure regime?

We recommend that boards:

- seek information and training, whether from management or external advisers, regarding the proposed regime, including to understand what will be required of directors and judgement calls that will need to be made regarding certain disclosures;
- ensure material climate-related matters are embedded in the company's broader strategy and that there are effective risk and governance frameworks in place to monitor, assess and manage climate-related risks and to prepare for compliance (including appropriate verification and sign-off procedures for climate-related financial disclosures);
- test and challenge management, including seeking information regarding the company's roadmap towards release of the first sustainability report and any potential hurdles to meeting proposed timeframes;
- set and articulate clear roles, responsibilities and accountabilities for management in relation to climate;
- support management to develop understanding, build internal capacity and capabilities, including to seek external advice or services where required (such as legal advice or early engagement with auditors on evolving assurance requirements);
- seek regular reports from management as to progress in line with the company's strategy; and
- consider what level of support the board will require prior to signing the directors' declaration for the first sustainability report and align with management on that process.

Boards should also consider how the regime will interface with other relevant laws and obligations, including prohibitions on false or misleading statements and misleading or deceptive conduct, and other regulatory requirements.

> Reporting entities will be required to make relevant disclosures in a new sustainability report, which will form part of their annual reporting suite

1 Speech delivered by Joseph Longo on 13 June 2023 at the Committee for Economic Development of Australia State of the Nation conference (Click here to read the speech).

Risks to be aware of

Failure to comply with the new regime may attract civil penalties under the Corporations Act. Additionally, ASIC can issue infringement notices for non-compliance.

When making climate-related financial disclosures, boards should be aware of the heightened risk of greenwashing claims. Both ASIC and the ACCC have announced greenwashing as an enforcement priority for FY24, and civil penalty proceedings have already commenced against several companies for alleged greenwashing. Importantly, ASIC has specifically warned that its future cases may move beyond claims of misleading or deceptive conduct, including by potentially pursuing claims relating to a breach of directors' duties in connection with a company's greenwashing-related conduct.

For directors in particular, there may also be concerns about the proposed requirement that directors provide a declaration in respect of all statements in the sustainability report, in the absence of full assurance of climate disclosures, and potential legal liability risks if such disclosures are later found to be incorrect.

The new regime may also present wider business risks, including:

- operational risk that may arise from inadequate internal processes to comply with the regime.
- strategic risk that may arise from disclosures unearthing inadequate management of climate-related risks and opportunities.
- reputational damage that may arise from disclosures revealing net zero targets or strategies that are out of step with peers.

As noted above, directors should focus on discharging their duties regarding climate-related risks and opportunities, including their duty of care and diligence, when reviewing and approving climate-related financial disclosures and relatedly, when signing their directors' declaration regarding the sustainability report.

Questions that boards should be asking management include:

- Have we undertaken a gap analysis to identify differences between current reporting practices and likely disclosures under the new regime? Do we understand the reporting boundaries, including how many companies within our group are captured by the new regime?
- Are our existing climate-related risk and governance structures and practices appropriate to comply with the new regime?
- Have we engaged with external providers where necessary, eg to understand and comply with external assurance requirements in relation to our climate-related financial disclosures?
- What judgement calls will need to be made in determining the nature and scope of disclosures, and what governance arrangements are in place for those judgement calls??

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Greenwashing and bluewashing risks

By Emily Turnbull, Julia Clemente

Combatting blue and greenwashing: ensuring valid ESG credentials and commitments

Australia is considered one of the highest-risk jurisdictions for greenwashing enforcement. Greenwashing (and, increasingly, bluewashing) is an enforcement priority for ASIC and the ACCC, both of which are taking action to address misleading or deceptive representations in relation to ESG matters, including environmental and human rights credentials. Third-party groups are also active in this space (see our *Insight* for further details of ASIC's 2024 priorities).

As companies face increasing stakeholder pressure regarding various ESG matters, they must ensure their representations, commitments and targets are credible, evidence based and transparent. Organisations that engage in greenwashing and bluewashing could face significant consequences through regulatory enforcement action, including pecuniary penalties and adverse publicity orders, while there can also be reputational damage and other ramifications (see our *Insight* for further details of how to mitigate greenwashing risks).

Boards play a critical role in determining the strategic direction of ESG matters, and this includes ensuring the accurate and reasonably based articulation of ESG credentials and commitments by their organisation.

Is the organisation appropriately managing greenwashing risks?

Boards should confirm their company's disclosures accurately reflect their actual ESG practices. High-risk disclosures, which should be a focus, include those containing:

- Representation as to future matters (such as net zero and other sustainability targets)–this includes forward-looking statements made for the purposes of the proposed mandatory climate-related financial reporting regime;
- the use of 'green' and 'blue' terminology and labelling (such as 'clean', 'green', 'sustainable' and 'carbon neutral'); and
- for financial services providers, representations as to active investment and ownership strategies, and ESG-focused investment screens.

Questions that boards should be asking management include:

- What governance processes and practices do we have in place to ensure that representations, including website and other public-facing statements and disclosures in relation to ESG matters, such as 'sustainable' investment products and services, are regularly reviewed and updated to make sure they are accurate and consistent with the organisation's ESG strategy?
- What is the suite of ESG-related laws and standards that should inform our policies and procedures and against which we should be reporting?

- What governance structures do we have in place to ensure an integrated approach to ESG representations across business units, including that communications, legal, risk and/or compliance, and ESG teams are working together to establish that internal signoffs are robust and effective?
- What legal review and verification measures should we take regarding high-risk disclosures, from both a greenwashing and bluewashing perspective?
- Are we ready for the proposed mandatory climate-related financial reporting regime and sustainable finance strategy (including the sustainable finance taxonomy)? Consider conducting a gap analysis and review of external assurance requirements (see further details of this in both the [Mandatory Climate-related financial reporting section] and refer to our *[Insight]*).

Boards play a critical role in determining the strategic direction of ESG matters area, and this includes ensuring the accurate and reasonably based articulation of ESG credentials and commitments by their organisation.

What is next for boards?

- To date, greenwashing enforcement action (from ASIC, in particular) has focused largely on representations made by financial services providers in relation to ESG-related financial products, including the application of investment screens. Going forward, we expect to see increased regulatory scrutiny of sustainability targets and use of ESG terminology, including the use of vague terms and inaccurate labelling regarding sustainability-related products and services including beyond the financial services sector.
- Across financial services, representations as to ESG-focused active ownership and investment strategies are increasingly a focus of criticism from third-party activists on the basis that they may not reflect a company's actual management or investment practices. Regulators are under pressure to follow suit with enforcement action.
- ASIC has described the proposed mandatory climate-related financial reporting regime and sustainable finance strategy (including the sustainable finance taxonomy) as the potential 'antidote to greenwashing'.[2] Nevertheless, the regulator has made clear it will continue to investigate and take enforcement action against greenwashing where necessary.
- As ASIC and the ACCC become more conversant in bluewashing issues, we also expect to see more enforcement activity around statements regarding social impacts such as company engagement with First Nations people. This is already a growing area of third party activism.
- In this context, particularly where high-risk representations are involved, boards should consider:
  - as noted above, whether governance processes, practices and structures are robust and fit for purpose to manage these risks;
  - how they can utilise the company's enterprise risk management process to identify and verify high-risk disclosures;
  - whether legal review and verification is needed for high-risk disclosures across externally facing representations (eg websites and issued documents such as product disclosure statements) to ensure accuracy, a reasonable basis and consistency; and
  - what external assurance arrangements are in place (if any) and whether these require uplift.

What are the risks to be aware of?

- Representations as to future matters (such as net zero and other sustainability targets) that are not based on reasonable grounds may be deemed to be misleading or deceptive under applicable legislation such as the Corporations Act. For example, indications that a reasonable basis may exist for net zero and other sustainability targets include:
  - internal approvals of the relevant target;
  - a sufficiently detailed and documented plan, informed by appropriate standards and/or guidelines and that does not rely on unrealistic pathways;
  - evidence of appropriate resourcing to implement the relevant target or plan; and
  - implementation of governance arrangements to facilitate a trajectory towards the relevant target or plan, including to monitor and report progress and milestones.
- Investors and consumers may attach significance and subjective meanings to terms like 'ethical investing' and 'responsible investing'. A key risk when promoting these types of credentials is that of overreaching. Always consider how customers and investors will understand broad claims, including whether the impression created is accurate, whether there are reasonable grounds for the claim, and whether these can be substantiated if an inquiry is received from a regulator.
- Organisations can get caught out where third-party providers are involved in implementing ESG-focused measures (eg investment screens and active ownership strategies). Always ensure you have adequate oversight of these providers' practices and procedures, so you can make certain they are fit for purpose and are accurately reflected in any externally facing representations.
- Greenwashing and bluewashing risks may also arise where public commitments to, and reporting against, soft law standards (such as the UN Principles for Responsible Investment or UN Guiding Principles on Business and Human Rights) are inconsistent with business practices. Always ensure your practices reflect the impression created by your organisation's commitments and reporting.
- Importantly, greenhushing is also viewed as a form of greenwashing, having been described by ASIC as saying, in effect, 'we have a strong ESG policy but cannot say anything

2 Karen Chester, Deputy Chair, ASIC, Responding to Climate Disruption Plenary Session, ASIC Annual Forum, 21 November 2023.

about it because "those restrictive regulators won't let us"'.[3] As such, making 'higher-level' ESG-focused disclosures will not protect organisations from engaging in greenwashing and can, in fact, increase the risks.

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Diversity and Inclusion

By Hannah Biggins, Michelle Bennett, Alexander Batsis, Yan-Lin Lee

Requirements to ensure D&I strategies are fit for purpose

Directors must exercise their duty of care and diligence when reviewing and approving the company's annual report, which includes any D&I-related disclosures it contains. As with other forms of disclosure, false, misleading or exaggerated claims or statements regarding D&I matters may result in a breach of directors' duties, or may constitute misleading or deceptive conduct under the Corporations Act, the ASIC Act, or the Australian Consumer Law (this conduct is also known as 'bluewashing'). Such claims or statements may give rise to complaints, regulatory enforcement actions, litigation, reputational damage and other consequences.

In Australia, the main diversity and inclusion (***D&I***)-related regimes are contained in:

- anti-discrimination, employment and human rights-related laws; and
- *the Workplace Gender Equality Act 2012* (Cth) (the ***WGE Act***),

and for Australian Securities Exchange (***ASX***) listed companies:

- the ASX Corporate Governance Council's (the ***ASX Council***) Corporate Governance Principles and Recommendations 2019 (4th Edition) (the ***ASX Principles***).

A number of Australian companies have also voluntarily adopted 'soft law' frameworks, such as the UN Sustainable Development Goals (which include 'gender equality' and 'reduced inequalities') as benchmark objectives when measuring and reporting on progress regarding D&I.

What are some of the key requirements for managing, and reporting against, D&I-related matters within the organisation?

In late 2022, amendments were made to the *Sex Discrimination Act 1984* (Cth), which imposed on businesses a positive duty to eliminate—as far as possible—certain unlawful behaviour, including discrimination on the grounds of sex, and sexual harassment. The positive duty aims to create change by preventing workplace sex discrimination and sexual harassment from happening, rather than responding to them after they have occurred. Since 12 December 2023, the Australian Human Rights Commission has been granted new powers to investigate and enforce compliance with the positive duty.

The ASX Principles require listed entities to report on how they follow each of the ASX Council's recommendations regarding corporate governance practices (or give an 'if not, why not' explanation for not following a certain recommendation). Relevant to D&I, recommendation 1.5 of the current 4th edition of the ASX Principles states that a listed entity should:

- have and disclose a diversity policy and set measurable objectives for achieving gender diversity in its board, senior executives and workforce generally, and report on its progress towards achieving those objectives;
- disclose certain metrics around the respective proportions of men and women on the board, in senior executive positions and across the whole workforce; and
- if within the S&P/ASX300 at the commencement of the relevant reporting period, have a measurable objective for achieving gender diversity in its board of not less than 30% of its directors of each gender within a specified period.

In commentary to recommendation 1.5, the ASX Council suggests that listed entities consider setting key performance indicators (***KPIs***) for senior executives on gender participation within their areas of responsibility, and linking part of their remuneration to achieving those KPIs. The commentary to recommendation 2.1 (regarding nomination committees) also encourages listed companies to maintain a diverse nominations committee in order to reduce the risk of 'groupthink'.

The WGE Act requires certain non-public sector employers to submit an annual report to the Workplace Gender Equality Agency, which must have (among other things) details regarding the gender composition of the workforce and the board, pay parity between women and men, and the availability and utility of employment terms, conditions and practices relating to flexible working arrangements for employees. The WGE Act was amended in early 2023. As a result:

- in February 2024, the WGE Agency published the first private sector employer gender pay gaps (in addition to its existing publication of the gender pay gap at a national, industry and occupational level);
- from 1 April 2024, employers will be required to report additional workforce data (eg age, primary workplace location and remuneration of certain employees including the CEO); and
- from 1 April 2024, employers with 500 or more staff must have a policy or strategy for each of the six gender equality indicators.

What are the risks to be aware of?

From a reporting perspective, directors must exercise their duty of care and diligence when reviewing and approving the company's annual report, which includes any D&I-related disclosures it contains. In particular, directors should carefully consider any forward-looking D&I-related disclosures (eg reaching a gender or racial diversity target within a specific period). They should test and challenge management to ensure that there are reasonable grounds (such as a credible action plan to implement and achieve a D&I-related target)

3 Joe Longo, Chair, ASIC, AFR ESG Summit, 5 June 2023.

for making the relevant disclosures before they are published (such as a credible action plan to implement and achieve a D&I-related target) and oversee progress towards any applicable future commitment or target.

There is increasing pressure on companies from shareholders and other stakeholders, advocating for greater progress in relation to D&I and, in particular, for more diversity on boards (see the proposed changes to recommendation 2.3 of the ASX Principles discussed below). Failing to have an appropriate D&I strategy in place can attract scrutiny by shareholders and other stakeholders. We have seen a range of stakeholders, such as superannuation funds, investment managers and proxy advisers, adopting D&I-related voting policies, to advocate for stronger action on D&I within their investee companies. For example, the Australian Council of Superannuation Investors maintains a policy that it will recommend to its members (which includes some of Australia's largest superannuation funds) to vote against the election or re-election of a male director on ASX300 boards that have less than 30% female representation.

What is next for boards?

On 27 February 2024, the ASX Corporate Governance Council published the Consultation Draft for a fifth edition of the ASX Corporate Governance Principles and Recommendations (the ***Consultation Draft***), which includes (among other things) updated and new D&I-related recommendations.

As part of the proposed fifth edition, a new ASX Recommendation 2.3 will be inserted, which provides that, if a board is considering any relevant diversity characteristics (beyond gender) for its board membership, it should disclose those diversity characteristics. The Consultation Draft proposes specific parameters for reflecting diversity on the board, differing from the Fourth Edition. For entities in the S&P/ASX 300 Index at the commencement of the reporting period, gender diversity is defined as a balanced board (at least 40% women / 40% men / up to 20% any gender) (Refer to our earlier Insight (What's trending: board skills and diversity reporting (allens.com.au)) for more information regarding board diversity reporting.)

Under recommendation 3.4, the Consultation Draft also seeks to extend the scope of Recommendation 1.5, to require a diversity and inclusion policy (compared to just a diversity policy). It introduces a new mandate for entities to disclose the effectiveness of their diversity and inclusion practices, considering measures against sex-based harassment and discrimination. The commentary in the Consultation Draft also broadens the meaning of diversity characteristics to encompass relationship status, family and caring responsibilities, inter-sex status, and race.

We recommend that boards:

- consider the new abovementioned Consultation Draft of the ASX Principles and how the company can prepare to implement these (subject to any changes as part of the consultation process);
- ensure the company's existing D&I-related strategy remains fit for purpose - for non-public sector employers captured under the WGE Act, if the employer has 500 or more staff, the strategy should (from 1 April 2024) include a policy for each of the six gender equality indicators;
- oversee implementation of the D&I related strategy and policy, including that it is embedded in the company's broader strategy;
- maintain focus on the company's D&I-related obligations, and guide management on these matters as required;
- have a firm understanding of the company's existing D&I-related disclosures, targets, frameworks, policies and procedures (including regarding board composition), especially in light of the fact that proposed entities will need to form a view and disclose the effectiveness of its diversity and inclusion practices; and
- seek regular reports from management, so as to progress in line with the company's strategy and targets, and update disclosures and targets if required.

Looking internationally:

- The UK's Financial Conduct Authority (the ***FCA***) and Prudential Regulation Authority (the ***PRA***) are seeking proposals to accelerate change in relation to D&I in the financial sector. The key proposals include an obligation for firms to develop a D&I strategy setting out how they will meet their objectives and goals; to collect, report and disclose data against certain characteristics; and to set targets to address under-representation of certain people. Both regulators have published consultation papers setting out their proposed rules and guidance to deliver improved D&I in the sector generally, with a policy statement expected to be published during the first quarter of 2024. Australian directors (particularly in the financial services sector) should monitor these international developments—though ASIC and the Australian Prudential Regulation Authority (***APRA***) have not yet foreshadowed D&I-related regulatory reform in Australia, the FCA and PRA's proposals may provide some indication of the future direction.
- In April 2023, the establishment of the Task Force on Inequality-related Financial Disclosures (***TIFD***) signalled a shift in how companies will need to treat social-related financial risks in the future, including in relation to D&I matters. The TIFD has not indicated when it expects to release a draft reporting framework, but has stated the framework will be designed to ensure interoperability with the TCFD and the Task Force on Nature-Related Financial Disclosures (the ***TNFD***).

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Human rights

By Rachel Nicolson, Emily Turnbull, Dora Banyasz, Billy Hade

Human rights is an increasing area of focus

As the regulatory and civil society scrutiny of companies' management of human rights issues continues to grow, it is increasingly important for directors to ensure a company-wide commitment to identifying and addressing human rights issues. To better address stakeholder expectations, directors should consider the potential adverse effects that the company may have on the human rights of staff, contractors, communities in which they work and also customers and question management about the due diligence and governance procedures that have been, or need to be, implemented.

Is the company conducting human rights risk assessments and due diligence?

Directors should ensure the company has human rights risk assessment and due diligence processes. These should facilitate its understanding of its salient human rights risks, as well as potential risks that may arise with specific activities, projects or third parties (see this section of the Guide for more details on Modern Slavery).

These processes should be adapted to the company's business and be focused on risks to people, not just to the company. It is also critical that directors oversee and test the adequacy of these processes to check that human rights issues are being identified and escalated to the board as appropriate.

> There is increasing focus on directors' accountability and oversight of the company's management of its human rights risks.

What are the risks to be aware of?

A company may be exposed to a range of risks in relation to human rights harms. This could occur as a result of it causing or contributing to harm, or being directly linked to the harm (these three potential ways of a business being connected to impact is set out in the UN Guiding Principles on Business and Human Rights (the ***UNGPs***), the authoritative global standard on the human rights responsibilities of business).

Further, these risks can materialise in different ways, including through shareholder and other stakeholder activism, private litigation and regulatory enforcement. Although companies themselves have been the focus of legal action and stakeholder scrutiny to date, there is increasing focus on directors' accountability and oversight of the companies' management of their human rights risks.

What is next for boards?

- The focus on board-level and director responsibility for managing human rights issues is expected to increase, including as a result of legislative trends overseas.
- For instance, the EU has proposed a Corporate Sustainability Due Diligence Directive which, if introduced, would require directors to consider the human rights consequences of their decisions, and to implement and oversee human rights due diligence by the company. And the ASX proposed 5th edition of the Corporate Governance Council Principles proposes that boards oversee due diligence on an entity's stakeholder relationships, including on human rights impacts.
- Regardless of whether Australia follows suit, these types of developments continue to encourage local activists and regulators to examine directors' management of human rights issues more closely.
- Accordingly, directors of Australian companies should start to put structures in place for overseeing and interrogating their company's human rights risk assessment and due diligence programs, in addition to monitoring the legislative landscape for future developments.

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Modern slavery

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Ensuring modern slavery compliance and good practice

The Modern Slavery Act 2018 (***MSA***) is Australia's key piece of human rights-related reporting legislation. Boards play an important role in complying with this modern slavery reporting requirement, as they must approve and sign the company's modern slavery statement.

The recommendations of the first statutory review of the MSA were released in May 2023, and sought to enhance Australia's approach to managing and reporting on modern slavery risks in companies' operations and supply chains. This included the recommendation of introducing mandatory due diligence (refer to our *Insight* for more details and see this section of the Guide for more details on Human Rights).

How is the company assessing and managing modern slavery risks in its operations and supply chain?

Companies are required to report annually on actions taken to assess and manage modern slavery risks in their operations and supply chains, including in relation to due diligence and grievance mechanisms. A company's approach to assessing and managing modern slavery risks should be informed by the UNGPs. As the MSA continues to be an area of focus by which the Government will seek to strengthen Australia's approach to combatting modern slavery, boards should continue to monitor developments and consider whether any uplift is required to existing frameworks and policies, as well as their implementation.

> Companies are required to report annually on actions taken to assess and manage modern slavery risks

What are the risks to be aware of?

As with human rights more generally, failing to assess and address modern slavery risks in a manner that is consistent with the UNGPs and other voluntary frameworks may attract scrutiny from shareholders, civil society groups, strategic litigants and other stakeholders.
Assessing and addressing modern slavery risks is now well beyond being a 'nice to have' practice, with the level of scrutiny demonstrated by each of:

- the focus on the 'S' in ESG;
- the increase in mandatory human rights due diligence laws globally;
- the increase in human rights-related complaints through non-judicial grievance mechanisms; and
- supply chain-related litigation, particularly in the US and UK.

A failure to adequately assess and address modern slavery risks may also mean a company may be found to have caused or contributed to modern slavery through its activities, which may give rise to complaints or litigation.

Additionally, failing to implement any commitments made in connection with modern slavery compliance may attract stakeholder scrutiny and a risk of bluewashing allegations. Finally, the upcoming changes to the MSA may mean stronger enforcement mechanisms are introduced for such things as failing to report or failing to have a due diligence system.

What is next for boards?

As the upcoming reform of the MSA is likely to include the introduction of a mandatory due diligence regime and the introduction of civil penalty provisions, directors should engage with management to understand the extent to which human rights due diligence systems are in place and embedded across their business, and interrogate the effectiveness of these systems, including their alignments with the UNGPs.

To ensure compliance and good practice, board members should also continue to:

- remain across the requirements under the MSA and expectations under the UNGPs;
- ensure adequate resourcing is available to assess and address modern slavery risks; and
- ensure all disclosures made in modern slavery statements are accurate.

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Biodiversity in business

By Jillian Button, Victoria Costa, Tiana Macleod

The nature-related financial impacts are real

There is scientific consensus that nature is in a state of decline, and increasing recognition that this decline poses risks to the global economy. According to the World Economic Forum, $44 trillion of economic value generation—over half the world's GDP—is moderately or highly dependent on nature.

Biodiversity is declining faster than ever before in human history. Addressing this decline will require a whole-of-society approach, including from the private sector, and organisations should be responsive to the increasing regulatory and stakeholder expectations in relation to nature and biodiversity.

With the release of the final recommendations of the TNFD and other developments focusing on better protecting nature (such as the adoption of the landmark Kunming-Montreal Global Biodiversity Framework, and in Australia, the Federal Government's Nature Positive Plan), companies around the world are taking steps to better understand their relationship with nature and biodiversity (see more details in our *Insight*). This involves consideration of both nature-related risks and opportunities – for instance:

- how the company's nature-related dependencies (eg, on water supply, pollination or carbon sequestration) and impacts (eg, by causing or contributing to habitat loss or soil erosion) may pose material financial risks to the company; and
- how the business might seek to harness nature-based opportunities (eg, by investing in nature-based solutions and participating in biodiversity markets such as Australia's recently established Nature Repair Market).

Addressing biodiversity in strategy, risk management and capital allocation?

Most corporates and capital providers currently have a limited understanding of their nature-related dependencies and impacts, meaning they are likely to be inadequately accounting for nature risks and opportunities in their strategy, capital allocation framework and decision-making.

The growing spotlight on nature will put greater pressure on boards to oversee their organisation's preparation for a more orderly transition to nature-related transparency and management. Boards should consider their organisation's holistic response to nature and how it can more proactively embed nature (as appropriate, having regard to materiality) into strategy, risk management and governance frameworks.

> $44 trillion of economic value generation—over half the world's GDP—is moderately or highly dependent on nature.

What are the risks to be aware of?

Failure to appropriately identify and manage nature-related risks arising from a company's impacts and dependencies on nature may give rise to serious consequences for companies, including: financial loss, supply chain disruptions and missed investment opportunities. Boards should also be alive to how existing corporate reporting obligations apply to nature, for example by seeking to ensure that material nature-related risks are adequately disclosed in an organisation's Operating and Financial Review, and for ASX listed entities, in accordance with continuous disclosure obligations. Consideration should also be given to the interface between nature-related risks and opportunities and directors' duties and duties under industry legislation such as the *Superannuation Industry (Supervision) Act 1993* (Cth) and *Banking Act 1959* (Cth). Failure to adequately account for nature-related risks and opportunities in business operations will likely attract scrutiny from stakeholders, with shareholders already taking action on nature-related matters, which may result in reputational damage and increased litigation risk.

Directors will also need to have regard to nature-related risks when considering whether any financial statements prepared by a company present a true and fair view of the financial position of the company. Guidance published by the Australian Accounting Standards Board provides that entities preparing financial statements should consider: whether investors could reasonably expect that climate-related risks / emerging risks could affect the amounts and disclosures reported in the financial statements; and what disclosures about the impact of these risks on the assumptions made in preparing the financial statements are material to the financial statements, for the purpose of determining relevant disclosures. This guidance is equally applicable to nature-related risks.

What is next for boards?

With increasing focus and expectations from stakeholders, nature and biodiversity should be firmly on boards' agendas and considered alongside the organisation's management of climate-related risks and opportunities.

- A new opinion issued by barristers Sebastian Hartford Davis and Zoe Bush clarifies that directors should take practical steps to ascertain the materiality of nature-related risks relevant to their organisation and discharge their directors' duties accordingly.
- Boards should also consider how value can be created through nature-related opportunities relevant to their organisation, including through the voluntary national market established under the *Nature Repair Act 2023* (Cth) which is intended to deliver improved biodiversity outcomes.

Elevating nature as a priority will also support boards in preparing their organisations for the foreseeable expansion of sustainability-related regulations to cover nature. For example, the Australian Government has already indicated that a number of climate-related proposals may be expanded to apply to nature in the future, including the proposed mandatory climate-related financial reporting regime.

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First Nations

By Dora Banyasz, Darcy Doyle, Lia Mikaelian

Embedding first nations protection into systems and processes

The recognition and protection of First Nations rights is an important part of the ESG landscape in Australia and globally.

There is a broad spectrum of activity in relation to strengthening respect for, and protection of, First Nations rights. This includes law reform, policy initiatives in certain sectors, commissions of inquiry like the proposed federal Makarrata Commission and treaty processes, and the establishment of state- or territory-based Voices to Parliament.

The UN Declaration on the Rights of Indigenous Peoples is becoming increasingly prominent in setting the benchmark for how companies engage and consult with First Nations groups globally, including in relation to the concept of free, prior and informed consent (***FPIC***).

Boards need to understand the touchpoints their company has with First Nations people. They must ensure there are appropriate mechanisms in place to effectively engage and consult with them, and protect their cultural heritage and broader human rights, in line with these international standards.

Has the company developed and implemented systems and processes to ensure consultation and engagement with First Nations peoples is occurring when required?

Initially, companies should take steps to understand the scope of First Nations rights that are potentially impacted by their business operations, in line with the UNGPs. This includes by engaging in meaningful consultation with First Nations people to better understand those potential impacts.

Where the rights of First Nations people may be impacted by a company's business operations, the company should establish a clear position on, and approach to, consultation and engagement with Indigenous peoples, as well as how and when FPIC will be implemented. They should then work on ensuring this approach is effectively operationalised, including through being built into systems and processes (such as compliance baselines, risk assessments and due diligence, data systems, cultural heritage management plans and training).

> We have also seen ASIC identify misconduct impacting First Nations communities as an enforcement priority.

What are the risks to be aware of?

In Australia, there is increasing scrutiny by stakeholders of whether companies have adequately consulted or engaged with First Nations people including whether they have obtained consent in relevant circumstances. Where there are alleged failures to do so, attention may be focused on the company's connection to human rights impacts. This scrutiny can lead to legal, commercial, reputational and operational risk. For example, following the Juukan Gorge Parliamentary Inquiry, we have seen governments, regulators and other stakeholders such as financiers and investors raise their expectations regarding engagement and consultation with Indigenous peoples. As a result, projects with perceived deficiencies in engagement and consultation may experience delays in obtaining approvals and finance. Projects have also faced legal proceedings (and consequent project delays), with causes of action relating to alleged failures to complete adequate consultation with First Nations communities.

What is next for boards?

Boards need to have strong oversight and responsibility for these issues, and they need to know how the company's approach to protection of First Nations rights is embedded in systems and processes across their business, and across all stages of a project.

Boards should also continue to monitor potential upcoming reforms to laws and standards concerning First Nations rights, such as to the *Environment Protection and Biodiversity Conservation Act 1999* (Cth) and the *Aboriginal and Torres Strait Islander Heritage Protection Act 1984* (Cth).

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Anti-money laundering

By Caroline Marshall, Bronte Hearn

Is your AML/CTF program in place, up to date and rigorously reviewed?

With the uptick in anti-money laundering and counter-terrorism financing enforcement, boards of entities subject to the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) (the ***AML/CTF Act***) must ensure they continue to adequately monitor AML/CTF compliance. Under the *Banking Executive Accountability Regime (BEAR)/Financial Accountability Regime (FAR)*, AML/CTF is also a prescribed responsibility, requiring an accountable person to be appointed, who oversees and assesses the effectiveness of the AML/CTF framework and AML/CTF compliance functions. FAR will extend the AML accountabilities to a wider set of entities in the banking, insurance and superannuation entities.

What is next for boards?

- Notwithstanding BEAR/FAR, the board is essentially responsible for the effective implementation of an AML/CTF program, including its approval and ongoing oversight. They must also ensure that an entity's AML/CTF program is subject to an independent review on a periodic basis, and that they are kept apprised of key AML/CTF risks and issues as they arise. Boards must also be comfortable that the level of AML/CTF reporting and escalation is adequate, so that they can discharge their ongoing oversight obligation.
- The board must ensure that the design of an AML/CTF program:
  - is informed by a comprehensive money laundering and terrorism financing risk assessment;
  - includes monitoring and assurance processes to detect non-compliance; and
  - is supported by sufficient resources.
- The Australian Transaction Reports and Analysis Centre (***AUSTRAC***) has published guidance on board and senior management responsibilities, which points to the importance of good governance and adequate oversight of AML/CTF matters by boards. AUSTRAC expects boards and senior management to have ongoing access to coordinated, structured and quality information on a consistent basis, not limited to specific events or incidents.

What are the risks to be aware of?

- AUSTRAC's focus on board accountability and good governance regarding AML/CTF compliance is clear. Allegations made in recent AUSTRAC proceedings against the casino industry highlight its concern regarding the alleged lack of board and senior management oversight of the entities' AML/CTF program (in particular, Part A of the AML/CTF program, which includes the processes and procedures to identify, mitigate and manage money laundering and terrorism financing risks). We expect AUSTRAC to continue its focus on this area.
- As part of its wider risk governance management mandate, APRA is taking an increased interest in AML/CTF compliance. It recently worked closely with AUSTRAC to review a bank's risk and compliance culture, and entered

into separate but simultaneous enforceable undertakings given by the bank as to its AML/CTF failures.

- Under BEAR/FAR, regulated entities are subject to a strengthened responsibility and accountability framework. Accountabilities under the BEAR/FAR regime sit alongside (and are not inconsistent with) existing directors' and officers' duties under the common law and the Corporations Act, as well as oversight obligations in the AML/CTF Act. The key obligations relevant to AML/CTF (both for an entity and accountable persons) are to:
  - act with honesty and integrity, and with due skill, care and diligence; and
  - take reasonable steps in conducting their business/responsibilities to prevent matters from arising that would adversely affect the entity's prudential standing or prudential reputation.

Directors can also face civil penalty proceedings for breaches of their directors' duties following AML/CTF compliance failings. Recent ASIC cases against current and former directors and officers of a casino operator, for alleged breaches of their duties under section 180 of the Corporations Act have shown the importance of directors' attention to ML/TF risks.

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Psychosocial health in the workplace

By Sam Betzien, Fiona Austin

Managing psychosocial risks

Psychosocial risk management refers to the field of work health and safety (***WHS***) management in which hazards affecting psychological health are identified and addressed. These hazards can arise from workplace factors such as:

- the design or management of work;
- the work environment; and
- workplace interactions and behaviours that may cause psychological harm.

Psychosocial health has been a focus for many organisations over the past few years, as a result of rapidly developing legislative reform. Boards and directors have a central role in not only ensuring that compliance with the reforms is achieved but also in taking advantage of the opportunities that good management in this area offer. Read our *Insight* for more details.

How is the board overseeing psychosocial risk in the business?

Boards must firstly ensure that psychosocial risks are being managed as part of the organisation's WHS strategy. This is a significant shift in approach as, historically, factors leading to psychosocial risk (such as work design and workplace conduct issues) tended to be dealt with as human resources issues (and often in a reactive rather than proactive way).

At a board level, this requires:

- the approval of organisational objectives and measurable performance criteria for psychosocial risk;
- ensuring the company's strategic WHS plan addresses psychosocial risk improvements;
- ensuring sufficient resources are allocated to deliver these plans for the short and long term; and
- supporting the development of additional leadership capability and competency for psychosocial risk management.

Boards will also need to closely monitor performance and assurance for psychosocial risk management, and to continuously oversee adjustment of objectives and plans as appropriate. This is likely to include:

- the development of specific indicators for psychosocial risk performance; and
- systems that are built in consultation with workers and specialists to ensure effectiveness and utility.

Boards and directors play a critical role in overseeing suitable worker and stakeholder involvement in psychosocial risk interventions. While many organisational risk management systems already (at least in theory) apply to psychosocial risk management, typically there is a need to update systems and tools to ensure appropriate collection of data in relation to psychosocial risks and hazards, and to design meaningful controls.

Directors can expect the following to be reviewed:

- **health programs:** including pre-employment, periodic health assessment and injury management programs for psychological risk management.
- **work design and work planning:** to address risks associated with high and low job demands (including cognitive, workload, physical, time and emotional demands) as well as job clarity, control and support needs.
- **business improvement:** including business process, systems and resourcing to address risks in work roles and interfaces, as well as improvements in managing change.
- **workplace amenity and facilities:** including physical work environments that provide appropriate measures for natural surveillance, privacy and security, and retreat.
- **flexible work:** including a good balance between work at home and work in office to enable peer support and collaboration.
- **skills development:** including worker competency programs to support management of high-risk hazards (such as conflict skills, emotional competencies, communication, difficult conversations, dealing with high work demands, positive behaviour expectations).
- **cultural programs:** including a focus on a 'speak up' culture.
- **career development:** including reward and recognition.

- **organisational justice:** including HR policies, grievance, complaints and disciplinary processes that are comprehensive, fair and human centred.
- **violence and aggression:** including security review and personal support tools.
- **bullying and harassment:** including interventions to address underlying factors and response, such as diversity programs.
- **hazardous work review:** including a fresh look at controls associated with high-risk work activities.
- **contractor management:** to ensure management of contracted psychosocial risk.

Many organisations are establishing specific indicators encompassing psychosocial risk management data and including benchmarking programs to demonstrate industry leadership in this field. Indicators might previously have focused on the incidence and cost of incidents and claims, but should now also consider developing additional criteria such as psychosocial risk control effectiveness, employee engagement and team performance as against industry peers.

What is next for boards?

Boards that focus on the value that psychosocial risk management brings will find that the benefits balance (or even outweigh) the costs involved in effecting change. Interventions will bring associated business performance improvements, as they focus on deep organisational barriers and roadblocks.

Minimising harm, making improvements to the experience and wellbeing of workers, and consequentially improving familial experiences and other worker contributions to the communities in which a company operates—all of this has flow-on social effects that are at the heart of the 'S' in 'ESG'.

Boards that oversee effective psychosocial risk management programs can champion and promote these benefits.

What are the risks to be aware of?

- There is a legal risk of regulatory enforcement action where companies have not established effective compliance programs to meet the requirements of the WHS laws.
- There is a legal risk associated with psychological harm and the contributions of psychosocial risk to other physical risk events. Read our *Insight* for more details.
- Directors also have personal responsibilities as 'officers' under WHS laws—which also require them to take reasonable steps to personally verify the true position and the adequacy of decisions made.

Boards should ensure they have adequate literacy in psychosocial safety risk management skills. Also, once systems are in place, they should consider seeking independent assurance to demonstrate compliance.

Contact for further information

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Whistleblowing

By Rachel Nicolson, Katie Gardiner

Does your organisation have a trusted whistleblower program?

Under corporate and public interest disclosure legislation, organisations have obligations in relation to how they handle whistleblower information and ensure that people who speak up or intend to speak up are not subjected to detrimental conduct for doing so.

Public companies, large proprietary companies and proprietary companies that are trustees of a registrable superannuation entity must also have a compliant whistleblower policy that provides information including in relation to how the company will investigate disclosures that qualify for whistleblower protection.

What is next for boards?

- Boards should ensure there is formal reporting from management to the board or a sub-committee of the board in relation to the company whistleblower program.
- Boards that ensure frequent and specific (but de-identified) reporting of information in relation to whistleblower reports and their outcomes will have greater visibility and insight into the organisation's overall risk and exposure.
- Understanding where problems lie can also enable boards to strategically focus on proactive measures to prevent wrongdoing in the first place.
- Boards should also ensure that they and the senior executive team are adequately trained on their whistleblower obligations.

What are the risks to be aware of?

- Failing to have a trusted whistleblower mechanism or act on disclosures adequately can lead to serious risk to the organisation or allegations being raised externally such as to regulators or the media.
- There is a legal risk of regulatory enforcement action where companies do not comply with whistleblower laws and ASIC currently have civil penalty proceedings on foot.
- ASIC has conducted a number of reviews of company whistleblower programs, including by way of issuing statutory notices to produce, and has indicated that it intends to conduct further reviews.

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Appendix: reporting duties and checklist

Best practice standards for ESG considerations—both here and internationally—are constantly evolving. The content in this document is therefore only a guide and should be read alongside legislative and regulatory developments, as well as changing stakeholder expectations regarding corporate governance.

The current Australian legal and regulatory landscape in relation to company directors includes:

- Directors' duties: in addition to fiduciary duties, company directors have a range of statutory duties under the Corporations Act. These include the duty to exercise reasonable care and diligence, and the duty to act in good faith in the best interests of the corporation and for a proper purpose. The consequences of breaching directors' duties can be severe, with both civil and criminal penalties potentially applicable. Directors may also be personally liable for any loss or damage caused by a breach of their duties.
- Directors' obligations under Corporations Act / Modern Slavery legislation to sign off on ESG disclosures.
- ASX Listing Rules: the ASX Listing Rules are a set of regulations governing the admission of securities to listing on the ASX, as well as the ongoing obligations of listed entities. They cover a wide range of areas, including continuous disclosure obligations and aspects of a listed entities conduct. The purpose of the ASX Listing Rules is to ensure the market operates in a fair, orderly and transparent manner, providing investors with sufficient information to make informed investment decisions.
- ASX Principles: ASX-listed entities are also required to report, on an annual basis, the extent to which they have followed the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (the ***ASX Principles***) and, if the ASX Principles are not complied with, to give reasons for not doing so (ie an 'if not, why not' approach). While the ASX Principles apply directly to ASX-listed entities, they are often seen as a benchmark for governance standards in the wider Australian corporate landscape.

Governance checklist

Directors should ensure their organisations have appropriate governance arrangements in place to support a consistent and integrated approach to ESG matters. We recommend boards consider the following:

- ☐ The board is able to evidence its ongoing oversight of key ESG risks (whether or not they are material risks). The board should retain ultimate responsibility and accountability for ensuring the company's long-term resilience in the face of such risks.
- ☐ The board composition is sufficiently diverse in knowledge, skills, experience and background to debate and make decisions informed by ESG risks and opportunities. The board's competencies with respect to managing ESG risks have been properly assessed (eg by conducting performance reviews or internal evaluations) and the criteria used to assess competencies and/or measures used to enhance competencies are properly documented.
- ☐ ESG considerations are embedded into board and committee structures. There is evidence of understanding, and the opportunity to discuss, ESG risks at board and sub-committee levels, which might include appropriate board training.
- ☐ There is evidence that the board has set clear roles and responsibilities for senior management in managing ESG risks and implementing relevant commitments, and holds management to account—eg ensuring management regularly reviews the effectiveness of key frameworks, policies and tools with respect to ESG risks, and makes appropriate revisions.
- ☐ Management of ESG risks is embedded within the company's broader risk management framework (including risk management policies and procedures) and strategic planning.
- ☐ There is evidence that the company's risk appetite framework incorporates the risk exposure limits and thresholds for ESG-related risks that the company is willing to bear.
- ☐ External expertise (eg from legal advisers, specialist consultants, academics and/or scientific bodies) is deployed where reasonably necessary to support the business to manage ESG risk, pursue opportunities and formulate and implement relevant commitments.
- ☐ The board has oversight over the company having regular exchanges and dialogues with peers, policymakers, regulators, investors and other stakeholders to encourage sharing of methodologies and to stay informed on current best practice in ESG matters.
- ☐ As regulating reform in relation to ESG issues continues to roll out, the board is satisfied the organisation has the necessary capabilities and resources available to it to achieve compliance.

Connect with us

Our team

Uplifting a company's ESG strategy and risk management, managing directors' duties and engaging effectively with stakeholders are just some of the ESG-related obligations boards must prioritise.

Our ESG specialists can help you understand and implement next steps for current and emerging ESG governance duties. Contact our team for further information.

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