

Comments on AASB Sustainability Reporting Exposure Draft

1 March 2024

Associate Professor Lien Duong,¹ Professor Mostafa Hasan,
Professor Grantley Taylor, and Dr Baban Eulaiwi

This memorandum serves as our submission to provide feedback on the AASB Sustainability Reporting Exposure Draft. We value the opportunity to share our insights in the development of this essential framework. Our input aims to help shape a forward-thinking climate disclosure framework that adheres to international standards and advances the objectives of sustainable and accountable financial reporting.

- **Material disclosure of climate-related risks and opportunities**

The AASB proposes that if an entity concludes that there are no significant climate-related risks and opportunities that could reasonably be expected to impact their outlook, they should disclose this and provide an explanation for how they arrived at that determination. We concur with this proposal. If entities have minimal exposure to climate-related risks and opportunities, a note indicating this fact would be valuable to users. This disclosure enables users to assess whether the entity should develop strategies to address climate-related business impacts. From the entity's standpoint, reduced compliance and regulatory costs would result from the need to furnish less information within reports.

- **Disclosing the location of the entity's climate-related financial disclosures**

The AASB incorporated paragraph Aus60.1 in the [draft] ASRS 1, advocating entities to exercise discretion in including a comprehensive index table in their GPFR. We support this proposed requirement. While the addition of an index table featuring relevant disclosure sections and corresponding page numbers would greatly benefit users, it might pose a significant burden on preparers due to the detailed disclosure requirements regarding governance, strategy, risk management, metrics, and targets. Entities should be allowed to exercise their judgment in determining the necessity for such an index table.

¹ Contacting author: Associate Professor Lien Duong, School of Accounting, Economics and Finance, Faculty of Business and Law, Curtin University. Email: l.duong@curtin.edu.au. Phone: (08) 9266 1212. Associate Professor Lien Duong, Professor Grantley Taylor and Dr Baban Eulaiwi are at Curtin University. Professor Mostafa Hasan is at Macquarie University.

- **Omission of interim reporting requirements**

We support the proposed removal of interim reporting requirements outlined in IFRS S1 paragraphs 69 and B48 from [draft] ASRS 1. This omission is expected to mitigate confusion and establish a more coherent framework for entities to follow when disclosing climate-related financial information. We believe that excluding these provisions will help reduce ambiguity and ensure clarity regarding expectations for climate-related financial disclosures by entities. Moreover, by eliminating optional requirements that could lead to discrepancies in reporting practices, it will promote a more standardised approach to climate-related financial disclosures. This proposed omission is consistent with findings from academic studies, such as Kajüter et al. (2022),² which indicate a lack of clear evidence for significant capital market-based benefits associated with higher reporting frequency.

- **Disclosure of climate resilience against at least two possible future dates**

The AASB suggests not specifying the upper-temperature scenario that entities must utilise in their climate-related scenario analysis, which primarily focus on assessing climate-related physical risks. We endorse this proposal. Reporting on various climate futures, including the impact of a 1.5 degrees Celsius increase above pre-industrial levels, acknowledges the variability of physical risks based on the location of operations and the level of regulatory control across jurisdictions. Specification of upper-temperature related effects represents an ambitious target and may not be easily quantifiable and may not lead to consistency in reporting of results, particularly for firms with operations across multiple jurisdictions. Nonetheless, entities could still disclose alternative scenarios illustrating how climate-related risks and opportunities may affect operations, strategy, governance, and metrics.

- **Disclosure of climate-related executive remuneration (ASRS 2 paragraphs 29(g) and Aus29.1)**

We fully support the inclusion of this clause. We firmly believe that entities should establish a remuneration policy that explicitly outlines the correlation between the remuneration provided to directors and key management personnel and the corporate performance influenced by climate change. Past research³ has shown that disclosing factors associated with remuneration benchmarks results in more informative and future-oriented disclosures, which ultimately benefit users. In our view, fostering a connection between remuneration metrics and climate-related considerations will likely result in more comprehensive and higher-quality disclosures of factors pertaining to climate change.

² Kajüter, P., Lessenich, A., Nienhaus, M., & van Gemmern, F. (2022). Consequences of interim reporting: A literature review and future research directions. *European Accounting Review*, 31(1), 209-239.

³ Chung, H., W. Judge, and Y. Li. 2015. "Voluntary Disclosure, Excess Executive Compensation, and Firm Value", *Journal of Corporate Finance* 32, 64-90.

- **Australian Carbon Credit Units (ACCUs)**

While IFRS S2 defines a carbon credit as “uniquely serialised, issued, tracked and cancelled by means of an electronic registry”, it is noted that non-Kyoto Australian carbon credit units (ACCUs) do not meet this definition as they are not uniquely serialised. To rectify this, the AASB proposes modifying the [draft] ASRS 2 so that carbon credits issued under the ACCU Scheme fulfill the definition of carbon credit.

We endorse this proposal as ACCUs play a crucial role in Australia's efforts to mitigate climate change by incentivising emissions reduction activities. These units can be sold for revenue, either to the Australian Government under a carbon abatement contract or to companies and other private buyers within the secondary market. The main driver of increased demand for ACCUs stems from the Safeguard Mechanism, where companies are anticipated to utilise ACCUs to fulfill their obligations. It is projected that demand from the Safeguard Mechanism is set to surge from less than 1 million ACCUs in 2022 to 26 million ACCUs by 2030.⁴

- **Definition of greenhouse gases (GHG)**

The decision of the AASB to incorporate the definition of GHG from IFRS S2 into [draft] ASRS 2 without modification is noteworthy, particularly considering the discrepancy regarding nitrogen trifluoride (NF₃). While NF₃ is included in the definition of GHG as per IFRS S2, it is not listed in the National Greenhouse and Energy Reporting Act 2007 and related regulations (NGER Scheme legislation) as a class of greenhouse gas.

Despite this disparity, the AASB proposed to maintain consistency with IFRS S2. The rationale behind this decision is understandable, as NF₃ emissions are not widely significant in Australia's manufacturing sector. Therefore, it is anticipated that few Australian entities would have substantial NF₃ emissions to report.

However, it's essential for stakeholders to remain vigilant and ensure that the inclusion of NF₃ in the definition of GHG does not lead to oversight or neglect of potential emissions. While NF₃ emissions may currently be minimal, environmental circumstances and reporting requirements can evolve over time. Therefore, ongoing monitoring and assessment of greenhouse gas emissions, including NF₃, remain imperative for robust and comprehensive sustainability reporting.

- **Converting GHG emissions into a CO₂ equivalent value**

The AASB's decision to align the conversion of greenhouse gases using Global Warming Potential (GWP) values with the reporting requirements under the NGER Scheme legislation is reasonable and pragmatic. By requiring entities to use GWP values from the IPCC 5th assessment report (AR5), as identified in [draft] ASRS 101, the AASB ensures consistency with the reporting framework established by the NGER Scheme legislation.

⁴ <https://www.dcccew.gov.au/climate-change/publications/australias-emissions-projections-2023>

We endorse this approach as it helps alleviate potential burdens on entities mandated to report climate-related disclosures, particularly those commencing from July 2024. This alignment ensures consistency and streamlines reporting processes, thereby facilitating compliance without unnecessary complexity or additional administrative burdens.

The disparity between GWP values from the IPCC 5th and 6th assessment reports lies in their respective assessments of GHG potency over a 100-year timeframe. The 6th assessment report integrates revised insights into the GWP values of different GHG, reflecting advancements in scientific understanding. Despite these updates, the fundamental principles governing GWP calculation remain unchanged.

- **Market-based Scope 2 GHG emissions**

IFRS S2 paragraph 29(a)(v) mandates the disclosure of an entity's location-based Scope 2 GHG emissions. However, the Treasury's second consultation paper introduced a phased implementation approach for requiring entities to disclose market-based Scope 2 GHG emissions as well. Therefore, the AASB introduced paragraphs Aus31.1(f) and AusC4.2 to propose that entities obligated by the Corporations Act 2001 to prepare climate-related financial disclosures disclose both their market-based and location-based Scope 2 GHG emissions.

We endorse the disclosure of both market-based and location-based Scope 2 GHG emissions, as they provide valuable insights into an organisation's environmental impact and sustainability practices. Location-based Scope 2 GHG emissions are solely based on the average emissions intensity of grid electricity in the geographical area where the organisation operates. While this approach offers simplicity and consistency, it may not fully capture the environmental benefits of renewable energy procurement or energy efficiency initiatives.

On the other hand, market-based Scope 2 GHG emissions reflect the indirect GHG emissions associated with purchased electricity, considering the emissions intensity of the electricity consumed. This approach provides a more accurate representation of an organisation's environmental footprint, especially if it procures electricity from renewable or low-carbon sources. It incentivizes companies to invest in cleaner energy options and supports the transition to a low-carbon economy.

By disclosing both market-based and location-based Scope 2 GHG emissions, organisations can provide stakeholders with a comprehensive understanding of their carbon footprint, demonstrating their commitment to environmental stewardship and transparency. This dual approach allows stakeholders to accurately evaluate the effectiveness of sustainability efforts while fostering accountability and driving positive change towards a greener and more sustainable future.

- **Scope 3 GHG emission categories**

The AASB is proposing to incorporate the Scope 3 GHG emission categories outlined in IFRS S2 into [draft] ASRS 2 as illustrative examples of categories for disclosing the sources of Scope 3 GHG emissions. It suggests that rather than mandating entities to categorise emissions sources in alignment with the categories specified in the GHG Protocol Standards, entities could consider these examples as guidance (refer to [draft] ASRS 2 paragraph AusB33.1 and paragraphs BC82–BC85).

We oppose this proposal as we believe that it raises several concerns. Our stance is grounded in the argument that while flexibility in reporting Scope 3 GHG emissions is commendable, departing from standardised categorisation poses significant risks to the reliability, transparency, and effectiveness of sustainability reporting. Departing from the established GHG Protocol Standards undermines the consistency in reporting methodologies, which is crucial for making meaningful comparisons between entities and industries. This consistency is vital for investors, stakeholders, and policymakers to accurately assess GHG performance. Moreover, allowing entities to choose from a broader range of categories risks obscuring the true extent of emissions. Therefore, it is imperative to maintain alignment with internationally recognized standards to ensure consistency, completeness, and credibility in emissions reporting. Consequently, we recommend retaining alignment with the GHG Protocol Standards within ASRS 2 to uphold robust and meaningful sustainability disclosures.

- **Providing relief relating to Scope 3 GHG emissions**

According to [draft] ASRS 2, paragraph AusC4.1, an entity would be exempt from disclosing their Scope 3 GHG emissions during the first annual reporting period. However, as highlighted in paragraphs BC80–BC81, the AASB introduced paragraph AusB39.1 to [draft] ASRS 2, suggesting that entities be allowed to disclose their Scope 3 GHG emissions for the current reporting period using data from the immediately preceding reporting period if reasonable and substantiated data for the current reporting period is unavailable.

We support the relief provided for Scope 3 GHG emissions, as many Australian entities are not adequately prepared for reporting Scope 1, 2, and 3 emissions, despite the mandatory reporting requirement set to commence from July 2024. Table 1 and 2 present data that derived from our research⁵ on voluntary TCFD (Task Force on Climate-related Financial Disclosures) reporting of ASX300 firms spanning from 2008 to 2019. These tables are cross-referenced against the Treasury proposal on climate-related financial disclosures for Australian corporations. The data from these tables highlights that numerous Australian companies will need to ready themselves for the impending mandatory climate disclosures. This is evident as the current

⁵ The data was also utilised in this journal article which was published in “Alshahrani, F., B. Eulaiwi, L. Duong and G. Taylor. 2023. “Climate Change Performance and Financial Distress”. *Business Strategy and the Environment* 32(6), 3249-3271”. <https://onlinelibrary.wiley.com/doi/10.1002/bse.3298>

voluntary reporting and assurance efforts are primarily concentrated on the largest firms within the Top 300 companies listed on the Australian Securities Exchange.

Table 1: Climate-related Financial Disclosures

	Consolidated Total Assets	Consolidated Revenue
Proposal – Group 1 (from 2024-2025) <ul style="list-style-type: none"> Entities to report under Chapter 2M of the Corporations Act, <i>and</i> Two of the three thresholds: ≥ 500 employees, assets and revenue, <i>and</i> NGER Reporting Entities under the NGER Act (National Greenhouse and Energy Reporting) 	$\geq \$1$ billion	$\geq \$500$ million
Our research (ASX300 firms: 2008-2019) <ul style="list-style-type: none"> 59.40% firms have voluntary TCFD reporting (at least one of the 11 categories). Median figures 	\$2.165 billion	\$1.353 billion
Our research (ASX300 firms: 2008-2019) <ul style="list-style-type: none"> 5.36% firms have voluntary TCFD reporting (for all 11 categories). Median figures 	\$9.605 billion	\$5.710 billion

Table 2: Scope 1, 2 and 3 Emissions Reporting and Assurance

	Consolidated Total Assets	Consolidated Revenue
Proposal – Group 1 (from 2024-2025) <ul style="list-style-type: none"> Scope 1 and 2 emissions: from commencement <ul style="list-style-type: none"> Limited Assurance: from 2024-2025 Reasonable Assurance: from 2025-2026 Scope 3 emissions: from the 2nd year reporting onwards (2025-2026) <ul style="list-style-type: none"> Limited Assurance: from 2025-2026 Reasonable Assurance: from 2027-2028 	$\geq \$1$ billion	$\geq \$500$ million
Our research (ASX300 firms: 2008-2019) <ul style="list-style-type: none"> 16.71% firms reported Scope 1 emissions (median figures) 	\$4.146 billion	\$2.298 billion
Our research (ASX300 firms: 2008-2019) <ul style="list-style-type: none"> 10.92% firms reported Scope 2 emissions (median figures) 	\$4.105 billion	\$1.978 billion
Our research (ASX300 firms: 2008-2019) <ul style="list-style-type: none"> 4.57% firms reported Scope 3 emissions (median figures) 	\$7.785 billion	\$6.905 billion
Our research (ASX300 firms: 2008-2019) <ul style="list-style-type: none"> 2.59% firms reported the Assurance level over their Scope 1, 2, and 3 emissions (either Limited or Reasonable Assurance) (median figures) 	\$20.952 billion	\$9.996 billion