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AASB
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ITC 48 Extended External Reporting

I welcome this opportunity to make a submission and would like to comment both generally as well as the specific questions.

General Comment
The development of general purpose financial reporting has been guided for the last 60 years by what we now refer to as conceptual frameworks. This is currently provided by the Conceptual Framework for Financial Reporting, and the concepts underpinning this can be traced to Accounting Research Study No.1, The Basic Postulates of Accounting by Moonitz published in 1961, and Accounting Research Study No. 3, A Tentative Set of Broad Accounting Principles for Business Enterprises by Sprouse and Moonitz published in 1962 by the AICPA. These frameworks identify the objective(s) of financial reporting, the user(s) of financial reports and how the information in financial reports is used. Importantly, this provides guidance on the scope and content of financial reports. It also provides a discipling mechanism on standard setters and it has contributed to the quality of general purpose financial reports.

Unfortunately, it does not seem that these issues have not been properly addressed in relation to Extended External Reporting. There are numerous consequences of not understanding who the users of the information are and how the information is used, including:

1. Whether reporting should be focused solely on carbon emissions or environmental impacts more generally (i.e., scope). The significance of this is highlighted by the impacts it would have on evaluation of the replacement of thermal coal as an energy source by coal seam gas (i.e., assuming a decision making focus). The former would simply require consideration of the volume of carbon emissions whereas the latter would require that consideration be extended to chemicals used in the process of extracting coal seam gas. While focusing on carbon emissions might be considered simplifying it is subject to unintended consequences such as those that saw diesel cars getting preference due to lower carbon emissions but ignoring other emissions.
2. Consideration of whether recognition should be given to the activities of the reporting entity or whether consideration extended to the wider implication of the business (i.e., suppliers and customers. This issue is analogous to how recognition is made in financial reporting to the costs of property plant and equipment. Recently a motor car racing business announced it was going carbon neutral by planting 20,000 trees. This

might cover the carbon emissions relating to fuel used but it totally ignores carbon emissions arising the manufacture of the cars and components. Is narrowly presenting the ‘immediate’ carbon emissions of the operations of the entity presenting relevant and reliable information for evaluation of the environmental impacts of the business? While this is a simple question in this context, it could equally be asked of airlines and every other businesses. Finally, failure to address this appropriately will create incentives for reporting entities to structure their business operations to minimize reported emissions, without regard to emissions by other entities in their supply chain, potentially in other jurisdictions.

3. Is extended external reporting intended to be complementary to financial reporting and does this require articulation into financial reports? This would likely be necessary to fully understand the implications for future financial performance and be relevant to investment decision making. Most obviously, environment impacts might be disclosed as liabilities or contingent liabilities and failure to do this creates the risk that disclosures simply become ‘political statements’. The importance of this is perhaps highlighted by papers considering the value relevance of environmental disclosures. Of particular interest is Clarkson et al. (2004) which suggests that environmental disclosures generally are relevant, but this is qualified by Clarkson et al. (2013) who find the relevance is limited to environmental disclosures that have economic consequences (i.e., those above the levels permitted by regulation and for which financial penalties are imposed). This later result might be characterized by investors being more like economists that environmentalists.
4. If extended external reporting is intended to facilitate aggregation of environmental impacts by government it is unlikely that this falls within the bounds of general purpose reporting. As such it is best undertaken by the relevant government agencies.

In summary without a proper framework it is difficult to understand how the AASB can endorse any specific framework for extended external reporting. This should not be interpreted as saying that extended external reporting should not be addressed by the AASB in the future, rather that it should be undertaken in a systematic manner and not an ad hoc basis. At this point in time the AASB should direct the majority of its resources to developing a framework to guide the development of extended external reporting. If what is recommended is solely the result of a political process it will surely fail.

However, as an interim measure consideration could be given to the identification of specific disclosures that might be considered relevant (i.e., listing without narrative). Such disclosures might be made electronically through a structured data file and users would be able to extract information that they consider relevant. Such a standardized approach would avoid issues with disclosures being inconsistent / variable and industry specific. Furthermore, this would provide:

1. Empirical evidence that would potentially support the development of a framework for extended external reporting (i.e., who the users of the information are and how is the information to be used); and
2. An appreciation of how users access information which would be relevant to the consideration of future directions in digital financial reporting.

Specific Comments

1. For the reasons identified above generally it is considered appropriate for the AASB to develop a framework to guide extended external financial reporting. However, until this is in place it is premature to adopt a position on specific guidance.
2. If the AASB does not endorse specific guidance this is redundant.
3. The TCFD is at best ‘ad hoc’ and the product of a political process. It is difficult to understand how these disclosures might systematically / meaningfully impact investors decision making. Rather it provides scope for management commentary and forward looking information and claims for which there are few constraints to ensure integrity in the reporting process. Selective disclosure and / or misstatement is likely. Hence it should not be endorsed.

I would like to conclude by saying that I believe that it is appropriate that the boundaries of reporting be extended, and this is potentially disclosing information relevant for determining the future prospects of firms. However, if this is to be realized it must be developed on a solid foundation.

Yours faithfully

Peter Wells

Clarkson, P. M., Fang, X., Li, Y., & Richardson, G. (2013). The relevance of environmental disclosures: Are such disclosures incrementally informative? *Journal of Accounting and Public Policy*, *32*(5), 410-431. https://doi.org/https://doi.org/10.1016/j.jaccpubpol.2013.06.008

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