Australian Government

Australian Accounting Standards Board

Staff paper

Project:	**Sustainability Reporting**	**Meeting**	AASB April 2022 (M186)
Topic:	**Proposed project scope**	**Agenda Item:**	3.2
		Date:	22 March 2022
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Objective

1 The objective of this paper is to **discuss** the potential scope of the Sustainability Reporting project.

Attachments

Agenda Paper 3.2.1 GRI 1 *Foundation* 2021 *[Supporting Material]*

Agenda Paper 3.2.2 GRI 2 *General Disclosures* 2021 *[Supporting Material]*

Agenda Paper 3.2.3 GRI 3 *Material Topics* 2021 *[Supporting Material]*

Agenda Paper 3.3.1 TRWG *Climate-related Disclosures* prototype standard *[Supporting Material]*

Agenda Paper 3.3.2 TRWG *Climate-related Disclosures* Prototype—Supplement: *Technical Protocols for Disclosure Requirements [Supporting Material]*

Agenda Paper 3.4.1 TRWG *General Requirements for Disclosure of Sustainability-related Financial Information* prototype standard *[Supporting Material]*

Structure

2 This paper is structured as follows:

(a) Summary of staff recommendation (paragraphs 3-4)

(b) Background (paragraphs 5-6)

(c) Staff analysis (paragraphs 7-19)

(i) The scope of the GRI Standards (paragraphs 10-12)

(ii) The scope of the ISSB and the TRWG prototype standards (paragraphs 13-16)

(iii) Staff recommendation and question to Board members (paragraphs 17-19).

Summary of staff recommendation

3 At its February 2022 (M185) meeting, in order to assist staff in developing the draft project plan the Board tentatively decided to use the work of the International Sustainability Standards Board (ISSB) as the foundation, with modification for Australian matters and requirements only where necessary.[1]

4 Although some of the feedback received to date[2] indicated there is an appetite for sustainability reporting which goes beyond the intended scope of the work of the ISSB, staff recommend that the Board focus specifically on closing the perceived gap in financial reporting. That is, consistent with the proposed scope of the work of the ISSB, staff recommend that, in developing the draft project plan, the proposed scope of the project be specific to sustainability-related financial reporting.

Background

5 In December 2020 the joint alliance of leading sustainability reporting standard-setters and framework providers[3] published *Reporting on enterprise value*, a prototype climate-related financial disclosure standard (the joint alliance prototype standard) that illustrates how their standards and frameworks, along with the recommendations set out by the Task Force on Climate-related Financial Disclosures (TCFD), can be used together to provide a starting point for the development of global standards for sustainability-related financial disclosure. In particular, Section 1: *A comprehensive corporate reporting system* of the joint alliance prototype standard provides an overview of the three levels of reporting:

(a) The highest (or broadest) level of reporting—as depicted by the largest square in Figure 1 below—includes in its scope all sustainability reporting matters that reflect an entity's positive or negative impacts to sustainable development[4]. Sustainability matters would therefore be defined as material if they represent material impacts to sustainable development. Such reporting is designed to inform assessments and decisions by a wide range of users who want to understand an entity's positive and negative impacts to sustainable development (referred to by the joint alliance prototype standard as 'sustainability reporting'). This level of reporting is currently addressed by the Global Reporting Initiative (GRI) (see paragraphs 10-12).

(b) The mid-level of reporting—as depicted by the middle square in Figure 1 below—includes in its scope those sustainability reporting matters that influence an entity's enterprise value. Such reporting is considered as financial in the sense that it relates directly to financial returns to providers of financial capital, but is not necessarily measured in monetary amounts (that is, material information can be qualitative, quantitative, or a combination of both). Consistent with the TCFD's methodology, this level of reporting is referred to as sustainability-related financial reporting in the joint alliance prototype standard. This level of reporting is the level of reporting the ISSB is seeking to address (see paragraphs 13-16).

(c) The lowest (or most specific) level of reporting—as depicted by the smallest square in Figure 1 below—includes in its scope those sustainability matters that influence

[1] See February 2022 (M185) Agenda Paper 3.9 *The proposed Australian perspective*.

[2] Being the feedback received in response to ITC 46 *AASB Agenda Consultation 2022-2026* (see February 2022 (M185) Agenda Paper 3.4 *Feedback summary—ITC 46* AASB Agenda Consultation 2022-2026).

[3] Being the CDP, Climate Disclosure Standards Board (now consolidated into the IFRS Foundation), GRI and Value Reporting Foundation (made up of the International Integrated Reporting Council and the Sustainability Accounting Standards Board).

[4] Described by the 1987 Bruntland Commission Report as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs".

enterprise value, in so far as they affect monetary amounts accounted for and disclosed in the financial statements (referred to as financial accounting and reporting in the joint alliance prototype standard). This level of reporting is currently addressed by the International Accounting Standards Board (IASB).

Figure 1: A comprehensive corporate reporting system

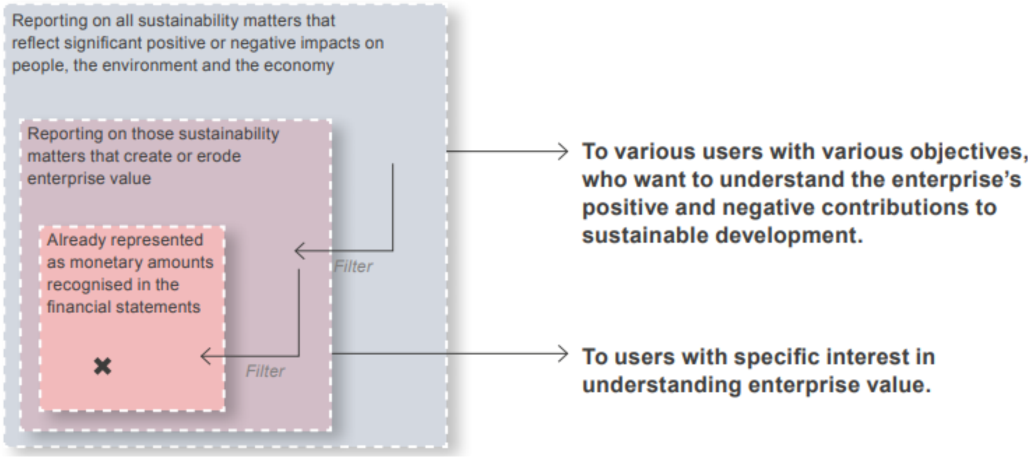
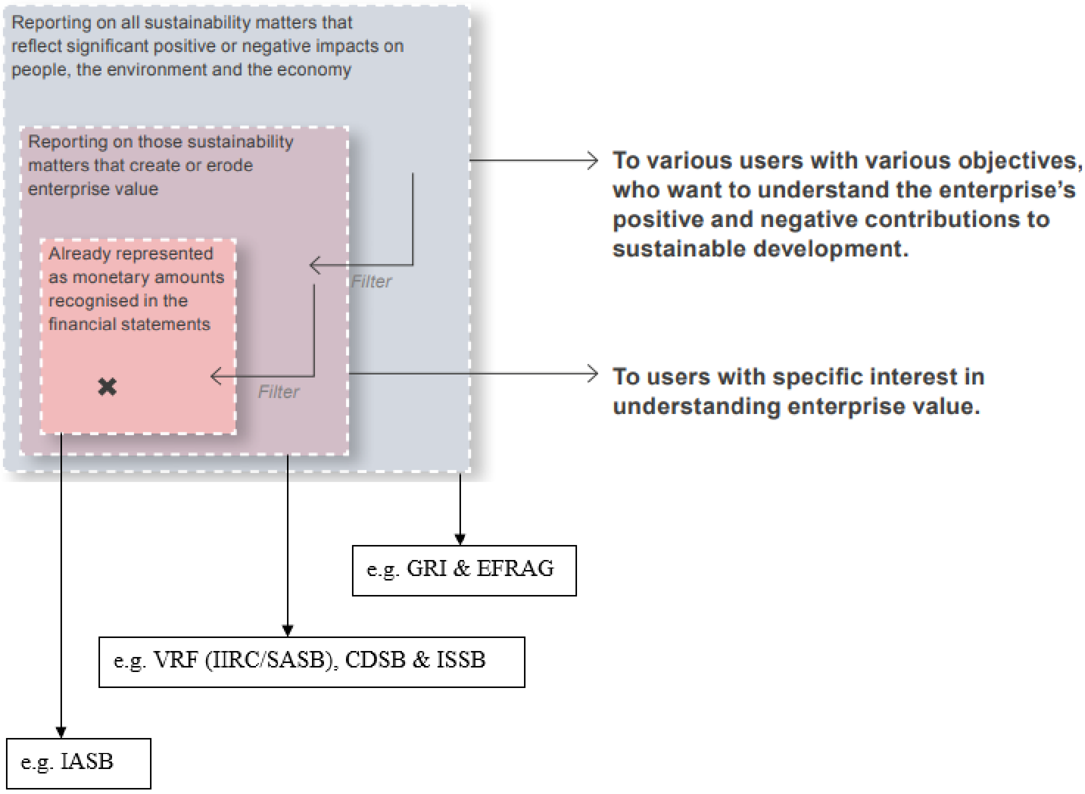


Figure 2: International perspectives mapped against Figure 1



6 The lowest (or most specific) level of reporting is already being addressed by the International Accounting Standards Board (IASB) and the highest (or broadest) level of reporting (that is, sustainability reporting) is already being addressed by the GRI Standards. However, consistent with the findings of the IFRS Foundation[5], feedback received so far[6] indicated there is a gap between these two levels of reporting which needs to be addressed (that is, the mid-level of reporting or sustainability-related financial reporting).

Staff analysis

7 Sustainability reporting helps directors and other senior management meet their reporting obligations. In Australia, interest in sustainability reporting matters has increased significantly.[7] Stakeholders are demanding more transparent, consistent and comparable information about an entity's value creation, retention and erosion. That is, stakeholders are demanding improved reporting of sustainability-related information because it:

(a) is becoming critical to understanding and assessing an entity's performance, financial position, financing and investment. For example, many respondents to ITC 46 commented that sustainability reporting is important because stakeholders want to better understand the costs associated with sustainability reporting matters such as climate change;[8]

(b) affects decision-making and the allocation of scarce resources:

(i) The competitiveness of Australian entities will likely be affected as sustainability reporting is mandated, or requirements introduced, in other jurisdictions. For example, the European Commission has proposed the European Union (EU) introduce a Carbon Border Adjustment Mechanism (CBAM) from 2023 that should initially cover goods in the cement, iron and steel, aluminium, fertiliser and electricity sectors. Under the CBAM, EU importers will buy carbon certificates equivalent to the carbon price that would have been paid had the goods been made in the EU (covering only Scope 1 and Scope 2 greenhouse gas emissions initially).[9] In order to determine that price, EU importers would need emissions data from the foreign entities they are buying from and, should that information not be provided, may look to other entities that are able to provide that information.

(ii) Sustainability reporting is required to maintain investor confidence in the Australian economy. For example, as observed by almost all respondents, primary users of general purpose financial reports and other stakeholders (such as customers, suppliers and employees) are increasingly focusing on and using sustainability-related information as part of their decision-making. Staff think that the absence or quality of such information will likely affect

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[5] See the November 2021 IFRS Foundation Trustees' Feedback Statement on the *Consultation Paper on Sustainability Reporting*.

[6] See February 2022 (M185) Agenda Paper 3.4.

[7] For example, see February 2022 (M185) Agenda Paper 3.4: All respondents to ITC 46 said that sustainability reporting is important to them. Almost all respondents were supportive of the Board expanding its scope of activities to include sustainability reporting, with most commenting that the Sustainability Reporting project should be considered a high priority for the Board.

[8] See February 2022 (M185) Agenda Paper 3.4.

[9] https://acuity.partica.online/acuity/acuity-au-dec-jan-flipbook/flipbook/14/

their decision-making when such information is being made readily available (and at a higher quality) in other jurisdictions.

(c) supports directors and senior management in discharging their reporting obligations. For example, in 2017 Commonwealth Bank shareholders moved to sue over the inadequate disclosure of climate-related risks.[10]

8 Staff think that this is representative of a fundamental shift in thinking of what 'accounting' (or traditional financial reporting) encompasses. Traditionally, stakeholders have viewed accounting through a financial lens—that is, accounting has predominantly been focused on meeting the information needs of primary users of general purpose financial reports through the financial statements. However, as demonstrated by recent outreach and the preliminary academic literature review[11]:

(a) sustainability-related financial information (which can be quantitative, qualitative or a combination of both) and financial statement information (which can be quantitative, qualitative or a combination of both) are interdependent; and

(b) the information needs of users of financial reports has evolved beyond information disclosed in financial statements to include sustainability-related financial information. For example, many respondents to ITC 46 (including preparers and users) said that sustainability-related information is considered to be of equal importance for decision-making to information disclosed in the financial statements.[12]

9 Consequently, in determining the proposed scope of the Sustainability Reporting project, staff have considered:

(a) the scope of the GRI Standards (see paragraphs 10-12); and

(b) the scope of the work of the ISSB and the IFRS Foundation's Technical Readiness Working Group (TRWG) which published the two sustainability-related financial disclosure prototype standards and a supplement (see paragraphs 13-16).

The scope of the GRI Standards

10 Many respondents to ITC 46, including preparers, observed that the GRI Standards are widely applied in Australia, and as such some respondents were supportive of an approach which would see the Board align their work on the Sustainability Reporting project with the GRI Standards.[13]

11 There are three universal GRI Standards (that is, there are three GRI Standards that are applicable to all preparers):

(a) GRI 1 *Foundation*—specifies the requirements that an entity must comply with to report in accordance with the GRI Standards (see Agenda Paper 3.2.1);

(b) GRI 2 *General Disclosures*—contains disclosure requirements for information about an entity's reporting practices and other details such as its activities, governance, and policies (see Agenda Paper 3.2.2); and

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[10] https://www.theguardian.com/australia-news/2017/aug/08/commonwealth-bank-shareholders-sue-over-inadequate-disclosure-of-climate-change-risks

[11] See February 2022 (M185) Agenda Papers 3.4 and 3.6 *Preliminary academic literature review*.

[12] See February 2022 (M185) Agenda Paper 3.4.

[13] See February 2022 (M185) Agenda Paper 3.4.

(c) GRI 3 *Material Topics*—provides guidance on how an entity should determine material topics and includes disclosure requirements for an entity's process of determining its material topics, its list of all material topics and how it manages each topic (see Agenda Paper 3.3.3).

12 The scope of the GRI Standards is explained in GRI 1 and addresses the highest (or broadest) level of reporting (see paragraph 5):

Table 1: Scope of the GRI Standards

Reference in GRI 1	Summary
Purpose of the GRI Standards (section 1.1)	• The objective of sustainability reporting is to provide transparency on how an organisation contributes or aims to contribute to sustainable development. • The GRI Standards enable an organisation to publicly disclose its most significant impacts on the economy, environment, and people, including impacts on their human rights and how the organisation manages these impacts. • ***Sustainable development*** refers to development which meets the needs of the present without compromising the ability of future generations to meet their own needs.
Users (section 1.2)	• ***Users of GRI Standards***: Any organisation can use the GRI Standards—regardless of size, type, geographic location, or reporting experience. • See also: stakeholder (refer below).
Impact (section 2.1)	• The organisation's impacts on the economy refer to the impacts on economic systems at local, national, and global levels. • The organisation's impacts on the environment refer to the impacts on living organisms and non-living elements, including air, land, water, and ecosystems. • The organisation's impacts on people refer to the impacts on individuals and groups, such as communities, vulnerable groups, or society (including impacts the organisation has on human rights). • The impacts on the economy, environment, and people are interrelated.
Stakeholder (section 2.4)	• ***Stakeholders*** are individuals or groups that have interests that are affected or could be affected by an organisation's activities. Common categories of stakeholders for organisations are business partners, civil society organisations, consumers, customers, employees and other workers, governments, local communities, non-governmental organisations, shareholders and other investors, suppliers, trade unions, and vulnerable groups.

The scope of the ISSB and the TRWG prototype standards

13 In April 2021 the IFRS Foundation Trustees published a Feedback Statement on the *Consultation Paper on Sustainability Reporting*. The Feedback Statement highlighted a growing demand to improve the global consistency and comparability of sustainability reporting and more effectively highlight the synergies between sustainability reporting and the financial statements. It also highlighted that, as sustainability reporting is increasingly becoming important for investors' decision-making, there is a growing demand for sustainability-related information that is more tailored to their needs. Consequently, the IFRS Foundation announced its intent to meet the information needs of investors and close the perceived gap between sustainability reporting and financial statements.

14 In November 2021 the TRWG published two prototype standards and a supplement:

(a) TRWG *General Requirements for Disclosure of Sustainability-related Financial Information* Prototype (TRWG *General Requirements* prototype);

(b) TRWG *Climate-related Disclosures* Prototype (TRWG Climate prototype); and

(c) TRWG *Climate-related Disclosures* Prototype—Supplement: *Technical Protocols for Disclosure Requirements* (TRWG Climate Supplement prototype).

15 Most respondents to ITC 46 commented on the recent establishment of the ISSB. However, there were mixed views about whether the Board should align with the approach of the ISSB. While many respondents to ITC 46 were supportive of the proposed direction of the ISSB in establishing global consistency in sustainability reporting, many respondents (including those that were not supportive of the ISSB's approach) were also concerned about the proposed scope of their work. In particular, these respondents commented specifically on:[14]

(a) the definition of material proposed in the TRWG *General Requirements* prototype—being that the definition aligns to the definition of material in the IFRS *Conceptual Framework for Financial Reporting* and is of a specific focus in terms of:

(i) scope of reporting—that is, the focus is on information that falls within the scope of general purpose financial reports; and

(ii) primary users—that is, the focus is on primary users of general purpose financial reports (being existing and potential investors, lenders and other creditors);

(b) the focus on disclosures only—being that global consistency and comparability in sustainability reporting can likely only be achieved if requirements or guidance on measurement and metrics and targets is included in addition to disclosure requirements.

16 The proposed scope of the work of the ISSB and the TRWG prototype standards is explained in the TRWG *General Requirements* prototype and addresses the mid-level of reporting or sustainability-related financial reporting (see paragraphs 5 and 13). The TRWG *General Requirements* prototype is of a similar function as IAS 1 *Presentation of Financial Statements* in that it provides general requirements for the disclosure of all sustainability-related

[14] See February 2022 (M185) Agenda Paper 3.4.

financial information and is generally consistent with the guiding principles in the IFRS *Conceptual Framework for Financial Reporting*:

Table 2: Scope of the TRWG prototype standards

Reference in TRWG *General Requirements* prototype	**Summary**
Objective (paragraphs 1-5)	• The objective of sustainability-related financial disclosures is to provide information about the significant sustainability-related risks and opportunities to which a reporting entity is exposed to assist primary users of general purpose financial reports in predicting the value, timing and certainty of an entity's future cash flows, over the short, medium and long term and therefore inform users' assessment of enterprise value. • Includes information broader than that included in the financial statements as it takes into account decisions made an entity on or before the reporting date that will give rise to future inflows and outflows that do not meet the criteria for recognition in the financial statements at the reporting date.
Scope (paragraphs 6-9)	• Sustainability matters that do not affect the reporting entity's enterprise value are outside the scope of general purpose financial reporting.
Applying conceptual elements (paragraphs 10-22)	• Sustainability-related financial information is material if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports. • Sustainability-related financial information influences those decisions if it influences users' assessments of the value, timing and certainty of the entity's future cash flows, and hence users' assessment of the entity's enterprise value.
Appendix A: Defined terms	• ***Enterprise value***: Enterprise value is defined as market capitalisation of an entity plus the market value of the entity's net debt. It is determined by capital market participants, based on their estimation of the amount, timing and certainty of future cash flows spanning the short, medium and long term. Enterprise value reflects users' assessments of future cash flows, including the value attributed to those cash flows by users. Essential inputs in determining enterprise value include corporate reporting in financial statements, as well as reporting on sustainability matters that it is [reasonably likely] will affect the entity's business model over time (that is to say, affect revenue, costs, assets, liabilities, cost of capital and/or risk profile). The term captures the notion of expected value creation, preservation or erosion over time for an entity's equity and debt investors. This expected value creation, preservation or erosion is distinct from but

Reference in TRWG *General Requirements* prototype	Summary
	fundamentally interdependent with an entity's creation, preservation or erosion of value for its stakeholders. • ***Primary users of general purpose financial reporting***: Existing and potential investors, lenders and other creditors. • ***Sustainability-related financial disclosure***: Disclosures about an entity's performance on sustainability matters that drive enterprise value, including information about the entity's governance, strategy and risk management of those matters. • ***Sustainability-related financial information***: Information that provides insight into drivers of enterprise value, providing a sufficient basis for users to assess the resources and relationships on which the entity's business model and management's strategy for sustaining and developing that model depend, by understanding: (a) how effective the entity's business model is at creating value and generating cash flows, including their timing and certainty, over the short, medium and long term; (b) how scalable and adaptable the model is, and; (c) how resilient and durable the model is. This information includes, but is not limited to, information about matters such as climate change; water use and discharge; biodiversity; and employees and human rights.

Staff recommendation and question to Board members

17 The proposed scope of the ISSB and the TRWG prototype standards is specific to sustainability-related financial information (which can be both quantitative, qualitative, or a combination of both). That is, consistent with feedback received so far, the proposed scope of the work of the ISSB will be specific to sustainability-related information that requires the disclosure of financial information or is otherwise integral to understanding and assessing an entity's financial reporting.

18 Consequently, when staff refer to developing sustainability reporting requirements, we are referring specifically to developing reporting requirements to address the mid-level of reporting or sustainability-related financial reporting. That is, staff recommend that in developing the draft project plan, the proposed scope of the project be consistent with the proposed work of the ISSB and focus on the mid-level of reporting or sustainability-related financial reporting.

19 It is important to note that even if the proposed scope of the project is focused as described in paragraph 18, staff will continue to engage with a broad range of stakeholders, including the GRI, to ensure the best outcomes possible when considering modifications or requirements for Australia. Furthermore, while we intend to focus on the mid-level of reporting, we are not dismissing the need for the highest level of reporting. That is, we do not intend to replace the highest level of reporting or for entities to stop engaging in the highest level of reporting should they currently, or wish to, do so. Instead, the proposed

focus of the Sustainability Reporting project is on bridging the gap between the highest and lowest levels of reporting.

Question to Board members	
Q1:	Do Board members agree with the staff recommendation in paragraph 18 that, in developing the draft project plan, the proposed scope of the Sustainability Reporting project be consistent with that of the proposed work of the ISSB and focus on sustainability-related financial reporting[15]?

[15] Being the reporting of information about the significant sustainability-related risks and opportunities to which a reporting entity is exposed to assist primary users of general purpose financial reports in predicting the value, timing and certainty of an entity's future cash flows, over the short, medium and long term and therefore inform users' assessment of enterprise value.