Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Climate-related Financial Disclosure**	**Meeting**	AASB August 2023 (M197)
Topic:	**Approach to the baseline of IFRS S2—remuneration disclosure requirement**	**Agenda Item:**	09.3
		Date:	24 July 2023
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Objective

1 The objective of this paper is to present staff analysis and recommendations on the Board's proposed approach to the cross-industry remuneration disclosure requirements in the baseline of IFRS S2 *Climate-related Disclosures*.

2 Staff will develop an Exposure Draft for the Australian-equivalent standards to IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 based on the Board's decisions at its August and September 2023 meetings. At a later stage, staff will consider whether any consequential changes to the non-mandatory guidance accompanying IFRS S1 and IFRS S2 would be needed (see Agenda Paper 7.1).

Structure

3 This paper is structured as follows:

(a) Summary of staff recommendation (paragraph 4)

(b) Background (paragraph 5)

(c) Staff analysis (paragraph 18)

(d) Staff recommendation and questions to Board members (paragraph 42)

Summary of staff recommendation

4 Staff recommend that the Board amend the baseline of IFRS S2 by removing paragraph 29(g) from IFRS S2 which requires an entity to disclose a description of whether and how climate-related considerations are factored into executive remuneration and the percentage of executive management remuneration that is linked to climate-related considerations.[1]

1 Note that this decision does not preclude the Board from including additional guidance or cross-references to relevant remuneration reporting requirements where they already exist.

Background

5 In June 2023, the International Sustainability Standards Board (ISSB) issued IFRS S1 and IFRS S2. Both IFRS S1 and IFRS S2 include remuneration disclosure requirements (see Appendix A for relevant extracts from IFRS S2).

6 Paragraph 27(a)(v) of IFRS S1 and paragraph 6(a)(v) of IFRS S2 require an entity to disclose information about how its governance body(s) or individual(s) oversee the setting of targets related to sustainability and climate-related risks and opportunities, and monitors progress towards those targets, including whether and how related performance metrics are included in remuneration policies.

7 Paragraph 29(g) of IFRS S2 goes further and requires an entity to also disclose information relevant to the cross-industry metric category of remuneration including:

(a) a description of whether and how climate-related considerations are factored into executive remuneration; and

(b) the percentage of executive management remuneration recognised in the current period that is linked to climate-related considerations.

Joint AASB and AUASB comment letter on ISSB Exposure Drafts on [Draft] IFRS S1 and [Draft] IFRS S2

8 In the joint response to the ISSB's Exposure Drafts on [Draft] IFRS S1 and [Draft] IFRS S2, the AASB and AUASB disagreed with the cross-industry metric category relating to remuneration in paragraph 21(g) of [Draft] IFRS S2 and recommended that the ISSB remove it. In particular, the response highlighted that many jurisdictions, including Australia, already have detailed remuneration disclosure (or reporting) requirements that are heavily regulated and subject to audit and assurance.[2]

9 In Australia, remuneration reporting requirements for an entity's key management personnel (KMP) (which includes both executive and non-executive management) are legislated in s300A of the *Corporations Act 2001* (Corporations Act) and s2M.3.03 of the *Corporations Regulations 2001* (Corporations Regulations) and have requirements under which an entity must include a discussion of the relationship between the remuneration policy and the entity's performance.[3] Section 300A(1)(ba) of the Corporations Act specifically requires that if an element of KMP remuneration is dependent on the satisfaction of a performance condition the remuneration report must include:

(a) a detailed summary of the performance condition; and

(b) an explanation of why the performance condition was chosen; and

(c) a summary of the methods used in assessing whether the performance condition is satisfied and an explanation of why those methods were chosen.

10 Furthermore, the AASB and AUASB disagreed with the proposed remuneration disclosure requirements because:

2 See September 2021 AASB Staff Paper *Review of Executive Remuneration Disclosure Requirements*.

3 Specifically, section 300A(1)(b) of the Corporations Act.

(a) explicitly linking executive remuneration to climate or other sustainability-related topics does not necessarily impact an entity's climate or sustainability-related performance;

(b) the AASB and AUASB questioned how detailed information on executive remuneration in relation to climate or other sustainability-related topics could reasonably be expected to influence users' decisions; and

(c) if similar requirements are incorporated into future IFRS Sustainability Disclosure Standards, the AASB and AUASB questioned how an entity subject to multiple significant sustainability-related risks would be able to demonstrate performance through metrics related to executive remuneration—that is, the AASB and AUASB said that an entity cannot be expected to link executive remuneration to its performance against every significant sustainability-related risk to which they are exposed.

11 As outlined in paragraph 7 above, the ISSB retained the remuneration disclosure requirements in IFRS S2.[4]

12 This Agenda Paper only considers whether the Board should depart from, amend or add to the IFRS S2 cross-industry remuneration disclosure requirements.

Not-for-profit KMP remuneration reporting requirements

13 At its June 2023 meeting, the Board decided to expand the scope of the Climate-related Financial Disclosure project, previously limited to the for-profit sector, to explore the development of sector-neutral Australian climate-related financial disclosure requirements.[5]

14 In respect of the public sector, information about remuneration policies and salary ranges of executives are publicly available on the relevant governments' website.[6] Benefits and entitlements for executives within the same rank are typically standardised across a jurisdiction. Accordingly, staff consider that it would be difficult to disaggregate the portion of an executive's remuneration that relates specifically to climate-related activities.

15 Consistent with for-profit entities, NFP public sector entities are required to include KMP remuneration disclosures in accordance with AASB 124 *Related Party Disclosures* in their general purpose financial reports (GPFR).

16 In addition to the requirements in AASB 124, Commonwealth public sector companies and entities are required to include the following disclosures in their GPFR, which aligns with the disclosures required by the Australian Securities Exchange (ASX) for listed companies:

(a) disclosing the remuneration of KMP on an individual basis;

(b) calculating total remuneration on an accrual basis, in line with the financial statements; and

(c) disclosing details of the remuneration policy.[7]

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4 See Agenda Item 4.1.0 of this meeting for further details.

5 See June 2023 Action Alert.

6 The Commonwealth Government and most State and Territory Governments update their executive remuneration policy and salary ranges on an annual basis.

7 Following an independent review in 2018, the *Public Governance, Performance and Accountability Act 2013* and the *Public Governance, Performance and Accountability Rule 2014* were amened to require additional disclosures to bring

17 In regard to charities, the Australian Charities and Not-for-profits Commission (ACNC) requires reporting of KMP remuneration in the Annual Information Statement (AIS) and annual financial reports for all large charities (whether preparing GPFR or special purpose financial reports) and medium charities that prepare GPFR reporting in accordance with AASB 124 or AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*, as applicable.[8]

Staff analysis

18 At its February 2023 (M193)[9] meeting the Board decided on the following set of criteria to apply when considering departing from, amending or adding to the baseline of IFRS Sustainability Disclosure Standards:[10]

(a) requirements in IFRS Sustainability Disclosure Standards do not adequately address Australian-specific matters and there is, or is likely to be, diversity in practice warranting Australian-specific requirements or guidance (see paragraph 21(a));

(b) requirements in IFRS Sustainability Disclosure Standards will not deliver user benefits that outweigh any undue cost or effort for preparers (see paragraph 21(b));

(c) requirements in IFRS Sustainability Disclosure Standards will not achieve international alignment or else will conflict with global sustainability reporting practices (see paragraph 21(c));

(d) the Board identifies equivalent disclosure requirements in Australian legislation that already meet the objectives of the IFRS Sustainability Disclosure Standards and would result in duplicate disclosure or reporting for Australian entities. In making this assessment, the Board would consider relevant Australian legislation such as the *National Greenhouse and Energy Reporting Act 2007* (see paragraph 21(d)); and

(e) transitioning from existing Australian practices to requirements in IFRS Sustainability Disclosure Standards will impose additional costs and/or time when compared with international counterparts, warranting deferral of the application date (paragraph 21(e).[11]

Requirements do not adequately address Australian-specific matters and there is likely to be diversity in practice warranting Australian-specific requirements or guidance

19 Staff note that neither IFRS S1 and IFRS S2 define the terms executive or executive management. Staff also note that executive and executive management are not defined in IFRS or Australian Accounting Standards.

20 If paragraph 29 (g) of IFRS S2 is included in Australian climate-related financial disclosure requirements without the terms executive and executive management being defined,

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the reporting of KMP remuneration by Commonwealth companies and entities more closely in line with the listed companies. See AASB Staff Paper *Review of Executive Remuneration Disclosure Requirements*.

8 See ACNC 'Key Management Personnel Remuneration' page. Exemptions to KMP remuneration reporting may apply.

9 Agenda Item 5.4.

10 See February 2023 (M193) Action Alert.

11 Subject to the passage of legislation, Treasury has indicated that mandatory climate-related financial disclosures will be implemented from 1 July 2024 and a phased approach will apply to reporting entities that meet prescribed thresholds and are required to lodge financial reports under Chapter 2M of the Act. Refer to pages 6 to 11 of the Climate-related financial disclosure Consultation paper.

entities will likely try to define the terms themselves which may cause diversity in practice. Therefore, reducing the comparability and usefulness of information disclosed.

21 Staff consider that the Board could define executive and executive management, or issue guidance on what is meant by the terms. However, staff do not recommend such an approach because:

(a) The Corporations Act defines 'executive officer of a body corporate' as a person who is concerned in, or takes part in, the management of the body. As outlined in paragraph 9 above, the Corporations Act has KMP[12] reporting requirements which includes both executive and non-executive management. If the Board was to define the terms in line with the Corporations Act this would mean that listed entities' remuneration reporting would include KMP remuneration details, however in the context of climate-related financial disclosures would only include the details of officers who meet the definition. Staff question whether this narrower disclosure will be useful to and understandable for users given the broader KMP requirements have already been legislated and are also required to be disclosed in the financial statements by AASB 124. Entities would also need to implement processes to report only for a subset of KMP (being executives and executive management) in the context of climate-related financial disclosures–the costs of which may not outweigh the benefits given users may not find the narrower disclosures useful and/or understandable.

(b) As outlined in paragraphs 13 to 17, NFP entities also have KMP reporting requirements in place. Consequently, defining the terms executive and executive management would likely create confusion. For example, in the public sector there are a large number of departmental employees employed under executive contracts that neither meet the definition of an executive officer as defined in the Corporations Act or who are considered to be a KMP.[13] If the Board was to define the terms in the context of climate-related financial disclosures there would likely need to be guidance and education provided to assist the consistent application of the terms.

22 Another option staff considered was amending paragraph 29(g) of IFRS S2 to replace 'executive and executive management remuneration' with 'KMP remuneration'. However staff are of the view that, although there would be benefits to this given KMP is a term already widely used and understood, this would result in duplicate reporting requirements as outlined in paragraphs 23 to 25.

Equivalent disclosure requirements in legislation already meet the objectives of the IFRS Sustainability Disclosure Standards and would result in duplicate disclosures/reporting

23 As noted in paragraphs 8 and 9, the Corporations Act and Corporations Regulations already legislate extensive and detailed remuneration reporting requirements.[14]

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12 KMP is defined in AASB 124 as those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

13 For example, a member of the senior executive group is generally considered a KMP because they are responsible for the delivery of the department's services as a whole however judgement is required to determine whether other senior executives have the authority and responsibility for planning, directing and controlling the activities as a whole. See Victoria Treasury and Finance guidance.

14 Australian remuneration reporting requirements are among the highest internationally, as noted in September 2021 AASB Staff Paper *Review of Executive Remuneration Disclosure Requirements* which observed that "only two jurisdictions (Australia and Germany) currently require the disclosed remuneration information to be audited, and

24 Staff consider that the requirements in s 300A(1)(b) and (ba) of the Corporations Act will result in entities disclosing a description of whether and how climate-related considerations are factored into KMP remuneration and the percentage of KMP remuneration linked to climate-related considerations if:

(a) climate-related financial risks and opportunities are material to the entity; and

(b) climate-related performance has been factored into an entity's remuneration policies and KMP remuneration.

25 Consequently, including remuneration-related disclosure requirements in an Australian equivalent of IFRS S2 would duplicate remuneration reporting requirements for entities in scope.

The benefits are unlikely to outweigh any undue cost or effort for preparers

Benefits

26 The Recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) do not include a recommendation for entities to disclose the amount (as a percentage) of executive remuneration impacted by climate considerations or disclose how climate-related considerations are factored into executive remuneration. Instead, this type of disclosure is included as part of TCFD **guidance only** and is identified as being information which could be disclosed as part of complying with recommended disclosures for:

(a) Governance—disclose the organisation's governance around climate-related risks and opportunities:

(i) Describe management's role in assessing and managing climate-related risks and opportunities;

(b) Metrics and Targets—Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material;

(i) Disclose the metrics used by the organisation to assess climate-related risks and opportunities in with its strategy and risk management.

27 In paragraph BC107 of the accompanying Basis for Conclusions to [Draft] IFRS S2, the ISSB cited a TCFD-led public consultation in June 2021 which found that investors overwhelmingly (71-91%) viewed cross-industry metrics for greenhouse gas emissions, physical or transition risks, climate-related opportunities and capital deployment to be very useful, while remuneration metrics were viewed as relatively less useful (only 42% viewed them as very useful).

28 As highlighted in the joint AASB and AUASB submission to the ISSB, explicitly linking executive remuneration to climate or other sustainability-related topics does not necessarily impact an entity's climate or sustainability-related performance (see paragraph 10).

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there are significant differences in the level of detail required to be disclosed. Few countries require as much information about their executive remuneration as Australia, and only two countries (Australia and South Africa) require the remuneration information presented outside financial statements to be measured in accordance with the relevant accounting standards."

Costs

29 Staff have identified the following significant potential unintended costs of retaining the cross-industry remuneration disclosure requirements in paragraph 29(g) of IFRS S2 in Australia:

(a) An entity that does not currently have climate-related considerations included within its executive remuneration arrangements could be unfairly penalised by users even if:

(i) climate-related financial risks and opportunities are not identified as being material to the entity; or

(ii) executive remuneration is not a tool utilised by the entity to achieve its climate performance objectives and targets.

That is, the cross-industry disclosure requirement becomes a compliance exercise rather than providing useful information to users.

(b) In trying to achieve compliance with the cross-industry disclosure requirement, an entity that does not currently have climate-related considerations included within its executive remuneration arrangements could be forced by users to re-negotiate and amend those executive remuneration arrangements at significant cost to the entity.

(c) The cross-industry disclosure requirement relates only to executive remuneration while existing Australian remuneration reporting requirements include all KMP (which includes but is not limited to executives). Given that the Australian remuneration reporting requirements do not require an entity to distinguish between its KMP and executives, staff anticipate that in order to comply with the requirement in IFRS S2, some entities may choose to disclose a subset of its remuneration disclosures outside the remuneration report. With reference to Treasury's most recent public consultation, remuneration disclosures made outside the remuneration report would not (at least initially) be subject to the same level of regulatory scrutiny or audit and assurance procedures as information disclosed in the remuneration report.

Meeting the needs of NFP public and private sector users

30 Staff also question whether requiring NFP entities to comply with paragraph 29(g) of IFRS S2 would result in useful information when users of NFP entity financial reports are more concerned with the accountability and transparency of how the funds provided to these entities are spent.[15]

31 In respect to executive remuneration, staff consider that:

(a) users would be more interested in whether an executive's remuneration is commensurate with the executive's overall performance in leading the entity to fulfil its objectives than in whether (or how) the executive's remuneration factors in climate-related activities specifically; and

15 Refer to Agenda Items 10.1 and 10.2 of this meeting for detailed analysis of NFP considerations.

(b) as mentioned in paragraph 14, for NFP public sector entities, it would be difficult to disaggregate the portion of an executive's remuneration that relates specifically to climate-related activities.

32 If NFP entities were required to make these disclosures without user need for it, the costs of disclosure would likely outweigh the benefits.

33 In light of the considerations in paragraphs 26 to 32, staff are of the view that the potential costs of complying with the paragraph 29(g) of IFRS S2 would outweigh the perceived benefits.

The requirement will not achieve international alignment or else will conflict with global sustainability reporting practices[16]

New Zealand

34 Paragraph 8(d) of the Aotearoa New Zealand Climate Standards 1 *Climate-related Disclosures* (NZ CS 1) requires an entity to disclose how the governance body sets, monitors progress against, and oversees achievement of metrics and targets for managing climate-related risks and opportunities, including whether and if so how, related performance metrics are incorporated into remuneration policies. Paragraph 22(h) of NZ CS 1 requires an entity to disclose management remuneration linked to climate-related risks and opportunities in the current period, expressed as a percentage, weighting, description or amount of overall management remuneration. The requirements included in NZ CS 1 provide more optionality than the requirements of IFRS S2 paragraphs 6(a)(v) and 29(g) and also make no reference to executive or executive management.

European Union

35 Paragraph 27(a) of the [Draft] European Sustainability Reporting Standard (ESRS) 2 *General Disclosures* requires disclosure of whether performance is being assessed against specific sustainability-related targets and/or impacts – and if so, which ones for members of the administrative, management and supervisory bodies of an entity and whether and how sustainability-related performance metrics are being considered. [17]

36 Paragraph AR6 of ESRS 2 also specifies that, for listed entities, this disclosure requirement should be consistent with the remuneration report prescribed in Articles 9a and 9b of the Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies. A reference to this remuneration could be made. Article 9a give shareholders the right to vote on the remuneration policy and where an entity awards variable remuneration requires the remuneration policy to set clear, comprehensive and varied criteria. The entity shall indicate the financial and non-financial performance criteria, including, where appropriate, criteria relating to corporate social responsibility, and explain how they contribute to objectives and the methods to be applied to determine to which extent the performance criteria have been fulfilled. Article 9B requires an entity's remuneration report to include an explanation of how the total remuneration complies with the adopted remuneration policy, including how it

16 See Agenda Items 11.1 and 11.2 of this meeting for a detailed overview of the ongoing work related to the assessment of international alignment.

17 Staff note that the ESRS are still in draft form and have not, at the time this paper was prepared, been finalised or endorsed for mandatory application. As such, the requirements referred to in this analysis may be subject to change.

contributes to the long-term performance of the company, and information on how the performance criteria were applied.[18]

37 Staff consider that the remuneration requirements in ESRS 2, IFRS S1 and IFRS S2 are broadly aligned.

GRI Standards[19]

38 Disclosure 2-19 of GRI 2: General Disclosures 2021 requires an entity describe the remuneration policies for members of the highest governance body and senior executives and describe how the remuneration policies relate to the entity's objectives and performance in relation to the management of the entity's impacts on the economy, environment and people. Guidance in the Standard states that if the entity uses performance-based pay, it should describe how remuneration for senior executives is designed to reward long-term performance. Disclosure 2-20 also requires an entity to describe the process for designing its remuneration policies and for determining remuneration.

39 Staff note that the GRI Standards are broader than IFRS S2 because they require disclosure of the entity's impact on the economy, environment and people. However, staff consider that the remuneration disclosure requirements in GRI Standards, IFRS S1 and IFRS S2 are broadly aligned.

Conclusion

40 Per paragraphs 23 to 25 above, staff consider that the requirements in the Corporations Act will result in entities disclosing a description of whether and how climate-related considerations are factored into KMP remuneration and the percentage of KMP remuneration linked to climate-related considerations if these disclosures are relevant.

41 Consequently, staff are of the view that even if an Australian equivalent to IFRS S2 excluded paragraph 29(g) of IFRS S2, this would not create a conflict or misalignment with widely accepted international and jurisdictional approaches as Australian entities should already be disclosing equivalent information where relevant.

Staff recommendation and questions to the Board

42 For the reasons highlighted in paragraphs 18 to 41, staff recommend that, in developing Australian climate-related financial disclosure requirements, the Board remove the cross-industry remuneration requirements (in paragraph 29(g) of IFRS 2) from the baseline of IFRS S2.

Questions to Board members

Q1: Do Board members have any questions about the information provided in this paper?

Q2: Do Board members agree with staff recommendations in paragraph 42?

18 Articles 9a and 9b of the Directive 2007/36/EC.

19 A high-level comparison between IFRS S2 and the GRI Standards is included in Agenda Item 4.1 of this meeting.

Appendix A: Extracts from IFRS S2 – remuneration disclosure requirements

Governance

6 To achieve this objective, an entity shall disclose information about:

(a) the governance body(s) (which can include a board, committee or equivalent body charged with governance) or individual(s) responsible for oversight of climate-related risks and opportunities. Specifically, the entity shall identify that body(s) or individual(s) and disclose information about:

…

(v) how the body(s) or individual(s) oversees the setting of targets related to climate-related risks and opportunities, and monitors progress towards those targets (see paragraphs 33–36), including whether and how related performance metrics are included in remuneration policies (see paragraph 29(g)).

Climate-related metrics

29 An entity shall disclose information relevant to the cross-industry metric categories of:

…

(g) remuneration—the entity shall disclose:

…

(ii) a description of whether and how climate-related considerations are factored into executive remuneration (see also paragraph 6(a)(v)); and

(iii) the percentage of executive management remuneration recognised in the current period that is linked to climate-related considerations.