Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Our Ref.: C/FRSC

Sent electronically through the IFRS Foundation Website (www.ifrs.org)

27 July 2022

Emmanuel Faber, Chair and Sue Lloyd, Vice-Chair
International Sustainability Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Emmanuel and Sue,

ISSB Exposure Drafts IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*; and IFRS S2 *Climate-related Disclosures (EDs)*

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing, ethics and sustainability disclosures for professional accountants, in Hong Kong. We are grateful for the opportunity to provide you with our comments on the EDs.

We have carefully reviewed the EDs and performed outreach with local stakeholders to seek feedback. We have summarised our primary observations and recommendations below. Our detailed comments and editorial suggestions are provided in Appendices A and B respectively.

Overall, we are supportive of the ISSB's lead in establishing a comprehensive global baseline of sustainability disclosures designed to meet the information needs of investors when assessing enterprise value. This can facilitate investors to assess the effect of significant sustainability-related risks and opportunities on an entity's enterprise value. It can also encourage entities to further integrate sustainability into their corporate thinking and business strategy by, for instance, establishing appropriate governance and risk management, as well as disclosing their strategy and metrics of significant sustainability issues. In the long run, it will likely enhance the competitive advantage and improve the corporate image of an entity.

The EDs contain many highly prescriptive requirements that are challenging even for companies that are more experienced in sustainability reporting. While we appreciate the urgency of addressing climate and sustainability-related risks and opportunities, it is important that the ISSB allows the market sufficient time to build up capacity for this relatively new yet significant reporting initiative in order for preparers to produce information that is truly meaningful to investors. The availability of reliable source data remains a major concern for all stakeholders and practice is still emerging and evolving as to what is appropriate in terms of methodologies, models, assumptions and drivers. This is particularly the case for Scope 3 emissions data and scenario analysis which in turn affects an entity's ability to quantify the anticipated effects of climate on its future financial position and performance. As such, we strongly recommend that the ISSB consider a phased approach to the mandatory adoption of certain aspects of the proposed standards. We also suggest that the ISSB adopt a proportionality approach in terms of the timing and extent of application by small and medium-sized entities (SMEs) as the challenges faced by them are more pronounced.

In addition, we strongly encourage the ISSB to collaborate with the US Securities and Exchange Commission (SEC) and the European Financial Reporting Advisory Group (EFRAG) in terms of their sustainability disclosure standards to achieve alignment in disclosure principles on investor-focused sustainability information as much as possible to achieve global consistency and to reduce costs for preparers and other stakeholders. A list of any remaining differences between the standards should be issued to allow a smooth transition between these standards. The ISSB may consider including certain transitional provisions in its standards to facilitate existing sustainability report preparers to transition to the ISSB standards.

Our other key comments include the following:

<u>Materiality</u>
We find it highly subjective and judgmental in terms of how to determine materiality for disclosing sustainability-related information. We recommend the ISSB specify the factors that an entity should consider when determining materiality, e.g. the likelihood and impact of the event, its frequency of occurrence, duration, etc.

<u>Comparative information</u>
We generally find that adjusting for all changes in estimates retrospectively will create a disconnect between prior year sustainability information and financial statements information. We recommend that entities distinguish between different types of changes in estimates and depending on the nature of change, adjust for it retrospectively or prospectively as appropriate.

<u>Current and anticipated effects</u>
The [draft] IFRS S2 requires an entity to disclose quantitative information unless it is unable to do so. However, it is unclear what “unable to do so” means. Besides, there are concerns about the usefulness of isolating the anticipated effects of climate-related risks and opportunities from other risks and opportunities as many of the ESG risks are interlinked and it is difficult to isolate one assumption/input from another to estimate each risk’s standalone effect. The end result of any arbitrary disaggregation could potentially be misleading. In addition, while it may be appropriate to provide quantitative information for short- to medium-term expectations, it may be more appropriate to provide qualitative information for long-term expectations due to the lack of reliable data for the long term.

<u>Climate resilience</u>
Climate scenario analysis requires a large amount of data and resources depending on the methodology used, and this may be difficult for entities especially SMEs or entities with limited access or knowledge on related topics. We recommend that the ISSB specify how many and which type of scenarios should be disclosed citing the more commonly-used and publicly-available scenarios as examples, as well as include the drivers/factors that each scenario should consider to increase comparability between entities and facilitate application of the requirements. Furthermore, we recommend that the ISSB require the disclosure of significant drivers, methodologies, estimates and assumptions used in the scenario analysis.

<u>Scope 1 and Scope 2 emissions for associates, joint ventures, unconsolidated subsidiaries or affiliates (non-controlling investments)</u>
There are many known challenges in terms of financial reporting where information from non-controlling investments is not easy to obtain due to a lack of control. For greenhouse gas emissions, the challenges could be further complicated by the investee’s (i) using a societal value approach; (ii) using a method that is not ‘GHG Protocol aligned’; (iii) using an operational control method while the reporting entity uses equity share method; and (iv) having a different period-end as that of the reporting entity. We recommend that the ISSB consider requiring the use of consistent methodologies as the reporting entity by non-controlling investments, similar to IFRS Accounting Standards requiring associates and joint ventures to use consistent accounting policies as the group.

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Scope 3 emissions
It is difficult to obtain high-quality and reliable source data for Scope 3 emissions as they fall outside an entity's direct management. We recommend the ISSB allow a phased approach for the disclosure of Scope 3 emissions, starting with the identification of material sources of Scope 3 emissions and proceeding to requiring quantitative Scope 3 information only once practice becomes more mature and more reliable information becomes available. In addition, the ISSB should provide guidance to assist entities in determining how many levels up and down the value chain they should disclose for Scope 3 emissions or refer stakeholders to relevant existing literature.

Appendix B of [draft] IFRS S2
We note that certain metrics in Appendix B might still not be applicable in many jurisdictions even though attempts have been made to internationalize them. This might hinder international adoption of the standard as entities might be prevented from asserting compliance with IFRS S2 given Appendix B is an integral part of the standard. We recommend that Appendix B not be made mandatory until the ISSB has conducted further industry-wide consultations and made relevant updates thereto to ensure the metrics in Appendix B can truly serve as an international baseline for global adoption.

Effective date
We suggest that a phased approach be allowed for certain elements such as Scope 3 emissions, scenario analysis as well as disclosure of emissions for non-controlling investments and financed emissions. If an entity takes this approach, it should explain why certain requirements have not been complied with and the expected timeline for compliance. This may encourage more uptake by entities and allow an earlier effective date for the other requirements of the standards.

If you have any questions regarding the matters raised in this letter, please contact me (ceciliakwei@hkicpa.org.hk) or Anthony Wong (anthonylwwong@hkicpa.org.hk), Associate Director of the Standard Setting Department.

Sincerely,

Cecilia Kwei

Cecilia Kwei
Director, Standard Setting Department

Work undertaken by HKICPA in forming its views

The HKICPA:

(i) issued an Invitation to Comment and an online survey on the EDs in April 2022 to its members and other stakeholders;

(ii) sought input from its Task Force which is comprised of a diverse selection of senior-level sustainability experts;

(iii) sought input from preparers who are experienced in preparing sustainability reports in Hong Kong; and

(iv) developed its views through its Financial Reporting Standards Committee, having reflected on its stakeholder views. The Committee comprises preparer representatives from various industry sectors, regulators, as well as technical and industry experts from small, medium and large accounting firms.

Detailed comments on ED IFRS S1

Question 1: Overall approach

Structure

1. The structure of the [draft] IFRS S1 is consistent with how the Task Force on Climate-Related Financial Disclosures has set out its standard, i.e. using the four-pillar approach. This structure may work well for the [draft] IFRS S2 but merely replicating the four pillars and making them more generic to all sustainability requirements may not serve the purpose of the general requirements standard (i.e. the [draft] IFRS S1).

   If the other topical standards would be structured using the same four-pillar approach, we consider that common requirements (e.g. governance and risk management) that apply to all topics should be repositioned and included in the [draft] IFRS S1, leaving only topical elements in their respective standards. This would make the future topical standards less cumbersome the [draft] IFRS S1 would function as the equivalent of the 'Conceptual Framework, Presentation and Change in Accounting Policy standard' and it can be structured with reference to IAS 1 *Presentation of Financial Statements*.

Verifiability

2. Unlike financial reporting, it is unlikely that auditors will be able to provide an overall opinion to the entire sustainability report when a significant amount of information is (a) qualitative, (b) forward-looking, or (c) only expresses a vision. However, for quantitative information, if the bases for determining the information are clearly defined in enough detail, then auditors may be able to provide assurance as long as the entity has appropriate internal controls and safeguards around those specific numbers.

3. In addition, there could be challenges in verifying Scope 3 emissions in particular those arising from an entity's upstream and downstream activities as well as financed and facilitated emissions. Challenges include the reliability and availability of source data, the completeness of Scope 3 emissions and whether the auditors could complete the assurance engagement within a reasonable timeframe given the many layers (upstream and downstream) from which an entity needs to collect data.

Question 2: Objective

Definition of sustainability-related information

4. The definition of "sustainability-related financial information" in Appendix A could be enhanced by including the guidance in paragraph 6. In particular, paragraph 6(b) should be explicitly reflected in the definition as it relates to internally generated intangibles of an entity or value creation and may not be implied from the existing definition.

5. Paragraph BC85 states that "… The entity could still assert compliance with IFRS Sustainability Disclosure Standards as long as its disclosures explain that fact. …" We consider this BC explains why paragraph 6 uses "could" instead of "should" and suggest that the ISSB include the explanation in paragraph BC85 explicitly in paragraph 6.

Significant and material

6. The [draft] IFRS S1 does not use "significant" and "material" consistently when it refers to sustainability-related risks and opportunities. The differences between these two terms should be clarified as this may cause confusion and inconsistent application in practice.

Enterprise value and societal value

7. Sustainability reporting is a new area for many parties and 'enterprise value' (as distinct from what might be referred to as 'societal value') is an abstract term for the vast majority of preparers. We suggest that a list of factors, examples and/or a diagrammatic representation be added in the [draft] IFRS S1 to supplement the definition of enterprise value so that users can determine what falls into enterprise value and what falls into societal value (and possibly some in both).

Question 4: Core content

8. We suggest that specific disclosures of expertise and/or training hours of relevant parties (e.g. board members, management teams, working-level teams, etc.) relating to sustainability matters be added in paragraph 13(c) of [draft] IFRS S1 or as application guidance to show how the governance body ensures that appropriate skills and competencies are available to oversee strategies designed to identify sustainability-related risks and opportunities.

9. Many entities are still formulating their responses for certain emerging risks and opportunities. We suggest that the ISSB require qualitative disclosures on emerging risks and opportunities that are not yet significant but could become significant in the foreseeable future under paragraph 21(a), e.g. disclose how management identifies and monitors such risks and opportunities.

10. We would like the ISSB to provide guidance in respect of the following areas:
    - Guidance for entities operating in different geographical regions and in multiple industries to present disaggregated information by segment (similar to the operating segment information in IFRS Accounting Standards) to increase the usefulness and transparency of metrics and targets. This could also facilitate primary users to understand the entity's performance in relation to sustainability-related risks and opportunities under different segments and provide a stronger connection with the financial statements.
    - Guidance to show the extent of disclosures expected by way of examples to illustrate the requirements in paragraph 22, in particular 22(a) to facilitate application.

Question 5: Reporting entity

Value chain

11. The ISSB should consider providing specific guidance to help preparers understand and report on material risks within the value chain as not all parts of the value chain are necessarily material to an entity. This includes providing specific guidance to determine how many levels up and down the value chain entities should report on (i.e. how to determine the boundaries for the value chain) or refer them to relevant existing literature, as it is not often clear under what circumstances cradle-to-grave information is required.

12. The ISSB should clarify the wording of paragraph 40(c) as it states, "investments [an entity] controls including investments in associates and joint ventures…": if an entity controls another entity, it is a subsidiary and not an associate or a joint venture. The ISSB should use terms that are aligned with those used in IFRS Accounting Standards and with the same definition.

Question 6: Connected information

13. We suggest that the ISSB provide more examples on how various sustainability-related risks and opportunities connect with the information in general purpose financial statements, and to provide more linkage in paragraph 42 between (i) strategy, governance and risk management and (ii) metrics and targets to link the objective in that paragraph with the explanation in paragraph 43.

Question 7: Fair presentation

14. We are concerned that the scope of using other frameworks, standards and industry practice in the absence of relevant ISSB standards as proposed in paragraphs 51 and 53 is too wide. First of all, these other frameworks and standards would not have gone through the IFRS Foundation's due process and it would not be meaningful (and perhaps even misleading) to assert compliance with the IFRS Sustainability Disclosure Standards if those other frameworks have been used. Secondly, using other frameworks may give rise to regulatory challenges as it will be difficult for regulators to enforce compliance when there is no clearly defined set of disclosure requirements. It would also be challenging for users and assurance providers to assess the completeness of disclosure.

    The ISSB can consider narrowing the choice to specified frameworks that have gone through robust due process, and to allow for the grandfathering of the entity's current approach to identifying material information whilst the ISSB continues its progress on the other topical standards.

15. In addition, we propose the following enhancements to paragraphs 51 and 53:
    - Recommend entities to consider sustainability-related risks and opportunities identified by regulators and/or government agencies through their respective laws and regulations that are relevant for investors in paragraph 51(d).
    - Paragraph 51 can make reference to other research reports to help entities identify relevant risks and opportunities e.g. World Resources Institute - Water Stress by Country, IPCC Sixth Assessment Report as well as the material topics used by rating agencies.
    - It is not clear what paragraph 53(c) means when management is to identify disclosures that are 'neutral': for example, would controversial events such as major oil spills or violation of law meet such a requirement?

Question 8: Materiality

Factors and guidance to determine materiality

16. Most respondents find it challenging to establish a materiality threshold for sustainability-related information as such information is mostly qualitative and forward-looking in nature as compared to financial reporting of past transactions that could be quantified. Even when it comes to quantitative disclosures, many respondents are not clear on how materiality should be assessed when disclosing *prospective* financial information as that could cover a period far into the future and it may not be appropriate to base the materiality assessment on the current year financial position or performance.

    We therefore suggest that the ISSB provide factors that entities should consider when assessing what is material (paragraph 56), for example, the likelihood and impact of the event (potential amounts involved), frequency (how often) as well as duration (short-, medium- or long-term). Having a list of factors for consideration may help promote consistency in the materiality assessment across entities and also align the expectations between preparers, auditors, regulators and other users of the sustainability information. It may also help provide context for the information, e.g. a small investment in a coal-related project could be qualitatively material to a fund that has a clear ESG mandate as compared to others without such a mandate. These factors should align as much as possible with those in *IFRS Practice Statement 2: Making Materiality Judgements* to achieve connectivity between financial and sustainability information. The ISSB could also consider referring stakeholders to other existing relevant literature.

    We fully acknowledge that the ISSB's focus is on providing investors with sustainability information that could reasonably affect enterprise value. Nevertheless, various entities have reported sustainability information under the double materiality concept for some time and it could be challenging for them to isolate the effects on investors from their existing multi-stakeholder assessment. The dynamic nature of sustainability issues (i.e. how they move from not affecting enterprise value to affecting and vice versa) also makes it difficult for entities to judge what information would affect enterprise value at different points in time. We therefore suggest that the ISSB provide more examples in the Illustrative Guidance to help entities understand how to apply this concept.

Disclosure of material policies, assumptions and judgements

17. We strongly recommend that the ISSB require disclosure of the basis of material policies, methodologies, significant assumptions and judgements for sustainability reporting in line with existing IAS 1 requirements. This will provide context for the sustainability information and allow users to compare different entities and over time for the same entity.

Prohibition of disclosures under local laws and regulations

18. We suggest that the ISSB provide examples of such circumstances, e.g. if the disclosure would 'prejudice against court ruling' (similar to the concepts in paragraph 92 of HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*).

Question 9: Frequency of reporting

19. We observed that paragraph 66 can be read in two ways (i.e. Views A and B below) and suggest that the ISSB clarify it.

    View A:
    If the reporting entity prepares interim or quarterly financial statements, then it must also present sustainability reports with the same balance sheet dates and for the same periods.

    View B:
    If the reporting entity prepares a sustainability report, that sustainability report should be issued together with a set of corresponding financial statements with the same balance sheet date and for the same period.

    Take the example of a listed entity that issues quarterly financial statements according to the local listing rules, although there is no similar requirement for sustainability report in that jurisdiction. If the entity were to claim compliance with the [draft] IFRS S1, under View A it must also issue a quarterly sustainability report together with its quarterly financial statements. In contrast, under View B, it would not need to issue a quarterly sustainability report as long as there is a set of financial statements with the same balance sheet date and period end when the entity issues its annual sustainability report.

Question 11: Comparative information, sources of estimation and outcome uncertainty, and errors

20. The [draft] IFRS S1 proposes that all changes in estimates should be adjusted for retrospectively for the purpose of maintaining consistency across different periods. However, we believe that one should distinguish between different types of changes in estimates and depending on the nature of the change, each type of change should be adjusted for retrospectively or prospectively as appropriate.

    Disclosures should be made based on all relevant facts and circumstances at the reporting date. If new facts and circumstances appear in subsequent periods and these new facts did not exist in the prior period, these changes in estimates should be adjusted for prospectively. In contrast, if these facts existed and should have been known to the preparer when it provided the original disclosures, then these changes should be applied retrospectively.

    If new facts and circumstances are adjusted for retrospectively regardless of when the triggering event arose, not only would this obscure important information, it would also result in a mismatch between sustainability-related information and financial information included in the corresponding financial statements.

21. In addition, we have the following suggestions:
    - Paragraph 63: clarify whether comparative information is required for one prior period only.
    - Clarify whether entities should avoid the use of hindsight when updating estimates for events occurring since the prior period.
    - Paragraph 90 requires disclosure if an entity identifies a material error in the sustainability-related information disclosed in a prior period. We suggest that an entity also disclose the impact of such a material error on the prior period financial statements to promote connectivity between the two sets of information, e.g. the impact on impairment assessment, provisions and key management remuneration etc.

Question 16: Costs, benefits and likely effects

22. We consider that the costs and benefits assessment of sustainability reporting should not be limited to a purely financial analysis because sustainability reporting will likely play a more pivotal role than financial reporting in the capital market in the future. There are broader public policy matters that need to be considered in the cost/benefit analysis and preparers would need to invest in sustainability reporting infrastructure so that users can make more informed investment and lending decisions.

23. Many respondents raised the many challenges that entities especially SMEs will face in adopting ISSB standards, including:
    - The lack of supply of appropriately skilled people in the short to medium term;
    - The time and costs needed to develop and/or recruit staff with appropriate skills; and
    - Known operational difficulties in collecting consistent and quality data.

    Hence, we suggest that the ISSB adopt a proportionality approach in terms of the timing and extent of application of ISSB standards by SMEs (e.g. a lighter version with fewer disclosure requirements).

<u>Detailed comments on ED IFRS S2</u>

Question 2: Governance

24. We recommend that the ISSB require additional disclosures regarding the continuous re-assessment of material climate risks and opportunities.

Question 3: Identification of climate-related risks and opportunities

25. Even though Appendix B to the [draft] IFRS S2 provides a rich source of potential industry-specific climate disclosure topics, similar to our concerns over how to determine which sustainability information is material, we recommend that the ISSB provide more guidance on identifying whether climate risk itself and which of the disclosure topics in Appendix B are significant to the entity.

26. We also note that time horizon plays an important role in assessing the impact of climate-related risks and opportunities. The ED, however, does not provide any guidance of what constitutes the "short, medium and long term". We acknowledge that what constitutes a meaningful time band depends on an entity's business model and nature of operations and that the ISSB has deliberately left this open for preparers to decide. Nevertheless, EFRAG's draft ESRS E1 *Climate Change* stipulates specific timeframes viz. less than 5 years, between 5 to 10 years and over 10 years for short-, medium- and long-term respectively for disclosing transition risk information.

    The ISSB should consider whether there is any merit in providing an indicative timeframe in IFRS S2 to help foster consistency amongst entities as they will look to other frameworks in the absence of specific guidance. For example, some respondents referred to the Intergovernmental Panel on Climate Change (IPCC) projections of short-, medium- and long-term as 2030, 2050 and 2100 respectively[1], which is very different from the EFRAG's requirement. Not only will this

[1] Refer to the 'New approaches in the assessment' section on page 8 of Summary for Policymakers issued by IPCC.

impair consistency in application, it will also be burdensome for group companies with multiple jurisdictional reporting obligations.

Question 4: Concentrations of climate-related risks and opportunities in an entity's value chain

27. Paragraph 12 does not specify whether qualitative or quantitative disclosure is required. We consider quantitative disclosures could be very useful in certain cases, for example, percentage of production facilities in areas at risk of flooding. The ISSB could consider requiring entities to disclose quantitative information over significant concentration of risks and opportunities where such information can be obtained without undue costs and effort.

Question 5: Transition plans and carbon offsets

28. We propose the following potential enhancements:
    - Require disclosure on the rationale behind the transition plan implemented under paragraph 13(a)(i), such as a cost and benefit analysis, SWOT analysis or management discussion and analysis, so as to allow investors to understand the decision-making process and potential changes to the business model.
    - Paragraph 13(a)(i)(1) mentions water-intensive operations and water-intensive assets. Although climate impacts water significantly, it also impacts other environmental aspects such as biodiversity. If the ISSB's intention is to link the impact of climate risk to other environmental risks, the ISSB could consider referring to other environmental risks instead of singling out water in this paragraph.
    - We believe that the definition of legacy assets could unintentionally capture long-life assets near the end of their useful lives. Instead, 'stranded assets' may be a more appropriate term as it is commonly used in climate change literature and they refer to assets that will soon become obsolete because of climate change, e.g. laws and regulations prohibiting their use.
    - Require disclosure in paragraph 13(b) of (i) the source of carbon offsets and (ii) how an entity's carbon reduction activities affect other sustainability topics (e.g. water usage and biodiversity) to enhance transparency of an entity's commitment to reduce its carbon footprint and connectivity between different sustainability topics.

Question 6: Current and anticipated effects

<u>Unable to do so</u>

29. We recommend the ISSB clarify what is meant by "unable to do so" (paragraphs 14 and 15). For example, would entities that do not have the in-house competency (although they can solicit the service of third party consultants) or that are unwilling to undertake quantitative/scenario analysis be able to claim they are 'unable to do so'? It is unclear how high the threshold is for 'unable to do so', e.g. is it similar to the IFRS Accounting Standard concepts of undue cost or effort or impracticable? Different entities, auditors, regulators and stakeholders will have a different interpretation of what constitutes inability. The ISSB should provide a clear definition of the term or alternatively follow the 'impracticable' concept and definition in IAS 1.

<u>Current effects</u>

30. We generally agreed with the proposed disclosures on current period information because the proposals:
    - would hold the entity accountable for addressing climate-related issues;
    - can provide the much needed linkage between financial statements and sustainability-related financial information; and
    - would promote greater transparency, enable more accurate pricing of an entity as well as incentivize low-emissions investment in the long run.

<u>Anticipated effects</u>

31. We have heard from many stakeholders that in practice it is difficult to isolate one assumption/input to estimate the effect of climate-related risk on an entity's financial performance, financial position and cash flows since climate-related risks interact with other risks and factors (e.g. economic factors). Isolating the effects of climate-related risk may be arbitrary or at best be subject to a significant degree of judgement and would likely be misleading.

32. We suggest the following in relation to the disclosure of the anticipated effects of climate-related risks and opportunities:
    - It may be appropriate to provide quantitative information for the short and medium terms; however, it may be more appropriate to provide qualitative information for the long term. This is because it is already difficult to estimate the effects of transition risks in the short term as government policy and regulations may change every three to five years particularly in the coming decade – developing an expectation for a longer period would necessitate a high degree of subjectivity and judgement that may border on speculation. In particular, one respondent from the marine transportation industry commented that its decarbonisation journey relies on the availability of green energy, green marine fuels, advancement and deployment of technologies for more energy-efficient cargo ships, as well as their interaction with evolving environmental regulations. There are many permutations on how these aspects will evolve in the medium to long term and so it will be challenging to estimate the effects of these factors for that time horizon.
    - The ISSB should require disclosure of the basis of preparation, the methodologies used, as well as the significant assumptions used and judgements made in determining the anticipated effects of climate risks and opportunities.
    - Inserting a disclaimer when quantitative information is provided.

Question 7: Climate resilience

<u>Scenario analysis</u>

33. It is widely acknowledged that climate-related scenario analysis requires a large amount of data and resources and this is a significant challenge for many entities, especially SMEs and entities with limited manpower and knowledge on climate science. We strongly recommend that the ISSB allow a phased approach for presenting a scenario analysis (see response in Question 14 of ED IFRS S2).

34. We also suggest the following to improve consistency and to manage the scope of work when conducting a scenario analysis:
    - To specify the number and type of scenarios that are required to be disclosed (e.g. weighted average outcome, most probable outcome, or base case).
    - To cite some of the more common and publicly-available scenarios as examples. For examples, the scenarios from the Network for Greening the Financial System, International Energy Agency, IPCC, 30-60 goals of the People's Republic of China, etc.
    - To include factors that each scenario analysis should consider to increase comparability between entities and facilitate application, including how to identify the relevant inputs and what methodologies are (and are not) acceptable. This should be accompanied by extensive examples illustrating how to apply appropriate models to different industries.
    - It is possible that other topical standards may also require scenario analysis. If so, guidance should be given on how the requirements for different scenario analyses under each topical standard interact with one another.

Question 9: Cross-industry metric categories and greenhouse gas emissions

35. We recommend that the ISSB elaborate on the requirement for "internal carbon prices", such as whether there is any benchmark that an entity should follow and the related disclosure requirements. Without this standardization, the impact of "internal carbon prices" on enterprise value may not be comparable as the internal carbon price and its underlying computation methodology could vary widely between entities.

<u>GHG Protocol</u>

36. We have the following concerns and suggestions in respect of using the GHG Protocol to define and measure Scope 1, Scope 2 and Scope 3 emissions:
    - Many local methodologies have been developed based on the GHG Protocol which achieves similar measurement outcomes. Certain jurisdictions also require entities to use their local measurement bases which would prevent such entities from asserting compliance with IFRS Sustainability Reporting Standards. The ISSB should consider allowing entities to use

methodologies that achieve similar outcomes as the GHG Protocol to define and measure Scopes 1, 2, and 3 emissions. Hence, the ISSB should not limit the determination of GHG emissions to the use of the GHG Protocol only.
- The ISSB should require explicit disclosure of the methodologies, significant inputs, assumptions and estimates used in determining Scopes 1, 2 and 3 emissions e.g. the emissions factors used and the limitations of the methodologies used.
- Any reference to the GHG Protocol Corporate Standard should be clarified to refer to the 'GHG Protocol Corporate Accounting and Reporting Standard' as there are several standards issued by GHG Protocol Initiative.
- The ISSB should clarify what is meant by "or otherwise brought into entities boundary" under the definition of Scope 2 emissions in Appendix A.

<u>Scope 1 and Scope 2 emissions for associates, joint ventures, unconsolidated subsidiaries or affiliates (non-controlling investments)</u>

37. The wide range of methodologies, assumptions and emission factors used by different entities to compute carbon emissions could impair internal consistency of a group's reported emissions, for example, a non-controlling investee's (i) using a societal value approach; (ii) using a method that is not 'GHG Protocol aligned' to compute emissions; (iii) using operational control method while the reporting entity uses the equity share method; and (iv) having a different period-end from that of the reporting entity. We recommend that the ISSB consider requiring the use of consistent methodologies as the reporting entity by non-controlling investments, similar to IFRS Accounting Standards requiring associates and joint ventures to use consistent accounting policies as the group.

38. We have several observations on paragraph 21(a)(iii)(2) mostly on the alignment of the terms used in IFRS Sustainability Disclosure Standards with those in IFRS Accounting Standards:
    - The scope of this paragraph seems to be broader than paragraph 40(c) of [draft] IFRS S1 as it includes "unconsolidated subsidiaries or affiliates" in addition to associates and joint ventures. Is this the ISSB's intention?
    - Clarify what is meant by "unconsolidated subsidiaries" – does it refer to "unconsolidated structured entities" in IFRS 12 *Disclosure of Interests in Other Entities* or is it to be used for reporting entities that meet the definition of an investment entity in IFRS 10 *Consolidated Financial Statements*?
    - Clarify what is meant by 'affiliates' as it is not a term used in IFRS Accounting Standards.

<u>Scope 3 emissions</u>

39. It is difficult to obtain high-quality and reliable source data for Scope 3 emissions as they fall outside an entity's direct management. Furthermore, as not many jurisdictions have regulations that require entities to provide carbon emissions data to their downstream customers or upstream suppliers, the completeness, availability and reliability of such data is a cause for major concern for our stakeholders. For example, a real estate industry stakeholder who is experienced in preparing Scope 3 emissions commented that they needed to work with a university to develop a model for calculating the emissions factor for constructing a building. Not everyone will have the means to conduct such a large scale exercise.

    At present, most of the sustainability reporting standards require Scopes 1 and 2 disclosures only with Scope 3 being mainly a recommended disclosure (with the exception of the EU Corporate Sustainability Reporting Directive which also proposes to require Scope 3 disclosures but only for entities that meet certain size requirements).

    We strongly recommend that the ISSB consider a phased approach for requiring quantitative Scope 3 emissions data to allow time for the market to build up capacity in the collection and recording of such data to ensure the ultimate disclosures provide meaningful information to investors. Furthermore, the ISSB should consider providing additional guidance and related disclosure requirements on how to ensure the inputs and factors used in emissions disclosures are relevant for the entity (e.g. the emissions factor used for rail transportation is appropriate for the entity in terms of the model and age of the train, the type of fuel used, routing, when the conversion data was last updated, etc.).

40. We recommend that the ISSB clarify or provide the following:
    - Guidance to assist entities in determining the boundaries of the value chain with regard to Scope 3 emissions disclosure or refer stakeholders to relevant existing literature.
    - Paragraph 21(a)(vi)(4) requires an explanation for omitting Scope 3 emissions disclosure if the reporting entity is "unable to obtain a faithful measure". Our concern and recommendation on "unable to obtain a faithful measure" are the same as "unable to do so" (see response in Question 7 of ED IFRS S2).
    - Paragraphs 21(b) and 21(c) require entities to disclose the amount and percentage of assets or business activities vulnerable to transition and physical risks. The terms "assets", "business activities" and "vulnerable" should be defined to pre-empt questions such as:
        - Whether assets mean total assets, total assets and liabilities or net assets, and whether the measurement is based on book value or fair value as of the reporting date.
        - Whether business activities refer to operating segment or cash generating units as defined in the IFRS Accounting Standards.

Question 10: Targets

41. The ISSB should clarify what is meant by the "sectoral decarbonisation approach" in paragraph 23(f): it is not clear whether the ISSB is referring to the approach developed by the Science Based Targets initiative.

Question 11: Industry-based requirements

Appendix B

42. The objective of the ISSB is to develop a comprehensive global baseline of sustainability-related disclosure requirements to meet the needs of capital markets. However, some respondents observed that certain metrics in Appendix B might still not be applicable in many jurisdictions even though attempts have been made to internationalize them. This might hinder international adoption of the standard as entities might be prevented from asserting compliance with IFRS S2 given Appendix B is currently proposed to be an integral part of the standard.

    We therefore recommend that the ISSB consider whether Appendix B should be mandatory guidance or should act as a reference only, akin to how the Climate Disclosure Standards Board's non-mandatory guidance currently applies. We also suggest that the ISSB conduct further industry-wide consultation on Appendix B before making its application mandatory as industry metrics are still evolving. Alternatively, the ISSB may consider industry-specific exemptions from mandatory application until Appendix B has been sufficiently improved and internationalised.

    Furthermore, a number of jurisdictions have established jurisdiction-specific emissions factors or other measurement bases which are publicly available and which arguably depict the local environment more accurately. We suggest that the ISSB require or allow an entity to use the jurisdiction-specific measurement bases before defaulting to what is specified in Appendix B (e.g. measurements established by the IPCC on pages 16, 27, 40).

43. In addition, we have the following observations and suggestions on Appendix B:
    - Some requirements are included in both the main text of the [draft] IFRS S2 as well as in Appendix B. For example, the cross-industry requirement in paragraph 21 stipulates that strategies and plans to manage overall emissions (which includes Scopes 1, 2 and 3) be disclosed. However, using Coal Operations (page 42 of Appendix B) and Construction Materials (page 53 of Appendix B) as examples, the same requirement only applies to Scope 1 emissions. In order to avoid such internal inconsistencies which may beg the question of which requirement takes precedence, we recommend that the ISSB remove from Appendix B industry-specific requirements that are already captured by the cross-industry requirements.

- Appendix B covers not only climate-related topics but also other sustainability-related topics such as water and raw materials management. The ISSB should clarify whether disclosure of these other topics is needed in order for an entity to comply with IFRS S2.
- More guidance should be given to entities that do not fit into any particular industry on how to find the relevant disclosure topics e.g. entities in crypto-related business could potentially be subject to both Asset Management & Custody Activities and Software & IT Services disclosure requirements.

<u>Specific comments on industry-specific requirements</u>

44. Commercial Banks (B16 of Appendix B):
    (i) Recent market research indicated that banks globally continue to commit a large amount of investments to green and sustainable financing but their medium- to long-term disclosures of climate-related opportunities is lacking in substance which reduces users' ability to assess the robustness of their strategies. The ISSB can consider inserting relevant guidance to help banks identify which of their lending and investment portfolios have such opportunities.
    (ii) Respondents from the banking industry suggested that the ISSB clarify the following:
        - The definition and emissions calculation methodology of "derivatives" and "undrawn loan commitment". In particular, given the nature of and arrangements involving derivatives can be complex, for example, they are usually executed with a loan facility, including both products in the emissions calculation may lead to double counting.
        - Whether trading book assets arising from securities financing transactions (i.e. reverse repos) are within the scope of financed emissions and how to calculate their emissions.
        - How to treat securitisation assets and liabilities: for example, if both the assets (mortgage loans) and the liabilities (securitisation liabilities) are on the balance sheet, it implies that the bank does not directly fund the assets. In this case, it is not clear whether the securitised assets should be included in the bank's financed emissions calculation. If the bank discloses both the financed (the mortgage loans) and facilitated (the securitization liabilities) emissions, this would again result in double counting the Scope 3 emissions.
    (iii) These respondents also raised the double-counting issues that exist in measuring Scope 3 emissions in financial products, e.g. those arising from syndicated loans, derivatives, exchange traded funds, sovereign bonds, loans for securitization, etc. The ISSB should consider providing more specific guidance on how to eliminate double-counting where possible and require disclosure of the techniques and policies used by the entity (similar to the disclosure requirements of IFRS 13 on fair value measurements). The ISSB should also consider consulting on the wider measurement issue in its upcoming agenda consultation.

45. Insurance (B17 of Appendix B): Respondents from the insurance industry had the following suggestions and concerns:
    - B17 should include more life insurance disclosure topics and metrics as life insurance is a significant part of the insurance industry. For example, quantitative metrics related to the loss of life as well as morbidity and mortality rate in relation to physical climate risks. In addition, the ISSB may consider separating the requirements for life insurance from general insurance as their nature is sufficiently different.
    - Despite the explanation in paragraph BC166, it is not clear whether the emissions from insurance underwriting activities should be included as financed emissions. The ISSB should consider clarifying the requirement and including it in B17 of Appendix B.
    - If an entity includes emissions from insurance underwriting activities, the ISSB could suggest using the premium level or sum insured as the business metric (i.e. the denominator) for intensity targets of such facilitated emissions.
    - As the ISSB proposes to allow entities to classify counterparties using standards apart from the Global Industry Classification Standard, the ISSB should include examples of such other standards e.g. International Standard Industrial Classification.
    - The funds held under investment-linked policies form part of the asset portfolio of an insurance company. However, the investment choice of such assets depends on the risk appetite and investment strategy of the policyholder as opposed to those of the insurance company. The ISSB should clarify whether the financed emissions of such funds should be reported under the insurance company, fund issuer and/or policyholder.

46. Mortgage Finance (B19 of Appendix B): Respondents from the banking industry would like to clarify whether financed emissions disclosure is required for the mortgage finance industry as no such metrics are required in B19.

47. Managed Care (B30 of Appendix B): Respondents from the insurance industry suggested that the ISSB add a metric on how the expected/foreseeable deterioration of claims experience or impact on the underwriting requirement of the policies due to extreme weather will be assessed and reflected in the insurance products under the "Climate Change Impacts on Human Health" topic as part of "Discussion and Analysis".

48. Real Estate (B36 of Appendix B): The following metrics need to be internationalized/clarified to facilitate the application of the entities:
    - Management of Tenant Sustainability Impacts – It is not common for Hong Kong lease agreements to have a cost recovery clause for resource efficiency-related capital improvements.
    - Energy Management – There is no relevant energy efficiency standard (i.e. ENERGY STAR) or energy rating in Hong Kong. In addition, it is not clear how the portfolio area used to calculate the energy consumption intensity should be determined: potential measurements could include total gross floor area, saleable floor area, etc.

49. Marine Transportation (B66 of Appendix B): The activity metric of "operating days" should exclude off-hire days of the vessel due to regular dry-docking. The GHG emissions of the vessel on such off-hire days are much less than full-scale operations and should be excluded to avoid distorting the activity metric.

<u>Financed emissions</u>

50. It appears that the proposal assumes emissions information (either at the project level or at the entity level) at the point of due diligence or loan drawdown can be obtained (albeit with a certain time lag). However, if ongoing Scope 3 emissions from borrowers is to be reported by banks, it may not be practicable for them to provide such information for the same period and at the same time as the financial statements given the volume of data to be collected.

    For example, if a bank's financial year-end is 31 December 202X and its deadline for financial reporting is 31 March 202X+1, it may not be practically possible for its borrowers to report (and for the bank to collect) their emissions information as of 31 December 202X by 31 March 202X+1. Under normal circumstances, greenhouse gas emissions will not change significantly for the same pool of borrowers within a short time. We recommend a window of at least one year from the end of the financial period for reporting sustainability information. Using the above example, the bank with a financial year end of 31 December 202X can report Scope 3 emissions using a cut-off date of December 202X-1 in their sustainability report to be filed with the securities regulators by 31 March 202X+1.

    If this approach is adopted, the time lag (i.e. the one-year window) should be disclosed in the sustainability report to enable users to cross-check the sustainability-related financial information with the financial statements of the following year.

51. There are mixed views as to whether the ISSB should specify the methodology for disclosing financed emissions. While a specified methodology may promote consistency, entities may need more flexibility in the early years to explore different approaches and for best practice to emerge and evolve. Regardless of whether the ISSB specifies a methodology, we believe that it would be beneficial for entities to disclose some sort of data quality score for financed emissions such as that recommended by the Partnership for Carbon Accounting Financials for transparency and comparability purposes.

Question 14: Effective date

52. Some respondents suggested that [draft] IFRS S2 could be implemented independently from and before [draft] IFRS S1 to address the urgent climate issue. Given that [draft] IFRS S1 is a general standard, it would be important to understand how it interacts with other standards before making it mandatorily effective. In particular, as [draft] IFRS S1 covers the full range of sustainability-related risks and opportunities (i.e. beyond climate) and requires an entity to consider other frameworks, standards and local practice in the absence of a specific IFRS Sustainability Disclosure Standard (paragraphs 51 and 53), it will take a significant amount of time for entities to fully identify all the relevant information across the full spectrum of sustainability topics.

    In contrast, other respondents agreed that both IFRS S1 and IFRS S2 should have the same effective date because the general requirements and guidance on materiality, reporting entity, frequency of reporting, comparative information and errors as set out in the [draft] IFRS S1 are important for the entities to prepare the climate-related disclosures.

    Given the pervasive impact of applying IFRS S1 to all material sustainability-related topics of an entity, we urge the ISSB to consider the appropriate effective dates of these two standards carefully.

53. We consider an implementation period of at least 3 years should be given as:
    - the novelty of the topic means that many entities lack the data, systems, processes and controls to produce the required information; and
    - entities currently providing sustainability-related disclosures need time to apply IFRS Sustainability Disclosure Standards as they may have might have adopted a different materiality principle and complied with different local regulatory requirements as compared with the EDs.

54. We suggest a phased approach for adopting certain requirements of the [draft] IFRS S2 (see table below). If this approach is taken, an entity should explain why certain requirements have not been complied with and an expected timetable for compliance at a future date. This may encourage more uptake by entities and allow for an earlier effective date for the other parts of the standard.

Disclosure requirements	**First year of application**	**Second year of application**	**Third year of application**
Scope 3 emissions	Only disclose the types of Scope 3 business activities	Disclose the corresponding Scope 3 qualitative information (e.g. what, where and how the emissions arose)	N/A (see response in Question 9 of ED IFRS S2)
Scenario analysis	Discussion of status of implementation plans as well as qualitative disclosures	Quantitative disclosures in priority business segments	Full disclosure of quantitative information

Disclosure requirements	First year of application	Second year of application	Third year of application
Emissions for associates, joint ventures, unconsolidated subsidiaries or affiliates	Exempt from disclosure	Qualitative disclosures	Quantitative disclosures. If obtaining reliable information from associates, joint ventures, unconsolidated subsidiaries or affiliates is impracticable, then the ISSB may consider requiring the reporting entity to disclose the reason.
Financed emissions	Only disclose the types of business activities involved in financed emissions	Disclose the corresponding qualitative information (e.g. what, where and how the emissions arose)	Full disclosure of quantitative information

Question 17: Other comments

55. We appreciate the IFRS Foundation and the Global Reporting Initiative recognising the need to further harmonise the sustainability reporting landscape at an international level. We agree with the initiatives proposed by the two organisations in their communique dated 23 June 2022 and look forward to seeing progress being made on that front.

    In addition, we strongly encourage the ISSB to collaborate with the US SEC and the EFRAG in terms of their respective climate-related/sustainability disclosure standards to align them as much as possible in terms of investor-focused disclosure principles to achieve global consistency and to reduce costs for preparers and other stakeholders. A list of any remaining differences between the standards should be issued to allow a smooth transition between these standards. The ISSB may consider including certain transition provisions in its standards to facilitate existing sustainability report preparers to transition to the ISSB standards.

56. There may be a case for the ISSB to consider having just one universal glossary that defines all the terms used in all IFRS Sustainability Disclosure Standards instead of including an appendix to each standard defining the terms used in that standard.

Appendix B

Editorial suggestions

	Paragraph(s)	Comments
1	1 and 2 of ED IFRS S1	The wording is not consistent in paragraphs 1 and 2: the words "material" and "all" are missing in paragraph 1. We propose the following edits to clarify the requirements and drive consistency within the [draft] IFRS S1. *Paragraph 1 - "The objective of [draft] IFRS S1 … is to require an entity to <u>disclose relevant information about all material sustainability-related risks and opportunities</u> that is useful ..."* *Paragraph 2 – "A reporting entity shall <u>disclose relevant information about all material sustainability-related risks and opportunities</u> to which it is exposed. …"*
2	11(c) of ED IFRS S1	It is unclear why paragraph 11(c) excludes "and opportunities" versus paragraphs 25 – 26 in relation to risk management.
3	12 and 25 of ED IFRS S1; 4 and 16 of ED IFRS S2	The word "significant" is missing from "sustainability-related risks and opportunities" under the objective paragraphs of "Governance" and "Risk management". Does it mean that an entity needs to deal with <u>*all*</u> sustainability-related risks and opportunities?
4	26(c) of ED IFRS S1; 17(c) of ED IFRS S2	What is the reason for not requiring an entity to disclose whether it has changed the process used for identifying and assessing climate-related *opportunities* in ED IFRS S1.26(c) and ED IFRS S2.17(c)? This is currently required for climate-related *risk* (paragraph 26(b)(iv)) (also for paragraph 17(b)(iv) of ED IFRS S2).
5	26(f) of ED IFRS S1; 17(f) of ED IFRS S2	Paragraph 26(f) of ED IFRS S1 (also for paragraph 17(f) of ED IFRS S2) should read as follows, "… integrated into the entity's overall [risk] management process."
6	40 of ED IFRS S1	Paragraph 40 provides a list of activities in the value chain that could potentially give rise to sustainability-related risks and opportunities. We believe that it may be more appropriate to move the list to after paragraph 20 which is the first time the term "value chain" appears in the [draft] IFRS S1.
7	42 of ED IFRS S1	Paragraph 42 should specify "… connections between various [significant] sustainability-related risks and opportunities …"
8	44 of ED IFRS S1	Paragraph 44 should indicate that the list is not exhaustive by inserting "including but not limited to".
9	51 of ED IFRS S1	Paragraph 51 should read as "To identify [significant] sustainability-related risks and opportunities…" otherwise it will be too broad. In addition, it should include "to the extent it does not conflict with an IFRS Sustainability Disclosure Standard" to be consistent with paragraph 54.
10	FN-IN-4 on page 157 of ED IFRS S2 Appendix B	"Presentation currency" is missing as a unit of measure for point (2) gross exposure.

~ End ~