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Submission to Exposure Draft ED SR1 ASRS 2

We thank the AASB for the opportunity to make a submission to the ASRS2. Our view is that the expansion of climate reporting requirements will likely incur disproportionate regulatory compliance costs on small and medium-sized businesses (SMEs) and not-for-profit entities. Acknowledging that nobody should avoid their responsibility of sustainability reporting, we advocate for the development and utilisation of artificial intelligence (AI) techniques to minimise the unnecessary regulatory burdens of SMEs and not-for-profits. Our suggestion is further supported by our responses to the discussion questions as follows:

Question 12

Do you consider the cross-industry metric disclosures set out in paragraphs 29(b)–29(g) of IFRS S2 (and [draft] ASRS 2) would provide useful information to users about an entity's performance in relation to its climate-related risks and opportunities? Please provide reasons to support your view.

Our submission

We submit that the cross-industry metric disclosures may highly likely discriminate the SMEs. Better regulatory compliance designs should be instituted to take into account the diversity of the SMEs, such as the industry, the type of entities, the business size, number of employees, number of shareholders, SMEs' role in the supply chain, their regulatory compliance capacity, and how could AI techniques be used to proactively capture and analyse data. One must consider the unintended consequences that the Scope 3 compliance requirements will have on the SMEs and not-for-profits. It is likely that, when a large corporation is required to disclose cross-industry data, the reporting responsibility will be passed onto the small businesses on the supply chain. For SMEs who do not understand the disclosure requirements or fail to provide such disclosures, they may not be able to do business with large corporations.

Question 13 Do you agree with the proposed requirements in [draft] ASRS 2 paragraphs 29(g) and Aus29.1 to disclose the information described in points (a) and (b) in the above box? In your opinion, will this requirement result in information useful to users? Please provide reasons to support your view.

Our submission

We disagree with the proposed requirements in draft ASRS 2. The academic literature shows that there are more governance incentives other than executive remuneration[1] that may affect the reduction of carbon emissions, such as institutional pressures[2], strategic

[1] Luo, L., Wu, H. and Zhang, C., 2021. CEO compensation, incentive alignment, and carbon transparency. *Journal of International Accounting Research*, *20*(2), pp.111-132.
[2] Villena, V.H. and Dhanorkar, S., 2020. How institutional pressures and managerial incentives elicit carbon transparency in global supply chains. *Journal of Operations Management*, *66*(6), pp.697-734.

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priorities[3], board behaviour[4], etc. The regulation should focus on both ex-ante and ex-post mechanisms (such as reporting). The regulation should also incorporate industry and sector-driven self-regulation. In addition, remunerations of SMEs executives is generally an art rather than science. Particularly, many SMEs executives don't have remunerations, which makes it difficult, if not impossible to get data on executives' remunerations.

18 Do you agree with the proposal in paragraph AusB39.1 of [draft] ASRS 2? Please provide reasons to support your view.

Our submission

We disagree with the proposal. There are at least three issues that raise concerns:

i. **The ex-post static data may not reflect the strategic priorities and focus of the entities;**
ii. **The outcome-focused metrics failed to capture the process of adoption of practical measures to reduce carbon emissions which is the ultimate goal; and,**
iii. **The SMEs often do not keep good records of their transactions; hence data quality tends to be low. If low-quality data were fed into the system, the errors would accumulate to the extent that the aggregate data may be meaningless.**

19 Do you agree with the AASB's approach in [draft] ASRS 2 paragraph AusB33.1 to include the Scope 3 GHG emission categories in IFRS S2 as examples of categories that an entity could consider when disclosing the sources of its Scope 3 GHG emissions, rather than requiring an entity to categorise the sources of emissions in accordance with the categories of the GHG Protocol Standards? Please provide reasons to support your view.

No, we disagree with the expansion of climate reporting to Scope 3 from the perspectives of SMEs and not-for-profits. A critical issue facing SMEs and not-for-profits is their lack of resources/expertise in regulatory compliance. Moreover, data privacy may be a great concern to SMEs who do not know how the data they provide may be used. The Scope 3 climate reporting will exert an unnecessary burden on SMEs. Our work on the application of AI in regulatory compliance utilising existing data from SMEs may be a good alternative. The Federal Treasury estimated that the regulatory cost for an established entity ranges from $700k to $1.5 million per entity[5], let alone those that are not familiar with the regulatory compliance. Should the government take the initiative of applying AI to automate the reporting process, the compliance costs on SMEs could be reduced significantly.

26 Do you agree with the AASB's view noted in paragraphs BC31–BC33 that the proposed clarification in [draft] ASRS 1 paragraph Aus6.1 and [draft] ASRS 2 paragraph Aus4.1, together with the practical expedients already provided through the baseline of IFRS S1 and IFRS S2, would be sufficient to

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[3] Christmann, P. and Taylor, G., 2002. Globalization and the environment: Strategies for international voluntary environmental initiatives. *Academy of Management Perspectives*, *16*(3), pp.121-135.
[4] Cavallaro, C.M., Pearce, J.M. and Sidortsov, R., 2018. Decarbonizing the boardroom? Aligning electric utility executive compensation with climate change incentives. *Energy Research & Social Science*, *37*, pp.153-162.
[5] Federal Treasury, 2023. Climate-related financial disclosures - Policy Impact Analysis. Retrieved on 1/3/2024 from: **https://treasury.gov.au/sites/default/files/2024-01/c2024-466491-pia.docx**

address the cost-benefit and scalability concerns for not-for-profit entities preparing climate-related financial disclosures? Please provide reasons to support your view.

Our Submission

We disagree with the proposed approach. Not-for-profits come in all the sizes and shapes. They generally don't have the resources and capacity to deal with regulatory compliance, let alone these sophisticated ones. It is necessary to provide training and education to raise the awareness of the not-for-profits about climate reporting and compliance requirements. AI techniques may be able to help to alleviate the regulatory compliance costs.

27 If you disagree with the AASB's view in Question 26, what other modifications could be made to the baseline of IFRS S1 and IFRS S2 as included in the [draft] ASRS to assist not-for-profit entities to comply with climate-related financial disclosure requirements without undue cost or effort? Please specify which requirements in [draft] ASRS 1 and [draft] ASRS 2 you would suggest modifying, how those requirements could be modified and why you think the modifications would be helpful.

Our Submission

We disagree with the AASB's view. We believe that education and training and application of AI techniques in automation of regulatory compliance could reduce the regulatory burden of not-for-profits and achieve the carbon emission reduction goals.

Kind regards

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