

Research Centre for Sustainable Hong Kong¹

City University of Hong Kong

Submission of Comments on IFRS' Sustainability Exposure Drafts

[IFRS S1 – General requirements for Disclosure of Sustainability-related Financial
Information]

[IFRS S2 – Climate-related Disclosures]

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1. First, we welcome the release of the two sustainability exposure drafts and see it as a critical step forward in the development of *global standards* in sustainability disclosure instruments, which are geared to influence market behaviors in favor of sustainability.
2. We are thus keen on ascertaining how the drafts may effectively influence market behaviors to the intended effect. To this end, our observations will focus on three dimensions: (a) clarity of the guidance, (b) practicality or feasibility, and (c) diversity of needs and demands in different jurisdictions and categories of stakeholders.

On clarity of the guidance

3. Clarity is a major theme in the consultation questions of IFRS S1 and S2. We observe several dimensions where clarity seems lacking:

3.1 On scope of disclosure – it is stated in IFRS S1 (p.11) – Question 3 – Scope - that
'Sustainability-related risks and opportunities that cannot be *reasonably* be expected

¹ Established in June 2017 by a cross-disciplinary research team, the Research Centre for Sustainable Hong Kong (CSHK) is an Applied Strategic Development Centre of City University of Hong Kong (CityU). CSHK conducts impactful applied research with the mission to facilitate and enhance collaborations among the academic, industrial, and professional service sectors, the community, and the government for sustainable development in Hong Kong and the Region. Linda Chelan Li, Professor of the Department of Public Policy at CityU, is Centre Director.

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² This Working Paper originates from a CSHK's submission to a consultation call by the International Sustainability Standards Board (ISSB) on its first two proposed standards regarding comprehensive global baseline of sustainability disclosures for the capital markets. It was also shared with the Hong Kong Green Finance Association (HKGFA; in which CSHK is founding institutional member) for incorporation into their submission to ISSB in July 2022.

to affect users' assessments of the entity's enterprise value are outside the scope of sustainability-related financial disclosures'. However, there is no clear explication on the criteria of 'reasonableness' in the Draft.

3.2 On materiality - this is closely related to 3.1 on scope, as there is an apparent reliance on the judgement of the reporting entity (the enterprise) on what constitutes *materiality* and that which decides what needs to be disclosed (that is, scope). However, from the perspective of the reporting entity, this effectively amounts to an absence of guidance.

The materiality principle as stated provides little guidance to assist reporting entities to arrive their assessments. It stresses the variability of what accounts as 'material' due to 'nature of sustainability-related financial information'. Materiality may also vary across enterprises. Material information 'disclosed by an entity may change from one reporting period to another as circumstances and assumptions change' (IFRS S1, p.16). This means that the burden of judgements is solely on the reporting entities and any suggested template (or guideline/'standards') will not relieve them of their responsibility, since 'even if a specific IFRS Sustainability Disclosure Standard contained specific disclosure requirements, an entity need not provide that disclosure if the resulting information was not material' (ibid).

We agree to relieve an entity from disclosing information otherwise required by the Exposure Draft (as a global standard) if local laws prohibit so. However, this also reminds us of the irreconcilability of the materiality principle and the formulation of a global requirement. If a global standard of some kind nonetheless is in place *despite* the materiality principle (the reporting entity being the principal responsible agent for it), the question is what should be such a standard and how that can be arrived and workable?

3.3. On core content: The reporting entities are required to disclose information relating to 'governance', 'strategy', 'risk management', and 'metrics and targets' in those sustainability/climate-related things material to their enterprise value. However, the definitions of these remain general. How exactly will 'governance', 'strategy' and 'risk management' be operationalized and thus reported? All these boil down to the reporting of 'metrics and targets', as well as disclosures of qualitative information on the processes. On metrics and targets, there is a lack of clear guidance of what metrics and targets should be employed by the reporting entities. The references to metrics and targets in IFRS S1 are very general – and stress the judgements of the reporting entities (they choose what metrics/targets to use and disclose). In IFRS S2, the definitions in Appendix A are dearth in methodological clarifications. For example, more clarifications on system boundary issues in attaining "carbon offset", like

reduction in GHG emissions, or an increase in carbon storage, the standard accounting approach, etc., are required, with references to research studies or international guidance documents on methodology.

On qualitative information, there can be issues of confidentiality deterring disclosure, in addition to ambiguity of expected boundaries. On this, please also refer to the last para under 3.2 above.

IFRS S2 Appendix B lists the industry-based disclosure requirements in relation to climate-related disclosures. B2 (49) tells that these are derived, and largely unchanged, from the existing SASB Standards. A question arises to how the requirements relate to other popularly used disclosure templates in the market, e.g. GRI. Reporting entities that have been using GRI will need more guidance and a conversion/comparison table might be helpful.

B11 (a) (p.51) states the plan to develop ‘modifications’ to the SASB standards to make them ‘more applicable globally’. This is a welcome move, given the importance to address diversity of circumstances across the globe within industries. But there is no further information on how the modifications are made, guiding principles or key dimensions.

On practicality

4. Without doubt practicality is a material criterion of assessing the Exposure Drafts given their objective being to improve the existing disclosure requirements in influencing corporate behavior in favor of sustainability. What is the likelihood of the proposed requirements be practiced by the reporting entities and to the intended effect? Our comments on this are closely related to those on clarity above, since clarity will almost certainly impact on practicality though not exclusively. Several concerns in this respect: -

4.1 Reporting entities require much clearer guidance on metrics/targets, and on the operationalization of ‘materiality’, including its variability characteristics. There will require more work on benchmarking of metrics. The current reporting practice has revealed a large range of diversities across reporting entities, sometimes making analysis itself difficult – this suggests the need for more research and analysis. It seems that much distance has yet to be travelled. More transparency and discussion of the nuanced and diverse empirical situations - how enterprises are doing the reporting in recent years, the challenges/difficulties they faced during the reporting, as well as comparison of different metrics/methodologies should be done to contribute towards this process of learning and development. [This is an area of research which our team is working on]. The Exposure Drafts do not seem to have included much analysis of

the perspectives of reporting entities which have been considered in their formulation. More discussion on that part will help to improve buy-ins.

4.2 Reporting entities vary a lot – not only by industry and nature of their business, but also by scale, and by location (which affects the cultural and institutional (regulatory) environment in which the entities are operating). Thus, how to enable a global set of requirements that can be of practice utility for diverse reporting entities is a major challenge. The last para of 3.3 already touches on this (modifications of SASB to suit differences across the globe). On scale, many reporting entities are of smaller scale in their operation than the larger ones. Therefore, much as the need to develop a separate set of general financial reporting requirements for the SMEs, there is a need to consider the requirements of SMEs in sustainability/climate-related disclosures.

On diversity of needs and stakeholders of sustainability-related risks and opportunities

5. The diversity consideration is a material consideration for practicality of the Exposure Drafts requirements, as discussed in 4.2. In addition, diversity is in itself a material consideration in assessing sustainability/climate-related risks and opportunities. The challenge however is to turn the goal of diversity into disclosable corporate behaviors. The current approach to disclosure premises the investors (existing and potential), lenders and other creditors of the reporting entities as the ‘primary users’ of the disclosure information. Conspicuously absent are the employees and customers/clients. Employees and clients theoretically should belong to the ‘information’ that are covered by the disclosure requirements. In other words, as material and integral stakeholders to the sustainability performance of the reporting entity, employees and clients are considered not as active agents but as part of the baseline information to be reported. However, which part and characteristics of their situation should be included will be subject to the materiality judgment of the managers at the reporting entity. Empirical studies on actual reporting especially in Asia suggest that the disclosures on employee and client welfare have been very limited under the current reporting systems/practices. There is a need to have more guidance to help reporting entities on what items can/need be reported. Possible disclosure items on diversity are, for example, workforce composition data, the number of hours of inclusive training provided to staff, and the amount spent on making workplace adjustments to accommodate staff with special needs. However, given what we discussed on the dearth of details over metrics/targets, we wonder whether the Exposure Drafts will be able to generate enough improvements in this regard.

Conclusion

6. IFRS S1 and S2 are important advancements. S1 in particular sets out ambitious targets and its broad scope reminds us of the challenge, and the benefits, of improving

sustainability. Our comments focus on clarity, practicality and diversity. When working on this submission, the challenges for Hong Kong where we are become even more compelling, as Hong Kong is still largely reporting with a generic template with no differentiation of industries/sectors. The upcoming new global standards will thus be a strong push and pull factor for Hong Kong to enhance its sustainability and climate-change reporting standards and practices.

Appendix

1. The Research Centre for Sustainable Hong Kong (CSHK), established in June 2017, is an Applied Strategic Development Centre of City University of Hong Kong (CityU). CSHK aspires to identify, analyze and develop solutions to meet critical sustainability issues in Hong Kong and the Asian Region from a cross-disciplinary, cross-border and cross-sector perspective. CSHK is currently composed of 25 Members from a wide range of disciplines, including public policy, philosophy, international relations, social and behavioural science, communication, law, economics and finance, accountancy, management science, civil engineering, biological engineering and environmental science. Major research themes of CSHK include (but not limited to): the Belt and Road Initiative, the Greater Bay Area, Healthcare and Medical Ethics (esp. COVID-19), Green and Sustainability (e.g. ESG reporting), AI Governance and Ethics and Diversity, Equity and Inclusion (DEI).

2. This submission draws upon the following research projects of the members and their discussion on the exposure drafts.

“Driving Better ESG Reporting and Performance– A Key to Strengthen Hong Kong’s Competitiveness in the Global Financial Market” is a research project with the objective to analyse the gaps in ESG risk management and reporting for listed companies in Hong Kong (taking the financial and biomedical sectors for in-depth study) and identify their challenges or difficulties in the reporting process. We will base on our findings to develop a comprehensive governance framework and ESG reporting template to help companies better manage their ESG risks and meet the disclosure requirements more effectively. Prof Phyllis Mo (Professor of Department of Accountancy and Associate Director of CSHK) is the Project’s Principal Investigator. Project team members include Prof Linda Li (Professor of Department of Public Policy and Director of CSHK), Dr William Chung (Associate Professor of Department of Management Sciences), Dr Ho Mun Chan (Associate Professor of Department of Public Policy), Mr Chun Kit Chui (PhD student of Department of Public Policy).

Dr Liang Dong (Assistant Professor of Department of Public Policy and School of Energy and Environment) conducts the following on-going research projects:

- **Towards Inclusive Circular Economy: Transnational Network for Wise-waste City** (构建包容性的循环经济:城市智慧减废合作网络): a Sino-Dutch international collaborative project that combines inclusive city theory to circular economy, to explore a pathway to

inclusive circular economy and conducts community demonstration projects in Chinese and Dutch cities.

- **Wise-waste System Integration Development and Policies Applications in Hong Kong:** a project aims to develop and demonstrate a wise-waste system based on the life cycle of waste management, integrating Internet of Things (IoT) and data science & tools, and developing social and cost-benefit analytical tool (combining agent-based model for recycling behavior simulation, integrating life cycle assessment, life cycle costing approach and social life cycle assessment for assessment), to examine the effect of the proposed system. Policy packages like the inclusive waste management and circular business model will also be developed for social support.
- **Collaborative Project on Carbon Neutrality Policies Toolkit Development:** a collaborative project investigates the Carbon neutrality policies toolkit in EU, USA, UK, China, Japan, Korea, Hong Kong, Singapore and Taiwan, and design the policies combination and insights to Hong Kong.
- **Collaborative Project on ESG Index System Development and Econometric Analysis:** a project has two targets: a) Design an ESG index system based on SDG framework, and conducts quantitative analysis on ESG and index system: we use the ESG score (e.g., MSCI) as function, use the designed ESG indicators as controlled variables, to analyse how the indicators will affect ESG score. B) We could build a recommended key indicator matrix for companies under different industries, supporting their more efficient performance improvement. Empirical study is conducted industry by industry.
- Consultancy project on applying life cycle assessment and carbon assessment on net zero building, with local companies and industries in Hong Kong

“Government-Sponsored Voluntary Environmental Programs and Firm Exits: A Longitudinal and Comparative Study”, carried out by Dr Ning Liu (Assistant Professor of Department of Public Policy), aims to understand the determinants of regulatees’ interests and continual efforts in environmental self-regulation. One central challenge to the effectiveness of voluntary environmental regulation (VEP) is whether and how regulatees are interested in such policy endeavors and able to commit to the program obligations. This study will conduct a longitudinal and comparative investigation of firm exits from government-sponsored VEPs. We are interested to explore how do organizational and industrial forces shape firm exits from government-sponsored VEPs, and how does regulatory and political complexity arise and moderate the organizational and industrial explanations of firm exits? The proposed research will provide significant insights into the theoretical development and practical implications of voluntary environmental governance.

“Exploring the Roles of Enterprises in Promoting Workplace Inclusion for People with Disabilities”, conducted by Dr Ricky Kwan (Assistant Professor of Department of Social and Behavioural Sciences), aims to explore the roles of enterprises in facilitating workplace inclusion for people with disabilities. Guided by empirical evidence, it promotes a paradigmatic shift in the orienting perspective of vocational rehabilitation social work, moving from a ‘charitable employment support’ focus to a new ‘workplace inclusion’ focus, the latter involves collaboration with enterprises to effect changes in organizational culture and practices for fostering social inclusiveness in workplaces for people with disabilities and other disadvantaged groups. The research product will extend the focus of social work from employment support for PWDs to cultivating an inclusive culture in the workplace.