Carbon Market Watch response to the IFRS Sustainability Disclosure Standard "IFRS S2 Climate-related disclosures"

Carbon Market Watch welcomes the opportunity to provide feedback to the IFRS S2 Climate-related disclosures standard. We focus below on questions 5, and 10 which cover the topics of target setting and reporting of information related to corporate climate mitigation action.

Question 5 - Transition plans and carbon offsets

(a) Do you agree with the proposed disclosure requirements for transition plans? Why or why not?

We broadly agree with these plans, though there are substantial elements missing - see next question.

(b) Are there any additional disclosures related to transition plans that are necessary (or some proposed that are not)? If so, please describe those disclosures and explain why they would (or would not) be necessary.

Below is a list of elements which should be required in order to understand the full scale of a company's plans.

Item 13(b)(i) requires disclosure of information related to the process in place for the review of the targets. This should be clarified to require information on the exact timing for the review of the targets, i.e. how often will the targets be reviewed, how often will the company assess and report the extent to which it is on track to reach the target, and what corrective action will be taken in case the company is not on track.

(c) Do you think the proposed carbon offset disclosures will enable users of general purpose financial reporting to understand an entity's approach to reducing emissions, the role played by carbon offsets and the credibility of those carbon offsets? Why or why not? If not, what do you recommend and why?

The disclosure requirements are insufficient, and partly inconsistent, as described in the answer to the next question.

(d) Do you think the proposed carbon offset requirements appropriately balance costs for preparers with disclosure of information that will enable users of general purpose financial reporting to understand an entity's approach to reducing emissions, the role played by carbon offsets and the soundness or credibility of those carbon offsets? Why or why not? If not, what do you propose instead and why?

Item 13(b)(iii) requires disclosure of the "*intended use of carbon offsets in achieving emissions targets*". While we strongly support the requirement to separately disclose the retirement of

carbon credits from internal emission reductions achieved by the company, the specific requirement is problematic in multiple ways.

First, because it refers to carbon *offsets* rather than *credits*. The disclosure requirement should be on *credits*, which is the actual asset that can be purchased and held. Offsetting is only one way of using a carbon credit. It implies compensation of emissions. This is not the only way, as a company could choose to purchase carbon credits but to not make any *compensation* claims with this. They could, for example, emphasize in their communications that they have purchased these to support climate action, but without presenting their products or company as carbon neutral or similarly imply that they have no net impact on the climate.

Using carbon credits through such a “contribution” approach, rather than a “compensation” approach, would mean that the credits are not actually counted as part of a company’s mitigation target. The target would focus exclusively on internal abatement. The reporting requirement under 13(b)(iii) should hence focus on reporting the retirement of carbon credits. These are not necessarily carbon offsets, and these are not necessarily used to achieve an emissions target.

In cases where carbon credits are actually used as offsets, and hence counted towards the achievement of a climate target, then reporting requirements under 13(b)(iii) need to be strengthened. 13(b)(iii)(1) requires information on “the extent to which the targets rely on the use of carbon offsets”, which is not specific enough. The requirement should be for information on the “precise and quantitative extent” to which the targets rely on the use of carbon offsets.

Item 13(b)(iii)(2) involves a more fundamentally problematic element of the reporting requirement, which is the possibility for companies to report the use of carbon credits without any third party certification. This issue is also present in the definitions section which differentiates between “carbon offset” and “certified carbon offset”. Companies should not be allowed to report the use of carbon credits that are not certified by a third-party. This would be an open door to the use of low-quality credits or flawed carbon accounting methods. For example, companies could implement mitigation projects themselves, with no transparency and no integrity, and issue unverified carbon credits to themselves, and report this as climate action. Many users of the general purpose financial reporting will not grasp the nuance of a verified vs non-verified offset, and this will create confusion regarding the robustness of the companies’ plans. Therefore, 13(b)(iii)(2) should be modified to clarify that only third-party certified credits (not “offsets”) can be reported.

Moreover, item 13(b)(iii)(3) is problematic, and inconsistent with the definitions section. In theory, carbon credits could be generated for emission reductions, removals, or avoidance. We strongly advise against allowing the reporting of credits based on emissions avoidance, as this term is undefined, and could encompass a wide range of activities, lacking environmental

integrity. Countries could decide to create credits for “avoided” emissions for leaving some of their fossil fuel reserves unexploited. A steel company could issue credits for “avoided emissions” because it produces steel that is used to build wind turbines. A car manufacturer could issue credits because they decide to stop manufacturing combustion engines. There is virtually no limit to accounting tricks when using this undefined concept of “avoided” emissions. The only two acceptable categories should hence be removals and reductions.

In this regard, section 13(b)(iii)(3), the definition of “carbon offsets” and the definition of “certified carbon offset” are all inconsistent with each other. Item 13(b)(iii)(3) refers to removal or avoidance. The definition of carbon offsets refers to emission reductions or removals. And the definition of “certified carbon offset” refers only to removals. These should be made consistent and refer to reductions or removal throughout (not avoidance).

Finally, item 13(b)(iii)(4) is unspecific. A more specific list of information requirements should be added. Companies should report at least the following: the volume of credits retired/cancelled, the serial number of these credits, the project and program that issued them, and the Validation & Verification Body that validated the verification report before issuance. Companies should also be required to make available the retirement certificate of the credits. Without this, there is no public proof that the company has actually retired these credits, and double (or multiple) claiming of the same credits cannot be ruled out.

Finally, the company should also be required to provide public information on the due diligence process it has followed to assess the quality of the credits it purchased, as well as the conclusion of that process.

Question 10 - Targets

Do you agree with the proposed disclosure about climate-related targets? Why or why not?

The required disclosure is insufficient, and further elements should be added.

First, more clarity should be required regarding the reporting of scope 2 energy-related emissions. Under the GHG Protocol, companies should report their scope 2 energy related emissions using both the market-based and location-based approaches. The first allows a company to report emissions based on the local grid intensity, while the second allows a company to report emissions based on the purchase of renewable electricity instruments, such as RE certificates. Both methods could be misleading. In addition to the GHG Protocol requirement to report both values, companies should hence be required to use the highest of the two values when they present their total footprint, i.e. their aggregate footprint across scopes 1, 2 and 3[1].

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[1] See for background NewClimate Institute (2022):”GUIDANCE AND ASSESSMENT CRITERIA FOR GOOD PRACTICE CORPORATE EMISSION REDUCTION AND NET-ZERO TARGETS” (p.10) and

Item 21(a)(vi)(2) which requires companies to disclose the categories included within their scope 3 emissions is not specific enough. First, it creates confusion with requirements found elsewhere (for example item 21(a)(i)(3)) which requires companies to report their scope 3 emissions, which is interpreted as meaning *all* scope 3 emissions. Item 21(a)(vi)(2) hence opens the door for companies to exclude some of their scope 3 emission sources, without providing strict guardrails. There should be provisions to ensure that companies can only exclude a small share of these, and only if due justification is provided.

In addition to setting those guardrails, it is very important to require companies to not only report the sources of emissions they have *included* in their scope 3 accounting, but also any sources they have *excluded*. Item 21(a)(vi)(2) currently only requires the company to report which sources are *included*, and this means that an external observer would need to guess what other scope 3 source might be relevant for that company, in order to understand which sources have been excluded.

Furthermore, item 21(f) which stipulates requirements related to the reporting of information on internal carbon prices, should include an additional item (iii) requiring clear information about whether the internal carbon price is applied as a shadow price, i.e. a virtual cost only used as part of investment calculations, or as an internal levy, i.e. an actual cost whereby real money is collected (e.g. for an internal fund). Where the internal carbon price is applied as an actual levy, the company should also be required to report on how the collected funds are used.

Finally, in item 23, which relates to information requirements about the company's target, additional requirements should be stipulated. First, there should be a clear and quantified assessment of the share of total emissions covered by the target. This means expressing the target coverage as a share of the full scope 1, 2 and 3 footprint of the company. For example, a company could have a target of reducing 50% of its emissions, but with this target actually only applying to 10% of its total footprint, due to the exclusion of certain scopes. This must be transparently reported.

Second, the target should clearly indicate what share of the mitigation effort is to be met through internal emission reductions, inside the company's value chain, as opposed to the use of carbon offsets.

(b) Do you think the proposed definition of 'latest international agreement on climate change' is sufficiently clear? If not, what would you suggest and why?
No opinion.

Benchimol, Gillenwater, Broekhoff (2022):"FAQ: Green power purchasing claims and greenhouse gas accounting"

Submitted 28 July, 2022

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