

Stepping up to mandatory scope 3 emissions reporting: practical considerations for a smooth transition

December 2024



For many Australian organisations, the reporting of scope 3 emissions is about to move from being “on the radar” to front of mind.

Until now, disclosure of scope 3 greenhouse gas (GHG) emissions¹ in Australia has been voluntary - that is, the disclosure of emissions both upstream and downstream from the reporting entity. However, the reporting of scope 3 emissions will become mandatory following the introduction of a mandatory climate-related financial disclosure regime in Australia for financial years starting on or after 1 January 2025. Importantly, the process of understanding scope 3 emissions is **critical** to the broader requirements related to identifying climate-related risks and opportunities (CRROs) across an entity and its value chain (particularly with respect to exposure to transition risks). In this paper, we explore:

- 1. Key considerations for organisations beginning their scope 3 reporting journey.
- 2. Challenges and considerations as it relates to the use of primary data versus secondary data.
- 3. Challenges and considerations associated with setting scope 3 targets.

Refer to the table below for a summary of the relevant scope 3 requirements and the associated available relief, as outlined in the amended *Corporations Act 2001* and the Australian Sustainability Reporting Standards (ASRS).

With the new law requiring climate-related financial disclosures starting from 1 January 2025, Australian entities will soon need to report their scope 3 emissions on an annual basis.

Relevant requirements	Available relief
Strategy Identify CRROs across the entity and value chain ²	Given the effort required by entities to determine their scope 3 emissions, the following transitional reliefs are available: ▶ Modified liability for Directors for three years from 1 January 2025 applies to scope 3 emissions (as well as scenario analysis and transition plans). ▶ Entities will not need to disclose scope 3 emissions in their first year of reporting. ▶ An entity can measure scope 3 emissions using information for reporting periods that are different from its own reporting period but only if certain conditions are met⁴.
Metrics and targets Reporting scope 3 emissions and targets ³	

“The approach to determining scope 3 emissions is expected to be refined over time.

Meg Fricke
Partner, Climate Change and Sustainability Services, Ernst & Young, Australia

1. Scope 3 emissions refers to indirect greenhouse gas emissions (not included in scope 2 greenhouse gas emissions) that occur in the value chain of an entity, including both upstream and downstream emissions. Scope 3 greenhouse gas emissions include the scope 3 categories in the Greenhouse Gas Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard (2011).

2. Paragraph 13(a) *Climate-related Disclosures* (AASB 2)

3. S2.29(a), *Climate-related Disclosures* (AASB 2)

4. S2.B19 *Climate-related Disclosures* (AASB 2)



What are some key considerations for organisations beginning their scope 3 reporting journey?

Reporting of scope 3 emissions can be daunting, particularly given the indirect nature of scope 3 emissions (which incorporate both upstream and downstream value chain activities) and the challenges this can pose in terms of obtaining third-party data or making appropriate estimates. The disclosure requirements adopt a proportional approach that over time allows for companies to become more practiced in scope 3 estimation methodologies and build on available data.

The below diagram provides a practical overview of how an organisation might go about reporting scope 3 emissions for the first time. It starts with considering the organisational boundary of the company, which is determined on an operational control, financial control or equity share approach. It's also important to have a high-level understanding of what your scope 3 emissions exposure could look like as not all of the 15 scope 3 categories may be applicable.

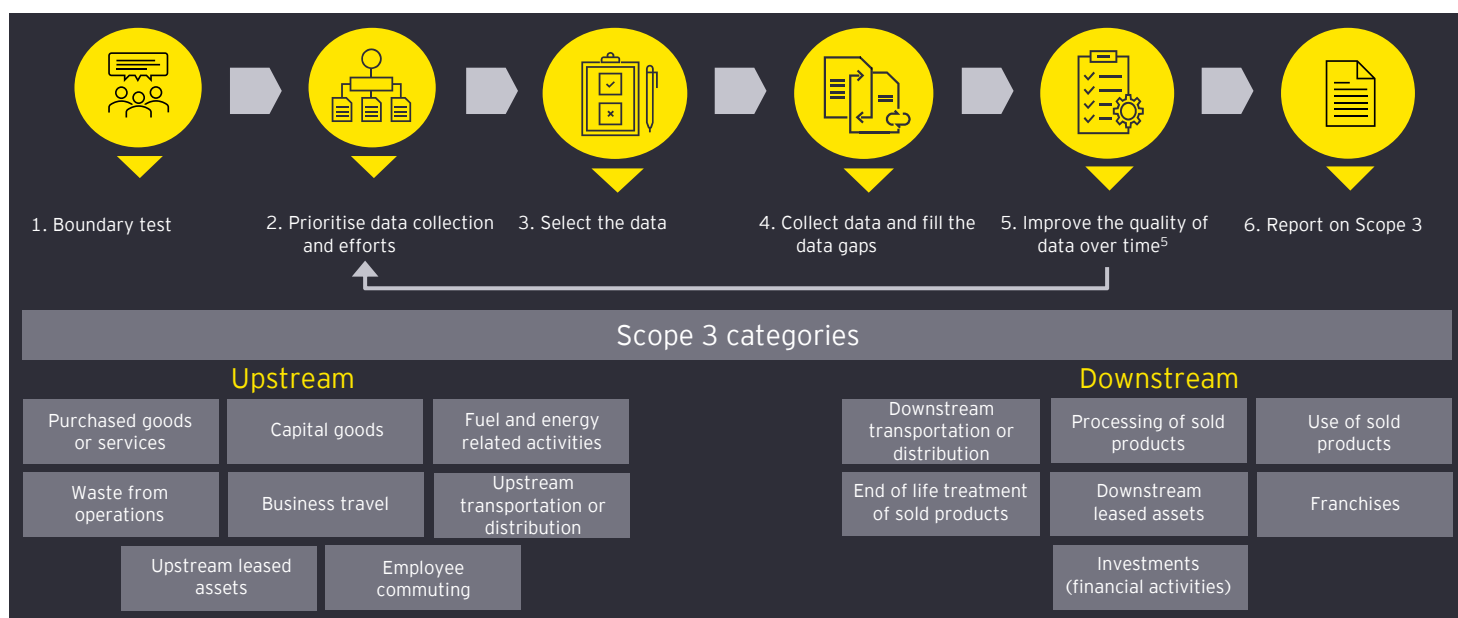
Having considered which categories across the entire value chain are relevant you need to identify what

(reasonable and supportable) information is available without undue cost or effort. This information can then be used to measure scope 3 emissions.

After completing this initial work, the entity can then consider where it wants to improve its data collection.

Once the process is completed for the first time, a better picture of the scope 3 emissions profile will emerge. In the second reporting period, organisations can now look to refine the data and go deeper into certain categories or even subsets of categories (e.g., taking highest emitting suppliers and engaging directly with them to obtain primary data instead of using secondary data) to improve the measurement over time.

In completing the process, it's important to be methodical - providing justification for decisions and clearly documenting outcomes making it easier to replicate in future years and to ensure a smooth external assurance process⁵. Entities are also required to disclose their key judgements, inputs and assumptions.



5. The AUASB has proposed a pathway to phase in assurance requirements, starting with limited assurance, such that by the fourth year of reporting for an entity, reasonable assurance will be required for all climate disclosures, including scope 3 emissions..



For those entities about to embark on scope 3 disclosures for the first time, here are four key considerations to keep in mind:

1 Consider how you will track progress and set meaningful targets.

It is important to consider which potential emission reduction initiatives might be feasible for your scope 3 emissions before building your inventory so that it can be designed in a way that will allow you to measure the results of these initiatives over time. For example, if you are planning to implement initiatives that involve working with, or incentivising, key suppliers to reduce their own emissions, then the inventory should be designed to accommodate data entry on an individual supplier-basis (at least for key suppliers) rather than as an aggregate number for a particular material, product or service. This way, actions taken by individual suppliers to decarbonise can be recognised in your scope 3 inventory as opposed to simply applying an industry-average emission factor to an aggregated activity data total.

2 Beware of double counting.

For certain sectors, there can be an overlap for scope 3 emissions reported in the different scope 3 categories⁵. This is particularly something to keep in mind for businesses whose products are typically used by other participants within their value chain. For example, if an oil and gas company reports the combustion of its fuel products as 'use of sold products' (Category 11), then some of the emissions associated with fuel use in upstream and downstream transport and distribution (Categories 4 and 9) are likely to have already been captured within the inventory. Many industry sectors have released their own specific scope 3 guidance that can help address these sector-specific nuances and such guidance should always be read in conjunction with ASRS, particularly for establishing the boundary and devising approaches to estimation.

3 Scope 3 reporting will require a collaborative effort from various internal stakeholders.

Scope 1 and scope 2 emissions reporting has been typically managed single-handedly by the environment, energy or sustainability function within a business. For scope 3 reporting, there will be a need to coordinate with a wider range of internal stakeholders to help identify:

1. The boundary for the scope 3 emissions inventory.
2. Which emission sources will be captured within this boundary.
3. What types of data are available for each emission source identified.

Often discussions will need to occur with team members that work in procurement, logistics and sales, amongst others, to ensure that the full value chain is being appropriately considered.

4 Recognise that your scope 3 inventory will become more accurate over time.

Companies should recognise that their scope 3 calculations will be a process of improvement over time, where the base year will typically use high-level estimates (often based on spend) to understand where the most material indirect emissions are likely to be occurring and then use that as a guide to focus on obtaining data from primary sources for the most significant areas in subsequent years. In addition to meeting the ASRS disclosure requirements, documentation of the approach and assumptions applied is critical to support a repeatable process or to identify changes year on year. Documentation in the form of a Basis of Preparation will also support external reporting and assurance. It is always possible to make historical adjustments to a baseline as the accuracy of data and calculation approaches improve over time.

Financed emissions

While scope 3 emissions reporting presents a significant challenge across various sectors, it is especially pronounced in the financial services industry. Here, financed emissions constitute the majority of an entity's emissions footprint and are of great interest to investors and other users of sustainability reports. Currently, there are methodologies available to assist in estimating these emissions, with the most notable being those published by the Partnership for Carbon Accounting Financials (PCAF).

In line with the broader challenges of scope 3 reporting, the experiences of voluntary reporters to date underscore the importance of engaging with customers regarding data availability. Where necessary, data gaps can be addressed in the short term by utilising third-party providers or employing data proxies.



Measuring scope 3 emissions: what are the considerations?

Overcoming the challenge of obtaining representative data for indirect emission sources is one of the main obstacles that scope 3 reporters need to navigate.

The measurement of an entity’s scope 3 GHG emissions is likely to include the use of estimation. In measuring these emissions, AASB S2 requires an entity to use judgement to prioritise inputs and assumptions that reflect data that is:

- Based on direct measurement
- From specific activities within the entity’s value chain
- Timely and faithfully represents the value chain activity and its GHG emissions
- Verified

Practical challenges with direct measurement mean that scope 3 emissions typically involve estimation with either or a combination of primary data and secondary data. Many commence their scope 3 reporting predominantly based on secondary data (e.g., data supplied by third-party data providers), using it as a guide as to where to focus efforts to obtain primary data for future reporting periods. This is likely to continue when applying the requirements in AASB S2.

The table below summarises some of the considerations to keep in mind when making judgements about the measurement of scope 3 GHG emissions.

► **Estimation:** involves using assumptions and inputs to estimate scope 3 GHG emissions. Inputs used in estimation are likely to include activity data (i.e., data that represents an entity’s activities which result in GHG emissions) and emissions factors that convert activity data into GHG emissions.

	Primary data	Secondary data
Overview	Data obtained directly from specific activities within the entity’s value Chain. Includes data provided by suppliers or other value chain partners related to specific activities in the entity’s value chain.	Data not obtained directly from activities within the entity’s value chain. Often includes industry-average data (e.g., from published databases, government statistics, literature studies, and industry associations) and proxy data (i.e., primary data from a specific activity that is used to estimate emissions for another activity).
Effort	High effort - involves directly requesting information from value chain partners.	Medium effort - requires a process to extract relevant data and allocate to scope 3 inventory.
Decarbonisation actions reflected in data?	Most - actions taken by value chain partners to decarbonise specific products or services should be captured in the data provided.	Limited to some - dependent on the approach taken. Therefore, an entity must consider whether the data faithfully represents its activities.



How does an entity go about setting a scope 3 target?

It is not mandatory for entities to set scope 3 emissions targets under ASRS; however, it is a relevant consideration where scope 3 emissions represent a large proportion of total emissions and connect to a key climate-related risk of the organisation.

If an entity does elect to set scope 3 emissions targets, the target must be disclosed and there are additional disclosures that are required in relation to that target (such as how the target is set, how it is reviewed, how progress is monitored, and generally how it intends to meet its target, including how it will resource the activities required to meet the target).

Target setting is an important aspect in helping entities to manage and reduce risks, leverage opportunities, and strengthen the business against transition risks. Furthermore, there is increasing pressure from investors to set targets that are informed by the latest science, aligned to the Paris Agreement, and encompass scope 3 targets.

Before embarking on target setting for scope 3, entities will need to make decisions in relation to:

Baseline year on which to measure the target - It might not always make sense to have the base year as the first year that you started reporting scope 3 emissions. It might be more pertinent to hold off for a few years until you have a reliable set of data.

- ▶ **Boundary of target** - Including whether the target is to apply to particular categories that are most significant, or over the entire portfolio.
- ▶ **Type of target** - Specifically whether you should use an absolute or intensity target. Refer to the box to the right for further considerations related to absolute or intensity targets.
- ▶ **How the target will be met** - You should have a clear plan in place to achieve the target before setting the target. This includes consideration of how you will resource the activities required to meet the target.

Types of targets: absolute or intensity?

Absolute target: This aims to reduce emissions from a certain baseline by a target year.

Example: Reduction of scope 3 emissions by 15% by 2023 from a 2018 base year.

Intensity target: This aims to achieve emissions reduction based on a metric.

Example: Reduction of emissions per tonne kilometre for third-party freight services.

For scope 3 emissions, especially those associated with downstream processing or the use of products, intensity targets (particularly for interim targets) may be an effective way of achieving performance that may be less likely to be influenced by growth or decline in output. However, they may not be seen as credible by stakeholders as absolute targets.

There is also a range of other targets related to scope 3 emissions that might address the most significant transition risks that an entity faces. Examples include:

- ▶ Investment targets into downstream technology that reduces emissions associated with use of your product
- ▶ Engagement targets whereby you engage with a certain number of your suppliers in setting their own science-based targets
- ▶ Initiative-orientated targets, which aim to encourage particular organisational behaviours to elevate the understanding and measurement of an entity's scope 3 footprint. An example of such a target could be to engage with a certain proportion of suppliers to capture data and/or understand their approach to decarbonisation.

Do not underestimate the thought and analysis required to support the setting of meaningful emissions reduction targets.

Start the process early.



How do Boards and executives get comfortable with the changes and uncertainty associated with the scope 3 journey?

Reporting of scope 3 emissions (along with the other requirements) will be the subject of executive and board review and approval as a consequence of the mandatory climate-related financial disclosure requirements.

For most organisations this will present challenges given executives and Boards may not be familiar with reviewing and approving information that has the level of uncertainty and expectation of change over time that scope 3 emissions presents.

Similar to other requirements, understanding the controls framework in place to prepare the scope 3 information is key – this includes understanding where data is coming from, what the review process is, how risks are being addressed, what management committees have oversight of scope 3, where improvements will be made and acknowledging that data may change in next reporting period. Restatements may be necessary.

To gain comfort and alleviate concerns, executives and Boards should consider baseline assurance (prior to limited assurance) to resolve any findings and recommendations that an assurance engagement might otherwise identify. Often referred to as “assurance readiness”, the procedures reflect a dry run for assurance and a “baseline” for future reporting under an assurance environment (with no requirement for public release – i.e. no assurance statement issued to the public).

With or without baseline assurance, it is critical that executives and Boards are involved in an entity’s scope 3 journey from the very beginning. This starts with understanding the ‘fundamentals’ of scope 3 emissions and how they can use information in decision making, noting scope 3 emissions should not be viewed by not just as a ‘number’ but as an indicator of transition risk.

Key takeaways

The introduction of the mandatory climate-related financial disclosure regime will require the disclosure of scope 3 emissions, which for many will be ‘a first’.

As discussed in this paper, scope 3 emissions measurement and estimations can be daunting, particularly given the indirect nature of scope 3 and the challenges this can pose in terms of obtaining third party data or making appropriate estimates.

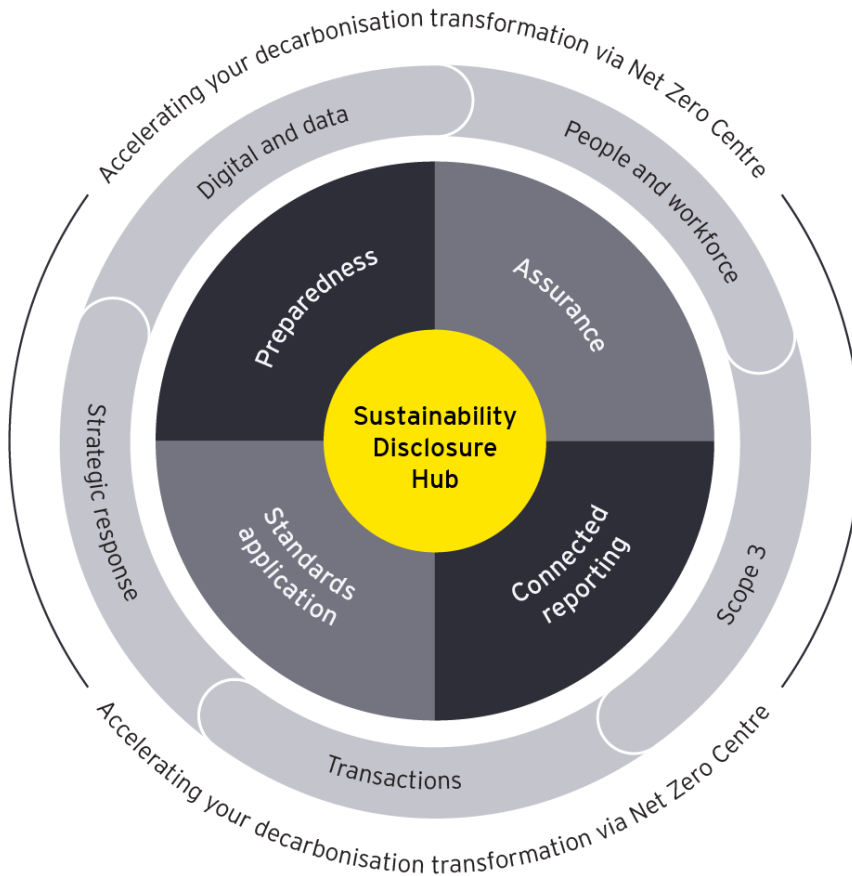
It is therefore crucial to remember that:

1. By starting early you’ll know what you’re doing by the time reporting of scope 3 disclosures will come into effect (from 1 January 2026 for Group 1 if an entity elects the transitional relief from disclosing scope 3 information in year 1 of ASRS reporting).
2. Your estimates may not be perfect the first time, but you’ll learn by doing.
3. Document your approach (estimates, assumptions etc.) to support external reporting and assurance.

Reporting of scope 3 emissions is a journey that will mature over time, so expect refinement along the way.

Sustainability Disclosure Hub

The EY Sustainability Disclosure Hub offers practical guidance to assist companies across the region prepare for mandatory reporting of climate and sustainability-related reporting.



Headed by Oceania market-leading financial and non-financial reporting professionals, the Sustainability Disclosure Hub brings together EY capability locally and across the globe - coupling financial and non-financial reporting strategy, readiness and assurance capabilities that have an intimate knowledge of the work of the [International Sustainability Standards Board](#) (ISSB) and local market insights, including the development of the climate-related disclosure requirements by the [Australian Accounting Standards Board](#) (AASB) and New Zealand's [External Reporting Board](#) (XRB).

The Sustainability Disclosure Hub collaborates closely with the EY Net Zero Centre, which helps EY clients to make the right decisions at the right times and set themselves on a pathway for success in a net zero economy.

Please reach out to our Sustainability Disclosure Hub team to discuss what the requirements mean to you.

Contact us

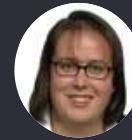
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