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The regulatory and standard-setting landscape on climate reporting

Based on a webinar discussion on 11 January 2021

In collaboration with Chapter Zero

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Investor and regulatory expectations of reporting on climate risks and opportunities are growing. We navigate the latest developments and look at the impact on financial statements.

Despite COVID-19, the climate crisis remains an urgent issue for businesses. This brings not just physical risks, but those associated with transitioning to a low-carbon economy.

In the UK and elsewhere, governments are targeting a green recovery from the pandemic and the financial centre has a role to play.

Last year, Mark Carney said that achieving net-zero will require a whole economy transition, with every company, bank, insurer and investor adjusting their business models accordingly. This could also turn an existential risk into the greatest opportunity of our time.

The shift in societal attitudes and expectations will manifest themselves in changes to consumer behaviour, policy, regulation and the cost of doing business. Consistent and comparable information on how a business is affected by climate change and how it is responding is therefore critical for investors in considering the long-term risk-adjusted returns.

Investors are clear in their expectations that financial reporting should reflect the reasonable assumptions about the impact of climate risk, and how the transition to a low-carbon economy will impact companies' profits, liabilities and assets. They are also very clear that if that is not the case, they will be considering using their own votes on the financial statements, on the approval of the auditor or on the election of directors. In addition, governments and regulators are responding with a range of policies to achieve the net-zero ambition.

> "The climate crisis remains an urgent issue for all businesses."
>
> **Veronica Poole**

Task Force on Climate-related Financial Disclosure (TCFD)

TCFD is a set of recommendations (not a global standard), designed to communicate how companies are addressing climate change.

It considers that climate is an undiversifiable risk and, therefore, is of particular interest to investors.

It identifies two types of risk – physical and transitional.

It focuses on the financial impacts of climate change on the company over time and includes four pillars:

- Governance
- Strategy
- Risk management
- Metrics and targets

These pillars are the disclosure elements companies are expected to cover when implementing the TCFD recommendations.

Speakers

Host:
Veronica Poole,
Head of Accounting and Reporting, Deloitte UK

Speaker:
Neil Stevenson,
Director, National Accounting and Audit, Deloitte UK

Speaker:
Hannah Armitage,
Project Director, Financial Reporting Council

Speaker:
Mark Manning,
Technical Specialist, Sustainable Finance and Stewardship, Financial Conduct Authority

Latest developments and requirements

TCFD aims to drive a step-change in how organisations manage climate-related risks and opportunities. They help to pave the way for a future corporate reporting standard on the sustainability-related financial disclosures.

Investors

Investors are increasing their call for consistent, high-quality information on climate, with alignment between narrative reporting and the financial statements. Recent updates include:

- A group of investors representing over $100 trillion assets under management have said that "Climate-related risks are material factors that should be reflected appropriately in financial statements." They therefore conclude that companies should disclose their key assumptions regarding climate-related risks and have called for these to be aligned with the Paris Agreement
- Institutional Investors Group on Climate Change paper – this set out expectations that companies should prepare accounts that reflect the impact of achieving net zero. It emphasised that materiality should be determined by investor views; that material climate risks must be disclosed in the financial statement and associated notes, and that disclosure must be company-specific not boilerplate.
- Climate Action 100+ progress report – this highlights a new benchmarking tool that will assess the progress of companies against their net-zero targets.

Financial reporting

Many of the current investor initiatives call on companies to adopt the guidance provided by IASB.
Last year, IASB issued educational guidance to help preparers apply existing IFRS requirements to climate-associated risks and opportunities.
For more information, see Deloitte's Closer Look publication.

In addition, the **FRC Climate Thematic** reviewed current practices in relation to climate-related considerations by boards, companies, auditors, professional bodies and investors. Its findings include a conclusion that the consideration and disclosure of climate change in the financial statements lags narrative reporting.
TCFD – it is mandatory for all premium listed companies with year ends commencing on or after 1 January 2021 to report under TCFD. The FCA is also consulting on broadening the scope beyond premium listed companies.

Developments towards a global comprehensive corporate reporting system

At the end of 2020, we saw ground-breaking moves towards global sustainability standards.
IFRS Foundation Trustees consultation – this proposes setting up a Sustainability Standards Board under the umbrella of the IFRS Foundation. Its priority would be a climate standard. This direction is supported by Deloitte as we believe global issues, global capital markets and global businesses require global standards.
Prototype Climate-related Financial Disclosure standard – the leading sustainability standard setters, CDP, CDSB, GRI IIRC and SASB, have a joint vision for a comprehensive corporate reporting system. They have released a prototype climate-related financial disclosure standard, which is built on the four pillars of TCFD. The paper also includes a prototype conceptual framework using adapted concepts from IASB and a prototype presentation standard for sustainability-related financial disclosures.
IOSCO Sustainable Task Force – the task force has stated its role in bringing together the work of the IFRS Foundation with the work of the sustainability standard setters. IOSCO has said that it stands ready to be an accelerator in the move towards a global solution for sustainability standards.

TCFD status report 2020

60%
Nearly 60% of the world's 100 largest public companies support the TCFD, report in line with the TCFD recommendations, or do both

Nearly 675 organisations have become TCFD supporters since 2019, an increase of
+80%

6%
Disclosure of climate-related financial information aligned with the TCFD recommendations increased, on average, by 6% between 2017 and 2019

Companies' disclosure of the potential financial impact of climate change on their businesses, strategies, and financial planning remains low

Since the start of 2021, it is mandatory for all premium listed companies to report under TCFD

"The pace of change in climate reporting and standard setting has increased rapidly. As a result there is actually the potential to have a climate standard developed in 2021, building on TCFD."
Neil Stevenson

"The drive for better reporting and better consideration of climate-related issues is not going to go away."

Hannah Armitage

New listing rule

At the end of 2020, the FCA published a policy statement, final listing rule and guidance promoting better climate-related financial disclosures for UK premium listed commercial companies.
For accounting periods beginning on, or after, 1 January 2021, the new listing rule requires companies with a UK premium listing to include a statement in their annual financial report setting out:

- Whether they have made disclosures consistent with the TCFD's recommendations/recommended disclosures in their annual financial report.
- Where they have not made such disclosures, an explanation of why and a description of any steps to be able to make consistent disclosures in the future.
- Where they have not made their disclosures in their annual financial report, an explanation of why and where they have disclosed.

The new FCA listing rule is part of a wider TCFD implementation strategy. It is the first step in a roadmap by government to bring most of the UK economy under TCFD reporting by 2023. This presents an indicative path for measures by FCA, BEIS, DWP, PRA and the Pensions Regulator up to 2025.

The FRC thematic review

FRC's wide-ranging review covered how companies, boards, auditors, professional associations and investors are taking account of climate-related challenges. They all have a key role to play in ensuring that disclosure is appropriate. The review found:

- More companies are disclosing climate-related considerations.
- More needs to be done around the consideration of climate issues and there needs to be better disclosure.
- Investors want to understand how boards consider and assess climate change and what that means for the company (something that is currently lacking).
- Disclosure from smaller companies lags larger companies.
- Most narrative reporting requirements were being met, with a number using TCFD. However, minimum disclosures are not necessarily comprehensive enough for users. On financial statement disclosures, there were a number of areas where statements could have been affected by climate-related issues. These disclosures lagged significantly behind narrative reporting, with only a quarter of companies in the sample referring to climate change in their financial statements.
- For auditors, the review looked at the big seven audit organisations and the firmwide procedures to consider climate change, and a set of 17 specific audits. Firmwide, there is a very significant variation of the focus given to climate change between the firms. On the specific audits, the files looked at were from entities that considered climate change to be a principal or emerging risk. The FRC found that, on more than half, the auditors had not considered climate change when identify and assessing the risks of material misstatement to the financial statements.
- For more information, please see the Summary report which highlights the findings across boards, companies, auditors, professional associations and investors, and links to more detailed findings.

"What we have been trying to do through our listing rule is ensure there is a sound basis for giving the market the information it ultimately needs to assess a company's future prospects." **Mark Manning**

Key takeaways

There are already requirements in place for climate reporting, but the regulatory environment is changing and expectations continue to grow. Boards, companies, auditors, investors and regulators all need to do more. Embedding climate considerations in to the business and related reporting remain high priorities for business, especially in light of increasing net-zero commitments by governments around the world. Companies need to link the consideration of climate change to what it means for the company, its business model and its strategy, and ensure this is consistent with the assumptions and judgements underpinning their financial statements.