ICAEW REPRESENTATION 21/17

Recommendations of the Task Force on Climate-related Financial Disclosures

ICAEW welcomes the opportunity to comment on the *Recommendations of the Task Force on Climate-related Financial Disclosures* published on 14 December 2016, a copy of which is available from this link.

This response of 12 February 2017 has been prepared on behalf of ICAEW by its Financial Reporting Faculty. Recognised internationally as a leading authority on financial reporting, the Faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. The Faculty provides an extensive range of services to its members, including providing practical assistance with common financial reporting problems.

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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MAJOR POINTS

Our support for the initiative

1. ICAEW strongly supports this Financial Stability Board (FSB) initiative. We commend the rigour and quality of the report of its Task Force and the proportionate approach adopted. We have set out below a number of observations and recommendations for improvement from our high level review of the proposals. Overall, however, we believe that with the support of the G20 governments and encouragement from regulators and investors, the report could act as a catalyst for significant improvement in the quality and consistency of disclosure of climate-related risks and opportunities and related governance and strategy issues, especially in sectors most vulnerable to changes in global climate.

2. This is a complex area of reporting and it is getting very crowded terms of initiatives, with many standard setting and other bodies seeking to effect change and much diversity in reporting practice. We recognise that some will argue that more should be done through this initiative to influence corporate behaviour and thereby reduce each organisation’s environmental footprint, as opposed to encouraging disclosure of climate-related risks that impact an organisation’s strategy. While we agree that much more needs to be done to address concerns about climate change, on balance we believe that these recommendations represent an important step in moving the debate forward, converging good practice and, importantly, stimulating discussion on climate issues at board level.

3. The Financial Reporting Faculty responded on behalf of ICAEW to the preliminary consultation undertaken by the Task Force in 2016 and was pleased to have had the opportunity to hold a joint webinar for ICAEW members with the Task Force on 23 January 2017, which was attended by individuals from over 20 countries. ICAEW would be pleased to consider how we might assist with efforts to raise awareness and understanding of the final recommendations once they are published.

Our approach to responding

4. In the limited time allowed by the Task Force for the consultation, the Faculty has not been able to conduct a detailed survey of the views and insights of ICAEW members. Instead, we summarise below some high level thoughts on the recommendations in the report, drawing on the expertise and experience of a number of ICAEW specialists from the preparer, investor and audit communities.

5. We have answered the questions posed in the Task Force’s on-line survey where applicable. Responses to non-administrative questions in the survey of general application have been extracted and set out below after our general comments.

Voluntary approach

6. We strongly support the proposed voluntary approach to implementation of the guidelines. Thinking and practice regarding the assessment of climate change risk are at a very early stage. Companies and other organisations are still experimenting with what to disclose and how to disclose it. We believe that it is right that a period of experimentation should continue for some time yet and that practices should continue to be allowed to evolve in response to market demand for information.

7. We acknowledge that a voluntary approach tends to lead in practice to diversity in the quality and style of disclosure, and that this in turn create issues for users regarding comparability. We suggest that the success of the proposed approach should be monitored closely for an agreed period of time with a view to reviewing the case for taking steps in the direction of a mandatory approach. An initial assessment of progress might be possible after say three years. Any move towards future regulatory intervention should involve further public

consultation, by the FSB or by other international or national bodies as appropriate. In the meantime, the Task Force recommendations could usefully clarify the factors that the Task Force or its successor body (or local regulators in the meantime) might consider when assessing the success of the voluntary disclosure regime. In our view, these factors should include any implications for small and medium-sized entities and appropriate cost/benefit analysis.

8. We support the inclusion of illustrative examples of metrics and targets, as set out in the annex, on a sector by sector basis. This guidance should go some way to reducing the diversity in disclosures. However, we believe that providing further guidance on how to calculate key metrics would be useful and that this could be extended to scenario analysis disclosures. This would introduce an element of standardisation, increasing the usefulness of the disclosures in terms of comparability. It would also assist organisations preparing climate-related financial disclosures for the first time, while not discouraging other organisations from experimenting with disclosures and metrics outside of the key metrics prescribed.

Implementation – managing expectations

9. As the report points out, disclosure practices in this area are at an embryonic stage and are highly diverse around the world, even within countries. In our April 2016 response to the Phase 1 report, we expressed concerns that guidelines that are too detailed or too far from current practice could either curb useful experimentation or, given that they will be voluntary, fail to gain acceptance. We therefore welcome the adoption of a step by step approach, illustrated by the five year implementation path on page 42 of the report. It will be important to set expectations clearly, emphasising the need to avoid complexity and clarifying that it will be acceptable for organisations to build up disclosures and scenario analysis over time rather than implement changes rapidly or completely. It should be very clear too that disclosures should be proportionate to the size of the reporting entity and the expected impact of climate change on its business model and the sector it operates in.

10. These clarifications extend to explaining where such disclosures should be incorporated. This is likely to be in the Strategic Report in the UK, but this issue may be more challenging in other jurisdictions. The Task Force will need to consider whether further guidance is required where elements of national legislation are not compatible with its recommendations in this or other respects, or where for example concerns around liability for the information given, even when voluntary, might dampen enthusiasm for the initiative.

Disclosure in the annual report

11. On balance, we support the proposal to include the recommended climate-related financial disclosures in mainstream financial filings, i.e. the annual report and accounts, rather than in separate reports or on company websites. This should encourage organisations to debate climate-related issues at board level, as well as signal to users the importance of understanding the potential financial impact of climate change.

12. However, the annual report is quite properly focused primarily on information for investors, and while some investors will no doubt welcome the Task Force's proposals, we are concerned that the result could be very extensive disclosures, adding to the already considerable volume of information in the annual report. Some of these disclosures will be new to investors, who may be unclear as to their meaning and significance, given the fundamental uncertainties surrounding both global and local effects of changes in climate and governmental and market responses to these changes. We therefore encourage careful application of the materiality concept in this context, ensuring that only high level strategic disclosures are included in the annual report. Additional disclosure can then be made, for example, on company websites, to which investors and other stakeholders can refer if they wish. This will facilitate different and innovative approaches to the presentation and updating of climate-related information. Disclosure may of course also be included, where applicable, in separate sustainability reports and in 'integrated reports' produced by a growing number of companies around the world in

accordance with the <IR> Framework published by the International Integrated Reporting Council (IIRC).

13. The market may ultimately demand more information on climate-related issues to be included in the annual report, but practice should be allowed to develop as investors become more familiar with the disclosures and the underlying issues. This will, again, allow companies to develop alternative and innovative approaches to disclosure. These could be more interactive and make use of more imaginative graphics than would be possible in the annual report and accounts.

14. We are aware that some stakeholders have significant concerns about the application of materiality in this area of reporting. The Task Force may wish to consider in the light of comments it receives on this topic whether further clarification and guidance is needed to help organisations assess the materiality of climate-related risks and understand the disclosure required in different circumstances to satisfy the recommendations. As the report recognises, climate-related risk may not necessarily impact operations over the time horizon generally considered for reporting purposes and may not be subject to significant change year by year.

Scenario analysis

15. We are mindful of the importance of avoiding complexity in corporate reporting. Nonetheless we support the recommendation for scenario analysis and disclosure of the results. We agree that it will be useful for informing strategic decisions, stimulating discussion at board level. However, producing such disclosures will be challenging for many companies, especially those with little experience of disclosing climate-related issues. As discussed above, experimentation will be an important factor in ensuring that this recommendation is successfully adopted by organisations. This approach will allow larger companies, with the necessary resources available, to lead by example and allow smaller companies which may wish to undertake such analysis to benefit from their experience.

16. The location of the scenario analysis disclosure will also need to be considered. If such disclosures are extensive, they may be better placed outside of the annual report, for the reasons cited earlier. A summary of the key findings of the analysis could then be included in the mainstream financial filings.

External assurance

17. The report makes no reference to the need for assurance. Our view is that some disclosures and the processes that underpin them will lend themselves to external assurance, and that this topic would benefit from further debate. However, any definitive conclusions will not be possible until organisations have embedded the new disclosures and demand from users for the information and its assurance can be more readily assessed.

18. In the short term, inclusion by UK companies of the new disclosures in the Strategic Report may create some confusion as to the level of assurance accorded to the disclosures. It may be helpful to emphasise the boundaries of the financial statement audit and clarify that disclosures in the Strategic Report are not audited or necessarily covered by another other form of assurance.

Sector by sector guidance

19. We strongly support inclusion of sector by sector guidance in the recommendations. In doing so the Task Force acknowledges the need for flexibility in the guidelines to reflect the very varied challenges that particular industries will face. A uniform approach is unlikely to be effective or to gain widespread acceptance.

Next steps

20. The report identifies areas for further work, including further research and analysis and the need to 'encourage standard setters and others to actively work toward greater alignment of adoption'. These further steps are of high importance if a step change in reporting of climate-related risk is to be achieved. It will be useful to understand the anticipated future role of the Task Force in this respect, how it or any successor body expects to engage with other relevant national and international bodies (including the IASB and the IIRC) and – importantly - how any future updating of the recommendations in the light of experience will be undertaken.

21. We would also welcome clarification of how the FSB anticipates that compliance with the recommendations will be encouraged and monitored.

RESPONSES TO SPECIFIC QUESTIONS

ICAEW has completed the Task Force's on-line survey where applicable. Responses to specific non-administrative questions in the survey of general application have been extracted and set out below.

Q6: How useful is a description of potential performance across a range of scenarios to understanding climate-related impacts on an organization's businesses, strategy, and financial planning?

Very useful.

Q7: Please elaborate on your response above. If you have selected "Not very useful" or "Not useful at all" please indicate what would be more useful.

We strongly support the recommendation for scenario analysis disclosures. We agree that it will be useful for informing strategic decisions, stimulating discussion at board level.

Q8: What do you view as effective measures to address potential challenges around conducting scenario analysis and disclosing recommended information?

Factor	Ranking
Allow a year or two to phase-in scenario analysis and related disclosures	1
Establish better practice standards around conducting and disclosing scenario analyses so that there are clearer rules of the road	2
Reduce the cost of conducting and disclosing scenario analysis	3

Q9: Please provide more detail on your fist choice in the box below.

Companies and other organisations are still experimenting with what to disclose in this area and how to disclose it. We believe that it is right that a period of experimentation should continue for some time yet and that market practices should continue to be allowed to evolve in response to investors' demands for information.

Q10a: How useful are the illustrative examples of metrics and targets?

Quite useful.

Q10b: Please provide more detail on your response in the box below.

We support the inclusion of illustrative examples of metrics and targets, as set out in the annex, on a sector by sector basis. This guidance will go some way to reducing the diversity in disclosures. However, we believe that providing further guidance on calculating key metrics would be useful. This would introduce an element of standardisation, increasing the usefulness of the disclosures for comparability purposes. This would also assist organisations preparing climate-related financial disclosures for the first time, while not discouraging other organisations from experimenting with disclosures and metrics outside of the key metrics prescribed.

Q14: Which types of organizations should describe how performance and remuneration take climate-related issues into consideration?

The Energy Group, as recommended by the Task Force.