Think Ahead ACCA

Call for feedback: report on climate-related disclosures by the Technical Expert Group on Sustainable Finance

Report issued for comment by the Technical Expert Group on Sustainable Finance in January 2019

Comments from ACCA
31 January 2019

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GENERAL COMMENTS

ACCA welcomes the opportunity to provide views in response to the Technical Expert Group on Sustainable Finance's report on climate-related disclosures.

We welcome the strong endorsement that the TEG report makes for the TCFD recommendations. However, there are key discrepancies between NFRD and the TCFD recommendations that relate fundamentally to the purpose of climate-related disclosures. As such, the TEG report, as it stands, could give rise to the incorrect expectation in the minds of preparers and stakeholders that publishing disclosures in a separate report, in line with the TEG's guidance, would satisfy implementing the TCFD recommendations. If they remain unaddressed, there is a risk of adding to the conflicting reporting requirements and standards that multinational entities already face.

It would not be possible to reconcile the conceptual differences between the NFRD and the TCFD recommendations, without revising the Accounting Directive. Although we understand the EU Commission does not intend to revise the NFRD at this time, in the longer term we would recommend that revisions to the NFRD are considered, in the broader context of the Accounting Directive as a whole.

In the meanwhile, the NBG needs to acknowledge these conceptual differences. An explicit statement in the NGB that climate-related financial disclosures should be included in mainstream financial filings, rather than in a separate report, will also go some way towards addressing the misalignment.

AREAS FOR SPECIFIC COMMENT

1. **Comments on Chapter 2, Principles and Rationale for NFR**

We welcome the strong endorsement that the TEG report makes for the TCFD recommendations.
The NFRD does seem to be the right regulatory framework within which to introduce climate-related disclosures. However, there are fundamental discrepancies between NFRD and the TCFD recommendations in terms of:

- materiality and the lens of analysis: while the TCFD recommendations focus on the impact of climate change on the entity, the NFRD introduces a second, opposite materiality lens based on 'the impact of (the company's) activity' on climate change;
- the intended audience of the disclosures: the audience of TCFD disclosures are investors, lenders and insurance underwriters, while the audience of NFRD disclosures include other stakeholders, including consumers; and
- the location of the disclosures: the TCFD recommendations clearly state that climate-related financial disclosures should be made 'within the mainstream financial report', whereas the NFRD allows non-financial disclosures to be made separately from mainstream financial filings.

These differences are acknowledged in Chapters 2.2, 2.3 and 2.4 of the report. However, it does not address the fact that together, they amount to a fundamental difference in terms of the purpose of climate-related disclosures. As such, the TEG report could give rise to the incorrect expectation in the minds of preparers and stakeholders that publishing disclosures in a separate report, in line with the TEG's guidance, would satisfy implementing the TCFD recommendations.

It would not be possible to reconcile the conceptual differences between the NFRD and the TCFD recommendations, without revising the Accounting Directive. In our view, this should be an option that the EU Commission considers in the longer term. In the meanwhile, the NBG needs to acknowledge these conceptual differences. An explicit statement in the NGB that climate-related financial disclosures should be included in mainstream financial filings, rather than in a separate report, will also go some way towards addressing the misalignment.

Footnote 29 introduces a new concept, 'significant climate-related matters,' which is not present in the NFRD. This risks further complicating reporting decisions, by creating what appears to be another threshold in addition to materiality and relevance.

Chapter 2.2 of the TEG report touches upon the need for connectivity between different disclosures required under the NFRD, but does not elaborate on this. From our discussions with preparers, this is an area that many companies find challenging. In order to achieve coherent reporting, it is necessary not only to achieve connectivity between different elements of the report, but also between financial and non-financial information, past performance and future forecasts, as well as different reports published by the company. We would recommend that the NBG makes reference to the International <IR> Framework (section 3B) for further guidance.

The encouragement to apply scenario analysis, in Chapter 2.6, is welcome. However, further guidance is needed, especially around the importance of setting out assumptions, and the need for comparability and consistency. This is extensively covered in the TCFD recommendations (p.29), and we would recommend that the NBG makes direct reference to that.

2. Comments on Chapter 3, Alignment of NFRD and TCFD

The approach of setting out Types 1, 2 and 3 disclosures is helpful, especially in challenging companies which are not making any climate-related disclosures to start doing so.

However, to support the aim of complete, reliable and comparable climate-related disclosures, we would recommend that they are presented in stronger terms:

- Type 1: These disclosures could be characterised more clearly as the minimum disclosures expected of all entities within scope of NFRD. The materiality-like assessment linked to some Type 1 disclosures on Table 3 ('Based on the company's own assessment carried out autonomously and/or in consultation with stakeholders, companies should disclose') is confusing and should be removed.
- Type 2: Rather than characterising these as supplementary, these should be seen as disclosures which should be made if the impact of climate change on the company is material.
- Type 3: These disclosures could be characterised as needing to be made, if the disclosures are considered to be useful and relevant to stakeholders' decisions.

In incorporating the Types 1, 2 and 3 disclosures approach in the NBG, the European Commission will need to consider how it fits within the existing guidance, which does not currently feature such categorisations.
Figure 2, while intended to visually present the mapping of TCFD recommendations across to the NFRD requirements, is oversimplified. At times, the classification of the strategy and risk management disclosures into NFRD elements is counter-intuitive. In order for the mapping to work, it would be necessary to clarify the definitions of each NFRD element in the NBG – especially with regards to the business model, which we discuss further below.

3. Comments on Chapter 4.1, Business model

Research by ACCA and our partners[1] show that there is significant diversity in what companies and stakeholders understand business models to mean. Even where there is agreement about what a business model encompasses within a company, reporting on business models has been, and continues to be, an area that preparers find particularly challenging.

In this context, we would recommend that the NBG refine the definition and content requirements of a business model in the context of the NFRD. At present, while the definition of the business model resembles that from the International <IR> Framework[2], the content requirements set out in the NBG is broader than what most would consider constitutes a business model: encompassing as it does companies' operational model, external environment, and strategy. It would be beneficial for the NBG to fully adopt the guidance on the business model in the International <IR> Framework (section 4C): this clearly covers non-financial inputs, outputs and outcomes, as well as informing strategy over the short, medium and long term.

While we welcome the TEG report's emphasis on forward-looking reporting, what companies consider to be the short, medium and long term varies from one organisation to another. Our integrated reporting research has shown that while companies may refer to short, medium and long term timescales, very few specify what they mean. We would recommend that the NBG elaborates the importance of considering different future timescales (these are mentioned in sections 3.4 and 4.4 of the NBG but not explained) and highlights the need to specify the timeframes considered.

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[1] See ACCA (2017) *Business models of the future: Emerging value creation*. <https://www.accaglobal.com/content/dam/ACCA_Global/Technical/Future/pi-emerging-business-models-FINAL-26-01-2017.pdf>, accessed 31 January 2018; and CDSB and CDP (2018) *First steps on climate-related financial disclosures in Europe: A snapshot of 30 companies' initial disclosures*. <https://www.cdsb.net/sites/default/files/supplementary_note_2_-_tcfd_diclosures.pdf>

[2] EU Non-Binding Guidelines paragraph 4.1(a): 'A company's business model describes how it generates and preserves value through its products or services over the longer term. The business model provides context for the management report as a whole. It provides an overview of how a company operates and the rationale of its structure, by describing how it transforms inputs into outputs through its business activities. In more simple terms, what a company does, how and why it does it.' This may be compared to the International <IR> Framework, paragraph 4.11: 'An organization's business model is its system of transforming inputs, through its business activities, into outputs and outcomes that aims to fulfil the organization's strategic purposes and create value over the short, medium and long term.'

4. Comments on Chapter 4.2, Policies and Due Diligence Processes

We welcome the TEG report's reference to the role of the board and top management in providing oversight on climate-change matters. In our view, board involvement is crucial to implementing coherent, effective and long-term policies to address climate change risks.
The explanation that 'processes addressing climate-related topics may be separate from other operational processes or they may be fully integrated into the company's risk management framework' is helpful. However, we would recommend a stronger encouragement in the NBG that companies move towards an integrated approach.
In describing the role of governance and control systems in mitigating climate-related risk on companies, we would recommend that the NBG makes reference to COSO/ WBCSD's guidance on Applying Enterprise Risk Management to Environmental, Social and Governance-related Issues. (https://www.coso.org/Documents/COSO-WBCSD-ESGERM-Guidance-Full.pdf).

5. Comments on Chapter 4.3, Outcomes

Box 3 includes, as a Type 2 disclosure, 'the interrelatedness and dependencies between climate-related risks and opportunities and other factors that affect the company's financial position.' This disclosure is a fundamental element of the TCFD recommendations. However, from our discussions with preparers, it is also very challenging to report on, even for companies experienced in climate-related reporting. We would recommend that additional guidance in the NGB makes reference to the International <IR> Framework (paragraph 3.8) in this respect.

6. Comments on Chapter 4.4, Principal Risks and their Management

The consistent categorisation of climate-related risks and opportunities underlie all aspects of the TCFD's recommendations. The need for a clear and consistent understanding of climate-related risks should be highlighted more than has been done in the TEG report. In explaining climate-related risks, the NBG should refer to section B of the TCFD recommendations on climate-related risks, opportunities and financial impacts.
We would recommend that the NBG clarifies the definition of principal risk in the context of Chapter 5, Article 19(1) of the Accounting Directive. In particular, it would be beneficial to illustrate factors which could result in climate-related matters becoming a principal risk.

7. Comments on Chapter 4.5.1, General and Supplementary KPIs

Tables 9 and 10 are very helpful, especially as it includes examples of metrics, the rationale for each 'KPI', and alignment with other reporting frameworks.
The use of the term 'KPI' is potentially misleading, as the metrics set out are not intended to measure companies' achievement of their business objectives. However, we note the term 'KPI' is used in the NFRD itself.
There is an opportunity to expand the themes covered further, to include companies' use of, and impacts on, other scarce natural resources, such as water.

8. Comments on Chapter 4.5.2, Sectoral and Company-specific KPIs

The reference to the TCFD recommendation's supplemental guidance for non-financial groups is helpful.

9. Comments on Chapter 5 Sector-specific guidance: Banks and Insurance Undertakings

The recommended disclosures are not fully aligned with the TCFD supplementary guidance for the financial sector, which in many cases are clearer and more precise. The NBG should refer to the Annex to the TCFD recommendations, in which supplementary guidance for banks and insurance undertakings are set out in detail. Equally relevant to articulate here is the importance of climate-related disclosures from the sector, which are explained by the FSB (and set out on p.22 of the Annex) as:

- to enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system's exposures to climate-related risks
- to foster an early assessment of [climate-related] risks and facilitate market discipline, and
- provide a source of data that can be analysed at a systemic level, to facilitate authorities' assessments of the materiality of any risks posed by climate change to the financial sector, and the channels through which this is most likely to be transmitted.

10. Any additional comments

Although we understand the EU Commission does not intend to revise the NFRD at this time, in the longer term we would recommend that revisions to the NFRD are considered, in the broader context of the Accounting Directive as a whole.
In particular, the inconsistencies that arise from the impact-focused definition of materiality that the NFRD introduced ('information to the extent necessary for an understanding of the impact of [the company's] activity') need to be addressed. In our view, there should be one single consistent definition of materiality, that set out in Article 2 para 16 of the Accounting Directive: 'material' means the status of information where its omission or misstatement could reasonably be expected to influence decisions that users make on the basis of the financial statements of the undertaking.'
Without addressing these inconsistencies, there is a risk of introducing yet another new framework, adding to the conflicting reporting requirements and standards that multinational entities already face.
In now updating the NBG, the European Commission has an opportunity to expand guidance on broader topics which are linked to climate change, including the use of natural capital and social inclusion.
As companies follow the guidance of their Member State competent authorities, it will be important for the European Commission to promote the updated NBG to these national authorities, in order that these new aspects are incorporated into national guidance.
Finally, we understand that the TEG does not intend to revise its report following this consultation. To ensure transparency and due process, we would recommend that a feedback statement is published to summarise the views received, and the conclusions reached by the European Commission based on these views.