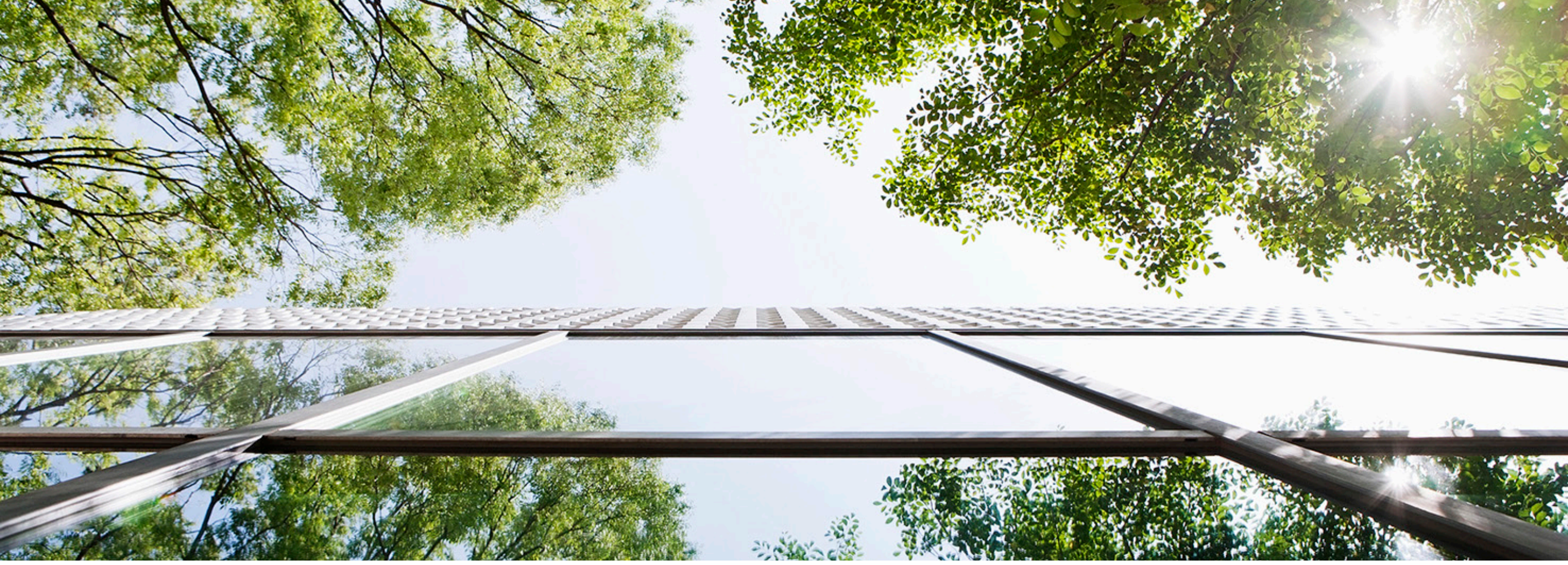

Climate-related Financial Disclosures

The TCFD disclosure requirements became effective for UK premium listed companies at the start of 2021 and will do so for standard listed companies from January 2022. Further new regulations will also become effective from April 2022 which will also capture some unlisted companies. Here we look at what it means for companies to report using the TCFD framework

What are TCFD or Climate-related Financial Disclosures?

Understanding corporate environmental impact: both the impact on companies and the impact that they have on the environment, is now widely considered to be a necessity by investors and also by governments and civil society. It is not easy, however, for companies to understand their own impact or for their investors and other stakeholders to understand them. The Task Force for Climate-related Financial Disclosure (TCFD) recommendations help to achieve and systematise this and have become a widely accepted framework for companies to report on the environment.

UK Government Policy

The Task Force on Climate-related Financial Disclosures (TCFD) recommendations have become the UK government's and regulators' preferred framework for reporting by companies on this. Moves to make this mandatory began early in 2020 when the Financial Conduct Authority (FCA) announced that it was intending to require premium listed companies to report on how they had complied with TCFD's recommendations from 2021. Further joint government-regulator plans were announced, at the Green horizons summit in November 2020, to widen the range of companies and organisations required to report over the next five years, along with a Policy Statement and final rules and guidance, released by the FCA in December 2020.

The UK also announced at COP26 in November 2021 that it will make climate-related disclosures mandatory across the economy by 2025, with most requirements coming in by 2023. The FCA has now extended its regulations to include standard listed companies and added more detail on the TCFD guidance they expect companies listed on the London Stock Exchange to follow. Further regulations, not covered in detail here as they do not apply specifically to companies, oblige: fund managers, banks, pension funds, insurers, and limited liability partnerships such as accountancy and law firms, to provide TCFD-aligned reporting.

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Which companies have to report and what requirements do they need to follow?

There are three pieces of legislation or regulation requiring Climate-related Financial Disclosures reporting that is either aligned with, or based on, the TCFD framework.

Premium listed companies

Premium listed companies need to state whether they have included disclosures consistent with the TCFD recommendations and, where they have not included particular recommendations or disclosures, to explain what is omitted, why and the timescale over which they expect to achieve compliance. The structure of this is similar to that required for corporate governance disclosures, though with more focus on disclosure and less on compliance with particular structural requirements; perhaps a better way to describe the requirements is 'report and explain' rather than 'comply or explain'.

The requirements for premium listed companies are set out in the Listing Rules and has already commenced, with reporting required for accounting periods beginning on or after 1 January 2021. Both UK and overseas companies listed are covered. Non-commercial companies; essentially investment trusts and OIECs, are exempt from the regulation, although certain fund managers will have to report under their own regime.

Standard listed companies

Standard listed companies also need to comply with the same regulations set out in the Listing Rules with respect to TCFD reporting, however these apply to accounting periods beginning on or after 1 January 2022.

AIM-listed companies and 'high turnover' companies with more than 500 employees

Companies within more than 500 employees that are either listed on AIM or have turnover of more than £500 million ('high turnover' companies) are captured by new legislation within the Companies Act regulations – *The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2021*. These require disclosures based on the TCFD recommendations, as set out in the original TCFD report. It is possible for companies to fall under the requirements of both the Listing Rules and the Companies Act regulations, and so for these companies care needs to be taken that compliance is achieved with both sets of requirements.

This requirement applies to accounting periods beginning on or after 6 April 2022 so will not capture companies with December year-ends until their 2023 reporting. There is a group exemption for companies whose parents report under this legislation where they are included in a group report.

Listing rules

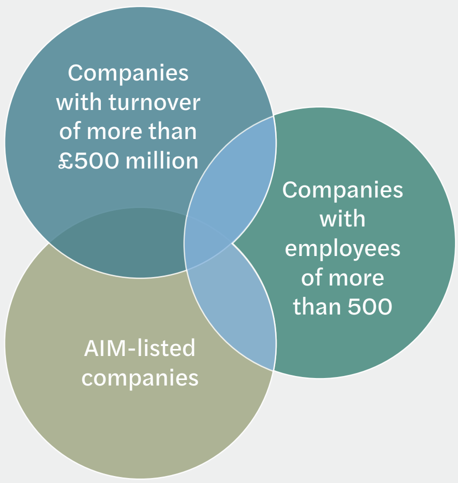
Premium listed companies

Premium listed companies are required to comply with requirements within the Listing Rules from 1 January 2022.

Standard listed companies

Standard listed companies are required to comply with the requirements within the Listing Rules from 1 January 2022.

Companies Act regulations



Companies in the (light blue) area are required to comply with the Companies Act regulations from 6 April 2022.

Where do companies have to report?

Premium and standard listed companies reporting under the Listing Rules need to provide disclosures in their annual report. For companies falling under the Companies Act regulations, the new disclosures are required to be included as part of a renamed and expanded Non-Financial and Sustainability Information Statement and thus will be part of the company's Strategic Report.

Whilst either of these requirements would normally be met by inclusion of a section in the annual report, given the extensive nature of some TCFD reports, there are provisions for including a larger separate report by cross-reference.

What are the requirements?

Although there are some differences between the requirements for companies reporting under the Listing Rules and those reporting under the Companies Act regulations, which will apply to both listed and unlisted companies over the thresholds, both sets of requirements are based on the TCFD final report from June 2017 (TCFD Report). This report lays out a set of recommended disclosures under four pillars of: Governance, Strategy, Risk Management and Metrics and Targets.

1. **Governance** should describe information on how, and how often, the board and its committees consider climate issues, how these are integrated with its other planning activities and how it monitors goals and targets related to climate. These disclosures should also cover which committees, or members of the board, or management are responsible for climate issues.

2. **Strategy** should describe the climate-related issues impacting strategy in the short, medium and long-term. It should cover both risks and opportunities and give the time-frame for each time horizon taking into account the life of the company's assets (including those not recognised in financial statements), and ensuring the period considered runs far enough out to capture the impact of climate change. Information should be provided in sufficiently granular form (e.g. product/service or geography) to capture issues affecting particular areas or products. Impacts outside the direct control of the company should also be considered, such as supply chain issues.

   Strategic disclosures should cover major investments taken or considered in response to climate change, possible future changes to operating costs and consideration of different climate scenarios. This scenario analysis is initially likely to be largely qualitative, for most companies, but with an expectation of evolving toward more quantitative analysis in future years. Impact should include both direct physical effects on the company and those known, or expected, to result from adaptation and transition activities. In particular, there is greater pressure to consider scenarios incorporating the impacts of the actions required to meet Paris-aligned scenarios or achieve a temperature increase of less than 2°C in the long-term.

3. **Risk Management** should describe how the organisation identifies, monitors and mitigates risks related to climate change, ideally indicating the size and scope of the risks considered and covering both physical and transition risks. The TCFD documents provide some useful lists of examples of potential risks to consider.

4. **Metrics and Targets** should provide evidence of the company's progress in controlling its climate impact or mitigating the impact/seizing of opportunities of climate change. While existing legislation provides for directly controlled measures in terms of energy use (scope 1 and 2), there is an expectation that this will, over time, extend beyond the traditional boundaries of company reporting to include scope 3 impacts, such as those arising from corporate supply chains. Disclosures should aspire to be consistent across time and, as far as possible, between peers with sufficient historical data to see trends arising. Metrics covered are likely to include energy use, as this is already a UK requirement, but may also include less geographically consistent issues, such as water use that may apply only, or principally, to some operations or regions. Targets should be disclosed giving: base years, time frames, key performance indicators (KPIs) used to follow progress and, as the Financial Reporting Council (FRC) noted in its Thematic Review: Streamlined Energy and Carbon Reporting, intermediate milestones to indicate progress toward claimed goals.

The TCFD Report summaries the recommendations disclosures of the four pillars, along with the eleven supporting recommended disclosures, as follows:

Governance	Strategy	Risk management	Metrics and Targets
Disclose the organisation's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material.	Disclose how the organisation identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
Recommended disclosures			
a. Describe the board's oversight of climate-related risks and opportunities. b. Describe management's role in assessing and managing climate-related risks and opportunities.	a. Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term. b. Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning. c. Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	a. Describe the organisation's processes for identifying and assessing climate-related risks. b. Describe the organisation's processes for managing climate-related risks. c. Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.	a. Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process. b. Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks. c. Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.

TCFD Final Report – Recommendations of the Task Force on Climate-related Financial Disclosures.
Figure 4: Recommendations and Supporting Recommended Disclosures

Premium and standard listed companies covered by the Listing Rules

The FCA's guidance, in its Listing Rules, refers directly to the TCFD Report. Also referred to are:

- Two documents published at the same time in conjunction with the TCFD Report:
  - [Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures] – an annex setting out guidance on implementation; and
  - [The Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities] – technical guidance on the use of scenario analysis.
- Three documents published more recently, which add additional recommendations (notably a transition plan to achieve net zero) and a list of potential metrics:
  - [Guidance on Risk Management Integration and Disclosure];
  - [Guidance on Metrics, Targets, and Transition Plans (updated)]; and
  - [Guidance on Scenario Analysis for Non-Financial Companies].

Companies covered by Companies Act regulations

The regulations for high turnover companies and AIM-listed companies are more specific and ask for disclosures under the following eight headings.

a. A description of the company's governance arrangements in relation to assessing and managing climate-related risks and opportunities.

b. A description of how the company identifies, assesses, and manages climate-related risks and opportunities.

c. A description of how processes for identifying, assessing, and managing climate-related risks are integrated into the company's overall risk management process.

d. A description of: (i) the principal climate-related risks and opportunities arising in connection with the company's operations, and (ii) the time periods by reference to which those risks and opportunities are assessed.

e. A description of the actual and potential impacts of the principal climate-related risks and opportunities on the company's business model and strategy.

f. An analysis of the resilience of the company's business model and strategy, taking into consideration different climate-related scenarios.

g. A description of the targets used by the company to manage climate-related risks and to realise climate-related opportunities and of performance against those targets.

h. A description of the key performance indicators used to assess progress against targets used to manage climate-related risks and realise climate-related opportunities and of the calculations on which those key performance indicators are based.

The Department for Business, Energy & Industrial Strategy (BEIS) will produce some guidance shortly giving their expectations on the content and level of detail expected of companies.

Exemptions within the Companies Act regulations

There are two classes of exemptions:

- **Nature of the business**: Where the directors believe that any or all of the disclosures set out in (e) to (h) are not necessary for an understanding of the company's business, these disclosures (in all or part) may be omitted, however a clear and reasoned explanation of why the directors believe this to be the case must be stated.
- **Subsidiaries**: As already noted above, subsidiaries need not report if they are included in the group Non-Financial and Sustainability Information Statement of a parent. While this will be useful within the UK it won't be available for subsidiaries of a non-UK parent.

Why have these requirements been introduced?

Users, particularly investors, want to understand how the company might be affected by the direct and indirect effects of climate change to understand the risks they face as investors, both for individual companies and for their portfolio as a whole. They would like to understand how the company plans for climate change and both the physical results, such as higher temperatures, increased sea level, weather volatility, water scarcity, and transition results, such as new products, regulations and taxes changing the costs of, or ability to produce, new and existing products along with changing consumer preferences. Additionally, as well as details of how the company manages risks and its future plans, users would like evidence of achievement, such as measurement of progress for those future plans in the same way that financial statements provide evidence of success or failure in financial terms.

Users understand that a company cannot be certain about what the effects of climate change will be and how they will impact commercially, but they want to understand how a company uses reasonable scenarios for future in its planning and produces information on how they are delivering against those plans.

Users would also like comparable information between different companies. While this is more difficult, it can be achieved to some extent for quantified historic information, such as carbon emissions. It is more challenging to produce, or aggregate, information about future plans as this is likely to contain a variety of different scenarios, assumptions and timescales. For areas such as water use, even aggregation within a company may be problematic as the degree of water scarcity and type of impact on water is likely to vary between countries, sites and activities.

How does a company implement these requirements?

There is no 'one-size-fits-all' solution to implementing these climate-related financial disclosures, as the impact of climate change, the detail of operations and the existing level of preparedness will vary between each company.

Here we offer some thoughts and considerations for planning to implement the requirements.

Who

The first stage of the process is to have a process. The board needs to consider, and demonstrate it has considered, the effects of climate change. Whoever (whether an individual or a committee) the board appoints to consider this should consider the companies' activities and determine the areas with most potential to be affected.

Look out far enough

It is important to look far enough into the future to capture long-term effects. This may be beyond normal planning horizons, however looking at only a three, or even five-year term, is likely to miss changes for which the company should be beginning to prepare for now, for instance considering what longer term investments are needed, will finance be available, how will the company generate value in a zero-carbon world? Pushing strategic horizons out further to drive more companies to consider the impact of climate change is one of the government's motivators in creating these regulations.

Focus

The board should not try to consider every eventuality or every product, but focus their efforts on the most material impacts, both of the environment on the company and of the company on the environment.

Integration and systems

The company needs to build systems to assess, measure and monitor climate impacts and risks, and be able to adjust its plans as the situation evolves. While bolt–on systems may cover initial data needs, it is clear that the future will require far more integration of non-financial information into management information systems to allow companies to plan, react and provide information to stakeholders. The requirements call for information on a company-wide basis, but customers, for instance in consumer goods, are likely to demand information at product level in the future (if they are not already). Firm foundations for such systems need to be built early even if the final product is not yet ready.

Risks

Having identified risks and opportunities, boards should attempt to quantify them, for instance what are the financial impacts, assess required mitigating actions and decide in advance when such actions need to be taken.

Scenarios

Fully quantified detailed scenarios in the medium and long-term are likely to be beyond the resources of many companies. It is important to remember, however, that scenario analysis is not new and not restricted to climate change, therefore any board will likely have a few "what if" plans, some more detailed than others, for instance in relation to the Covid-19 pandemic, or the possibility of a cyber-attack. Scenario planning for climate change is likely to be largely qualitative in its early years.

Scenario analysis should not try to consider every possibility, but a few key areas which might destroy or open up opportunities for the company should be considered. Considering these and preparing contingency plans should not just be for stakeholder disclosure; it increases corporate resilience. It may expose previously unrecognised risks, make the need for monitoring evident or spur investment into new opportunities.

KPIs

Boards should seek simple measures to assess progress. These should aim for comparability over time and comparability with peers but remain simple enough to understand, and be credible, with external stakeholders. Intensity measures are much more likely to be useful than absolute ones. In this respect, care should be taken with the denominator used for intensity. Taking carbon emissions as an example, while revenue is a common choice, for instance tCO_2e per £m of revenue; it can be measured across the company and does relate the measure to company size, it is affected by inflation, pricing and product mix in ways which are not related to carbon efficiency. Measuring use per tonne of product, unit of distance, head of staff or similar is likely to be more useful. More than one measure may be required to reflect different categories of use.

Targets

The FRC has noted many companies claiming that they are aiming for net zero have little in the way of measurement of progress along their path, or sometimes even detail of when the target is intended to be achieved. Credible targets require measures, milestones and timescales. While not everything is helpful for the public domain, there are increasing expectations of transparency.

Communication

The importance of credible measures and intermediate targets is clearly noted above. It is unlikely that progress on improvement of net zero paths, much like those for profits or revenue growth, will occur on a smooth and regular basis. Changes over time need explanation. This applies both to positive and negative changes. As the fields of non-financial measurement evolve, expectations of explanation will begin to converge with those for financial measures. Companies should be prepared to explain and justify year-on-year changes and expectations for future years, particularly following major impacts like those of the Covid-19 pandemic. Sources and drivers of carbon emissions should be explained in the same way as financial results are.

How we can help

Mazars has a dedicated Accounting Technical Services (ATS) team that has extensive knowledge and experience in assisting clients in understanding and applying the complex requirements surrounding narrative and corporate reporting.

Depending upon your needs, we can support you at varying levels, ranging from advising you on the requirements applicable to your business, to determining the required information, and/or providing full project management support; scoping the information and information systems required, and preparing the required information for your business.

As has been noted above, the TCFD statement is likely to be a living document where the detail and extent of reporting evolves over time. Implementation too will be a rolling process, with plans including building information systems for future years as well as reviewing the current year's figures.

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