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IFRS in Focus

Task Force on Climate-related Financial Disclosures issues its Final Report

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The Bottom line

The Task Force on Climate-related Financial Disclosure, established in 2015 by the Financial Stability Board, has issued its final recommendations, which aim to provide investors, asset owners, asset managers, lenders and insurance underwriters with consistent climate-related financial disclosures that are useful in understanding material climate-related risks.

The Recommendations encourage market-led, industry-focused initiatives within the financial reporting envelope, and address governance, strategy, risk management, and metrics and targets. They are applicable to all organisations.

The recommended disclosures focus on climate-related risks (including physical and transitional risks) and opportunities (including better resource efficiency), and related financial impacts on cash flows, assets and liabilities, net income and other metrics.

Implemented effectively, they should result in greater transparency through more quantitative financial disclosures and, in particular, reporting metrics about the actual or possible financial impact of climate-related risks. Financial statement items may also be affected directly.

The governance processes for the disclosures are envisaged by the Task Force to be similar to those used for existing public financial disclosures and involve review by the chief financial officer and audit committee.

Policy background: the financial implications of climate change

On 29 June 2017 the Task Force on Climate-related Financial Disclosure issued its Final Report (the Report), a set of voluntary recommendations that seek to respond to their G20 mandate and are compatible with current capital market disclosure requirements. The Report was preceded by a consultation on the Task Force’s Recommendations, released in December 2016 and is largely consistent with it. The Report has a simple aim: to ensure that investors, lenders, asset owners and insurance underwriters have clear and consistent climate-related financial disclosures that are useful in understanding material climate-related risks. This information, in turn, should lead to a better pricing of climate-related risks and opportunities.

Immediately after the Paris Agreement of December 2015, which committed nearly 200 governments to strengthen the global response to the threat of climate change, the Financial Stability Board, at the request of the G20, established the industry-led Task Force, led by Michael Bloomberg.

The Task Force sees risks related to climate change as one of the "most significant, and perhaps most misunderstood" risks facing organisations today. The Paris Agreement will lead to short, medium and long-term effects and disruption as economies transition to a lower-carbon economy. This transitional risk is important to policymakers interested in the stability and resilience of the global financial system. If the economic impact of sharp changes in energy use and the revaluation of carbon-intensive assets are to be managed effectively, global financial markets will require better and more consistent information to support well-informed investment, lending and insurance underwriting decisions.

Responsibility for the disclosures

The Report's key recommendation is that that climate-related financial disclosures should be included in an organisation's mainstream (i.e. public) financial filings (the annual financial statements and related disclosure documents) filed with securities markets regulators in accordance with national disclosure requirements. Most G20 jurisdictions already require a discussion of material risks and uncertainties, and these would include material climate-related risks.

The Report acknowledges that most information included in financial filings is subject to a materiality assessment. However, because climate-related risk is a non-diversifiable risk affecting nearly all industries, many investors think that specific aspects of this risk require specific action. Consequently, the Report recommends that disclosure of an organisation's governance and risk management processes and procedures should always be provided whilst disclosures about strategy and metrics and targets should be subject to normal materiality assessment.

Implementing the Report's recommendations will likely result in more quantitative financial disclosures and, in particular, reporting information about the actual or possible financial impact of climate-related risks. In addition, financial statement items may be affected directly: cash flows from operations, asset valuation, net income and capital ratios. Consequently, climate-related financial disclosures are envisaged to be subject to internal controls similar to those for other financial information and that "the governance processes should be similar to those used for existing financial reporting and would likely involve review by the chief financial officer and audit committee, as appropriate."

Observation

The Task Force is not seeking immediate regulatory change. Rather, it is using 'soft power', to encourage market-led, industry-focused initiatives within the financial reporting envelope. Hence it is not surprising that the Task Force is placing this in the In-tray of the CFO and the Audit Committee to ensure that there are appropriate systems in place to generate data that is reliable, verifiable and objective.

Recommendations and Guidance

The Recommendations are built around four thematic areas that represent the primary elements common to the operation of all organisations.

- *Governance:* The organisation's governance around climate-related risks and opportunities.
- *Strategy:* 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.
- *Risk Management:* How the organisation identifies, assesses, and manages climate-related risks.
- *Metrics and Targets:* The metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

The Report includes guidance to assist in developing effective climate-related financial disclosures consistent with the Recommendations and Recommended Disclosures. There is supplemental guidance for the financial and non-financial sectors, highlighting important sector-specific considerations.

Primary users

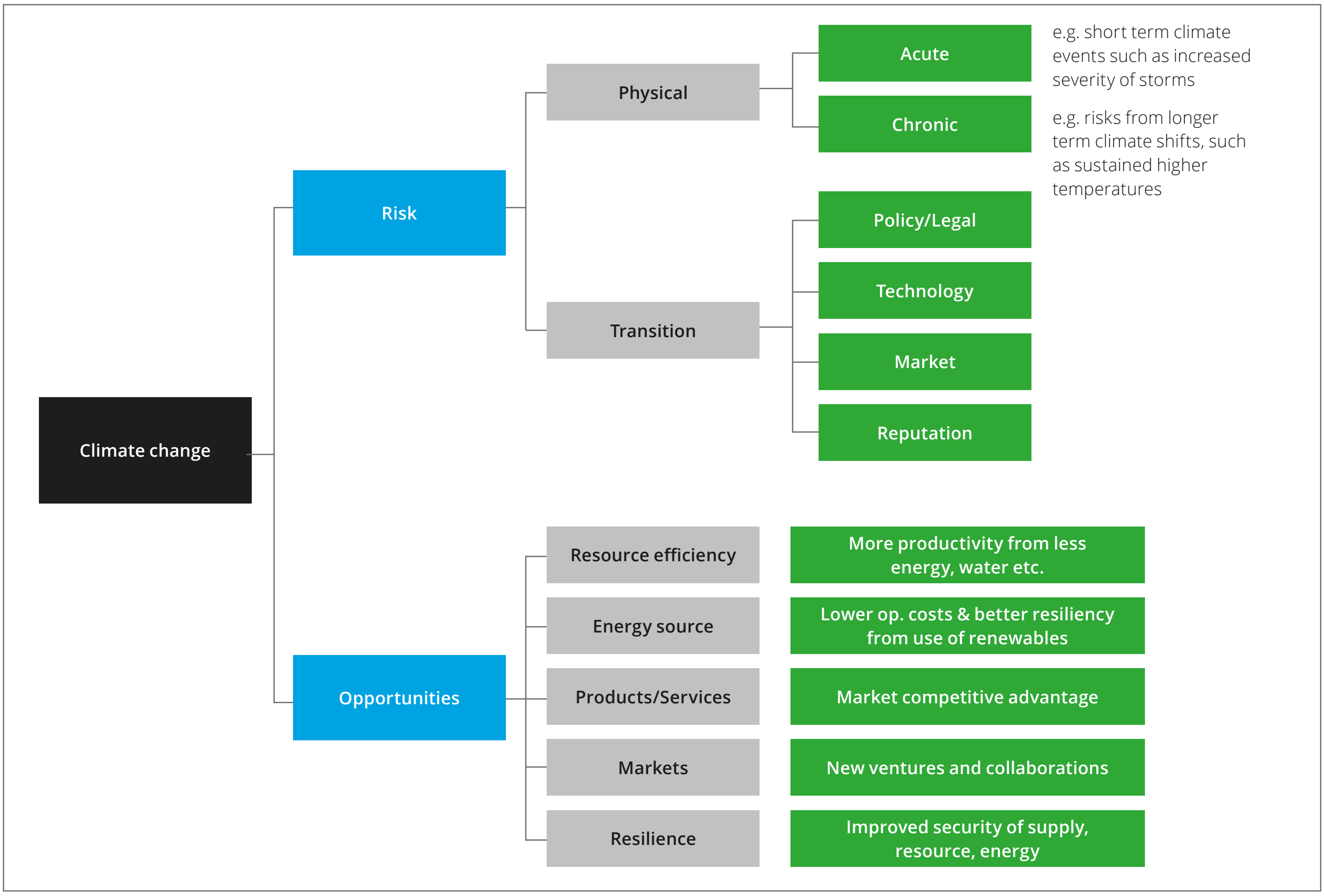
At the FSB's request, the Task Force considered carefully whether the target audience of users of climate-related financial disclosures should "extend beyond investors, lenders, and insurance underwriters" ('primary users'). The Report confirmed that the primary users are the "appropriate target audience" because they "assume the financial risk and reward of the decisions they make." In addition, they note that whilst "many other organisations, including credit rating agencies, equity analysts, stock exchanges, investment consultants, and proxy advisors" will use the disclosures throughout the credit and investment chain, such organisations depend on and use the same types of information as primary users.

Observation

The Task Force's primary user group is largely consistent with that of securities markets regulators, financial reporting standard-setters and related organisations such as the Climate Disclosure Standards Board, the International Integrated Reporting Council and the Sustainability Accounting Standards Board. It is also consistent with the Task Force's desire to include climate-related financial information in mainstream financial filings filed with securities markets regulators. However, adding insurance underwriters in the primary user group seems to blur the line between securities markets oversight and prudential regulation.

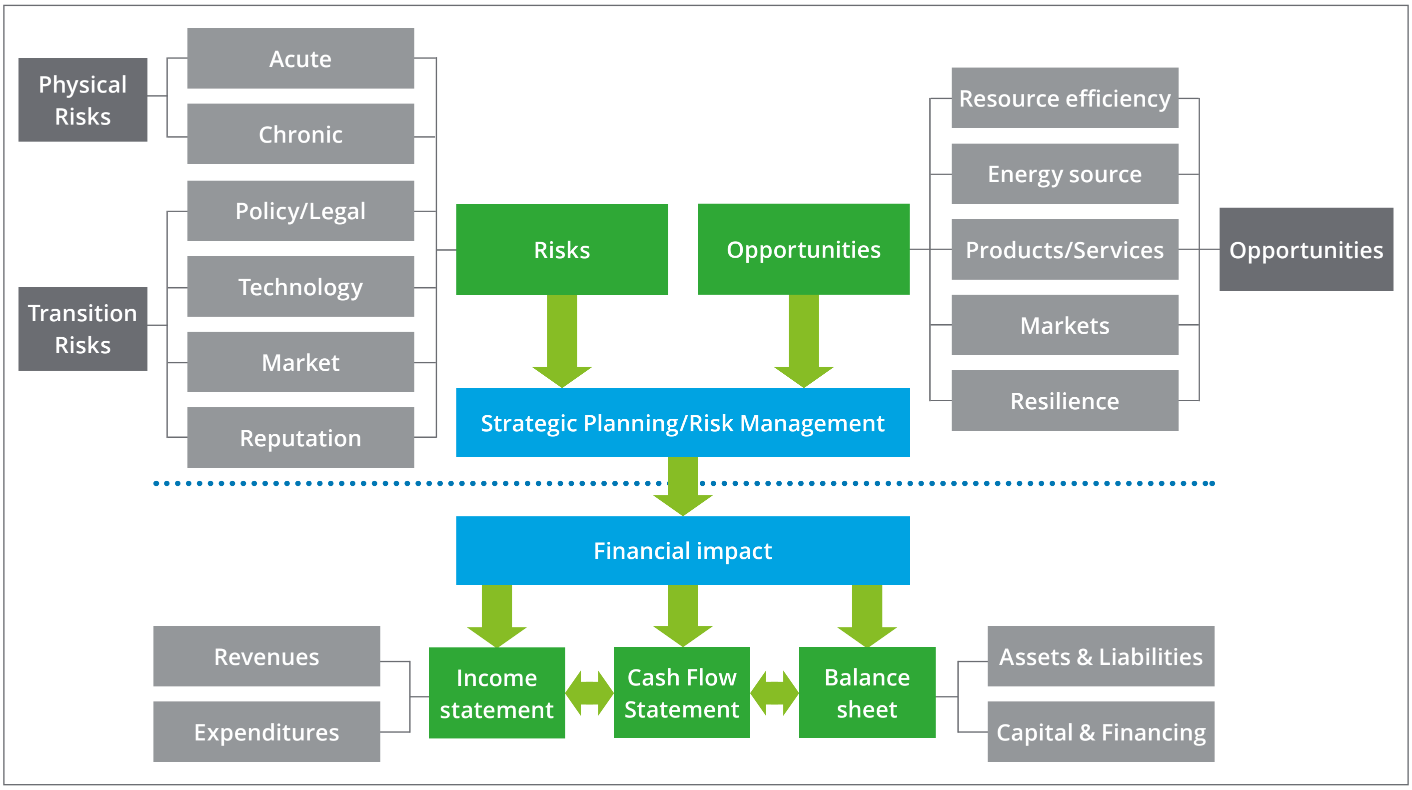
Climate-related risks, opportunities and financial Impacts

The Report draws on several climate-related disclosure frameworks to provide a common framework to promote better alignment and thus greater consistency for climate-related financial disclosure. The framework categorises these disclosures as climate-related risks and climate-related opportunities, with sub-categories as necessary:



Financial Impacts

A primary goal of the Report is to achieve "better disclosure of the financial impacts of climate-related risks and opportunities" on an organisation. Investors, lenders, and insurance underwriters "need to understand how climate-related risks and opportunities are likely to impact an organisation's future financial position as reflected in its income statement, cash flow statement, and balance sheet." The Report demonstrates how the financial impacts are related to the risks and opportunities noted above:



Source: *Final Report of the Task Force on Climate-related Financial Disclosure*

Recommended Disclosures

The principal Recommendations and Recommended Disclosures are summarised below.

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

Source: *Final Report of the Task Force on Climate-related Financial Disclosure*

Changes since December 2016

As a result of the December 2016 consultation, the Task Force has made changes and clarifications to the recommendations and accompanying material – the Implementation guidance and Technical Supplement – to assist preparers apply the Report's recommendations effectively, including:

- *Exposure to carbon-intensive companies:* In order to address concerns about the accuracy and completeness of reported GHG data and the limited application of the metric, the Report replaces the 'GHG emissions associated with investments' metric with a 'weighted average carbon intensity metric'. The new metric is intended to measure an organisation's exposure to carbon-intensive companies.

- *Remuneration:* Where climate-related risks are material, the Report recommends that organisations consider describing whether and how related performance metrics are incorporated into remuneration policies.

- *Data availability and quality:* The Report addresses redundancies of the metrics, simplifies the non-financial illustrative metrics tables; ensures consistent terminology is used; and clarifies the links between the metrics, climate-related risks and opportunities, and potential financial implications.

- *Scenario analyses:* The Report clarified that organisations should describe how resilient their strategies are to climate-related risks and opportunities, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.

Observation

Using common metrics should bring greater comparability within industries and across sectors and the changes made by the Task Force in response to constituents' concerns should lead to better acceptance and adoption by preparers.

Disclosure principles

The overall disclosure framework is supported by seven 'principles for effective disclosures' that are intended to "guide current and future developments" in climate-related financial reporting. The Task Force intends that by using these principles, organisations "can help achieve transparent, high-quality disclosures that enable users to understand the impact of climate change on organisations." The principles are consistent with common regulatory requirements and/or recent statements by some national and regional securities markets regulators on the use of alternative performance measures. Any disclosures should be:

- Relevant
- Specific and complete
- Clear, balanced and understandable
- Consistent over time
- Comparable among companies within a sector, industry or portfolio
- Reliable, verifiable and objective
- Timely

Observation

The Task Force's recommendations can be used by all organisations, although it is implicit that publicly-listed organisations are the immediate focus. By tying the disclosures explicitly to the responsibility to present a clear, balanced and understandable discussion of climate-related risks and opportunities and the related financial effects in the context of continuous financial disclosure by publicly-listed organisations, the Task Force has stated without any doubt that the Chief Financial Officer and the Audit Committee have ultimate responsibility for those disclosures.

The success of the Report's recommendations depends on near-term, widespread adoption by organisations in the financial and non-financial sectors as well as the on-going leadership of the G20 and its member countries.

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