Do your climate related financial disclosures instil confidence?

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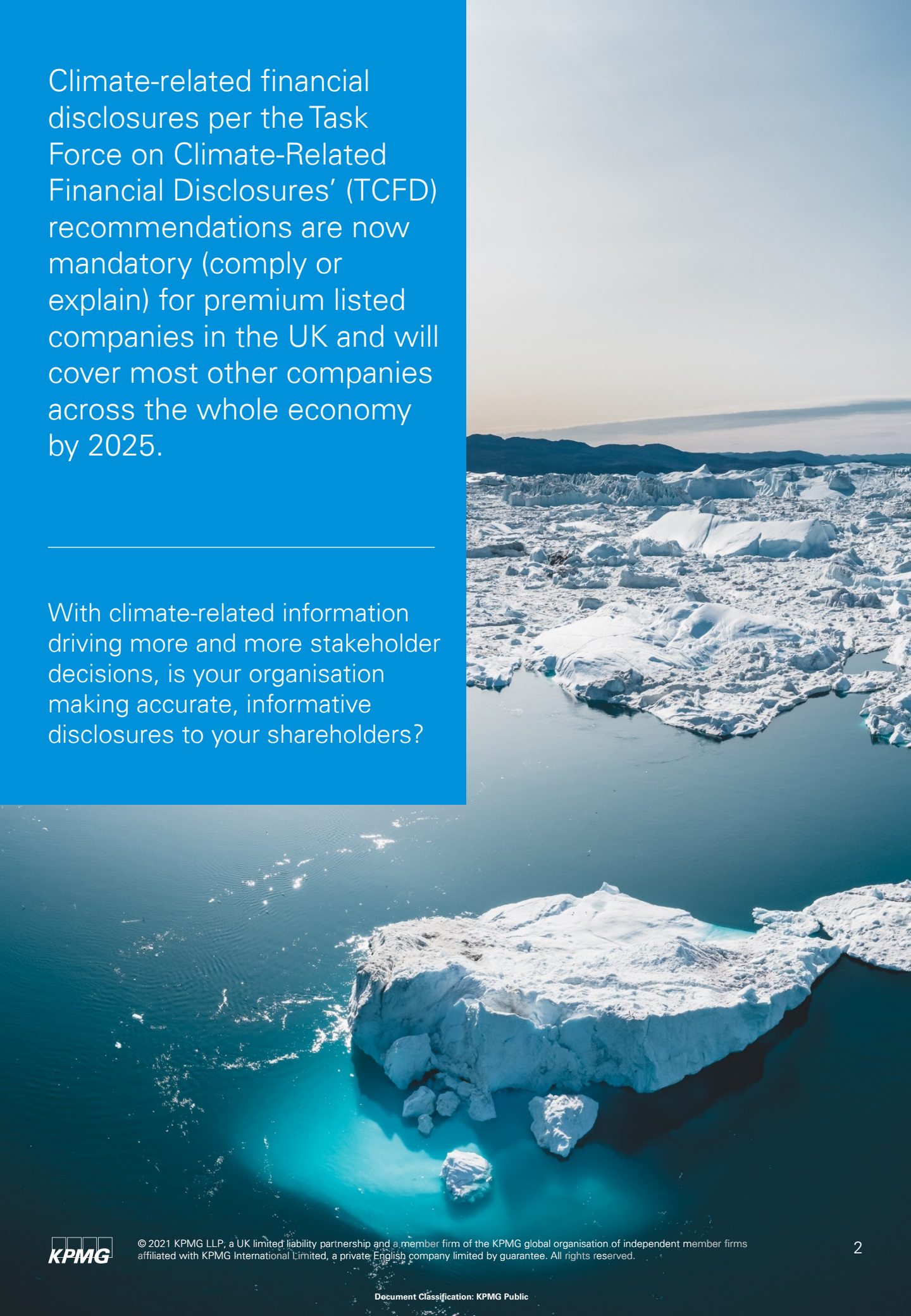
Climate-related financial disclosures per the Task Force on Climate-Related Financial Disclosures' (TCFD) recommendations are now mandatory (comply or explain) for premium listed companies in the UK and will cover most other companies across the whole economy by 2025.

With climate-related information driving more and more stakeholder decisions, is your organisation making accurate, informative disclosures to your shareholders?



The stakeholder perspective

Climate change is reshaping our planet, and the action required to safeguard our collective future has never been more urgent.

Investors, customers, regulators and governments are realising this, so they are demanding reliable climate-related disclosures from businesses. Stakeholders are realising that purely financial information only tells half the story, and that they need a rounded understanding of the impact of climate change on business strategy, operations and profitability. Increasingly, economic decisions will rely on climate-related information[11].

But it won't stop there – the economic impacts of a warming climate and our mitigation efforts will decide[11] which businesses will be viable in the coming years.

Management require comprehensive, accurate information to develop climate-resilient strategies. By getting ahead of this issue now, organizations can better understand their climate value at risk and consequently take necessary measures.

The regulatory perspective

Financial markets need clear, comprehensive, high-quality information on the impacts of climate change. As TCFD chair Michael Bloomberg put it, "increasing transparency makes markets more efficient, and economies more stable and resilient."[1]

In response to this need, the TCFD published disclosure recommendations in 2017. The recommendations are to be included in the annual report, and are structured around four thematic pillars of organisations' operations: governance, strategy, risk management, and metrics and targets.[6] Only three years later, these recommendations were supported by over 1,500 organisations, representing a market capitalisation of over $12.6trn.[2]

And momentum is growing: the G-7 are calling for compulsory climate change reporting for businesses[3], and the IFRS Foundation are establishing a new International Sustainability Standards Board (ISSB), paving the way for a set of global standards for climate reporting.[4]

Already, in the UK, all premium listed companies have been mandated by the Government to report in line with the TCFD recommendations from 1 January 2021 on a comply or explain basis. This is expected to include most UK companies by 2025.[5]

To be confident in their investment decisions, investors need reliable information.

Many investors are also setting their own requirements for disclosures as a pre-condition for accessing funding. As the green bond market is showing us[12], many institutional investors are going further and demanding third-party assurance over the reliability of companies' climate-related financial disclosures. Therefore, there is an opportunity now for businesses to lead in demonstrating their climate-related financial disclosures are reliable by obtaining third-party assurance.

The case for assurance

Under such scrutiny, it is not surprising that we are seeing increasing interest from businesses in getting assurance over their new disclosures. Although assurance is not currently compulsory, businesses are alert to the reputational and financial risks of disclosing inaccurate information to regulators and increasingly sophisticated 'green' investors.

In this emerging area of disclosures, there are concerns about the quality of information being released to the market. Incomplete disclosures raise questions about whether adequate attention has been paid to material topics. Further, climate-related financial risks are being identified without supporting metrics, which may leave investors wondering if management have the data that they need to manage their risks.

Assurance helps address such problems. The assurance process challenges business leaders to ensure their disclosures fully reflect the underlying governance, strategies, risks and opportunities of the reporting entity. Further, each assurance cycle presents opportunities to improve management systems, such as implementing robust controls, and obtaining verifiable data.

Public Interest Entities (PIEs) are also likely to consider assurance in the context of the Audit and Assurance Policy proposed by the UK Government in March 2021 in the BEIS white paper, "Restoring trust in audit and corporate governance". This policy will describe directors' approach to the internal and external assurance gained over reported information and, in the case of listed companies, would be subject to an advisory shareholder vote[7]. As we have seen, assurance over climate-related financial disclosures is likely to be a focus area for investors.

As assurance is currently voluntary, businesses may select certain areas of TCFD disclosures to gain assurance over in the first instance. We are seeing that many businesses are choosing to begin with the numerical aspects of the "metrics and targets" pillar[13]. This is in keeping with a global move to gain assurance over ESG metrics, with our KPMG Survey of Sustainability Reporting 2020[8] showing that 62% of the world's largest companies now obtain external assurance over their numerical non-financial disclosures. One of the TCFD's principles for effective disclosure is "disclosures should be reliable, verifiable, and objective"[10]. The best way to meet this principle and ensure the quality of this data is using the same quality assurance and compliance approaches as for financial statements.

Therefore, we expect market leaders to move towards assurance over the full suite of disclosures to provide maximum comfort to the users of their reports.

Are you assurance-ready?

The TCFD recommended disclosures and sample questions which your assurance provider may ask you. Please note this list of questions is not exhaustive and is subject to change depending on your organisation's circumstances.

Disclosure	What kind of questions will your assurance provider be asking?
Governance	
a. Describe the board's oversight of climate-related risks and opportunities.	– How often are actions taken as a result of board level discussions about climate risks and opportunities?
b. Describe management's role in assessing and managing climate-related risks and opportunities.	– Who are the named individuals with climate-related responsibilities, and what are their reporting lines?
Strategy	
a. Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.	– What is the process for identifying climate-related risks and opportunities with a material impact on finances?
b. Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.	– How have time horizons been defined in relation to the useful life of assets?
c. Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	– Are the climate-related scenarios focused on material climate issues, and are they based on complete, accurate data and appropriate assumptions? – What platform has been used for scenario analysis?

Are you assurance-ready? (cont.)

Disclosure	What kind of questions will your assurance provider be asking?
Risk management a. Describe the organization's processes for identifying and assessing climate-related risks. b. Describe the organization's processes for managing climate-related risks. c. Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.	– What processes and controls are in place to identify, monitor and manage material climate risks? – Is the functioning of controls adequately documented? – How is relevant data evaluated for reliability?
Metrics and targets a. Disclose the metrics used by the organization 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 organization to manage climate-related risks and opportunities and performance against targets.	– Are the metrics chosen appropriate to the risks and opportunities identified in Strategy Pillar? – Are metrics based on defined methodologies? – How is data sourced and how is the reliability of data being addressed in this emerging field? – Are there relevant targets and KPIs in place? – Are metrics well incorporated in remuneration policies?

Assurance options

There are a range of third party assurance options that KPMG can provide to businesses seeking assurance over climate-related financial disclosures for the first time. Assurance products can be strengthened in subsequent reporting cycles until the desired level of assurance is obtained. Assurance can be provided over selected quantitative or qualitative disclosures or over the full suite of disclosures.

Assurance Readiness Assessment:

The first step on the road to third party assurance is for an entity to develop in-house reporting criteria based on the broad TCFD guidance. In our assurance readiness assessment, we assess whether your reporting criteria are a suitable basis for third party assurance by considering the crucial qualities of relevance, completeness, reliability, neutrality, and understandability. Gap analysis is provided to show where any development is needed.

Agreed Upon Procedures:

A tightly defined scope of work set by the entity seeking a factual report of findings over selected areas of the climate-related financial disclosures.

Assurance options (cont.)

There are various options for this type of assurance:

Assurance opinions can be made privately or made available to the public.

Private opinion	Public opinion
A private opinion can be issued for internal use. This may be a desirable option for first-time assurance, providing the option to learn from the assurance process before committing to public assurance.	A public opinion may be made available to the public and is published alongside the disclosures that are being assured. This demonstrates the completeness and accuracy of disclosures to users of the report.

Assurance levels could be limited or reasonable assurance.

Limited assurance	Reasonable assurance
A lower level of assurance than that provided in a financial statements audit. The assurance provider performs a more limited set of procedures compared to those required to give reasonable assurance.	Reasonable assurance is a similar level of assurance as provided in a financial statement audit. Although this level of assurance has not yet been seen over climate-related financial disclosures in the UK, we believe that the importance of this subject matter means market leaders will adopt reasonable assurance voluntarily in the coming years, while the longer term regulatory horizon suggests this could ultimately become mandatory.

Assurance for audited entities

We can provide climate-related financial disclosures assurance services for audited entities under the FRC's Revised Ethical Standard for Audit and Assurance 2019. Indeed, there is a strong argument that assurance from a qualified, independent auditor is beneficial for both the robustness of the assurance provided, and for the gaining efficiencies in these complementary services.[9]

For more information on TCFD disclosures and assurance, please reach out for a conversation with a member of our team.

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