ICAEW
REPRESENTATION 69/24

TCFD-ALIGNED DISCLOSURE: EXPOSURE DRAFT FOR PHASE 3 (STRATEGY PILLAR)

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ICAEW welcomes the opportunity to submit evidence to the public consultation on HM Treasury's Phase 3 Exposure Draft for Task Force on Climate-related Financial Disclosure (TCFD) dated 25 July 2024, details of which are available from this link.

ICAEW supports the adoption of the TCFD framework in public sector annual reports

- Climate change is a major risk for businesses, individuals and government alike, therefore using a recognised reporting framework will facilitate better reporting by public bodies and aid consistency in how climate risks are disclosed.

Policy reporting requires further guidance

- The proposed definition of what is material is wider for central government reporting than it is for the private sector and so it is important that this is made prominent to users of the guidance.
- The proposed guidance states that physical risks to the government estate as a result of a warming planet will be the key consideration for central government entities. However, for some departments, the principal risk will be the effectiveness of policies and regulation in transitioning the economy and society to net zero.
- Using global warming levels of 2C and 4C for scenario analysis will require careful communication to avoid conveying a message that keeping to the Paris agreement of preventing global mean temperatures from rising above 1.5C pre-industrial levels is not achievable.

This should be a step towards adopting wider nature-related financial disclosures

- The environment is key to a well-functioning economy and to citizen health and well-being.
- Reporting is needed on international commitments to reverse biodiversity loss by 2030.
- Reporting on natural capital should be encouraged for those entities it particularly relates to, such as the Environment Agency. HM Treasury should provide guidance to those entities wishing to adopt nature-based reporting frameworks on a voluntary basis.

ICAEW
Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
icaew.com

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Registered office: Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK

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This response has been prepared by ICAEW's Public Sector team, part of Reputation and Influence, in consultation with ICAEW's Public Sector Advisory Group. ICAEW's Public Sector team supports members working in and with the public sector to deliver public priorities and sustainable public finances, including over 13,000 in ICAEW's Public Sector Community. ICAEW engages with policy makers, public servants, and others to promote the need for effective financial management, audit and assurance, financial reporting and governance and ethics across the public sector to ensure public money is spent wisely.

For questions on this submission please contact our Public Sector team at representations@icaew.com quoting REP 69/24

KEY POINTS

We support the adoption of the TCFD framework in public sector annual reports

1. Climate change is a major risk for businesses, individuals and government alike, and so using a recognised reporting framework should facilitate better reporting by public bodies. We therefore concur with adopting the TCFD framework, which will help with consistency across the public sector in how climate risks are disclosed and enable sharing of best practice disclosures with other users of the TCFD framework.
2. We also support the use of the comply or explain approach. We believe doing so will assist preparers in providing relevant and useful disclosures, help avoid the use of boiler-plate language, and provide clarity where public bodies have been unable to disclose particular information concerning their impact on climate or the risks they face.

Reporting on the impacts of policies and regulation

3. The TCFD framework is underpinned by financial materiality which means that entities need to consider the potential impact of climate-related issues on their financial performance and position.
4. HM Treasury has rightly attempted to widen the scope to include policy and regulatory impacts and outcomes in paragraphs 1.61 to 1.63. However, we recommend expanding the implementation guidance in chapter 3 for the Strategy pillar to provide clarification on how to determine which policies to include and their scope, including whether primary and/or secondary impacts should be considered.

Beyond TCFD

5. Sustainability is not just about climate. Consideration also needs to be given to how public bodies are contributing to sustainability more widely and we are encouraged to see many central government entities making use of UN's Sustainability Development Goals to demonstrate how their activities are addressing wider societal and environmental issues.
6. The ISSB is likely to commence a project on biodiversity, ecosystems and ecosystem services which HM Treasury will no doubt follow closely. We believe that public bodies who have a direct responsibility for the natural environment should be encouraged and supported to make nature-based disclosures on a voluntary basis.

ANSWERS TO CONSULTATION QUESTIONS

Question 1

Is the Principal, new and emerging risk section sufficiently clear? Does the guidance on risk assessments, risk reporting and risk prioritisation adequately set out the expectation and disclosure requirements, and support preparers? If not, what further detail should be added?

7. Yes, we believe that this section is helpful to preparers in understanding principal, new and emerging risks. However, it is quite detailed, and we think it might be better placed in a stand-alone section within the FReM since it could be applied to risk more widely, not just climate related risks.
8. We have some concerns about how materiality will be applied to the TCFD model, especially in relation how climate risks relating to policy and regulatory functions are disclosed.
9. The strategy pillar of the TCFD framework is subject to materiality yet the guidance on materiality in paragraphs 3.5 and 3.6 is quite limited. It is known from PACAC's report 'Accounting for Democracy: making sure Parliament, the people and ministers know how and why public money is spent' that reporting on key policies could be improved and is something most primary users would like to see.

10. The materiality paragraphs are less helpful in deciding what should be reported in the strategic elements within the front half of the annual report. Paragraph 3.6 simply states that organisations must consider the importance of narrative information to primary users when assessing whether to include climate-related information, without providing any further guidance on how to make this judgement.
11. The TCFD reporting and disclosure regime focuses on ‘financial materiality’ aimed at providing information on how climate-related risks and opportunities are likely to impact an organisation’s current and future financial position, including the income statement, the cash flow statement and the balance sheet. The impact of an organisation’s activities on wider environmental, social and economic systems is not the key focus of the TCFD framework.
12. The focus on financial materiality may make it difficult to decide which policies to report on and how to report on them, since it is the external impact that is of interest, not only the potential impact on the financial position (such as the costs of the policy). There is also a risk of excessive disclosure given that what is material to an individual public body may be immaterial to society or government as a whole.
13. In order to drive more meaningful long-term climate disclosures, we recommend that the guidance clarify that since the primary user of general-purpose financial reports is Parliament, the effectiveness and impacts of policies will be of key interest, not just value for money considerations that impact the financial statements.
14. We therefore support adapting the definition of materiality in the FReM to encompass the whole annual report (FReM 2024-25 para 2.6.6) to clarify that while the TCFD framework is being adopted with only minor adaptations, the materiality considerations may be different when compared to the private sector, especially in the context of climate risks to the economy and society, including a public body’s policy and regulatory contribution to the achievement of net zero.
15. IPSASB has been working extensively on widening their climate standard to include guidance on climate policy reporting and an exposure draft should be available in October 2024. The contents of the exposure draft may provide helpful input as HM Treasury finalises its proposed guidance.
16. As noted in paragraph 7, we found this section to be quite lengthy and the use of the same headings under ‘risk identification and assessment’ and ‘risk reporting’ is confusing. The content under risk identification and assessment could be captured in a few generic paragraphs rather than splitting it out under the various headings. We would also encourage the table on p40 to be moved to sit below the heading of risk reporting on p38 as it provides a good summary of the key principles.
17. HM Treasury should consider combining risk identification, materiality and policy reporting for inclusion in the guidance on performance reporting in chapter 5 of the FReM.

Question 2a

Do you support our approach to not adapt Strategy recommended disclosure a) or the Supporting Guidance from TCFD? If not, why not?

18. Yes, we agree with not adapting the recommended disclosure or supporting guidance but in line with our comments for question 1 above, we recommend that HM Treasury review the use of financial materiality.
19. The last bullet point under the ‘Supporting guidance from TCFD’ heading on p.41 seeks a description of the process used to determine risks and opportunities that could have a material financial impact on the organisation. This should not always be the key consideration for the public sector since policy effectiveness and outcomes will be of interest to Parliament. We recommend that a footnote is added to make it clear that wider considerations are required for public sector entities with reference to relevant paragraphs.

Question 2b

Is the additional detail on time horizons, impacts with respect to broader public sector considerations and climate-related opportunities sufficiently clear? Do you support this public sector interpretation? If not, why not?

20. The additional guidance on time horizons for Strategy recommended disclosures (a) is clear in that organisations should use their own interpretations for short-, medium- and long-term time horizons.
21. We do not consider the section ‘Climate-related issues’ on page 42 necessary. The TCFD guidance could include an introductory paragraph stating that information should be fair, balanced and understandable.
22. In our view, paragraph 3.38 which references a different approach for time horizons in Strategy recommended disclosures (c) should be clarified or deleted. It currently only says that (c) supports longer-term horizon scanning yet recommended disclosures (a) also has a long-term time horizon bucket. This is potentially confusing. Unless the paragraph can briefly outline that some time horizons are mandated for (c), we recommend deleting it.

Question 3a

Do you support our approach to not adapt Strategy recommended disclosure b) or the Supporting Guidance from TCFD? Do you support the interpretations for Strategy recommended disclosure b) and the Supporting Guidance from TCFD? If not, why not?

23. Yes, we support the approach not to adapt the TCFD guidance and we agree with changing the language to be more suitable for a public sector context.

Question 3b

Is the additional clarification and guidance on impacts with respect to broader public sector considerations sufficiently clear? If not, why not? Do you believe further guidance is required in this sub-section? If so, what?

24. No, the guidance could be clearer.
25. The guidance provided in the TCFD framework is at a very high level with most recommended disclosures being open to interpretation. In our view many preparers will need to seek external input to help facilitate with climate reporting.
26. One area where the guidance could be clearer is on impact reporting. The guidance seems slightly at odds by being rooted in the TCFD financial materiality model. On the one hand organisations are asked to describe the impact of climate-related issues on their financial performance and financial position yet on the other hand are encouraged to report on the external impacts (effectiveness) of regulatory and policy activities.
27. Whilst we do not dispute that policy setting and regulatory roles of government can have significant influence on the economy, environment and people, we do wonder how these activities will be brought into scope of the TCFD framework. Paragraph 3.44 states that government interventions and their effectiveness may be impacted by climate-related issues and that, where material, these should be disclosed. The way materiality is applied in the TCFD framework with its focus on financial position is at odds with the requirement to disclose the effectiveness of government policies.
28. We therefore recommend including linkages to the materiality section within the FReM ‘Choosing what to publish and how to publish it’. The opening paragraph under the heading ‘Public sector considerations and further guidance’ should make it clear that materiality considerations for central government entities may require different judgements in the disclosure of policy and regulatory risks to those used in disclosures about the entities’ own activities.
29. IPSASB is creating a specific disclosure requirement section for public sector climate policy programmes which could inform HM Treasury’s guidance in this area.

30. In paragraph 3.40, the guidance asks for a description of potential impact pathways. This terminology may not be familiar to users of this guidance and should be explained. More guidance could be provided for impact pathways for example whether second and third order effects on supply and distribution chains should be considered. Paragraphs 3.41 and 3.42 are not necessary and could be deleted.

Question 3c

Are the disclosure requirements and guidance for quantification sufficiently clear? Do they strike the appropriate balance, considering the utility of the information for decision-makers and annual report users, as well as the ability of reporting entities to adequately make a quantified assessment? If not, why not?

31. As indicated above, we believe that many preparers will find the high-level nature of this guidance difficult to implement in practice. The guidance for quantification simply states that entities are ‘encouraged to disclose quantified financial information alongside any significant estimates and assumptions’. Although the requirement itself is understandable, implementing it could be challenging.
32. We agree with the view in paragraph 3.49 that over longer time horizons a more qualitative approach will be more appropriate and useful for primary users. There is a risk that highly uncertain numerical projections may be mis-interpreted which could lead to future curtailment in disclosures should these become politically sensitive.
33. Given the high-level nature of the guidance, it is too early to say whether the disclosure requirements strike an appropriate balance. We are encouraged by HM Treasury’s efforts to review the TCFD central government reporting landscape over the coming years to draw out best practice and to identify problem areas. Experience will show if further guidance is required to ensure transparent and decision-useful information is being delivered.

Question 4

Are you supportive of the adaptation to Strategy recommended disclosure c) to remove the revenue size thresholds consideration for robust scenario analysis; and instead apply this guidance in deciding the level of detail for climate scenario analysis? Do you believe further guidance is needed in this section? If so, what?

34. Yes, we support the removal of revenue thresholds since the level of funding for each department is not in correlation to the level of climate risk exposure.
35. The guidance states in paragraph 3.56 that for entities which have identified climate risk as a principal risk, climate scenario analysis must be applied to test the strategic resilience of the organisation.
36. The level of detail will increase if entities need to carry out scenario analysis for the end of century reference point. We have some comments regarding the scoping which we address in our response to question 6 below.

Question 5

Are you supportive of the application guidance setting a common reference periods of mid-century (2050s)? If not, why not? Which alternative reference period (or anchor point) would you suggest, if any?

37. We support making the year 2050 a mandatory reference point for all entities having to conduct scenario analysis after identifying climate risk as a principal risk.
38. 2050 is a significant year on the UK’s journey to becoming net zero, having been enshrined into law for when net zero would be achieved. In our view it will be beneficial for central government entities to report on physical but more importantly on transition risks using 2050 as an anchor point to underline UK Government’s commitment and reputation.
39. The 2050 reference period should be linked to normative scenario planning which describes an achievable and most preferred end state, which is for the UK (government) to be net zero

and therefore contribute to keeping to the Paris agreement of preventing global warming of more than 1.5C above pre-industrial levels. This normative scenario planning could then be combined with other types of scenario planning to focus on how these goals can be achieved.

Question 6a

Are you supportive of the application guidance setting a common reference period of the end of the century (2080- 2100)?

40. Yes, we are broadly supportive for some entities to apply scenario analysis to a long-term anchor point (the criteria being listed in question 6b below).
41. The effects of climate change will be most acute towards the end of the century and governments should be taking a long-term view on the nation's resilience.
42. Due to the inherent uncertainty of continued global emissions and their effects on the planet (such as irreversible tipping points), we support the preference of adopting pre-agreed global warming level pathways so that all entities can analyse the impact of what a world at 4C would look like. We also agree with the guidance that narrative reporting will play a more prominent role than quantitative modelling for such long time periods.
43. We explain in more detail in our response to question 8 that communication of why a global warming level of 2C or more is selected will be vitally important as it could signal that UK's transition efforts (and costs) to limit global warming is outside of its control and thus in vain.

Question 6b

Are you supportive of this additional reference period being mandated where reporting entities:

1. own, manage or regulate significant long-life assets or infrastructure; or,

2. deliver essential public goods and services which are likely to be significantly impacted; or,

3. set longer term policy which is, or regulate industries/sectors that are, likely to be significantly impacted. Do you support the chosen test characteristics?

If not, why not? What alternative text characteristics would you suggest? Is this guidance sufficiently clear for reporting entities? If not, why not?

44. We support the principle that not all entities should be conducting scenario analysis using the end of this century as a reference point. Only those entities that are materially impacted in their ability to provide goods and services by rising temperatures (4C) should be within scope. However, we are concerned that public bodies will have difficulty in deciding whether they are in scope or not and, if they are, what to report – external impact on the wider economy and society or internal impact on strategy and operational effectiveness or indeed both.
45. Paragraph 5.18 of the ED states that preparers must consider both financial materiality with respect to their financial statements and the broader impacts on the organisation's current and future performance with respect to their objectives and strategy. The FReM 2024-25 also makes it clear that the impact of and the management of key risks need to be disclosed (such as in paragraph 5.3.1).
46. More clarity is needed on what HM Treasury's intentions are as it appears that wider reporting is being encouraged to include external impacts of policy and regulatory functions but since the underlying reporting structure is confined by the use of financial materiality of the TCFD framework, there is a degree of tension. This could result in entities being in scope when they may not be and vice versa, depending on how the requirements for using 'end of century' as a reference point have been interpreted.
47. Given that the reporting on the effectiveness and outcomes of policies is generally of low quality, we believe that further guidance in this area should be considered. How would an

entity determine what policies to include and what is a significant impact of a policy are two key questions with which the guidance should help preparers.

48. There is a further complication when considering multi-faceted policies that may be co-owned by a number of departments. There may be one overall responsible department but if they are not in charge of day-to-day administration of a policy, they may not have the necessary information to report on it.

49. We also recommend that the guidance clearly states that only entities that have long-life assets or infrastructure are in scope if these are materially affected by climate change. Many office buildings will not be if they are of a modern standard. We recommend making footnote 32 on page 50 more prominent by bringing it into the core text.

Question 7

Are you supportive of mandating a total of three reference periods (or points)? Are you supportive of near term reference periods (or points) being selected by the organisation? Is this guidance sufficiently clear? If not, why not?

50. We support near term references being open to interpretation by entities but question whether three reference points are required which for some entities would mean two near term reference points.

51. We question if meaningful insights from two near term scenario reference periods can be established given that the impact of climate change is likely to have greater consequence after 2050. Furthermore, given that scenario analysis is only mandatory from 2025/26, it leaves a twenty four-year gap until 2050 which could be covered by one reference period such as 2030 or 2035 and then 2050. It will remain to be seen if the costs outweigh the benefits of providing two near term reference periods.

Question 8

Are you supportive of aligning climate scenario analysis with the global warming level/temperature pathways set out by the CCC (2°C and 4°C end of century)? If not, why not? Do you believe further guidance is needed in this section - including on alternative physical and socio-economic pathways? If so, what?

52. Whilst we do not disagree with proposals, amending the TCFD framework to remove the global warming scenario of 2C or less to a 2C and 4C scenario will require careful communication. It may convey the message that transitioning to net zero by 2050 may be a wasted exercise if global temperatures are not going to be kept to below 2C (or Paris aligned 1.5C).

53. Consequently, businesses and individuals may be less inclined to invest in alternative technologies and change behaviour, making green policy initiatives more difficult to implement. There is already a large cohort who question the UK's net zero ambitions and conveying a message that temperatures are likely to continue to rise regardless could jeopardise the Government's ambitions to transition to net zero.

54. The requirement to describe transition plans under the Strategy pillar of the TCFD framework including GHG reduction targets is supported by a scenario analysis of 2C or less and moving to a 2C and 4C temperature pathway may make reporting disjointed. We would urge HM Treasury to consider keeping 2C or less as well as including 4C to keep in line with international commitments of limiting temperature rises to within 1.5C.

55. We support the alternative pathways as described in the draft guidance from paragraph 3.83 onwards, in particular IPCC SSP-RCP could provide decision useful insights for government entities and their primary stakeholders. Not all government entities will be subject to material physical risks and providing an analysis on socio-economic factors could be especially insightful for policy setting entities and those with regulatory functions.

56. Given the alternative pathways set out in the guidance, we recommend that the wording is softened in paragraph 3.72 where it currently says 'entities conducting climate scenario analysis <u>must</u> use two global warming pathways. It should be a recommendation.

Question 9

Is the guidance on transition pathways and shadow carbon pricing sufficiently clear? Does this support preparers with this type of analysis and disclosure? If not, what further detail should be added? Are there any other potential or perceived risks which have not been addressed in this guidance?

57. In line with our response to question 8, transition scenarios are likely to play an important part of government reporting given its commitment for the UK to be net zero by 2050. We therefore support the inclusion of transition pathways.
58. We agree with paragraph 3.53 that physical risks are likely to be more relevant for some government bodies and that disruption to some types of physical assets such as critical infrastructure could have far reaching effects (systemic risk of climate change).
59. Nevertheless, transition risk should be considered by all departments since costs will be involved in reaching net zero such as replacing petrol powered vehicles with electric ones and changing heating systems. There will be further considerations on transition risks for those entities responsible for transitioning the economy to becoming net zero, including difficult sectors such as aviation and agriculture.
60. We anticipate that most, if not all, entities will require expert support with climate scenario pathways and we therefore believe the guidance to be sufficient.
61. Whilst overall responsibility for net zero lies with DESNZ, many climate related policies are shared by departments. HM Treasury may wish to consider some additional guidance on who should be reporting on climate related polices as there is a principal/agent issue. Shared policies also run the risk of shortfalls in data for reporting purposes.

Question 10

Do you support the approach that scenario analysis is conducted every 3 to 5 years, or more frequently where the assumptions used no longer apply? Is the associated guidance sufficiently clear? If not, why not? Do you believe further guidance is needed in this section? If so, what?

62. Yes, we support the proposed approach that scenario analysis is conducted every three to five years.

Question 11

Is the Climate Scenario Analysis section sufficiently clear? Does the guidance on transition driven pathways, and support preparers with this type of disclosure? If not, what further detail should be added? Do you believe further guidance is needed in this section?

63. The TCFD is only a framework and does not provide as much detail as a standard would. It is unlikely that a preparer would be able to implement TCFD as it is a complex task that requires specific expertise.
64. We are encouraged to see that HM Treasury are working on creating a best practice guide which will help drive up reporting quality over the coming years. Given that the private sector has already been implementing TCFD for a number of years means that there is already a rich database of example disclosures to draw upon.
65. For the above reasons there is no need to provide additional detail.