



30 May 2018

Inquiry Director (Low emissions)
Low-emissions economy
New Zealand Productivity Commission
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Attention: Steven Bailey

Dear Steven

Low-emissions economy Draft report

1. The External Reporting Board (XRB) is pleased to have the opportunity to comment on the New Zealand Productivity Commission's *Low-emissions economy Draft report*.
2. The XRB is an independent Crown Entity responsible for financial reporting strategy and the development and issue of accounting and auditing & assurance standards in New Zealand.
3. We acknowledge the significant effort that has gone into the Commission's comprehensive report on how the government can establish the conditions – institutions, laws, prices, policies and regulations – that encourage shifts to lower emissions and ease the frictions (economic and social) that can accompany such change.

XRB's role, responsibilities and focus

4. Under the Financial Reporting Act 2013, the XRB issues accounting standards for all entities that are required, or opt, under law to prepare financial statements that comply with accounting standards issued by the XRB. XRB accounting standards apply in the for-profit entity, public sector entity and not-for-profit entity sectors (to listed and unlisted entities).
5. In issuing its standards, the XRB focuses on users' needs for information in general purpose financial reports (GPFR), that is, information intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs. The XRB takes various actions to ensure that we continue to set standards that meet the general purpose needs of users of financial/corporate reports, including, for example, through its due process consultation as required under section 22 of the Financial Reporting Act 2013 and by carrying out user-needs research.

6. The Financial Reporting Act 2013 provides in section 17 for the XRB to issue financial reporting standards on non-financial reporting. Section 17(1) provides for the XRB to issue standards in relation to a reporting entity's performance, related party transactions and non-financial matters that are ancillary or incidental to financial reporting.
7. The XRB does not currently have the power to issue standards requiring the disclosure of other non-financial matters. However, section 17(2) provides for the Minister of Commerce and Consumer Affairs to recommend to the Governor-General to make an Order in Council authorising the XRB to issue financial reporting standards that relate to reporting on an entity's governance, an entity's strategic direction and targets, the social, environmental, and economic context in which an entity operates and/or any other matter relating to an entity's performance or position.
8. The Minister may make a recommendation only if he or she is satisfied that it is desirable for those standards to be issued in order to provide for the integrated reporting of an entity's performance or position in terms of both financial and non-financial information (section 17(3)). No Orders in Council have been made under section 17(2) to date.
9. As stated in the Draft report, our research with McGuinness Institute indicates a demand for extended external reporting (EER) information, which comprises all information above and beyond mandatory requirements. EER includes information on an entity's strategies, business models, risks and impacts as they relate to environmental, social and governance matters and/or any other matter relevant to the entity. The XRB's current strategic priority is to engage with reporting entities to raise their awareness of EER and the benefits of voluntarily reporting EER information relevant to both the entity and its stakeholders. The XRB is currently re-considering its strategy in relation to EER and has not yet determined whether it will make a request for an Order in Council be made under section 17(2) which would authorise issuing one or more accounting standards on EER.

Comments on Draft report recommendations on reporting

10. Our comments are focused on Chapter 6 *Investments* as it relates to reporting, in particular, the section on climate-related financial disclosure requirements. We make no comment on other aspects raised in the Draft report.
11. We acknowledge the Commission's focus is on climate change and New Zealand's obligations under the Paris Agreement. We appreciate that, as a result, the Commission sees an urgent need for entities to report specifically on climate change so that the government is able to report on progress in meeting New Zealand's Paris Agreement obligations.
12. To this end, we note the findings of the Commission on reporting as set out in finding F6.6 to finding F6.9.
13. We also note the recommendations of the Commission that:
 - The Government should officially endorse the recommendations of the Task Force on Climate-related Financial Disclosures (R6.2); and
 - The Government should incorporate mandatory climate-related financial disclosures into existing regulatory instruments as appropriate. The disclosures should be in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)(R6.3).

14. We make the following comments on these two recommendations from an external reporting perspective.

Holistic approach to EER

15. We consider that any external reporting by entities on climate change related disclosures needs to adopt a “holistic”, “top-down” approach that covers all relevant EER matters, not just climate change matters.
16. The TCFD recommendations would potentially require the disclosure of a considerable amount of information. The risk is that if the Commission recommends the adoption of the TCFD recommendations only for climate change related disclosures, external reports may become too detailed when an entity also includes information on other relevant EER matters, or alternatively, an entity may include only climate change related information while excluding other equally relevant EER matters. In our view, the TCFD’s recommended headings (governance, strategy, risk management and metrics & targets) and their principles of effective disclosure are relevant to all EER content, not just to climate change matters.
17. The developing nature and types of EER (including climate change matters and other aspects of environmental, social and governance matters) mean that there is a risk that prescribed requirements may not be future-proofed. Developments both in the content elements of what should/could be reported as relevant information and the manner in which EER information and its impacts should/could be reported may change over time: prescribed requirements may not be able to cope with the pace of evolving and changing information needs.
18. The multi-faceted aspects of EER impacts different types of entities differently: what is relevant/material is entity-specific. Different reporting frameworks may be appropriate depending on the particular aspect of EER that is relevant/material to an entity. Also, engagement with industry and stakeholders may not result in disclosure requirements that are necessarily “in line with” TCFD’s recommendations. Therefore, it may be more useful if the government endorses the TCFD recommendations as one of the frameworks that an entity could use, but not the only one.

General purpose reporting

19. The TCFD recommendations state that the preparers of climate-related financial disclosures should provide the disclosures “in their mainstream (i.e., public) annual financial filings”. The XRB considers that information disclosed in external annual corporate reports should be in the nature of a general purpose information relevant to investors and other stakeholders for decision-making purposes. How entities choose to report EER information should fit with this general purpose objective and meet the qualitative characteristics of useful information¹.
20. The XRB is concerned with information overload in annual corporate reports if requirements on just one topic of EER (climate change) result in voluminous disclosures. In addition, entities may adopt a “compliance mentality” rather than a “communication of relevant information mentality” if the requirements are too detailed or prescriptive. The XRB prefers a principles-based approach to setting any requirements on EER.

¹ The qualitative characteristics of useful general purpose financial information set out in the *2018 New Zealand Conceptual Framework* are: relevance, faithful representation, comparability, verifiability, timeliness and understandability. Cost is a pervasive constraint on the information that can be provided by financial reporting.

21. In this regard, the Commission may wish to consider whether information on climate change related disclosures, particularly information on the various metrics related to climate change, should be disclosed in a separate report, rather than as part of an entity's annual external report. A separate report may be a better vehicle for comparing information and more detailed metrics on climate change matters within, and between, different sectors.

“Who” and coverage

22. We note the Commission's recommendations are silent on “who” should be responsible for issuing the “mandatory climate-related financial disclosures” under the regulatory instruments. Making this clear in the New Zealand context is important because it affects the classes/types of entities that will need to apply the requirements (coverage of entities) and the nature of the disclosure requirements.
23. We note the Commission's finding in F6.8 that guidelines provided by the NZX will not provide coverage that will be sufficient to drive adequate investor awareness and behaviour change across the New Zealand economy.
24. The TCFD recommends “all financial and non-financial organisations with public debt or equity” implement its recommendations. If the TCFD recommendations are adopted, the classes/types of entities that are required to disclose climate change related disclosures is still limited to a subset of entities in New Zealand. It may exclude significant sectors or large entities that have activities that might have a greater impact on climate change, for example, the agricultural sector. Taking a narrow view of the classes/types of entities that are required to disclose climate change related disclosures might not result in any meaningful aggregated reporting from New Zealand to meet its Paris Agreement obligations or provide useful information to the potential users of the information.
25. Standards issued by the XRB apply to all entities (across the for-profit entity, public sector entity and not-for-profit entity sectors) that have a legislative requirement, or opts, to prepare general purpose financial reports that comply with XRB's standards. While coverage is more comprehensive under the XRB's standards, other considerations arise including the need to address cost-benefit issues, particularly for the smaller entities.

Recommendation

26. While we appreciate the urgency for climate change reforms and requirements, we recommend the Commission takes a holistic view and approach to requiring entities to report externally when making its recommendations to the government. In our view, a holistic approach would incorporate climate change related matters into the wider reporting of EER matters.
27. We recommend that, if the TCFD recommendations are to be officially endorsed by the government, it should note that this is just one of the frameworks that can be utilised for the disclosure of EER information. We are concerned that piecemeal requirements to reporting EER will potentially result in voluminous information on discrete matters (such as climate change) that may not be useful or relevant to users. We prefer a principles-based approach to enable all entities to continue to innovate and evolve their reporting, and to ensure that the most relevant EER matters are reported in a consistent and meaningful way.
28. If “mandatory climate-related financial disclosures” are considered necessary, we recommend that the Commission considers the question of which entities should apply those requirements (coverage) as this will determine “who” should issue those mandatory

disclosures and what the nature of the information should be. We recommend the Commission considers prescribing the disclosure of climate change related metrics in a separate report, rather than as part of the entity's annual report.

29. The XRB is keen to continue discussions with the Commission on its work on climate change disclosures and the relationship of that work with the XRB's work on EER.
30. If you have any queries or require clarification on any matters in this submission, please contact Lay Wee Ng (laywee.ng@xrb.govt.nz) or me.

Yours sincerely



Graeme R Mitchell
Chairman
External Reporting Board