



13 December 2019

Climate-related financial disclosures consultation

Ministry for the Environment

Manatū Mō Te Taiao

PO Box 10362

Wellington 6143

By email: [crfd@mfe.govt.nz](mailto:crfd@mfe.govt.nz)

Dear Sir/Madam

**Submission on *Climate-related financial disclosures – Understanding your business risks and opportunities related to climate change: Discussion document***

*Introduction*

1. The External Reporting Board (XRB) is pleased to have the opportunity to comment on *Climate-related financial disclosures – Understanding your business risks and opportunities related to climate change: Discussion document* (the Discussion document).
2. As you may be aware, the XRB currently has a project on *Extended External Reporting* (EER). EER is an umbrella term adopted by the XRB to refer to broader and more detailed types of reporting, beyond the types of information presented in an entity's statutory financial statements. Climate-related financial disclosures fall into the scope of EER.
3. The XRB has a significant interest in EER, given its role as an independent Crown entity responsible for financial reporting strategy and the development and issuance of accounting and auditing and assurance standards in New Zealand.<sup>1</sup>
4. The XRB has observed growing demand from stakeholders for:
  - (a) increased transparency from entities in relation to material risks (including environmental, social and governance risks) and strategies for managing those risks;
  - (b) forward-looking information about an entity's long-term sustainability;
  - (c) information about an entity's key resources and relationships; and
  - (d) greater visibility around corporate citizenship.<sup>2</sup>

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<sup>1</sup> Information about the role, responsibilities and focus of the XRB is provided in Appendix A.

<sup>2</sup> In 2017 the XRB and the McGuinness Institute undertook two surveys on EER in New Zealand. The survey findings are available here - <https://www.xrb.govt.nz/information-hub/current-research-reports/>

5. The XRB has been working to promote awareness of EER and the benefits of EER. The XRB has developed an EER section on its website which explains what EER is, describes the benefits of EER and brings together a range of useful information and resources about EER.<sup>3</sup>
6. In March 2019 the XRB issued a Position Statement on EER.<sup>4</sup> The XRB Position Statement strongly supports entities reporting of EER information in their annual reports, to the extent that the EER information is relevant for the intended users of those annual reports.
7. The XRB considers that intended users (audience) of annual reports are the same as the primary users of general purpose financial reports (GPFR).<sup>5</sup> In the case of for-profit entities the primary users of GPFR are existing and potential investors, lenders and other creditors (as per the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting*).
8. Where more detailed EER information on a specific topic (for example, climate change) is required for public policy purposes, but is **not material** to users of the annual report, in order to avoid 'information overload' the XRB believes that such EER should be presented outside the annual report.<sup>6</sup> Information overload undermines the relevance and understandability of the annual report for its intended users.

*Response to the proposals in the Discussion document*

9. The XRB agrees with the conclusions set out in paragraph 48 of the Discussion document, notably: (a) that climate change presents material financial risks, both transitional and physical, to many businesses; and (b) that pressure is building from institutional investors for companies to make climate-related disclosures. (*Question 2*)
10. The recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) are clearly focused on entities disclosing climate-related financial information that is material and decision useful for **investors** (*emphasis added*). The XRB considers that the TCFD recommendations are consistent with its Position Statement on EER. Therefore, the XRB is supportive of entities applying the TCFD recommendations when reporting climate-related financial information in their annual report – to the extent that the information disclosed is material and decision useful to the intended users of the entity's annual report.
11. The XRB recognises that the TCFD recommendations are emerging as best practice in the reporting of climate-related financial information and has promoted the TCFD recommendations and associated resources on the EER section of the XRB website.<sup>7</sup> (*Question 14*)

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<sup>3</sup> <https://www.xrb.govt.nz/extended-external-reporting/>

<sup>4</sup> <https://www.xrb.govt.nz/extended-external-reporting/xrb-position-statement/>

<sup>5</sup> The overarching objective of GPFR is to provide financial information to external users who have a need for an entity's financial statements but are unable to demand them. Individual primary users have different, and possibly conflicting, information needs. GPFRs seek to provide information that will meet the needs of the maximum number of primary users.

<sup>6</sup> Such as in a separate report, on an online register or on the entity's website.

<sup>7</sup> <https://www.xrb.govt.nz/extended-external-reporting/eer-navigational-resource/global-resources/>

12. Having given consideration to the arguments set out in the Discussion document for maintaining the status quo and for mandating the TCFD requirements, on balance, the XRB is supportive of mandating, on a comply or explain basis, the TCFD recommendations (or a TCFD-aligned framework) for entities with future requirements to make climate-related financial disclosures (*Questions 11, 12*). The XRB has not commented on which entities these proposals should apply to (*Questions 21, 22, 23*).
13. However, the XRB has concerns with the 'comply or explain' mechanism as proposed in the Discussion paper. The Discussion paper proposes that the only circumstance where an entity can 'explain' is when they see themselves as not being materially affected by climate change. The XRB supports a comply or explain mechanism that provides entities the ability to not comply with some of the disclosures, subject to explaining why. This is the way we understand that a 'comply or explain' mechanism is typically used in government regulation and financial supervision, for example, the NZX Corporate Governance Code. (*Question 18*)
14. In New Zealand, entities have already invested in adopting or applying the principles of other international EER frameworks, for example the *International Integrated Reporting Framework*. The XRB believes that the TCFD recommendations can complement other EER frameworks, however, where other EER frameworks are aligned with the TCFD recommendations, the XRB is supportive of allowing entities the flexibility to apply such EER frameworks. The XRB supports the proposal that the Government would specific a list of aligned frameworks and recommend that the work of the *Corporate Reporting Dialogue* is used to inform the selection of alternative frameworks.
15. The XRB acknowledges that the status quo is not currently providing intended users of annual reports with all the material information they need to make appropriately informed investment decisions. If the status quo is retained, the XRB believes that better education, monitoring and enforcement is needed to ensure entities disclose material information – needed for intended users of annual reports need to make better-informed investment decisions. (*Question 13*)
16. If the TCFD recommendations were to be made mandatory for the classes of entities described in the Discussion document, the XRB has the following comments.
  - (a) The XRB agrees, with the view in the Discussion document, that the function of implementing a climate-related financial disclosure regime should not sit with the national accounting standard setter, being the XRB. As outlined in Appendix A to this letter, the XRB does not have the mandate to establish who is required to report in accordance with standards it issues. Nor does the XRB have the necessary experience to set detailed requirements or standards for climate-related financial disclosures. (*Question 35*)
  - (b) The XRB would support a definition of materiality based on the International Accounting Standards Board's (IASB) definition of material. Specifically, the XRB would support a definition focused on 'information that could reasonably be expected to influence the decisions of the primary users of GPFs'. However, the XRB believes that entities would need additional guidance to apply such a definition to non-financial information, including climate-related financial disclosures.

The IASB has issued guidance to help entities make materiality judgements, but this guidance is in relation to GPFs.<sup>8</sup> The XRB notes that, as part of the IASB's current *Management Commentary* project, the IASB is looking at developing guidance for entities making materiality judgements about non-financial information. The IASB has indicated that it expects to issue a consultation document under this project in the second half of 2020. (*Question 17*)

- (c) The XRB questions whether the proposed timeline and transition period is sufficient to allow entities adequate time to implement the recommendations, particularly the disclosures pertaining to scenario analysis.

Typically, when the XRB issues standards it provides a three to four-year implementation period, to allow entities sufficient time to implement the necessary systems and processes needed to reliably capture the relevant information – taking into consideration the need to provide prior year comparative information.

Therefore, the XRB strongly recommends that a longer transition period is considered. Balancing the need for urgent action and the need to provide entities with sufficient time to prepare for the changes, the XRB suggests that a phased approach is considered. The first phase could focus on entities disclosing qualitative information on governance, strategy and risk management. During the early phases relief from providing scenario analysis disclosures could be considered. (*Questions 20, 33*)

- (d) The XRB does not agree with the proposals to have a stand-alone climate-related financial disclosures report within the annual report. Requirements for a separate report (or section) within the annual report could encourage a siloed approach to annual reporting and may lead to a plethora of other reports covering other significant topic specific disclosures.

The XRB would like to see consideration given to entities reporting EER information in their annual reports having the flexibility to disclose such information in a format which best allows them to '*tell their story*'. For example, entities adopting the *International Integrated Reporting Framework* or *GRI* may wish to disclose material climate-related financial risks together with other material risks. (*Question 25*)

- (e) The XRB is generally in support of cross-referencing within annual reports to avoid unnecessary duplication of information. In some cases, the XRB also supports cross-referencing to information outside the annual report (for example, if information is not material to the intended users of an entity's annual report but may be of interest to a wider set of stakeholders). (*Question 26*)
- (f) The XRB is aware of growing demand for assurance over EER, including climate-related financial disclosures. The XRB believes it is necessary for investors to have trust and confidence over EER information reported by entities. However, the XRB is conscious that assurance over EER is a rapidly-evolving area and, at present, there is significant variation across jurisdictions. The International Auditing and Assurance Standards Board (IAASB) is currently developing guidance for practitioners to apply the applicable

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<sup>8</sup> IFRS Practice Statement 2 *Making Materiality Judgements*

assurance standard in a consistent and appropriate way. Therefore, in the short term, the XRB does not support mandatory requirements for assurance. The XRB believes that it is important to wait for any climate-related financial disclosures to mature and for adequate controls and systems to be implemented to reliably capture information needed to report, before determining what users require in terms of assurance. (Questions 28, 32)

- (g) The XRB believes the Government will have an important role to play in developing and publishing guidance and education materials, particularly in relation to: (i) when it is appropriate to 'explain' rather than 'comply'; (ii) assist entities in performing scenario analysis; and (iii) assist entities in making materiality judgements about climate-related financial disclosures. The XRB considers that such materials will be needed in order for entities to provide high-quality climate-related financial disclosures that are comparable and useful to investors. (Questions 36, 39)
  - (h) The XRB believes that a regulatory body having clear responsibility for monitoring and enforcement functions will be critical to ensuring entities provide, in their annual reports, climate-related financial disclosures that meet the information needs of investors. The XRB recommends that a regulatory body takes an educational approach in the early years to the enforcement of these disclosures. To help entities comply with the TCFD recommendations, we recommend that the regulator publishes the findings from its monitoring activities annually, and sets out expectations for the next reporting season. We believe this will be particularly helpful for entities on a journey towards complying with the TCFD recommendations during the transition period. (Question 36)
17. The XRB would welcome further discussions with MBIE and MfE on their work on climate-related financial disclosures.
18. If you have any queries or require clarification on any matters in this submission, please contact Judith Pinny ([judith.pinny@xrb.govt.nz](mailto:judith.pinny@xrb.govt.nz)) or me.

Yours sincerely



Michele Embling

Chair

External Reporting Board

## Appendix A

### XRB's role, responsibilities and focus

1. The XRB is an independent Crown entity responsible for financial reporting strategy and the development and issuance of accounting, and auditing and assurance, standards in New Zealand. The XRB was originally established under section 22 of the Financial Reporting Act 1993, with continued existence under section 12 of the Financial Reporting Act 2013.
2. The XRB develops and issues accounting standards for the for-profit, not-for-profit and public sectors.
3. New Zealand legislation set by the Government establishes **who** is required to report in accordance with standards issued by the XRB (for example, Companies Act 1993, Charities Act 2005, etc.). The XRB is responsible for the XRB accounting standards themselves which state **what** and **how** entities are required to report. the XRB does not have the mandate to establish who is required to report in accordance with standards it issues.
4. In developing and issuing its standards, the XRB focuses on the information needs of the primary users of general purpose financial reports (GPFRs).<sup>9</sup> The overarching objective of GPFR is to provide financial information to external users who have a need for an entity's financial statements but are unable to demand them. Individual primary users have different, and possibly conflicting, information needs. GPFRs seek to provide information that will meet the needs of the maximum number of primary users.
5. Section 17 of the Financial Reporting Act 2013 allows for financial reporting standards issued by the XRB to cover non-financial reporting. Section 17(1) states that a financial reporting standard may relate to reporting on an entity's performance, an entity's related party transactions, or any other non-financial matter that directly relates, or is incidental or ancillary, to an entity's financial reporting, or other non-financial matters authorised by an Order in Council made under subsection (2).
6. 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 that the Governor-General, by Order in Council, authorise 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.
7. The Minister may make a recommendation only if he or she is satisfied that it is desirable for such 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.

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<sup>9</sup> Primary users of general purpose financial reports consist of existing and potential investors, lenders and other creditors.