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| **To:** | New Zealand External Reporting Board (XRB) |
| Date: | 2 May 2022 |
| **Comment Letter:** | NZ CS1 |

To whom it may concern

Thank you for the opportunity to offer comment on NZ CS 1 *Climate-related Disclosures NZ CS 1 Strategy, and Metrics and Targets Consultation Document.* We are also thankful to the XRB for its responsiveness with respect to changes incorporated to sustainability -related guidance based on earlier comments and feedback received.

We confine our comments to Questions 1, 3 4, 7, 8 and 14. In each case, we have taken the liberty to respond to the questions, while also adding some additional background information and argument. We hope these comments are helpful.

If you require further information about this submission, please do not hesitate to contact us via the information below.

Yours sincerely,

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Our comments contain reflections on the recommendations contained in NZ CS 1, in light of various factors including the likely users and their decisions needs, as well as the requirement for reporting of comparable and consistent information.

***Question 1:***
***Do you think the proposed Strategy section of NZ CS 1 meets primary user needs?***
***a) Do you think that the information in this section of the standard will provide information that is useful to primary users for decision making? If not, please explain why not and identify any alternative proposals.***
***b) Do you consider that this section of the standard is clear and unambiguous in terms of the information to be disclosed? If not, how could clarity be improved?***
***c) Do you consider that this section of the standard is adequately comprehensive and achieves the right balance between prescriptiveness and principles-based disclosures? If not, what should be removed or added to achieve a better balance?***

Comments:

We support the need for climate-related disclosures which focus on strategy. Myriad users seek information about not only risks and opportunities that companies face, but also information about strategies and approaches by companies that seek to deal with those risks and opportunities. In fact, we see strategy related disclosures for climate to be key, since users will need to assess the likely implications for future prospects of the entity.

We do, however, advocate careful consideration of additional detail that could be required in company disclosures. While supporting the need for principles-based disclosure requirements to enable companies to communicate higher quality entity-relevant information, we also support the need for sufficient (prescriptive) disclosure guidance to facilitate meaningful comparison across key aspect of disclosures. This would include requiring both transition and physical risk disclosures as well as requiring minimum disclosures of specified bases for scenarios, specific projected timeframes, and the level of the entity for which the scenarios are reported. In our view, it is crucial for entities to disclose the assumptions implicit in the disclosures made.   These aspects are discussed further in subsequent sections of this document.

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***Q3: Do you agree that we should not prescribe which global mean temperature increase scenario(s) should be used to explore higher physical risk scenarios (such as 2.7°C and/or 3.3°C or by using Representative Concentration Pathways (RCP) such as RCP4.5 or 6), but rather leave this more open by requiring a 'greater than 2°C scenario'? Why or why not?***

Comments:

As indicated above, we support the need for disclosure which facilitates greater comparability. We support the need for principles-based guidance, balanced with more prescriptive guidance to enable comparability. Companies should consider a range of scenarios that include primarily transition risks (e.g., 1.5 or 2 degree scenarios) or primarily physical risks (e.g., 2.7+ degree scenarios, etc.). This will give managers and primary users of reporting understanding of risks to the company and will stimulate management to develop strategies to address the range of possible impacts of climate change on the company. Perhaps a greater issue than the specific scenario used is what are the assumptions underlying the scenarios. For example, in our study of ASX 50 scenario analysis disclosures (where 37 of 50 provided disclosures), we found tremendous variation across companies with respect to key assumptions underlying the analyses. For example, the timeframe of the scenario varied tremendously (see the table below). This is a key assumption, since in the shorter term, there are few differences in risks across scenarios related to temperature and sea level rise. This variation in timeframe makes comparison across companies extremely difficult.

| **Year** | **2030** | **2040** | **2050** | **2060** | **2070** | **2100** |
|---|---|---|---|---|---|---|
| **# Companies** | 8 | 7 | 12 | 2 | 1 | 7 |

Management tends to be short-term oriented and corporate timeframes are relatively short. Given these characteristics of business and the increasing uncertainty associated with projecting the distant future, we suggest that the XRB ask managers to evaluate scenarios for a specific timeframe and that the timeframe be relatively short. This will enhance comparability of disclosures across companies and will enhance the ability of managers to report based upon credible scenarios.

In our research, we also found tremendous variation in the assumed pathways to each level of temperature rise, such as steady versus tumultuous decline in emissions. This makes it difficult to compare across companies, although these assumptions can reveal different types of risks that companies might face.

The number of potential scenarios and accompanying assumptions that companies can employ are endless. It is beyond the scope of the XRB's duties to dictate specific scenarios and assumptions, unless there are some general guidelines that can facilitate comparison across firms and transparency. The goal of scenario

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analysis is for management to identify and manage climate risks. Management should be choosing scenarios that appropriate for them to do so. Primary users of the financial statements should be able to evaluate whether management has done a good job of identifying and managing risk. In terms of enhancing comparability, and as suggested above, the XRB can require some characteristics of the scenarios employed by managers such as the timeframe and specifying examination of a higher temperature rise scenario to focus on physical risks. However, more detailed requirements for specific scenarios should be avoided. Comparability and transparency can be enhanced if managers are given leeway to choose scenarios, but are required to provide more complete disclosure of the major scenario characteristics and underlying assumptions.

In sum, we believe that the specific scenarios used are less important than disclosure of issues such as 1) why the specific scenarios were chosen; 2) major assumptions underlying the analysis; 3) insights about risks faced by the company; and most importantly 4) what the company is doing strategically and operationally to mitigate the risks (i.e., what did they learn and what are they going to do about it).

**Q4: We do not require transition plans to be tied to any particular target such as net zero and/or 1.5°C, but that entities will be free to disclose this if they have done so. Do you agree? Why or why not?**

Comments:

We agree that transition plans tied to any particular target should not be required disclosure. The problem with requiring disclosure of transition plans *tied to a particular target* is that there are many pathways to net zero and/or 1.5°C (even within a given industry) which would require different actions by management and will be influenced by future factors external to the firm such as regulation, the success of global efforts to decarbonize, etc. While it is important for management to consider how to transition, it is not clear to us how disclosures tied to any particular target would enhance the transparency and comparability of disclosures. Management should disclose their strategies to address climate risks identified in the scenario analyses, but not necessarily plans tied to a specific target.

**7) Do you think the proposed Metrics and Targets section of NZ CS 1 meets primary user needs?**

Comments:

We agree that disclosure of methodologies and assumptions used to calculate metrics and targets is extremely important as it will make it easier for primary users to evaluate performance across entities.

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Disclosure of scope 3 GHG emissions should include qualitative discussion of major causes of scope 3 impacts for the entity. This will help put the scope 3 disclosures in context. Note that use of sold products is in Figure 6, but was not included in the narrative on p. 40.

**8) We have not specified industry-specific metrics. The guidance will direct preparers where to look for industry-specific metrics. Do you believe this is reasonable or do you believe we should include a list of required metrics by industry? If so, do you believe we should use the TCFD recommendations or follow the TRWG prototype?**

Comments:

We agree that industry-specific guidance should remain unspecified at this point, but that disclosures should by be guided by developing industry practice. We note that climate risks can vary considerably within industry. For example, a hotel/resort that is in a remote area with endangered flora and fauna faces very different climate risks than a hotel/resort that is in an urban area. Further many entities have operations that span industries, which complicates disclosure.

The technology for measuring climate risks is still evolving and climate risks are primarily forward-looking. Focus of additional disclosure should be on the policies and strategies that entities are employing to reduce their risk or to adapt to climate change.

**14) The XRB has proposed a definition of material (Information is material if omitting, misstating, or obscuring it could reasonably be expected to influence decisions that primary users make on the basis of their assessments of an entity's enterprise value across all time horizons, including the long term). Do you agree with this definition? Why or why not?**

Our comments are made in light of the acknowledged complex nature of the materiality concept – even when applied in the more narrow financial reporting setting.

We support the need for an encompassing definition of materiality that does not comprise quantitative thresholds based on financial statement magnitudes. We also appreciate and agree with the longer-term time dimension embedded in the definition contained in NZ CS1. One concern with the definition as stated is that it may lead to companies narrowing their view of what matters are material, which may result in over-reliance on quantitative thresholds based on financial statement magnitudes in the short term. In our research we have we found a very small number of companies in the ASX 50 disclosed direct implications of scenarios for financial statement magnitudes for assets, liabilities, revenues and expenses. Compare this to the notions of materiality inherent in risk-related guidance documents such as the AASB's APS 2 *Making Materiality Judgements* (2017). That

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document refers qualitative external factors such as the nature of the industry and expectations of users must be considered when making materiality judgements. Under this seemingly broader concept of materiality, it appears more difficult for entities to scope out disclosure based on claims of (im)materiality. We would, therefore, support the careful reconsideration of the materiality definition and the incorporation of a greater focus on risk.

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