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Climate Related Financial Disclosure (CRFD) – coming ready or not?



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Whilst most of us have been preoccupied with coronavirus (COVID-19) pandemic health issues, organisations focused on the stability and integrity of financial markets have been aligning around the need to recognise the potential dangers to the world's economic health emerging from sustainability issues generally and, climate change in particular.

Demand for consistent and comparable disclosure



In April 2020, the International Monetary Fund (IMF) released a global financial stability report¹ which sought to assess the financial stability challenges posed by the COVID-19 pandemic. Whilst the bulk of the report focussed on how the economic impact of COVID-19 could place financial markets and institutions under significant stress, impact portfolio flows, and the profitability of the banking sector, it also included a consideration of physical risks associated with climate change. The report identified that such risks did not appear to be reflected in global equity valuations and that improved disclosure of exposure to climate change was necessary to better assess physical risk.

The IMF report notes that an increasing number of firms are voluntarily disclosing climate risk information. The report also notes that financial stability could be enhanced through the development of mandatory disclosure standards on material climate change risks with these being incorporated, in the longer term, within financial statements prepared in accordance with International Financial Reporting Standards (IFRS).

Also in April 2020, The International Organization of Securities Commissions (IOSCO) published a report² entitled "*Sustainable Finance and the Role of Securities Regulators and IOSCO*". The report summarises the outcome of, amongst other things, a survey conducted in 2019 with securities regulators and market participants on various sustainability issues. One of the key findings emerging from the survey is concern surrounding the number and diversity of sustainability frameworks and standards including sustainability related disclosures and the need to improve consistency and comparability.

When considering how best to respond to this finding, the IOSCO report refers to the successful global adoption of IFRS, which are perceived as high quality and being promulgated through a publicly accountability, transparent, and rigorous due process.

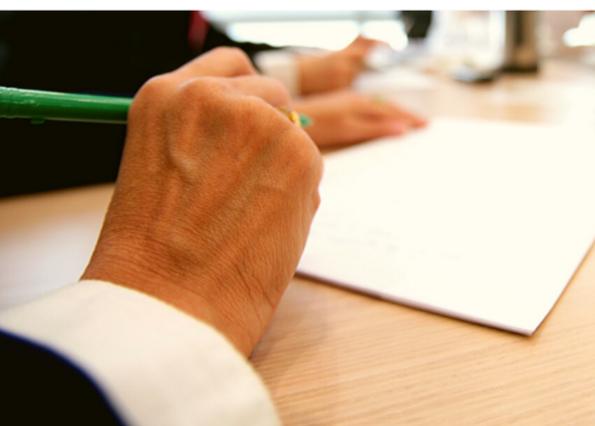
[1] *Global Financial Stability Report: Markets in the Time of COVID-19*, International Monetary Fund, April 2020
<https://www.imf.org/en/Publications/GFSR/Issues/2020/04/14/global-financial-stability-report-april-2020>

[2] *Sustainable Finance and the Role of Securities Regulators and IOSCO: Final Report*, April 2020
<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD652.pdf>

In May 2020, the Investor Advisory Committee of the Securities Exchange Commission (SEC)³ in the United States of America approved recommendations for the SEC to update requirements for reporting on environmental, social and governance (ESG) factors.

The comments by the IMF, the IOSCO, and the SEC reflect the concerns of their stakeholders more broadly. In response, the IFRS Foundation issued a Consultation Paper in September 2020 to identify the level of demand from stakeholders in the area of sustainability reporting and ascertain how the IFRS Foundation might best respond. The survey confirmed the urgent need to improve the consistency and comparability of sustainability reporting through a set of comparable and consistent standards.

Responding to the demand



In early February 2021, the IFRS Foundation announced its intention to proceed further with exploring the establishment of a Sustainability Standards Board (SSB) with a view to producing a definitive proposal by the end of September 2021.

Subsequently, in late February 2021, IOSCO⁴ indicated its intention to work with the IFRS Foundation Trustees in their consideration of establishing an SSB which would sit alongside the International Accounting Standards Board (IASB) under its existing governance structure with a view to promulgating sustainability disclosure standards.

In March 2021, the SEC invited public input into the examination of its disclosure rules⁵ to ascertain whether the present rules facilitate the disclosure of consistent, comparable and reliable information on climate change. In so doing, the SEC will consider the advantages and disadvantages of developing a single set of global standards applicable to companies around the world, including US companies, and if so, which set should be selected.

Also in March 2021, the UK Department for Business, Energy and Industrial Strategy (BEIS) issued a consultation paper⁶ seeking views on proposals to require mandatory climate-related financial disclosures from public companies, large private companies and Limited Liability Partnerships and noted its support for the IFRS Foundation developing sustainability-related reporting standards.

More recently in April 2021, the European Union (EU) announced its intention to revise its Corporate Sustainability Reporting Directive⁷ to include the adoption of sustainability reporting standards. These standards are to be developed by the European Financial Reporting Advisory Group (EFRAG), which has previous experience in advising the EU on IFRS and working closely with the IASB.

[3] Page 3 of May 2020 Minutes of Meeting, Securities and Exchange Commission Investor Advisory Committee.

<https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac052120-minutes.pdf>

The full recommendation is available here: <https://www.sec.gov/spotlight/investor-advisory-committee-2012/esg-disclosure.pdf>

[4] IOSCO sees an urgent need for globally consistent, comparable, and reliable sustainability disclosure standards and announces its priorities and vision for a Sustainability Standards Board under the IFRS Foundation, IOSCO Media Release, 24 February 2021.

<https://www.iosco.org/news/pdf/IOSCONEWS594.pdf>

[5] Public Input Welcomed on Climate Change Disclosures, U.S. SEC, Public Statement, 15 March 2021.

<https://www.sec.gov/news/public-statement/lee-climate-change-disclosures>

[6] Consultation on requiring mandatory climate-related financial disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships (LLPs), Department for Business, Energy & Industrial Strategy, United Kingdom, 24 March 2021.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/972422/Consultation_on_BEIS_mandatory_climate-related_disclosure_requirements.pdf

[7] Questions and Answers: Corporate Sustainability Reporting Directive proposal, European Commission, 21 April 2021.

https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_1806

Priority for climate related information

Consultation undertaken by the IFRS Foundation indicates that climate-related information is the area of most concern to stakeholders within the broader area of sustainability reporting⁸. Consequently, if the SSB is established, it would initially focus on climate related reporting standards. However, a significant number of stakeholders expressed support for any SSB extending the scope of its standard setting in the longer term to other aspects of sustainability reporting, including the interrelationship between ESG factors.

Basis for future standards

The IOSCO, BEIS and the EU each make reference to a framework developed by the Task Force on Climate-related Financial Disclosures (TCFD) established by the Financial Stability Board (FSB), which is based on four pillars for disclosing climate related risks and opportunities within existing reporting procedures.

The four pillars comprise:



Governance – the organisation’s governance around climate-related risks and opportunities.



Strategy – the actual and potential impacts of climate-related risks and opportunities on the organisation’s business, strategy and financial planning.



Risk Management – the processes used by the organisation to identify, assess and manage climate-related risks.



Metrics and Targets – the metrics and targets used to assess and manage relevant climate-related risks and opportunities.

The TCFD issued a status report⁹ on the adoption of its climate related financial disclosures in October 2020 which indicated that 60% of the world’s largest public companies had disclosed climate related information aligned with its recommendations. Interestingly, the report noted that users identified Strategy information as the most useful although this had the lowest level of disclosure.

[8] IFRS Foundation Trustees' Feedback Statement on the Consultation Paper on Sustainability Reporting, April 2021. <https://www.ifrs.org/content/dam/ifrs/project/sustainability-reporting/sustainability-consultation-paper-feedback-statement.pdf>

[9] 2020 Status Report, Task Force on Climate-related Financial Disclosures, October 2020. <https://www.fsb.org/wp-content/uploads/P291020-1.pdf>

Just making financial reporting more complicated

For those directors who may be sceptical about CRFD on the basis that it will just add more layers to reporting requirements, it may be encouraging to note that there is also a current emphasis on focusing only on relevant information. The April 2021 IASB Exposure Draft *Disclosure Requirements in IFRS Standards—A Pilot Approach* includes proposals that reflect the increasing recognition among stakeholders that the emphasis in mandating disclosure requirements should be increasingly on relevant information which can best be achieved through eliminating irrelevant information. The IASB's proposed new approach to developing disclosure requirements in IFRS is aimed at enabling companies to apply judgement and reduce the disclosure of 'boilerplate' information.

In its invitation to comment the IASB acknowledges that notes to financial statements sometimes include too much irrelevant information through a 'checkbox' approach to disclosure. By minimising requirements to disclose particular information and focusing on disclosing material information only, the financial statements would be more useful.

Proactively embracing the inevitable



The attention which is being paid to CRFD by international bodies such as the FSB, IMF, IOSCO, SEC and EU is indicative of the demand for more relevant information, the nature of which, as in the past, evolves in response to the changing financial landscape and risk environment. It therefore appears inevitable that mandatory reporting of CRFD will be implemented in many countries in the near future with the successful adoption of IFRS providing a blueprint for the establishment of an international sustainability standard setting body.

With the starting point for CRFD likely to be the TCFD framework, an opportunity exists for reporting entities to now proactively incorporate the framework into their existing reporting so that they are better prepared to implement any subsequent mandatory requirements. In doing so, reporting entities have the opportunity to satisfy the increasing demand by investors for not more disclosure, but relevant material disclosure.