UK Endorsement Board

Climate-Related Matters: Summary of Connectivity Research

Executive Summary

Project Type	Research
Project Scope	Limited

Purpose of the paper

This paper is to provide an understanding of the current issues already identified relating to the reporting of climate-related matters in financial statements and connectivity to sustainability disclosures in the narrative reporting sections of the Annual Report. This paper will enable the UKEB to be aware of findings of relevant recent research concerning UK reporting, identify key themes and to identify potential areas of further research.

Summary of the Issue

This represents the first deliverable per the Climate-related Matters Research Project Initiation Plan (PIP)[1].

The paper has been prepared to support the UKEB response to both the ISSB Request for Information (RFI) on its workplan and the IASB's project regarding Climate-related Risks in Financial Statements.

The paper contains the summary of the three key themes found from analysing 24 research reports and articles which commented on issues related to connectivity between climate-related risks as described in narrative reporting and the financial statements. The three key themes are:

- **Connectivity**—Approximately 80% of the reports found an overall lack of connectivity between climate-related narrative disclosures and disclosures in the financial statements.
- **Occurrence and quality**—Approximately 50% of the reports found an increase in the occurrence of climate-related disclosures over time but the quality of disclosures remains low.
- **Estimates and judgments**—Approximately 50% of the reports found that estimates and judgements relating to climate-related disclosures is a critical area of poor connectivity.

1 Climate-related Matters Research Project – UKEB project webpage.

The report does not attempt to comment on any particular causes or solutions to issues identified as these will be considered by other deliverables in the PIP.
Decisions for the Board
1. Do Board members have any questions or comments on the themes noted in the paper? 2. Do the Board members approve the publication of the report on the UKEB website, subject to any amendments requested by the Board?
Recommendation
N/A
Appendices
Appendix A: Climate-Related Matters: Summary of Connectivity Research

Climate-Related Matters: Summary of Connectivity Research

April 2023

Contents

Executive Summary

Key connectivity themes identified by stakeholders

1. The UKEB conducted a desktop review of 24 research reports and articles published since 2020, that comment on climate-related disclosures and their connection with financial statements.

2. The exercise identified three broad themes which are set out below in order of prevalence.

An overall lack of connectivity between climate-related narrative disclosures and their associated disclosures in the financial statements

3. Approximately 80% the reports and articles reviewed noted concerns with a lack of connectivity within Annual Reports. This generally arose as frustration from stakeholders with an abundance of narrative climate-related commentary but with very limited means to link the effect to the financial statements.

While there has been an increase in the occurrence of climate-related disclosures the quality of disclosures remains low

4. Approximately, 50% of the research reviewed noted a significant, and encouraging, increase in the frequency of climate reporting in annual reports over the past two years. However, they also noted that the quality of the disclosures was low and, therefore, not yet decision-useful for users.

More transparency is required regarding climate-related estimates and judgements used to prepare financial statements

5. Approximately 50% of the reports reviewed mention estimates and judgements being a critical area of poor connectivity. Common areas related to overall inconsistency, failure to disclose how (or if) climate-related risks had been reflected and whether (or not) Net Zero commitments were aligned with the estimates, judgements and assumptions used in the financial statements.

Disclaimer

6. Please note that that the content of this report does not represent a UKEB policy position

1. Introduction and approach

The UK Endorsement Board (UKEB)

1.1 The UK Endorsement Board (UKEB) adopts and endorses IFRS Accounting Standards for use in the UK. Before the UK's exit from the EU, the EU Commission was responsible for IFRS Accounting Standards being adopted for use by companies in all Member States.

1.2 After EU Exit, the Government set up the UKEB, an independent body, with specific delegated powers: to adopt international accounting standards for use within the UK, when they meet the statutory criteria; and, to influence the development of a single set of global international financial reporting standards. The UKEB reports annually to Parliament on how it has performed its delegated functions.

1.3 The UK Government's 'Green Finance Roadmap'[1] set out the commitment to adopting the IFRS Sustainability Disclosure Standards for use by the UK registered entities. This commitment was a core component of the economy wide 'Sustainability Disclosure Requirements' (SDR) regime.

1.4 As such, like many other jurisdictions, the UK Government intends to establish a framework for the endorsement and adoption of IFRS Sustainability Disclosure Standards.

1.5 In the UK, no single organisation has yet been delegated a statutory function to consider and adopt IFRS Sustainability Disclosure Standards for use in the UK. Work to develop the necessary framework is ongoing.

1.6 Therefore, in the meantime, the UK Government, has asked the UKEB, the Financial Conduct Authority (FCA) and the Financial Reporting Council (FRC) to engage with the International Sustainability Standards Board (ISSB) and to respond to their consultations, according to their respective regulatory objectives and functions[2].

1.7 Accordingly, the UKEB is assisting the UK Government by carrying out work in this area to consider the overlap or impact of the proposed ISSB IFRS Sustainability Disclosure Standards with IFRS Accounting Standards.

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1 Greening Finance: A Roadmap to Sustainable Investing, October 2021.

2 Letter from Lord Callanan to the ISSB regarding exposure drafts IFRS S1 and IFRS S2, August 2022.

International Sustainability Standards Board (ISSB)

A new sister board to the IASB

1.8 At the twenty sixth Conference of the Parties (COP 26), the IFRS Foundation announced the establishment of the ISSB, as a ‘sister’ board to the IASB. The purpose of the ISSB is to develop a comprehensive global baseline of high-quality sustainability disclosure standards to meet users’ information needs.

1.9 The IFRS Foundation had consulted on the ISSB’s establishment and found strong support for the proposals from stakeholders. The ISSB was considered to be the most appropriate body to issue global international sustainability disclosure standards as working with the IASB, under the IFRS Foundation’s due process, both boards could ensure that standards developed would lead to companies providing cohesive, comprehensive and consistent reports and disclosures.

1.10 The objectives of the IFRS Foundation, as set out in its Constitution, are to develop, in the public interest, through both its boards, high quality, understandable, enforceable, and globally accepted standards for general purpose financial reporting, based on clearly articulated principles.

1.11 The IASB is responsible for developing accounting standards and the ISSB is responsible for developing sustainability disclosure standards. These complementary sets of IFRS Standards are intended to result in the provision of high-quality, transparent, and comparable information in financial statements and in sustainability disclosures that are useful to investors and other participants in the world’s capital markets in making economic decisions.

IFRS Sustainability Disclosures Standards

1.12 Since COP 26, the ISSB has developed and issued two Exposure Drafts (ED):

a) IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* (General Requirements Exposure Draft) requires entities to disclose information about all their significant sustainability-related risks and opportunities; and

b) IFRS S2 *Climate-related Disclosures* (Climate Exposure Draft) which focuses on climate-related risks and opportunities.

1.13 While the ISSB incorporated the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) into both standards, the requirements of [draft] IFRS S2 are more granular than the TCFD recommendations. In March 2022, the ISSB published a comparison of the key differences between the requirements in the EDs and the TCFD’s recommendations[3]. The draft standards

[3] Comparison: [Draft] IFRS S2 Climate-related Disclosures with the TCFD Recommendations, March 2022.

also include metrics, tailored to industry classifications, derived from the industry-based SASB Standards.

1.14 Since the issue of the two EDs, the ISSB has redeliberated the comments received and made several tentative decisions to amend the proposals[4]. The ISSB has indicated that it intends to finalise both standards in the first half of 2023 and that their effect date will be 1 January 2024.

1.15 The ISSB made a recent tentative decision[5] to delay the application of [draft] IFRS S1 to enable entities to focus their efforts on ensuring they can meet investor information needs regarding [draft] IFRS S2. However, entities will still be required to provide full reporting on sustainability-related risks and opportunities, beyond climate, from the second year of reporting.

ISSB Agenda Priorities

1.16 For the ISSB's first consultation on its agenda priorities, it is intending to determine its agenda topics for the next two years. At present it is expected to comprise four topics[6]:

a) biodiversity, ecosystems and ecosystem services;

b) human capital;

c) human rights; and

d) a joint project with the International Accounting Standards Board (IASB) on connectivity in reporting, building on the IASB's Management Commentary project and the Integrated Reporting Framework (the 'connectivity project').

1.17 Subject to the ISSB's consideration and approval, at its April 2023 meeting, the RFI will be published in May 2023, and the comment period will end in September 2023.

1.18 The ISSB will encourage stakeholder feedback primarily via electronic survey, rather than following the IASB approach of inviting open comment letters, to facilitate a timelier analysis of feedback. The ISSB staff intend to present an analysis of the RFI feedback in the fourth quarter of 2023.

4 ISSB Updates.

5 ISSB decides to prioritise climate-related disclosures to support initial application, (April 2023).

6 ISSB Staff Paper Consultation on Agenda Priorities (March 2023).

International Accounting Standards Board (IASB)

IASB and climate-related matters

1.19 IFRS Accounting Standards require companies to consider all risks in their financial statements, including climate related risks, when their effect may be considered material to investors. This was initially clarified in the article 'IFRS Standards and climate-related disclosures'[7], and later, through educational material 'Effects of climate-related matters on financial statements' (November 2020)[8].

1.20 However, based on the feedback to the Third Agenda Consultation[9] in July 2022, the IASB established a maintenance pipeline project entitled 'Climate-related Risks in Financial Statements'. This project is intended to consider stakeholder concerns from the consultation such as:

a) why companies that are expected to be impacted by climate related risks do not disclose information about the effects in their financial statements;

b) why companies that make net zero commitments do not recognise liabilities or impairments; and

c) how companies can factor long-term uncertainties into the measurement of amounts in the financial statements.

1.21 At the IASB's March 2023 meeting[10] it agreed to activate this project now that the ISSB has finished its redeliberations on draft IFRS S1 and S2, so there is a stable platform for the IASB to use. The IASB project will explore whether and, if so, how financial statements can better communicate information about climate-related risks. As a maintenance project, the project outcome will be narrow in scope i.e., any amendments to IASB Standards will be minor.

1.22 The project is currently researching the potential causes of stakeholder concerns relating to climate-related risks in the financial statements. These include:

a) unclear or insufficient requirements in IASB Standards;

b) lack of compliance with current requirements by companies; and

c) investor information needs that go beyond the objective of financial statements.

1.23 The IASB intends to leverage the work of the ISSB and consider questions such as:

a) whether to cover climate-related opportunities, as well as risks;

7 IFRS Standards and climate-related disclosures' (November 2019).

8 Effects of climate-related matters on financial statements' (November 2020).

9 Third Agenda Consultation: Feedback Statement (July 2022).

10 IASB Staff paper: Agenda reference 14 Climate related Risks in the Financial Statements (March 2023).

b) whether the IASB should cover all sustainability risks or only climate;

c) how scenario analysis could be considered when measuring assets and liabilities in the financial statements; and

d) whether connectivity mechanisms used in the ISSB Standards could be mirrored in IASB Standards. For example, using consistent assumptions and explaining connections between the sustainability information and financial statements.

Connectivity between the IFRS boards

1.24 The IASB Chair, Andreas Barckow, and ISSB Chair, Emmanuel Faber, co-authored an article[11] explaining how the two boards will work together to produce holistic, comprehensive and coherent general purpose financial reports.

1.25 They note that investors are interested to see how matters reported in financial statements and sustainability financial disclosures are connected. Examples provided of tangible connectivity products include:

a) The many concepts and terms used in IASB and ISSB standards.

b) The requirement, in [draft] S1, to provide sustainability related financial disclosures as part of the financial report.

c) The requirement, in [draft] S1 and S2 for companies to explain how sustainability and climate related risks and opportunities are reflected in financial statements and use assumptions consistent with the financial statements.

d) The IASB new project on Climate-related Risk in the Financial Statements, that will use learnings from the ISSB's work in S1 and S2.

1.26 The article explains that, to achieve connectivity in products, the IASB and ISSB are building connectivity into their processes. Engagement between the boards will enable them to identify and address common issues and to identify opportunities to use common language and concepts.

1.27 The ISSB, in its forthcoming agenda consultation, will request feedback on whether it should undertake a project that moves beyond connecting the information in the financial statements and sustainability-related financial disclosures to closer integration in reporting (i.e. 'integrated reporting'), and how such project could be undertaken.

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11 Connectivity—what is it and what does it deliver? (March 2023).

UKEB project background and methodology

Background

1.28 The aim of the UKEB report is to build awareness of connectivity matters by reviewing recent research, with a focus on climate-related disclosures and their connectivity to the financial statements of UK listed entities.

1.29 The outcome of the research is to develop a body of evidence which identifies potential disconnects between TCFD and Streamlined Energy and Carbon Reporting (SECR) narrative disclosures and the disclosure of the associated financial effects, as appropriate, in the financial statements with a focus on UK Annual Reports.

1.30 This research is consistent with the UKEB's statutory functions, as well as the request from the UK Government for the UKEB to carry out additional work regarding the connectivity between the [draft] IFRS Sustainability Disclosure Standards and the IFRS Accounting Standards.

1.31 The evidence gathered will help the UKEB to obtain insight into UK entities existing experience of reporting on climate-related matters, by using TCFD as a proxy for [draft] IFRS S2 *Climate-related Disclosures*. This will support the UKEB to provide evidence-based responses to both the IASB, on its project on climate-related Risks in Financial Statements, and to the ISSB, on its RFI on its future agenda. The report does not attempt to comment on any particular causes or solutions to issues identified as these will be considered separately.

1.32 Please note that that the content of this report does not represent a UKEB policy position.

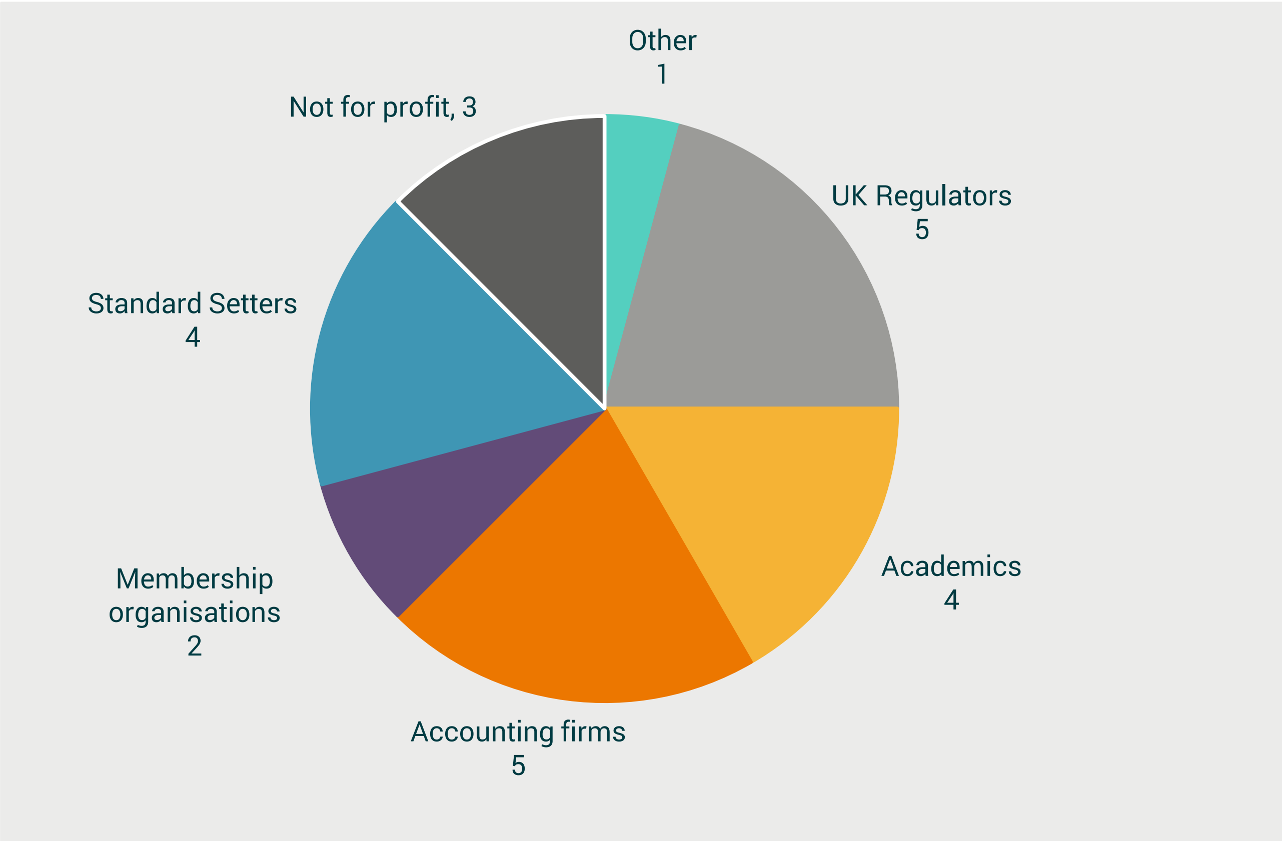
Methodology

1.33 This report is a summary of connectivity themes identified through desk-based research of reports and articles published since 2020, which included consideration of connectivity between climate-related disclosures and financial statements.

1.34 In addition to literature searches undertaken by the UKEB Secretariat, the Secretariat also contacted several academics (including members of the UKEB Academic Advisory Group) to assist in identifying relevant academic research. Only a limited number of academic papers were identified. This was consistent with the expectations of the academics we spoke to, who identified that this is still a relatively new research topic.

1.35 The diagram below illustrates the reports and articles, reviewed by type of author and Appendix A provides the links to the documents.

24 Research reports and articles reviewed



2. UK context

Current UK Reporting Framework

IFRS Accounting Standards requirements

2.1 The Companies Act 2006 sets out the duty for UK registered entities to produce individual and group accounts, and the applicable accounting framework to be used.

2.2 Public companies listed on a regulated market in the UK must use UK-adopted international accounting standards for their group accounts. Private companies, above the small company threshold, may also choose to produce their accounts using international standards. Around 14,000 UK registered private companies report under these standards on a voluntary basis.

2.3 The UK Endorsement Board (UKEB) adopts and endorses IFRS accounting standards for use in the UK.

Narrative reporting requirements

2.4 In the UK, the reporting requirements for registered entities are set out in Company Law. Since 2013, the Companies Act 2006 has required all large and medium-sized UK registered entities to file a Strategic Report as part of their publicly available Annual Report. Quoted companies are additionally required to include information about environmental matters (including the impact of their business on the environment), their employees and social community and human rights issues.

2.5 In 2018, legislation[12] came into force which implemented the Government's policy on SECR. The legislation requires all UK quoted, large unquoted and large limited liability partnerships (LLPs) to report on their energy use and greenhouse gas emissions.

2.6 Under its Listing Rules, the FCA mandated climate reporting for premium listed companies, for accounting periods beginning on or after 1 January 2021. These initial requirements to report against the recommendations of the TCFD were introduced on a comply or explain basis.

2.7 In January 2022, The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022[13] extended the requirement to provide TCFD disclosures to all large companies & LLPs, of which there are over 1,300 for financial years starting on or after 6 April 2022.

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12 The Companies (Director's Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018.

13 The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022.

2.8 To help ensure that UK and global investors, and other stakeholders have access to consistent, relevant and reliable information on how companies are addressing sustainability matters, the UK remains committed to an international approach to sustainability reporting.

3. Key connectivity themes

3.1 The desktop review of twenty-six recent research reports and articles commenting on climate-related risks and their connections with financial statements indicated four broad themes. In order of prevalence, these were:

a) **Connectivity:** the level of connectivity between climate-related narrative disclosures and the disclosures in the financial statements.

b) **Occurrence and quality:** an increase in the frequency but not quality of climate-related disclosures.

c) **Estimates and judgements:** a lack of transparency regarding the use or impact of climate-related matters in the estimates and judgements used to prepare financial statements.

3.2 These three areas are discussed in more detail in the section below. Due to the range of reports and articles published by stakeholders, for ease of reference, within each section includes an overall high-level summary and then comments on relevant research from stakeholders in the following order:

a) Standard Setters.

b) Regulators.

c) Membership organisations.

d) Accounting firms.

e) Academics.

f) Not for Profit.

g) Other.

1. Connectivity

3.3 This section notes comments made in relation to the connectivity between climate-related disclosures and TCFD and the financial statements prepared under IFRS Accounting Standards. The highlighted box below summarises the feedback noted at an overall and stakeholder level.

Connectivity section summary

Approximately 80% the reports and articles reviewed noted concerns with a lack of connectivity within Annual Reports. This generally arose as stakeholders found an abundance of narrative climate-related commentary but had very limited means to link this to the financial statements.

- **Standard Setters** noted the importance of connectivity between climate-related disclosures and the financial statement and recognised that it was a topic of interest to their stakeholders.
- **Regulators and Membership organisations** noted a common challenge of over-disclosure in the front half of Annual Reports and under-disclosure in the financial statements.
- **Accounting firms** shared this observation, as well as noting a lack of medium- and longer-term considerations or use of voluntary disclosure to support users understand the differences between sustainability information and financial information.
- **Academics** noted poor disclosure behaviours and an inherent lack of connectivity between climate-related disclosures with information in their financial statements and that due to this the TCFD may not be a useful proxy for firms' climate commitments.
- **Not for profit** research indicated that there was a poor level of connectivity with the financial statements as most climate-related assumptions and estimates were not visible in the financial statements.
- **Other** no specific observations noted.

Standard Setters

3.4 The Chairs of the IASB and ISSB published an article[14] noting the importance of connectivity between the IASB and ISSB products and processes.

3.5 In addition, the IASB staff paper[15] noted that stakeholders have been asking for greater clarity about how sustainability-related risks and opportunities disclosed in

14 Connectivity—what is it and what does it deliver? ISSB and IASB Chairs (March 2023)

15 Climate-related Risks in the Financial Statements (March 2023)

applying IFRS Sustainability Disclosure Standards would connect with and interact with the financial statements.

Regulators

3.6 In November 2020, the FRC published a Climate thematic[16] which noted an increase in the number of companies providing a minimum level of narrative reporting on climate-related issues. The report noted that:

a) Entities should consider whether the 'annual report and accounts, taken as a whole, presents a consistent message about the most significant risks presented by climate change, and includes all information that may be material for decision making'.

b) Only a quarter of companies sampled had made any reference to climate change in their financial statements, although almost all had addressed climate change in their narrative reporting.

c) It was generally unclear how forward-looking assumptions and judgements applied in preparation of the financial statements were consistent with narrative discussion of climate change in the strategic report.

d) There were apparent inconsistencies where uncertainties associated with climate change could reasonably have been expected to have had a significant impact on the financial statements but had not been disclosed.

3.7 The report concluded that consideration and disclosure of climate change in financial statements was lagging narrative reporting and that users expected to see disclosures regarding the financial implications of climate change.

3.8 The FRC published a second Thematic review of Task Force on Climate-related Financial Disclosures (TCFD) and climate in the financial statements[17] and found mixed results. For example, in relation to impairment reviews, the FRC report noted that, while several entities had disclosed when climate change had not impacted certain assets useful economic lives, others had only provided generic statements regarding impairment impacts. This made it unclear if, or how, climate risk had been reflected in cash flow projections or discount rates.

3.9 In other instances, some entities had provided insufficient detail in their financial statements, when compared to extensive disclosures about climate-related risks and opportunities in their Strategic Reports. It was observed that one entity had referred to climate change over 100 times in the front half of their Annual Report but then made no reference to it within the financial statements.

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16 FRC Climate Thematic Review (November 2020).

17 FRC Thematic Review of TCFD and climate in financial statements (July 2022) The FRC selected 25 FTSE premium listed companies reporting in accordance with TCFD framework and under the Financial Conduct Authorities (FCA) listing rules. The FRC report included a specific section (section 8) on connectivity and noted that the FRC expected companies to consider connectivity between TCFD disclosures and financial statements when preparing financial statements.

3.10 The FRC advised that it expected preparers to consider if narrative reporting disclosures were consistent with the judgements and estimates in the financial statements and that it would challenge entities disclosing significant climate risks or net zero transition plans with no explanation of how that had been considered when preparing their financial statements.

3.11 In March 2023, the FRC Corporate Reporting Review (CRR) team published their public case summaries noting four cases[18] where the regulator had raised queries regarding climate-related risk disclosures. These cases referred to disclosures concerning the following topics:

a) significant sources of climate-related estimation uncertainty and in relation to the impairment of assets;

b) the relative impact and uncertainty of disclosed climate-related risks and opportunities;

c) climate targets and ambitions; and

d) statement of consistency with the TCFD Recommendations.

3.12 All cases (since closed) referred to 2021-year end reporting and involved an exchange of substantive correspondence between the regulator and the entity.

Membership organisations

3.13 IOSCO's Sustainable Finance Taskforce (SFT)[19] concluded that investor demand for sustainability-related information was not being properly met. In relation to connectivity issues, the report noted:

a) There was often a disconnect between sustainability information, either in the narrative sections of companies' annual reports, or separate publications, and the companies' financial statements.

b) Financial Statements often failed to reflect material sustainability information due to a lack of consistency in content and a mismatch in timing between the separate publications.

3.14 The ESMA statement[20] communicated that consistency between IFRS financial statements and non-financial information is a priority area for 2022 Annual Financial Reports.

18 CRR Case summaries (March 2023).

19 IOSCO Report on Sustainability-related Issuer Disclosures (2020) IOSCO's fact finding report aimed to determine (1) what sustainability information investors sought to inform their investment decisions and (2) to identify any gaps in the information investors and other stakeholders are currently receiving.

20 ESMA: PUBLIC STATEMENT European common enforcement priorities for 2022 annual financial reports (October 2022).

Accounting Firms

3.15 PwC research observed[21] that the front half of Annual Reports often included significant content on climate change but then there was often little or no mention of this in the financial statements. Recognising that there can be valid reasons for this apparent disconnect, they also noted that this type of explanation is not often provided by entities to investors.

3.16 The research found a lack of quantified financial impact disclosures from climate-related matters. Only 8% of companies in their sample had quantified the financial impact of physical and transitional risks. They also found that while climate change was particularly relevant to impairment reviews, especially in high carbon emitting sectors, little information was generally provided regarding any climate-related risk assumptions used in the financial statements.

3.17 PwC research also noted that TCFD financial disclosures tended to focus on the materiality of climate change related to the current balance sheet. They emphasised that the TCFD framework actually requires entities to consider the potential impact of climate-related issues on future financial performance and position but found little evidence of this in their sample.

3.18 In an earlier report, PwC[22] noted that investors look to entities to explain the meaning, relevance, and effect of ESG issues on their business. However, the quality of information, regarding plans for reaching environmental and social commitments, as well as progress towards ESG targets, was lacking. The report also commented that while investors have high expectations of sustainability-related reporting, their information needs are not currently being met, as one-third of investors classed the current quality of ESG reporting as poor.

3.19 A Deloitte report[23] observed that there can be an actual or perceived lack of connectivity between published climate commitments, such as TCFD disclosures, and the financial statements. In some circumstances, this can contribute to a perception that 'words are hollow' until they change the numbers. The conceptual difference was highlighted between the narrative disclosures, which communicate an entity's future intentions, and historic financial reporting, which was designed to primarily show the effects of past transactions and events.

3.20 This report suggested that additional voluntary disclosures could be considered by preparers to help users understand why stated or expected actions are, validly, not yet reflected in the financial statements.

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21 PwC Report: The green shoots of TCFD reporting - An analysis of the first 50 companies to report under the Listing Rules (May 2022) PwC reviewed the first 50 Annual Report by FTSE 350 companies under the new FCA Listing Rules requirement to report against TCFD recommendations.

22 PwC's Global investor survey: The economic realities of ESG (December 2021).

23 Deloitte: A Closer Look Investor demand for corporate reporting in line with the Paris Agreement on climate change (March 2022)

3.21 A KPMG report[24] noted that when climate change or climate-related risks were mentioned in the financial statements, it was mostly included in significant estimates and judgements in relation to the impairment of plant, property and equipment and goodwill. However, based on the limited level of disclosure in the financial statements, they concluded that 'for many UK reporters their Annual Reports have net zero in the front, but zero detailed climate disclosures in the financial statements'.

Academics

3.22 A joint report by ACCA and University of Glasgow Adam Smith Business School[25] compared climate-related and financial disclosures between 2019 to 2020 reports for a sample of entities in the construction materials and chemical industries. They noted that, overall, entities poor disclosure behaviour had not changed dramatically.

3.23 The ACCA and University of Glasgow Adam Smith Business School[26] conducted further research on these industries and identified they were least prepared for the financial statement disclosures and noted the importance of these disclosures as a connection between the 'front and back' of an entity's annual reports. The analysis noted that the entities 'appear not to inherently connect climate-related disclosures with information in their financial statements.'

3.24 Brendan O'Dwyer & Jeffrey Unerman[27] noted that there are currently significant discrepancies between the way in which material issues are identified and disclosed in mainstream corporate financial reports and in sustainability reports. They note that a key issue underlying materiality is how climate-related financial disclosures can be integrated into a mainstream corporate reporting model that might insufficiently cater for them. They note the risk that the TCFD's advice to adopt the approach to materiality that is applied to a corporation's mainstream financial reporting might result in limitations being transferred to the TCFD reporting.

24 KPMG Report: Is Transparency on Track? (November 2022) KPMG reviewed Full Year 2021/2022 ESG disclosures of a sample of 100 companies included 58 FTSE100, 16 FTSE250, 16 private, and 10 other reporters.

25 ACCA and University of Glasgow Adam Smith Business School Climate change risk-related disclosures in extractive companies (August 2021). The research used a sample 56 entities 2019 and 2020 annual reports from extractives industries (which included 6 UK entities). The objective was to explore the depth and integration of climate change related disclosures by companies in extractive industries with the accounting policies and financial reporting and to compare them with the previous year's level of disclosure.

26 ACCA and University of Glasgow Adam Smith Business School - Companies' readiness to adopt IFRS S2 Climate-related disclosures (August 2022). The objective of the research was to compare construction materials and chemicals companies current reporting practices with those proposed by the ISSB's ED IFRS S2 and gauge the extent of their 'preparedness'. The analysis was based reporting packages of 100 companies for year 2018-2020: 50 of the largest emitters worldwide from each of the two industries (including three FTSE 350 entities).

27 Shifting the focus of sustainability accounting from impacts to risks and dependencies: Researching the transformative potential of TCFD reporting Brendan O'Dwyer & Jeffrey Unerman (Accounting, Auditing & Accountability Journal) (May 2020).

3.25 The Swiss Finance Institute[28] research noted that there was a current lack of standardisation and precision in climate risk disclosures, resulting in concerns that entities were not providing sufficiently granular and decision-useful information in their climate-related reporting. They concluded that investors, financiers, and societal stakeholders considered that the available climate-related disclosures were not decision-useful, comparable, nor complete. They concluded that currently the TCFD framework was not a useful proxy for firms' climate commitments.

Not for profit

3.26 Carbon Tracker published a research report[29] in 2021, regarding the extent to which entities had disclosed climate risks within their financial statements and reached similar conclusions finding:

a) little evidence that companies had incorporated material climate-related matters into their financial statements;

b) that most climate-related assumptions and estimates were not visible in the financial statements; and

c) that most companies did not tell a consistent story across their reporting.

3.27 The Climate Action 100+[30] report found that the quality and quantity of entities' decarbonisation strategies and plans remained 'alarmingly low' and that there continues to be widespread failure to integrate climate risks into accounting practices.

28 How Cheap Talk in Climate Disclosures relates to Climate Initiatives, Corporate Emissions, and Reputation Risk Swiss Finance Institute Research Paper Series N°22-01 (January 2022).

29 Flying blind: The glaring absence of climate risks in financial reporting (September 2021) This report assessed 107 publicly listed carbon-intensive firms (including 36 European and UK companies).

30 Climate Action 100+ Net Zero Company Benchmark Interim assessments (October 2022) 159 of 166 high emitting entities were assessed in this research based on progress against the three engagement goals of Climate Action 100+ and a set of key indicators related to business alignment with the goals of the Paris Climate Agreement.

2. Occurrence and quality

3.28 This section notes comments made in relation to the occurrence and quality climate-related disclosures and their connection with financial statements. The highlighted box below summarises the feedback noted at an overall and stakeholder level.

Occurrence and quality section summary

Approximately, 50% of the research reviewed noted a significant, and encouraging, increase in the frequency of climate reporting in annual reports, over the past two years. However, they also noted that quality of the disclosures was low and, therefore, not yet decision-useful for users.

- **Standard Setters** found poor connectivity in relation to connections between various elements of report.
- **Regulators** noted improvements on prior period disclosures but a lack of useful information. The lack of connectivity is an active area of investigation.
- **Accounting firms** found disclosures had increased but were generally brief and rarely included financial quantification.
- **Academics** noted poor quality disclosures, a lack of preparedness by entities and continued disconnects with financial reporting.
- **Not for profit** identified incremental progress but found that there was limited evidence that climate change issues were being considered in the preparation of financial statements.
- **Other** (TCFD) found that not enough companies were disclosing decision-useful climate-related financial information, which may hinder investors, lenders, and insurance underwriters' efforts to appropriately assess and price climate-related risks.

Standard Setters

3.29 The European Reporting Lab[31] review of climate-related disclosures found poor connectivity in relation to connections between various elements of report and references to supporting information elsewhere (such as a sustainability report, or greenhouse gas report).

31 How to improve climate-related reporting Supplement 1: Climate-related reporting practices European Reporting Lab @EFRAG (February 2020).

Regulators

3.30 The Financial Conduct Authority (FCA) found an overall improvement in the completeness and consistency of disclosures with the TCFD framework following their regulatory intervention[32]. That is, more companies since 2020 were making disclosures that were either partially or mostly consistent with the TCFD framework. Reporting gaps were in respect to quantitative elements e.g., scenario analysis and metrics and targets.

3.31 The FRC's initial Climate thematic[33] noted an increase in the number of companies providing narrative reporting on climate-related issues and their follow up thematic noted that significant progress had been made on climate reporting[34]. However, the second thematic concluded that connectivity between TCFD and financial statements disclosures was generic in nature, tended not to be company specific, and that only a small portion of companies had disclosed the impact of climate change on amounts recognised in the financial statements.

Accounting Firms

3.32 A KPMG report noted[35] that more companies were including relevant climate information in their financial statements, but that the disclosures were generally brief and rarely included any financial quantification.

3.33 A PwC report found[36] that, while 78% of companies referred to climate change in their financial statements (also noting a significant increase from only 22% observed in the FTSE 350 by PwC in the prior year), disclosures were often brief and high level.

3.34 A Deloitte report[37] found that that 90% of their sample of premium listed commercial companies had clearly identified statements of compliance with TCFD but that there was a 'spectrum' of approaches taken.

32 FCA review of TCFD-aligned disclosures by premium listed commercial companies (July 2022) The research consisted of quantitative analysis of the disclosures of 171 premium listed commercial companies that had published their annual financial report by the end of April 2022; and qualitative analysis of the consistency of disclosures with the TCFD framework for a sample of 31 of those companies.

33 FRC Climate Thematic Review (November 2020).

34 FRC Thematic Review of TCFD and climate in financial statements (July 2022) The FRC selected 25 FTSE premium listed companies reporting in accordance with TCFD framework and under the Financial Conduct Authorities (FCA) listing rules. The FRC report included a specific section (section 8) on connectivity and noted that the FRC expected companies to consider connectivity between TCFD disclosures and financial statements when preparing financial statements.

35 KPMG Report: Is Transparency on Track? (November 2022) KPMG reviewed Full Year 2021/2022 ESG disclosures of a sample of 100 companies included 58 FTSE100, 16 FTSE250, 16 private, and 10 other reporters.

36 PwC Report: The green shoots of TCFD reporting - An analysis of the first 50 companies to report under the Listing Rules (May 2022) PwC reviewed the first 50 Annual Report by FTSE 350 companies under the new FCA Listing Rules requirement to report against TCFD recommendations.

37 The new FCA compliance statement on TCFD disclosures: Observations from first reporters (April 2022) Deloitte surveyed the first 30 annual reports published by UK premium listed companies with December 2021 year ends (22 FTSE 100, 7 FTSE 250 and 1 FTSE All share index).

Academics

3.35 Joint research by ACCA and Glasgow University Adam Smith Business School[38] noted that almost 80% of their sample of extractive entities identified climate change as an important issue to be considered within their 2020 business model disclosures.

3.36 However, in a later report[39] it was found that most entities in their construction materials and chemicals sample fell short of the type and level of disclosure that the ISSB has proposed.

Not for Profit

3.37 A Climate Action 100+[40] report found that companies had exceeded their sustainability disclosure expectations by presenting further incremental progress since their March 2022 Benchmark assessments. However, they also noted that the near-term accountability mechanisms and robust plans required to achieve the entities stated climate goals, remained lacking.

3.38 A Carbon Tracker[41] report also concluded that there was still limited evidence that climate change issues were being considered by entities with the most significant greenhouse gas (GHG) emissions when preparing their financial statements. The report found that while companies were setting net zero targets, these were not being reflected in the assumptions or estimates used to prepare entities financial statements.

Other

3.39 The TCFD status report[42] provided an overview of current disclosure practices, in terms of their alignment with the TCFD recommendations. The research indicated that users still required disclosure of the actual and potential financial impacts of climate-related issues.

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38 ACCA and University of Glasgow Adam Smith Business School: Climate change risk-related disclosures in extractive companies – a follow up report (August 2021) The research used a sample 56 entities 2019 and 2020 annual reports from extractives industries (which included 6 UK entities). The objective was to explore the depth and integration of climate change related disclosures by companies in extractive industries with the accounting policies and financial reporting and to compare them with the previous year's level of disclosure.

39 ACCA and University of Glasgow Adam Smith Business School - Companies' readiness to adopt IFRS S2 Climate-related disclosures (August 2022). The objective of the research was to compare construction materials and chemicals companies current reporting practices with those proposed by the ISSB's ED IFRS S2 and gauge the extent of their 'preparedness'. The analysis was based reporting packages of 100 companies for year 2018-2020: 50 of the largest emitters worldwide from each of the two industries (including three FTSE 350 entities).

40 Climate Action 100+ Net Zero Company Benchmark Interim assessments (October 2022) 159 of 166 high emitting entities were assessed in this research based on progress against the three engagement goals of Climate Action 100+ and a set of key indicators related to business alignment with the goals of the Paris Climate Agreement.

41 Still Flying Blind: The Absence of Climate Risk in Financial Reporting (October 2022).

42 Task Force for Climate-related Financial Disclosures: 2022 Status Report (October 2022) The Task Force reviewed the alignment of information included in 1,434 reports from public companies from five regions in eight industries.

3.40 They noted that users were using climate-related financial disclosures in their decision-making (90%) and to price assets or determine rates (66%).

3.41 However, the Task Force also noted concerns from stakeholders that not enough companies were disclosing decision-useful climate-related financial information, which may hinder investors, lenders, and insurance underwriters’ efforts to appropriately assess and price climate-related risks.

3. Estimates and judgements

3.42 This section notes comments made in relation to the estimates and judgements used in climate-related disclosures and their connection with financial statements. The highlighted box below summarises the feedback noted at an overall and stakeholder level.

Estimates and judgements section summary

Approximately 50% of the reports reviewed mention estimates and judgements relating to climate-related disclosures is a critical area of poor connectivity. Common areas related to overall inconsistency, failure to disclose how (or if) climate-related risks had been reflected and whether (or not) Net Zero commitments were aligned with estimates, judgements, assumptions used in the financial statements.

- **Standard Setters** the IASB staff paper noted that for their project Climate-related Risks in the Financial Statements they will leverage the work of the ISSB.
- **Regulators and Membership organisations** noted that while some entities had made appropriate disclosures, investors continued to call for better information in financial statements, including connecting net zero targets to relevant disclosures. The ESMA statement advised that consistency between IFRS financial statements and non-financial information would be a priority area for 2022 annual reports.
- **Accounting firms** noted the lack of disclosure and emphasised the importance of this information to investors.
- **Academics** noted that overall entities low level of disclosure in 2019 had not improved dramatically in 2020.
- **Not for profit** concluded that for entities with significant GHG emissions there remained limited evidence to confirm that climate change issues were considered in the preparation of financial statements.
- **Other** no specific observations noted.

Standard Setters

3.43 In an article published by the IASB Chair, Andreas Barckow[43], he explained how the IASB's project on Climate-related Risks in the Financial Statements will relate to the work of the ISSB. He noted that the IASB could leverage the ISSB's work and consider questions such as how companies use assumptions consistent with the financial statements when applicable and to disclose information about the

43 Connectivity in practice: the IASB's new project on Climate-related Risks in the Financial Statements (March 2023) IASB Chair.

current and anticipated effects of sustainability-related risks and opportunities on the financial statements.

Regulators

3.44 The FRC Lab[44] report noted that investors continued to call for better information in financial statements, including connecting net zero targets to relevant disclosures. Their research found that investors valued information on the uncertainties and assumptions that impact a company's ability to reach net zero emissions, as well as factors that may cause companies to change plans. However, current reporting was not always clear or transparent in this area.

3.45 The FRC Lab findings highlighted the need for companies to disclose specific estimates leading to material adjustment and to quantify key assumptions. The importance of sensitivity disclosures was also highlighted, and the Lab noted that IAS 1 *Presentation of Financial Statements* (paragraphs 122, 125, 129) and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (paragraph 39) provide requirements for these disclosures.

3.46 The initial FRC Climate Thematic[45] noted that Climate change was not generally addressed in disclosures of significant judgements, or about sources of estimation uncertainty which have a significant risk of resulting in a material adjustment within the next financial year. The recognised that while uncertainties associated with climate change can often be resolved over a timeframe greater than 12 months but also that this was not always the case.

3.47 The second FRC thematic[46] found that a few entities in their sample had considered climate change in the context of estimation uncertainty, although some entities had disclosed why it was not considered relevant and some entities had made additional disclosures regarding sensitivities to TCFD scenarios in the financial statements.

3.48 The FRC CRR[47] team raised two queries with a listed company in relation climate-related estimate and judgements. The first related to the relative impact and uncertainty of disclosed climate-related risks and opportunities. The FRC asked the entity to clarify the relative impact of the disclosed climate related risks and opportunities on gross margin. The second related to climate targets and ambitions where the FRC noted that the entities climate transition plan in the annual report included large number of targets and aspirations, but that it was unclear if these are incorporated into budgets, business plans and accounting assumptions.

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44 FRC Lab Report: Net zero disclosures (October 2022) Review of net zero disclosures with participants from a range of UK and international institutional investors, analysts, and retail investors through a series of in-depth interviews.

45 FRC Climate Thematic Review (November 2020).

46 FRC Thematic Review of TCFD and climate in financial statements (July 2022).

47 CRR Case summaries (March 2023.)

Membership organisations

3.49 ESMA[48] communication emphasised that issuers should specifically consider judgements and estimates, provisions, contingent liabilities and contingent assets, and the impairment of non-financial assets when preparing their financial statements.

3.50 IOSCO's Sustainable Finance Taskforce (SFT)[49] also noted similar concerns regarding investor requirements for clarity with the assumptions used to prepare financial statements.

Accounting firms

3.51 A PwC report noted[50] that climate change was particularly relevant to impairment reviews, especially in sectors with high GHG emissions but that little information was provided about the assumptions used relating to climate risk.

3.52 A Deloitte report[51] found that only one entity in its sample of 30 UK listed entities had connected the TCFD scenario disclosure with the relevant judgements and estimates used in the financial statements. It was noted that while this link is not a requirement of TCFD, investors have highlighted the importance of being able to understand the connection to the financial statements.

Academics

3.53 While the joint research by ACCA and Glasgow University Adam Smith Business School[52] noted that a significant proportion of their sample had identified climate change as an important issue there was no significant improvement in recognising climate change as an important factor in judgements and sources of estimation uncertainty, accounting policies on provisions and contingent liabilities, exploration and evaluation assets, tangible and intangible assets, or financial instruments.

3.54 The research did identify a significant increase in the number of entities recognising climate change as a key factor in their policies on impairment testing but only a minority recognised impairment losses where climate change was disclosed as an influential factor. As noted in the authors' 2019 research, none of

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48 ESMA: PUBLIC STATEMENT European common enforcement priorities for 2022 annual financial reports (October 2022).

49 IOSCO Report on Sustainability-related Issuer Disclosures (2020) IOSCO's fact finding report aimed to determine (1) what sustainability information investors sought to inform their investment decisions and (2) to identify any gaps in the information investors and other stakeholders are currently receiving.

50 PwC Report: The green shoots of TCFD reporting - An analysis of the first 50 companies to report under the Listing Rules (May 2022).

51 The new FCA compliance statement on TCFD disclosures: Observations from first reporters (April 2022) Deloitte surveyed the first 30 annual reports published by UK premium listed companies with December 2021 year ends (22 FTSE 100, 7 FTSE 250 and 1 FTSE All share index).

52 ACCA and University of Glasgow Adam Smith Business School: Climate change risk-related disclosures in extractive companies – a follow up report (August 2021) The research used a sample 56 entities 2019 and 2020 annual reports from extractives industries (which included 6 UK entities). The objective was to explore the depth and integration of climate change related disclosures by companies in extractive industries with the accounting policies and financial reporting and to compare them with the previous year's level of disclosure.

the sample entities identified climate-related risks as an important factor in determining the useful lives of its assets in 2020.

3.55 In provisions and contingent liabilities notes, only marginal differences were identified. The authors concluded that, overall, entities disclosure behaviour did not change dramatically from 2019 to 2020.

Not for profit

3.56 Carbon Tracker's initial report was followed up with a second in 2022[53]. The report found that there remained limited evidence to confirm that climate change issues were considered in the preparation of financial statements of the entities with significant GHG emissions. That is, while companies were setting net zero targets, they were not factoring these into the assumptions and estimates used in preparing their financial statements. The key findings in relation to connectivity with financial statements were:

a) nearly all entities assessed provided insufficient information regarding whether climate-related matters were considered in the preparation of financial statements;

b) despite noting that climate risks may impact significant assumptions and estimates, nearly all of the entities assessed did not disclose relevant assumptions and estimates used in the preparation of financial statements;

c) while many entities recognised climate risks as material and indicated that they were taking steps to meet emission targets, climate considerations were not fully reflected in the financial statements; and

d) entities that had set net zero targets did not factor these into assumptions and estimates used in preparing financial statements. Out of 137, only 3 companies provided sensitivities to net zero aligned inputs.

53 Still Flying Blind: The Absence of Climate Risk in Financial Reporting (October 2022) Carbon Tracker reviewed 137 sets of 2021 financial statements and audit reports of the Climate Action 100+ focus companies. The focus companies (45 from UK/Europe) represent the world's largest corporate greenhouse gas emitters.

4. Next steps

4.1 The UKEB Secretariat will continue to develop preparatory information to support the UKEB to form a comprehensive, evidence-based response to the ISSB's RFI and the IASB's project on Climate-related Risks in Financial Statements. This will be achieved via a series of connectivity themed public papers and a deep dive assessment of a sample of annual reports.

Connectivity Papers

4.2 The UKEB Secretariat will continue developing a series of papers on the theme of connectivity between draft sustainability disclosure standards and accounting standards. The topics of past and future papers are shown in the table below, for information.

<table>
<tr><th>UKEB meeting</th><th>Connectivity Topics</th><th>Status</th></tr>
<tr><td>March</td><td>Asset recognition, measurement, and impairment</td><td>Complete</td></tr>
<tr><td>April</td><td>Liabilities and provisions</td><td>In progress</td></tr>
<tr><td>May</td><td>Fair value and measurement</td><td>In progress</td></tr>
<tr><td>June</td><td>Disclosures</td><td rowspan="3">Pipeline</td></tr>
<tr><td>July</td><td>Other considerations</td></tr>
<tr><td>September</td><td>Conceptual Framework</td></tr>
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Appendix A: Research reports and articles reviewed

Ref	Report	Author	Date published
Standard setters' papers and articles			
1.	Climate-related Risks in the Financial Statements – Staff paper	IASB	March 2023
2.	Connectivity—what is it and what does it deliver?	IASB Chair & ISSB Chair	March 2023
3.	Connectivity in practice: the IASB's new project on Climate-related Risks in the Financial Statements	IASB Chair	March 2023
4.	How to improve climate-related reporting Supplement 1: Climate-related reporting practices	European Reporting Lab @EFRAG	February 2020
Regulators' research			
5.	Corporate Reporting Review: Case Summaries	FRC	March 2023
6.	FRC Lab Report: Net zero disclosures	FRC	October 2022
7.	CRR Thematic review of TCFD disclosures and climate in the financial statements	FRC	July 2022
8.	Review of TCFD-aligned disclosures by premium listed commercial companies	FCA	July 2022
9.	Climate Thematic Review	FRC	November 2020
Membership organisations			
10.	European common enforcement priorities for 2022 annual financial reports – Public statement	ESMA	October 2022

Ref	Report	Author	Date published
11.	Report on Sustainability-related Issuer Disclosures	IOSCO	June 2021
Accounting firm publications			
12.	Is Transparency on Track?	KPMG	November 2022
13.	The green shoots of TCFD reporting - An analysis of the first 50 companies to report under the Listing Rules	PwC	May 2022
14.	The new FCA compliance statement on TCFD disclosures: Observations from first reporters	Deloitte	April 2022
15.	A Closer Look: Investor demand for corporate reporting in line with the Paris Agreement on climate change	Deloitte	March 2022
16.	PwC's Global investor survey: The economic realities of ESG	PwC	December 2021
Academic research			
17.	How cheap talk in climate disclosures relates to climate initiatives, corporate emissions, and reputation risk	Swiss Finance Institute Research Paper Series N°22-01	April 2023
18.	Companies readiness to adopt IFRS S2 Climate - related disclosures	ACCA and University of Glasgow Adam Smith Business School	August 2022
19.	Climate change risk-related disclosures in extractive companies – a follow up report	ACCA and University of Glasgow Adam Smith Business School	August 2021
20.	Shifting the focus of sustainability accounting from impacts to risks and dependencies: Researching the transformative potential of TCFD reporting	Brendan O'Dwyer & Jeffrey Unerman (Accounting, Auditing & Accountability Journal)	May 2020

Ref	Report	Author	Date published
Not for-profit publications			
21.	Climate Action 100+ Net Zero Company Benchmark: Interim assessments	Climate Action 100+	October 2022
22.	Still Flying Blind: The absence of climate risk in financial reporting	Carbon Tracker	October 2022
23.	Flying Blind: The glaring absence of climate-risks in financial reporting	Carbon Tracker	September 2021
Other			
24.	Task Force for Climate-related Financial Disclosures: 2022 Status Report	TCFD	October 2022

Contact Us
UK Endorsement Board
1 Victoria Street | London | SW1H 0ET | United Kingdom
www.endorsement-board.uk