Ten considerations for preparing TCFD climate-related financial disclosures

In 2015, the Financial Stability Board (FSB) established the Task Force on Climate-related Financial Disclosures (TCFD) to create consistent and voluntary financial disclosures relating to climate change. The aim is to help investors, lenders, and insurance underwriters accurately evaluate and price climate risks.

As the TCFD framework is mandatory in certain jurisdictions or aligned with their regulations, it is essential to consider the following ten insights while commencing or advancing your climate-related reporting journey. These insights can also be helpful for organisations preparing to implement the International Sustainability Standards Board (ISSB)'s Standards, which are IFRS S1 'General Requirements for Disclosure of Sustainability-related Financial Information' and IFRS S2 'Climate-related Disclosures', as the TCFD recommendations are fully incorporated into them.

1. The reporting journey

Climate-related financial disclosures should be viewed as a journey rather than a destination. Due to the dynamic and developing nature of climate change, ongoing evaluations are necessary to account for its changing progression and updated impacts that arise from scientific data and analysis. We advise entities to disclose efforts made by management towards improving their current state. We believe transparency is key and will assist users in understanding where entities are in their reporting journey.

You can see a good example of this in the 2023 annual report of Smiths Group Plc:

> In FY2024, we plan to continue our progress in reporting against all four pillars of the recommendations and align with the recommendations of the Transition Plan Taskforce (TPT) which is due to be released later this year. This will include conducting a quantitative scenario analysis. More detailed information on FY2024 priorities in reporting against TCFD is outlined in the TCFD summary in our FY2023 Sustainability at Smiths report.

Source: Smiths Group Plc 2023 Annual report, page 47

2. Focus on what is material

The length of the report should be driven by the information that needs to be disclosed. Reports should focus on information that is material (ie information that is necessary for an understanding of an entity's development, performance, position) to the entity's climate-related financial information. Key messages should not be obscured by the volume of reporting. Entities can consider the use of links to reference existing information within the annual report rather than duplicating disclosures.

Based on the Financial Conduct Authority (FCA)'s study of 171 premium listed commercial companies in the UK, regulated companies' disclosures averaged 15 pages, while non-regulated companies' disclosures averaged only 5 pages.

3. Time horizons

Justification for time horizons chosen by the entity should be linked to the overall business strategy and not solely based on addressing climate-related risks and opportunities. The longer-term nature of some climate-related risks and opportunities needs to be considered when setting an entity's time horizon. It is important to note that these timeframes are likely to be much longer than entities have ever considered in the past, as financial timeframes tend to be much shorter. The following factors are helpful when entities are assessing timeframes:

- the life of assets
- budgetary cycles
- the length of financing arrangements
- the profile of the climate-related risks they face
- sectors and geographies in which they operate, and
- the nature of the company's business and operations.

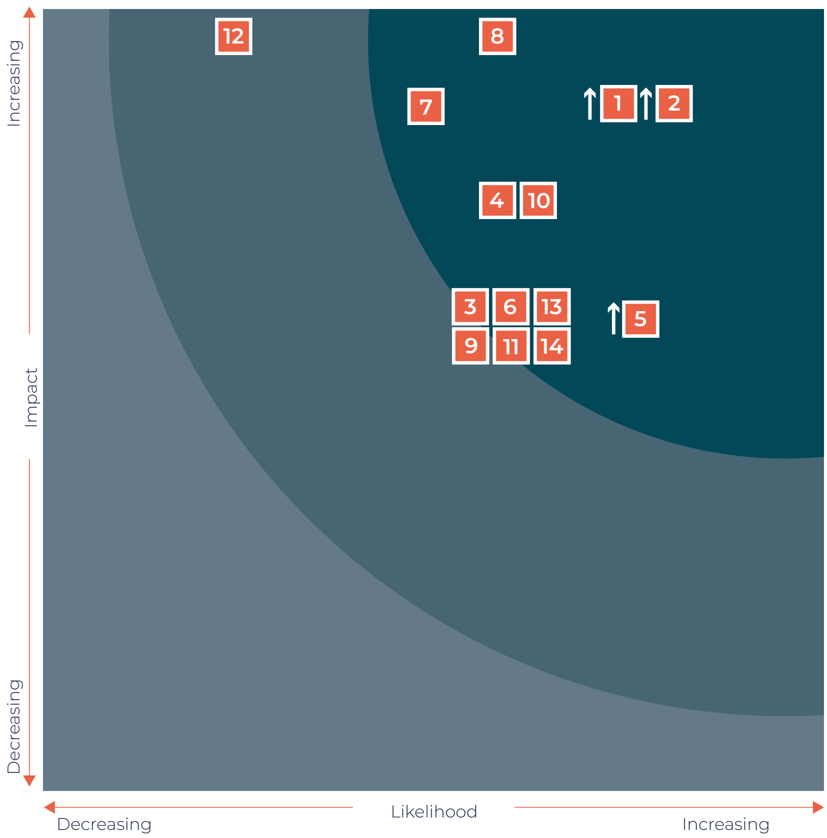
4. Linking to the overall risk management process

Entities are required to disclose how their processes for identifying, assessing, and managing climate-related risks are integrated into their overall risk management. When an entity discloses this integration, there should be a connection between the information disclosed for managing climate-related risks and opportunities and the entity's risk management framework for other principal risk and opportunities disclosed.

You can see a good example of this by DiscoverIE Group plc.

The 2022 annual report of DiscoverIE Group plc includes climate-related risks as part of the Group's strategic risk assessment process. These risks are evaluated based on their likelihood and potential impact across various timeframes.

Risk heat map



1 Instability in the economic environment
2 Business acquisitions underperformance
3 Climate-related risks
4 Loss of key customers
5 Loss of key suppliers / supply
6 Technological changes
7 Major business disruption
8 Cyber security
9 Loss of key personnel
10 Product liability
11 Inventory obsolescence
12 Liquidity and debt covenants
13 Foreign currency
14 Non-compliance with legal and regulatory requirements

KEY
Category of risk:
- Strategic Risk
- Operational Risk
- Financial Risk
- Regulatory/Compliance Risk

Source: DiscoverIE Group plc 2022 Annual Report, page 45

5. Consistency of data on a timely basis

Entities should set targets with a clear definition of the baseline time period against which progress will be tracked. However, just setting these targets is not enough. Entities should also ensure that they have access to data to monitor performance and apply a consistent methodology to support how management is monitoring the achievability of these targets.

6. Events after the reporting period

Disclosures should align with the reporting period of the annual report and should focus on the current state of the entity during the reporting period. However, the climate-related regulatory environment is evolving quickly and therefore it is helpful to disclose information on future changes (planned or executed).

Events that occur after the reporting period could be treated similarly to the way post balance sheet events are presented in the entity's financial statements. For example, a separate note on events after the reporting period or a summary at the end of the relevant section to which the event relates. This will ensure that there is a distinction between activities which relate to the period being reported on and those activities which relate to future periods.

7. Metrics and targets

The existence of the well-established Greenhouse Gas (GHG) Protocol has resulted in widespread familiarity with GHG-related metrics and targets. Virtually every entity discloses GHG emissions as part of their metrics and targets, but it is critical to ensure that there is a clear linkage between the principal climate-related risks and opportunities that have been disclosed, and the corresponding metrics and targets. This linkage will result in cohesive reporting that demonstrates to users that metrics and targets selected by management are relevant to the identified climate-related risks and opportunities. A table may be a clear way to demonstrate the linkage to users.

You can see a good example of this in from the 2023 annual report of Smiths Group Plc, which shows the relationship between metrics and other TCFD recommendations.

MONITORING METRICS AND TARGETS

The table below outlines the key metrics and targets used to monitor climate risks and opportunities. Performance against the majority of these metrics is monitored by the SSE Committee. Further detail, including historical performance, can be found on pages 44 and 45. Our FY2023 Sustainability at Smiths report describes the basis of preparation of our metrics and targets.

	Unit of measure	Metric	Metric target set and reported?	Metric performance for FY2023	Linked to identified climate risks and opportunities
GHG EMISSIONS	tCO_2e	Absolute Scope 1 & 2 emissions	Yes – zero by 2040 with 50% reduction by 2032	(11.8)% reduction year-on-year	Pricing on GHG emissions – tracking our GHG emissions helps us to remain aligned with upcoming regulations and is of value to our customers seeking to reduce emissions in their supply chains.
GHG EMISSIONS	tCO_2e	Absolute Scope 3 emissions	Yes – zero by 2050	(4.8)% reduction year-on-year	Pricing on GHG emissions – tracking our GHG emissions helps us to remain aligned with upcoming regulations and is of value to our customers seeking to reduce emissions in their supply chains.
PHYSICAL RISKS	%	All site business continuity plans to be reviewed annually	Yes, not reported externally	N/A	All identified physical risks – reviewing our site business continuity plans enables us to plan and mitigate against potential physical risks from climate change.
TRANSITION RISKS	%	Revenue from green technologies	No – data to be reported in FY2024	N/A	Monitoring revenue from products with sustainability, including climate, benefits.
TRANSITION RISKS	%	% reduction in normalised non-recyclable waste	Yes – 5% reduction between FY2022 and FY2024	(20.2)% reduction vs FY2021 baseline	Cost and availability of resources – monitoring our reduction in waste and setting targets helps to reduce the resources used by our business.
TRANSITION RISKS	%	% reduction in normalised water use in water-stressed areas	Yes – 5% reduction between FY2022 and FY2024	(17.1)% reduction vs FY2021 baseline	Cost and availability of resources – monitoring our water use and setting reduction targets helps to reduce the resources used by our business.

Source: Smiths Group Plc 2023 Annual report, page 57

8. Scope 3 emissions

Scope 3 emissions captures all the emissions that an entity is indirectly responsible for through its value chain (up and down). The upstream and downstream emissions have been divided into 15 distinct reporting categories in scope 3. The 15 categories in scope 3 are intended to provide companies with a systematic framework to measure, manage, and reduce emissions across a corporate value chain.

Entities should disclose all categories that are applicable and form the basis of the disclosed information. This is important for comparison to targets set and performance of peers, in addition to transparency of metrics reported. Also, entities should provide details of the categories that have been included within the scope 3 emissions they have disclosed.

9. Generic information

Entities should avoid providing general and broad information on climate change. Instead, disclosures should clearly explain the precise effects of climate-related risks and opportunities, taking into account the entity's business model and processes.

10. Transparency and connectivity

Investors and reporting bodies have observed a lack of transparency and connectivity between narrative reporting and climate-related assumptions and estimates. Users of the annual report are demanding better connectivity and transparency between narrative reporting and climate-related assumptions and estimates in annual reports. The judgements, estimates, and assumptions made when evaluating the impact of climate-related risks and opportunities are crucial for assessing and comparing the entity's resilience to climate change.

How we can help

We hope you find the information in this article helpful in understanding the challenges when reporting under the TCFD framework. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact or your local member firm.

Grant Thornton

grantthornton.global