

Otago Business School academics' submission to the XRB Climate Disclosure Standards

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We commend the XRB on a vastly improved draft, which makes a significant leap forward in moving New Zealand towards greater climate-related disclosure. The comparison tables to the TCFD Recommendations and the ISSB Exposure Draft Climate-related Disclosures were extremely useful, although a comparison to the European Union policies would have been very interesting and insightful. The basis for conclusions provided great context and alleviated some concerns that arose while reading the standard.

The supporters of this submission are split into two groups, those that helped write it and those that endorse it, named as 'authors' and 'signatories' above, respectively.

In preparing this submission we have first answered the consultation questions and then give very detailed comments for each of the Climate Standards below.

Responses to Consultation Questions

1. Do you think draft Aotearoa New Zealand Climate Standards will meet primary user needs?

Mostly yes, but double materiality would make the disclosures much more useful to a wider range of primary users, which are currently too narrowly defined. For more details, please see comments on each part of the standards in the next sections.

a. Do you think that the proposed disclosure requirements will provide information that is useful to primary users for decision making? If not, please explain why not and identify any alternative proposals.

Yes certainly, many possible improvements and concerns are outlined in the rest of this submission.

b. Do you consider that the draft Aotearoa New Zealand Climate Standards are clear and unambiguous in terms of the information to be disclosed? If not, how could clarity be improved?

Please see comments in the detailed comments below.

c. Do you consider that draft Aotearoa New Zealand Climate Standards are comprehensive enough and achieve the right balance between prescriptiveness and

principles-based disclosures? If not, what should be removed or added to achieve a better balance? Please consider your answer to question 5 when responding to this question.

Please see comments in the detailed comments below.

2. Do you have any views on the defined terms in draft Aotearoa New Zealand Climate Standards?

In summary, firstly, the scope of the primary users is not broad enough to be defined. Regulators and wider stakeholder groups, such as communities and/or where entities operate, should also be a target audience for these disclosures. Secondly, the External Reporting Board has not defined the terms – “carbon intensity” “aligned with science”, and “materiality”. Future users of the standards will benefit from a better definition of the concepts. Please see detailed comments below.

3. Do you have any practical concerns about the feasibility of preparing the required disclosures in draft Aotearoa New Zealand Climate Standards? In responding to this question, please consider the proposed first-time adoption provisions in NZ CS 2 and your answer to question 4) Please also clearly explain what would make the specific disclosure unfeasible to disclose against either in the immediate term or the longer term.

Managed Investment Schemes (MIS) are going to have an exceptionally more difficult journey as these standards were not really written with them in focus. The model employed by the European Union of separating the Sustainable Finance Disclosure Regulation (SFDR) and the Corporate Sustainability Reporting Directive (CSRD) avoids this issue. More comments on this in our response to Question 5.

4. Do you agree with the proposed first-time adoption provisions in NZ CS 2? Why or why not?

Yes, we agree with the proposed first-time adoption provisions

5. Do you think the draft staff guidance documents will support CREs when making their disclosures and support consistent application of the disclosure requirements? Why or why not?

Generally, both guidance documents are useful, but also both are lacking in detail, for example, the guidance for MIS should include reference to methodologies such as that of the Partnership for Carbon Accounting Financials Global GHG accounting and reporting standards.

- a. *Do you think the guidance is under, adequately or overly specific and granular?*
- b. *As explained earlier as well as in the following sections, we consider the guidance needs to be more specific and granular. Do you consider that anything in the guidance should be elevated into the standard? Should anything be demoted from the standard into guidance?*

Yes, several components should be elevated into the standard. Please see detailed comments below.

6. Paragraphs 13 to 19 of draft NZ CS 3 are the proposed location of disclosures requirements. Paragraphs BC14 to BC20 of the basis for conclusions on draft NZ CS 3 explain the XRB Board’s intent regarding these proposed requirements. Do you agree with the proposed location of disclosures requirements? Why or why not?

Yes, outside of the paragraphs on cross-referencing as these do not have the primary user in mind. This approach could easily be used to make it harder to understand the already complex disclosures.

Detailed comments on each of the standards

Draft NZ CS1

- *Paragraph 11:* It is not fully clear that this reflects the impact on the entity rather than the impact on the planet. It would be worth making this clearer.
- *Paragraph 12:* This paragraph on scenario analysis is quite general. We appreciate that the draft standards are principle-based, but we believe that further guidance on the use of scenarios should be provided. We recommend that the scenarios refer to specific sources of scenarios (i.e. IPCC as used by MfE, Greening the Financial System or IEA scenarios) so that the scenarios are comparable. This would enable comparability and consistency principles described in Table 1 of Draft NZ CS1.
 - IPCC provides Fifth Coupled Model Intercomparison Project (CMIP5) simulations utilized in the Climate Change Projections for New Zealand Report released by the Ministry for the Environment in 2018. The IPCC has now released a more accurate version named CIMP6.
- *Paragraph 14:* Some clarification may be needed around current and anticipated impacts as one could argue that using a forward-looking scenario to assess climate impacts addresses both current and anticipated impacts.
- *Paragraph 20 (b):* There should be a minimum set of industry metrics required, as in the ISSB standards, unless deemed immaterial with reasoning. Disclosing entities can disclose additional metrics if they deem material.
 - The reasoning for not requiring industry-specific metrics given BC 38 and 39 are inadequate.
 - A set of the minimum industry-specific metrics could easily be taken from the work by the TCFD and/or the ISSB.
 - While we again underscore our appreciation for the principle-based nature of the standard we argue that disclosing entities will require significant guidance in meeting the requirements of the standard. If that guidance, such as a minimum set of industry metrics, can come directly from the standard a greater level of comparability can be achieved thereby increasing the usefulness of disclosures for primary users.
 - This is again very important for primary users in respect to the comparability and consistency principles of Draft NZ CS3.

- *Paragraph 21 (a)*: We agree that emissions outside of carbon need to be disclosed in Co2 equivalents, but the conversion factor (global warming potential difference) used, and its source also need to be disclosed.
- *Paragraph 21 (b)*: The type of GHG intensity being referenced should be defined.
 - GHG intensity is essentially a ratio of emissions to a financial metric, measuring emission efficiency. However, to calculate this we could use scope 1, 2 and/or 3 emissions in the numerator and several possible metrics in the denominator, such as Revenues, Total Asset Value, Capital Expenditure, etc.
 - It should be defined within the standard, which intensity, at a minimum, should be disclosed, for the sake of comparability and transparency. Disclosing entities could then disclose more variations, should they choose, if they are relevant to their business.
 - Using different emission intensity calculations results in vastly different values and interpretations, conflicting directly with the comparability principles in Table 1 of Draft NZ CS3.
- *Paragraph 21 (c)*: If the amount of assets or business activities at risk is disclosed, the total amount of assets (given in financial statements) or business activities should also be disclosed, so that primary users can calculate percentages. This is particularly useful for the sake of comparability.
- *Paragraph 21 (g)*: The disclosure on the internal emission price is great, but it should also be disclosed how this is used. If it is just a price value without an explanation of how that is used, what is the use of that information for a primary users? This point is also acknowledged in the ISSB.
- *Paragraph 22 (c)*: The Base year should be defined for sake of comparability and consistency across CREs (two principles outlined in Draft NZ CS3)?
- *Paragraph 22 (c)*: Descriptive progress reporting is important, but so are the metrics used to measure this progress.
 - We suggest the standard requires metrics, some may already be required under the standards, with a potential first-time adoption provision for one year.
 - Leaving this for guidance or future updates is not in line with international developments, i.e. ISSB.
 - Furthermore, reasoning as to why some (if any) targets were not met and what entities are doing to achieve those in the future could be useful for stakeholders.
- *Paragraph 22 (e)*:
 - Offsets can be a legitimate part of a decarbonization strategy, for hard-to-abate emissions, i.e. air travel, and for such emissions offsets and their source should be disclosed.
 - It is important that emissions AND emissions intensity targets are set, not one OR the other.

- The intensity can vary significantly due to the type of business it is and the type of operations it engages in, as the denominator is significantly affected by this (see comment on paragraph 21 (b) above).
 - Further, intensity reductions by are not necessarily due to a decrease in climate impacts and risks as the denominator of the ratio could be changing rather than emissions.
 - “Aligned with science” is very vague, what does this really mean?
 - This is also not defined in the defined terms in appendix A, due to the fast-moving interpretation of what “aligned with science” means (BC46). How do entities disclose in this way when this phrase cannot even be defined?
 - This is better defined by the ISSB standards.
 - Targets should be aligned with the Science-based target initiative or another appropriate framework for defining “aligned with science”.
 - Are the standards only asking for emission targets (rather than targets on other cross-industry metrics)?
- *Appendix A: Primary users do not include regulators or other stakeholders, it should be explained why that is, as these are arguably primary users.*
 - *BC 47: This is a great decision as New Zealand has been relying on offsets too much in many policies and we are glad that is not the case here.*
 - *BC 48: Emissions factors and their sources are important, as this hugely affects how emissions of an entity are estimated. This is an important assumption or part of methodology which should be disclosed under CS3 and is also required in the ISSB draft standards.*
 - *Paragraphs 24 and 25: We acknowledge the appropriateness of the adoption of limited assurance at the early development stage of climate change-related disclosures, but suggest for this to be a first time adoption provision, so that the reasonable assurance is incorporated from the second reporting year onward, rather than after a review of the standards. We also encourage climate change-related reporters to move towards obtaining reasonable assurance on such disclosures. To achieve the latter, further guidance from the New Zealand Auditing and Assurance Board is undoubtedly appreciated and needed to be in place.*

Draft NZ CS2

- *First-time adoption provision 2: Why is there a need for a provision on time horizons? This should not be difficult to disclose. We agree with adoption provision 3, as indeed financial impact will be hard to estimate, although making a judgement on when risks might materialize, at least within a range, should be an easier first step. There is no reasoning for this provision, provided in the basis for conclusions. Understanding the time frames being considered by disclosing entities would be very useful for primary users.*

Draft NZ CS3

- *Table 2 Consistency*: When methodologies and/or circumstances change, that should be explained, but disclosing entities should continue to disclose the value under the old methodology and the new methodology, at least for some time after the change, for the sake of consistency and its implications.
 - In *BC 40* it is mentioned that material errors could be restated, however it is troubling that a valid cause for such errors is “fraud”. It is important that errors are restated, but with explanation and that is in fact an error and not a change in methodology.
 - We disagree with the argument made in *BC41*, as an entity’s progress on climate risk and opportunities will be difficult to judge without consistent metrics across time.

- *Section on Cross-referencing*: This provision seems unnecessary; all climate disclosure information should be in one place for the sake of usability avoiding the process of locating and reading through multiple documents.

- *Section on Materiality*: Allowing entities to avoid certain disclosures within the standards, if they deem that information immaterial, is unadvisable. The disclosures required should be required regardless of the entity’s view on their materiality.
 - If there is additional information the entity deems material, then this should also be disclosed.
 - As it stands these standards would allow reporting entities to avoid all the disclosures if they judged climate change immaterial, defeating the purpose of these standards.
 - The standard may need to provide minimum material issues for each industry and take a prescriptive stance on a minimum standard of materiality. Leaving materiality to the discretion of reporting entities creates opportunities for entities not to report on issues, which may in fact be material to them. We fully appreciate that materiality is best determined by individual entities. However, given the steep learning curve and the lack of reasonable assurance across the standard, a more prescriptive stance on materiality is necessary.

- *Paragraph 37*: Initially reads well, but once we get to the basis for conclusions many issues arise:
 - *BC31 and 32* are somewhat flawed arguments for single materiality being as good as double materiality. The ‘circling back’ argument does not mean double materiality should not be considered. Why would an entity disclose in such a way, when it is incentivised to not disclose more risks than it needs to under these standards? Either the standards are based on single or double materiality, it cannot be both. Double materiality across the standard would be more aligned with the desired outcome of capital being allocated for the transition.
 - *BC33* if the fundamental concept of materiality is whether the information is likely to influence primary users’ decision making then the standard should be based on double materiality. At least some primary users are not only concerned about the impact of climate change on their financial performance, but also about their impact on climate change.

- *BC35* Climate change is about more than just carbon emissions. Using a double materiality definition across the standard would eliminate the need for these arguments of why the standard in its current form is just as good as a double materiality standard.
- *BC37* We don't agree that removing this part of the definition is a good idea. Encouraging long-term thinking is never a bad thing in the context of climate change and enterprise value calculations/modelling often do not incorporate true long-term considerations, but rather 5, maybe 10, year horizons at most.
- *Paragraph 50 (a) (iii)*: The emission reduction pathways should also describe what types of carbon sequestration or offsets are being employed.