

UK Sustainability Disclosure: TAC call for evidence.

Response to the Financial Reporting Council from the Finance & Leasing Association

About the FLA

- The Finance & Leasing Association (FLA) is the UK's leading trade association for the asset, consumer, and motor finance sectors in the UK, and due to the diversity of its membership is the largest organisation of its kind in Europe. Our members include banks, subsidiaries of banks and building societies, the finance arms of leading retailers and manufacturing companies, and a range of independent firms.
- In 2022, members of the Finance & Leasing Association (FLA) provided £150 billion of new finance to UK businesses and households, £51 billion of which helped consumers and businesses buy new and used cars, including 84% of private new car registrations.
- 3. £116 billion was in the form of consumer credit, accounting for over a third of all new consumer credit written in the UK. £34 billion of finance was provided to businesses and the public sector to support investment in new equipment, representing over a third of UK investment in machinery, equipment and purchased software in the UK last year.

Introduction

- 4. We welcome the opportunity to respond to the Financial Reporting Council's call for evidence to the UK Sustainability Disclosure Technical Advisory Committee (TAC), issued in its capacity as TAC secretariat.
- 5. Our response is split into two main sections: The General Comments section considers the broader context around the potential suitability of IFRS S1 and S2 hence forth "the IFRS Standards" for endorsement as the UK Sustainability Disclosure Standards (UKSDS). The second section provides short responses regarding the criteria specified in the call.



General Comments

Support for the IFRS standards

- 6. We support the introduction of the UKSDS and agree that they should form the basis of any future requirements in UK legislation or regulation for companies to report on risks and opportunities relating to sustainability and climate change.
- 7. We further support the endorsement of the IFRS Standards to create the UKSDS. Endorsing the IFRS Standards has a number of advantages, both general and specific.
- 8. It is important to recognise the general point that no set of standards is perfect and that it is far better to have a single "good" set of standards that all agree to use and to stick to it, than continue with the fragmented reporting environment created by choice between competing standards.
- 9. A report in 2016 by KPMG identified 383 sustainability reporting instruments across 64 countries. This is clearly unhelpful when consistency and comparability of information is what is required by users of this information. Having to comply with differing reporting requirements across jurisdictions significantly adds to the burden of reporting.
- 10. More specifically the IFRS standards benefit from the IFRS Foundation's reputation and experience in producing financial reporting standards. Their reputation will encourage uptake internationally.
- 11. The standards benefit from being able to build on established financial reporting practices and experience. Many of the conceptual foundations and general requirements of IFRS S1 are adapted from the IASB's Conceptual Framework for Financial Reporting and the IFRS Accounting Standards. Concepts such as "material information" and "fair presentation" are already well established and widely understood by entities already experienced in financial reporting. This will facilitate implementation.
- 12. The Standards also build on and consolidate more specific work on sustainability and climate related reporting initiatives including the Sustainability Accounting Standards Board (SASB) Standards now part of the IFRS Foundation the recommendations of the Task Force for Climate-related Financial Disclosures (TCFD), the Integrated Reporting Framework and the Climate Disclosure Standards Board (CDSB) Framework.
- 13. Furthermore, some of these preceding instruments are already a requirement for certain companies and LLPs. The Companies (Strategic Report) (Climate related Financial Disclosure) Regulations 2022 and the Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022 require entities within scope to provide climate-related financial disclosures within a non-financial and sustainability information statement in the Strategic Report, based on the TCFD framework. This – and the scale and resource of the entities in scope - makes them well placed to adapt to the IFRS standards.



- 14. The IFRS standards already enjoy broad support from the G7, the G20, the International Organization of Securities Commissions (IOSCO), the Financial Stability Board, and a wide range of finance ministries and central banks having been extensively consulted upon prior to publication.
- 15. Regarding their suitability we see no aspect of the IFRS Standards that would be more problematic for firms operating in UK than competing businesses in other jurisdictions. Although they are rigorous and demanding, they are written at a high level and are aimed primarily at large, well resourced, and sophisticated organisations well capable of responding accordingly. Thereafter the considerations are more around issues such as data quality, approach, interpretation, and assurance.
- 16. In the sea of standards, the IFRS Standards are the best developed and most widely supported. It makes them the logical choice from what is available. A bespoke UK standard would only add to the clutter.

Implementation of the IFRS Standards.

- 17. Following adoption, the approach to implementation of the IFRS standards will be important.
- 18. We warmly welcome the Government's intention to only divert from the global baseline if absolutely necessary for UK specific matters. Maintaining the maximum possible alignment is the right approach and we are not aware of any UK specific matters which would require deviation.
- 19. The Government may wish to consider its approach to setting the thresholds that define scope of any implementing legislation or regulation. Initially, it may be worth aligning introduction of the IFRS standards with the thresholds already put in place under the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 and the Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022. These are at Annex A for ease of reference but crudely summarised apply to large entities with more than 500 employees and a turnover of more than £500m.
- 20. This approach would provide logical progression from the TCFD based approach and maintain consistency on the type of entity expected to report on sustainability and climate related risks and opportunities.
- 21. Any subsequent expansion of scope should also be considered in relation to other established thresholds such as that for large companies¹. We are aware that the government is currently reviewing company size thresholds as part of its *Smarter regulation non-financial reporting review*, and would caution against change for change's sake. As with reporting standards, consistency is key and alignment with existing provisions helpful.
- 22. The Government will need to consider its approach to maintaining alignment between the UKSDS and the IFRS standards. We are not well sighted on the formal process for updating the latter but assume that there will be an

¹ Two of: Annual Turnover more than £36m; Balance sheet total more than £18m; average number of employees more than 250.



evidence-based review process followed by updates. We further assume that the government's approach to this would be for the FRC to gather evidence on implementation from users, entities etc, in time to feed into the ISSB's own review process and to implement any revisions to the UKSDS accordingly. This would avoid the potential for divergence emanating from a purely UK level update cycle. It would be helpful to have the government's approach to updates and revisions outlined in the response to this call for evidence.

- 23. The Government will also need to consider its approach to managing the quality, consistency and cost of data required for robust reporting under the IFRS standards. For example, climate and sustainability-related data is fragmented, inconsistent, incomplete, and often expensive. Compliance and data assurance costs could be significantly reduced by access to a single open access database of carbon compliance data from manufacturers. If provided alongside a single source of clear guidance on methods and interpretation, this would be extremely helpful to reporting entities, potentially enabling later expansions of the scope of requirements.
- 24. The Government will need to consider its approach to the measurement of greenhouse gas emissions (GHGs). The IFRS climate standard hereafter S2 requires an entity to disclose its greenhouse gas emissions measured in accordance with the Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (2004)² (the GHG Protocol).
- 25. However, the GHG Protocol does not require disclosure of scope three emissions whereas S2 does. S2 also allows entities to deviate from using the GHG Protocol if required to do so by a jurisdictional authority or an exchange on which it is listed. As the standard itself allows for a degree of flexibility, this raises questions around the UKs approach, and how open-ended requirements will be defined.
- 26. Our suggestion would be for guidance to clarify that S2 compliance requires the application of the GHG Protocol's methodology to the scope three reporting.
- 27. It is also worth noting that the Streamlined Energy and Carbon Reporting (SECR) requirements allow for entities to select any of the major greenhouse gas reporting methodologies, whereas S2 states that entities must use the GHG Protocol. The government should align the SECR so that there is a harmonized approach. Different reporting methodologies adds to complexity and undermines comparability.
- 28. More widely, GHG accounting and reporting practices are evolving and there is much work still to be done to improve consistency in this area.
- 29. On a separate but related matter, the government will need to consider the interrelationship between the UKSDS and the UK Green Taxonomy. This will be an important tool for enabling investor to understand which activities can be accurately considered to be green, and support green financial disclosures. We understand the Taxonomy to be under development and encourage the

² International Financial Reporting Standards Foundation / International Sustainability Standards Board, IFRS S2 Sustainability Disclosure Standard: Climate-related Disclosures, B23.



government to continue to support this important work, and where possible, accelerate it.

- 30. The Government will need to consider its approach to providing guidance to entities on using the UKSDS, and to ensuring that this remains consistent with the IFRS standards. This should be developed in close collaboration with key stakeholders.
- 31. We would encourage the Government to set out its thinking on monitoring, assurance, and enforcement regarding the UKSDS. Our expectation would be that this aligns closely with the FRCs approach to other reporting requirements, but early confirmation of timings and expectations would be appreciated.
- 32. Although technically outside the scope of this call, we encourage the government to commence work on how best incorporate nature related financial disclosures into the UK policy and legislative architecture. Now that the Taskforce on Nature-related Financial Disclosures (TNFD) has published its final recommendations, reporting entities will want certainty on what will be required from which organisations, and by when.
- 33. Here it would be useful to have a reporting road map which brings together plans on reforming corporate reporting, and introduction of new reporting requirements related to the UKSDS, the UK Green Taxonomy, ESG rating and the TNFD recommendations. The updated Green Finance Strategy is a starting point, but it would be helpful for the Government to elaborate on the next decade in more detail.
- 34. In conclusion the UKSDS needs to be considered in the context of a wider reporting environment that is growing in size and complexity, and in which reporting entities particularly value stability and consistency. Proportionality is also an important consideration when considering which entities to bring within scope.

Consideration of Criteria

35. The call for evidence seeks views on whether application of these standards in a UK context will result in disclosures that are understandable, relevant, reliable and comparable for investors. It also considers technical feasibility, timeliness alongside financial reporting, and proportionality of costs to benefits. This section provides short responses to each criterion in turn.

Will applying these standards in a UK context result in disclosures that are Understandable?

36. To someone familiar with reporting requirements these standards are comprehensible and include concepts and approaches familiar from wellestablished financial reporting practices. They should be able to provide understandable disclosures accordingly. Clarity should improve as businesses become more accustomed to reporting to these standards.



- 37. However, some elements may need clarification, and transitional arrangements should reflect the need to give reporting entities at least one reporting cycle to test their approach to meeting the new requirements. Implementation should be collaborative between entities and the FRC and should be sensitive to the degree of adjustment required to adapt to more qualitative reporting.
- 38. The design of transitional arrangements should include a consideration of learning from the introduction of TCFD framework aligned disclosures. These arrangements should also be subject to open consultation.

Will applying these standards in a UK context result in disclosures that are relevant?

39. The IFRS standards have benefitted from the developmental experience of other standards. These are the right set of standards to endorse for the UKSDS.

Will applying these standards in a UK context result in disclosures that are reliable?

40. The IFRS standards are well thought through with no obvious issues. There will be a process of adjustment as reporting entities get used to the new arrangements, but this would be the case with any standard.

Will applying these standards in a UK context result in disclosures that are comparable for investors?

- 41. The IFRS standards support industry standards and build upon established practice. Adopting the global baseline as the UKs own standards is the right approach and will aid comparability of disclosures.
- 42. Comparability would be further supported by maintaining the alignment as the global standards evolve but otherwise keeping differences to an absolute minimum. Stability of requirement will help businesses to develop greater consistency. Guidance will also play an important role in improving the comparability of disclosures.
- 43. The comparability and consistency of decision-useful information is underpinned by standards, thus making them essential for the efficient functioning of capital markets, and the UKs aspiration to be a world leading global centre for green finance. Endorsing the IFRS Standards as the UKSDS would be entirely in keeping with the Government's Edinburgh reforms agenda.
- 44. However, there is still work to be done to improve the availability and consistency of data available to reporting entities as discussed above.



Is it technically feasible to apply these standards in a UK context?

- 45. This is technically feasible. However, they are, to date, the most ambitious sustainability / climate-related reporting requirements asked of entities, and this must be given due regard in enforcement expectations.
- 46. While the standards are clear, meeting them will require considerable specialist expertise and the subjective nature of many of the requirements will lead to a degree of variation. This will need to be monitored in the early phases of implementation and adjustments made accordingly. The vast majority of entities will report in good faith and given the complexity and scale of the challenge monitoring and enforcement should be approached in a supportive and collaborative way.

Are there any considerations of timeliness alongside financial reporting?

47. Non-financial reporting needs to be given equal weight to financial reporting and should be seen as providing important strategic information pertinent to it, not as a separate unrelated exercise.

Are costs proportionate to benefits?

- 48. This needs to happen so as to align global financial flows with the globally critical sustainability, climate, and nature related objectives required to secure a liveable future for all. The costs of not doing this will far outweigh any additional burdens on large organisations.
- 49. In terms of proportionality, the arrangements for introducing the TCFD aligned reporting requirements would seem a reasonable starting point, with adjustments based on experience from their introduction. Thereafter, and following a post introduction review, it may be worth exploring proportionate reporting requirements for entities below the (crudely summarised) £500m turnover/500 employee threshold, possibly based on Companies Act definitions. While the latter are currently under review, we see little value in changing from the current thresholds which are well established.

Do you have any comments on the cost of compliance?

- 50. As mentioned above, the Government could assist with cost of compliance issues through the provision of a single open access database of reporting data.
- 51. The cost of compliance will be heavily influenced by the Government's approach to scope. If the reporting to the UKSDS is only required of those entities already obliged to report to TCFD, then the additional requirements should be minimal, particularly when the size and resource of such organisations is taken into account. The impact on smaller organisations that have not already established climate and sustainability reporting processes and infrastructure would be more marked. Any expansion of reporting



requirements should be accompanied by a rigorous assessment of cost implications for those new into scope.

52. The benefits of compliance should also be considered. The risks associated with climate change will intensify over time and entities need to prioritise mitigation and adaptation in their strategic risk analysis. Reporting on short medium- and long-term sustainability and climate related risks and opportunities will help entities to properly understand them and become more resilient entities as a result.

11 October 2023



Annex A

Extract from, Department for Business Energy and Industrial Strategy, *Mandatory climate-related financial disclosures by publicly quoted companies, large private companies and LLPs: Non-binding guidance,* February 2022.

The disclosure requirements will apply to a company or LLP if it meets the following scope criteria:

- 1. All UK companies that are currently required to produce a non-financial information.
- 2. statement, being UK companies that have more than 500 employees and have either.
- 3. transferable securities admitted to trading on a UK regulated market or are banking.
- 4. companies or insurance companies (Relevant Public Interest Entities (PIEs)).
- 5. UK registered companies with securities admitted to AIM with more than 500 employees.
- 6. UK registered companies not included in the categories above, which have more than 500 employees and a turnover of more than £500m.
- 7. Large LLPs, which are not traded or banking LLPs, and have more than 500 employees and a turnover of more than £500m and;
- 8. Traded or banking LLPs which have more than 500 employees.