Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

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Dear Mr. Blasco

Technical Expert Group on Sustainable Finance: Report on Climate-related Disclosures

On behalf of the Accounting Standards Committee of Germany, I am writing to comment on the Report on Climate-related Disclosures prepared by the Technical Expert Group on Sustainable Finance (herein referred to as TEG) for consideration by and on behalf of the Euro-

pean Commission. We strongly support the overarching objective of the European Commission to ensuring long-term competitiveness of the EU economy through fostering sustainability and transferring to a low-carbon, more resource-efficient and circular economy as foreseen in the Commission's Action Plan: Financing Sustainable Growth published in March 2018.

We agree that climate change represents a significant threat and risk to companies' strategy, business models and future financial performance. Information about this risk and any mitigating effects arising from public policy decisions are therefore of utmost importance to all stakeholders, including (but not limited to) providers of capital.

We note that the European Commission aims at incorporating the recommendations of the *Task force on Climate-related Financial Disclosures* (TCFD) into the non-binding "Guidelines on non-financial reporting", the latter being designed to assist companies in meeting the requirements of the Non-financial reporting Directive 2014/95/EU (henceforth cited as NFRD) amending the Accounting Directive (2013/34/EU) in 2014. We further observe that a number of entities have already started including elements of the TCFD proposals in their annual reports. However, in order to further disseminate the TCFD reporting goals, we strongly feel that the non-binding guidelines must be conceptually coherent with the requirements of the Accounting Directive in order to achieve appropriate acceptance throughout Europe. Our main concern is that this coherence is not convincingly demonstrated by the TEG report – if possible at all.

In this context, section 2 of this report deals with the principles and the rationale for non-financial reporting and lays out the key differences between the NFRD requirements and the TCFD recommendations. The two pieces of literature differ with regard to their direction and approach to disclosing causal relationships:

- Article 19a of the Accounting Directive, which was introduced by the NFRD requires the management report of certain entities to include "*information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters"* (emphasis added). In referencing to the non-binding guidelines of the Commission, the TEG observes that the phrase underlined above constitutes a new (non-financial) element of reporting. This observation is consistent with Recital 3 of the NFRD that reads "*In this context, disclosure of non-financial information helps the measuring, monitoring and managing of undertakings' performance and their impact on society.*" In other words, the new core element of non-financial reporting under the NFRD is the information on how an entity's activities impact its environment, including global climate change.
- In contrast, the TCFD recommendations focus on the opposite causal relation, i.e. "*how the physical effects of climate change and the anticipated transition to a low-carbon and climate-resilient economy impact companies*" (emphasis added). Whilst their specificity might be new, we would have viewed these recommendations being in line with a classic risk report where entities would report on risks that are material to their business. The requirement to disclose relevant information about material risks and their consequences, however, are better tied to Article 19 rather than 19a of the Directive.

We therefore fail to see how the TCFD's approach to recommend disclosure of impacts on the entity can be convincingly tailored to meet the NFRD's requirements, which focus not only on the impact _on_ the entity's activity but also _of_ the entity's activity. We thus urge the European Commission to carefully consider which elements of the proposed TCFD contents would sit better with requirements in Article 19 of the Accounting Directive rather than with the NFR amendments in Article 19a when updating the non-binding guidelines.

In the same context, we note that in section 2 of the report (subsection 2.1) the TEG explicitly acknowledges the different reporting audiences underlying the NFRD on one hand, and the TCFD on the other. In our view, the TEG is right in quoting Recital 3 of the NFRD that it *"is intended to meet the needs of investors and other stakeholders as well as the need to provide consumers with easy access to information on the impact of businesses on society"* whereas the TCFD's target audience is investors, lenders, and insurance underwriters. In our view, this difference also shows the different perspectives. However, we fail to see an appropriate solution or compromise presented in the TEG report, and we therefore recommend that this issue be addressed and considered by the European Commission in the course of developing the draft amendments to the non-binding guidelines.

In section 3 of the report, the TEG assigns specific TCFD recommendations to the various reporting elements of the NFRD as regards disclosures. In general, and notwithstanding our reservations raised above, we welcome these efforts, as entities should be assisted in understanding how the TCFD disclosures may be mapped to the NFRD disclosure requirements. We believe that the suggested mapping on page 14 of the report may serve as a helpful illustration of such an alignment. However, we strongly recommend that the European Commission explicitly retain this as a suggestion, as stated in the TEG report. Furthermore, we note that the mapping on page 14 contains additional options coloured in light grey. For example, information on the organisation's strategy might be – according to the mapping figure – disclosed in three different sections of the non-financial statement. Whilst reasonable and appropriate in certain circumstances for some entities, these additional options could equally result in questionable or at least redundant disclosures. In order to allow for streamlining disclosures for both, preparers and users, we highly recommend flagging these options as "alternative", rather than as "additional". With regard to duplicative disclosures, we feel that the report should be reviewed for further opportunities to streamline recommendations as we note a number of redundancies in section 4 of the TEG report. For instance:

- Table 3 on page 17 lists the disclosures on the impact of the company's activities on climate change twice, first in the box 'outcomes' of the general disclosures section and then again in the box 'business model' of the supplementary disclosures section.

Further, the following recommendations are repetitive as well:

- the recommendation to report on how strategies might change to address potential climate-related risks (Box 1 General disclosure, page 19),
- the recommendation to report on the resilience of the company's strategy to climate-related risks (Box 1 Supplementary disclosure, also page 19), and
- the recommendation to report on the impact of climate-related risks and opportunities on the strategy, financial planning (Box 3 on page 22).

The aforementioned list should be read as constituting examples rather than a complete inventory of repetitive requirements. Therefore, we urge the European Commission to have these checked and cleared before finalising its work on the amended non-binding guidelines.

We further think that there are a number of disclosures proposed in section 4 that we do not think are meaningful. These include disclosure of an incomplete 'green debt ratio' (page 32 of the report), which would not cover green financing arrangements of unconsolidated investments, as well as the development of greenhouse gas emissions by asking companies to compare their emissions to national and international policy targets (page 22 of the report), where – given the diversity of national policies – we fail to see how disclosures could add to meaningful comparability of different entities in different sectors and across jurisdictions.

Whilst the European guidelines on non-financial reporting are labelled 'non-binding', we have been made aware that several stakeholders consider them quasi-mandatory. Against this background it should be noted that the TEG recommend a significant number of additional climate-related disclosures without taking the aspect of decision-usefulness of financial reporting into account appropriately. We clearly see the risk that the total volume of disclosures to be made could easily reach a level that is counterproductive to the aim pursued. It would be a pity if the European Commission, with best intentions, contradicts the widely shared objectives of the IASB's Disclosure Initiative, a project aiming at enhancing entities' communication with investors and users. Also, some of the suggested disclosures contain commercially sensitive information (eg. percent investment (CapEx) and/or expenditures (OpEx) in the reporting year for assets or processes that support products or services associated with Taxonomy activities, page 31), so that the provision of those needs to be further investigated in order not to create competitive disadvantages for European companies in the global arena.

Lastly, we note that the preceding proposal as well as other ones (e.g. on page 32) reference to the Green Taxonomy, which we are not aware a document exists at this stage, thus making evaluations difficult.

If you would like to discuss our comments further, please do not hesitate to contact Thomas Schmotz (schmotz@drsc.de) or me.

Andreas Barckow

President