Deloitte.

Annual report insights 2020 – Planet

Surveying FTSE reporting

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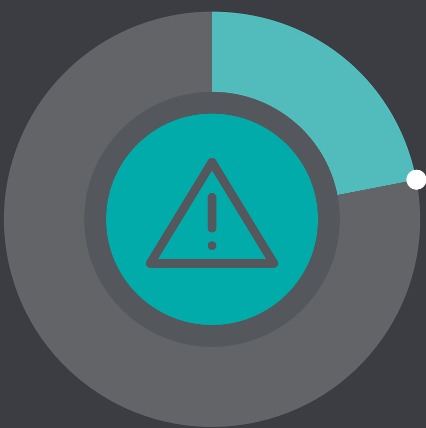
Planet

90% acknowledged climate change

64% referred to TCFD

22% made fulsome disclosures in line with TCFD...

... while 42% are working towards compliance



Of the 22% citing climate change as a standalone principal risk, ...

... a quarter did not have a KPI clearly linked to climate change

64% disclosed a target in relation to GHG emissions

40% stated their scope 3 GHG emissions

Investors, regulators and other business stakeholders continue to demand better disclosures on climate change matters and to challenge companies that are not factoring the effects of climate change into their critical accounting judgements.

The FRC's Lab published a report in October 2019, Climate-related corporate reporting, which aims to reflect the views of investors on existing reporting by companies and to help companies move towards more effective and comprehensive reporting. Structured around the, currently voluntary, TCFD framework (which identifies four pillars of disclosure: governance, strategy, risk management and metrics and targets, each discussed in turn below), the Lab's report sets out challenging questions for boards to ask themselves and examples of good practice.

Also in October 2019, in its Annual Review of Corporate Reporting, and in an open letter to all Audit Committee Chairs and Finance Directors, the FRC further emphasised their expectation that boards address and report on the effects of climate change. Citing climate change as one of the defining issues of our time, it highlighted the responsibility that boards have to consider the likely consequences of any business decisions in the long-term and their expectation that they address, and where relevant report on, the effects of climate change. Reporting should set out how the company has taken account of the resilience of the company's business model and its risks, uncertainties and viability in both the immediate and longer term.

Subsequently, in February 2020, the FRC commenced a major review of the extent to which UK companies and auditors are responding to the impact of climate change on business to ensure reporting requirements are being met. Their focus includes evaluating the quality of disclosures under the 2018 Code regarding risk, emerging risk and long-term factors affecting their viability and whether the recommendations in their Lab report have been adopted.

The Financial Conduct Authority (FCA) published a consultation paper in March 2020 proposing to enhance climate-related disclosures by companies with a UK premium listing – suggesting that such companies would report on the TCFD recommendations on a 'comply or explain' basis. In particular, this would require premium-listed companies to include a statement in the annual report setting out:

- whether they have made disclosures consistent with the TCFD's recommendations in their annual report;
- an explanation of 'why' where they have:
  - not made disclosures consistent with some or all of the TCFD's recommendations; or
  - included some or all of the disclosures in a document other than their annual report; and
- where in their annual report (or other relevant document) the various disclosures can be found.

Such a requirement would potentially take effect for accounting periods beginning on or after 1 January 2021, so our focus in this year's survey was centred very much on current levels of alignment with TCFD.

It was encouraging to see 90% of companies referring to climate change within their annual report, with 64% referring to TCFD – a significant increase from only 1 in 5 companies last year. Uptake of reporting in line with TCFD also increased, with 22% making fulsome disclosures in line with TCFD (2019: 4%) while 40% are working towards compliance. Most of those companies reporting in line with TCFD included the bulk of the disclosures within their annual report, with a handful cross-referring to their website or other publications for the information.

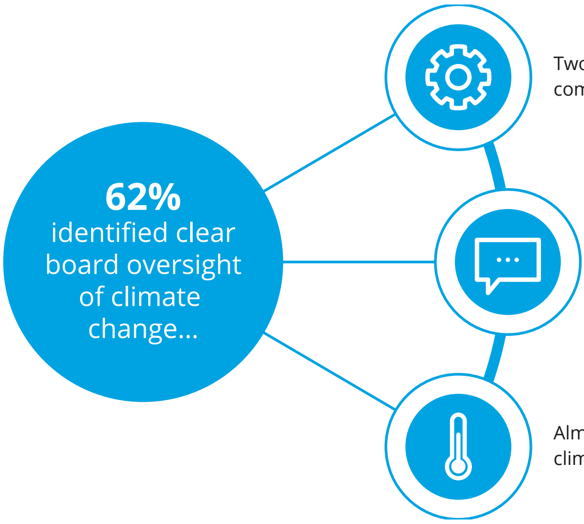
For those that had adopted TCFD and were making clear disclosures in line with the recommendations, the authenticity of climate-related disclosures varied somewhat. Some of the disclosures clearly struck a chord with the broader company strategy, complementing the broader vision or purpose, while some came across as disconnected from the rest of the report, more as if it were a reporting add-on than a fundamental, integrated way of doing business.

It was surprising that a number of reporters in key industries likely to be significantly impacted by climate change (such as aerospace and automobiles) had not made reference to TCFD nor clearly adopted many of the recommendations.

Land Securities Group PLC is an example of where the climate change disclosures were fully integrated into the rest of the strategic report. The company's 'net zero' response to climate change was cited in the opening summary pages as being a key part of the company's broader sustainability aims. The business model identified three material outputs (financial, physical and social) and a separate section in the strategic report was dedicated to the review of each of these. The prime focus of disclosures around "physical space" addressed climate change, demonstrating the integration of the issue within the business. The group strategy included an overview of investment through the life-cycle which cited sustainability as being a key driver. Climate change is also identified as a principal risk, and a related KPI is disclosed with a link to directors' remuneration. Finally, carbon pricing has been incorporated into decision-making, alongside financial cost.

Governance over climate change

A company's response to climate change needs to be led from the top, with disclosures making clear the level of attention given by boards.



Two thirds of these indicated there is a process by which the board or committee is informed about climate issues

Almost a quarter of these stated the frequency by which the board or committee is informed about climate issues

Almost half of these confirmed the board or committee consider climate change when making key decisions

Disappointingly, many companies had not clearly taken heed of the TCFD recommendations with respect to the involvement of the finance function. The CFO or finance director of only four companies were clearly involved in the oversight of climate change. This mirrors the TCFD 2019 Status Report which found there is insufficient involvement of finance and risk teams in TCFD reporting. This is critical for information to be robust and reliable if climate considerations are to be appropriately reflected in investment and lending decisions.

Equally disappointing, in the descriptions of board oversight, only 8% described how the board monitors and oversees progress against goals and targets for addressing climate-related issues, despite 42% of companies disclosing a climate-related metric as a KPI (see below).

s172(1) statement

TCFD recommends disclosure around whether the board considers climate-related issues when reviewing and guiding strategy, major plans of action, risk management policies, annual budgets, and business plans as well as setting the organization's performance objectives, monitoring implementation and performance, and overseeing major capital expenditures, acquisitions, and disposals. This links closely in with board decision-making disclosure as part of the new s172(1) statement.

24% specifically called out climate change as having been discussed by the board within their s172(1) statement. 6 companies gave examples of board decisions made within their s172(1) statement that referred to climate change. Lloyds Banking Group plc identifies a key board decision concerning tackling climate change, outlining the engagement activities that they undertook prior to making the decisions, and highlighting the long-term implication of those decisions.

KEY BOARD DECISION
TACKLING CLIMATE CHANGE

Across the globe, action to combat climate change is needed. We support the Government's Clean Growth Strategy and are supporting our customers with a range of initiatives to help them become more sustainable and think about environmental impacts, including access to green finance.

The transition to a low carbon economy impacts us all and subsequently is a fundamental element of our strategy and core to Helping Britain Prosper.

In 2018 following a detailed review by the Board, we introduced a new sustainability metric to our Helping Britain Prosper Plan, signalling our intent and commitment and in January 2020, we announced an ambitious new goal to help reduce the carbon emissions we finance by more than 50 per cent by 2030. Read more about our ambitious goal and other commitments on pages 28 to 31 or in our approach to ESG presentation online https://www.lloydsbankinggroup.com/ investors/financial-performance/

Our engagement process

- In developing our proposals, various stakeholder groups have been engaged including customers, colleagues, shareholders, suppliers, government and regulators
- The annual responsible business materiality study specifically identified environmental sustainability and climate change as a critical issue and as a result further detailed analysis was undertaken by the Group sustainability teams
- The Responsible Business Committee, a sub-committee of the Board, provides direction and oversight, whilst at Executive level, the Group Executive Sustainability Committee (GESC), supported by divisional Governance Forums and working groups, provide oversight
- The Board were briefed on key climate related issues by external industry experts and also engaged on a number of external fronts

Long-term implications

The Board believe we have a responsibility to help drive progress towards a sustainable and resilient UK economy, taking into consideration the needs of different stakeholders and risks to the business, and were comfortable endorsing ambitious plans, given the benefit to the Group and future generations

>£4.9bn
Green finance
Read more about our approach to green finance on page 29

>50% by 2030
We aim to help reduce the emissions we finance by more than 50 per cent by 2030

Link to strategic priorities

- Leading customer experience
- Maximising Group capabilities

Risk management

TCFD calls for information regarding three main areas of risk management:

1. a description of the processes for identifying and assessing climate-related risks,

2. a description of the processes for managing climate-related risks, and

3. a description of how these processes are integrated into the organisation's overall risk management.

Climate-related risks are inherently more complex and long-term in nature than most traditional business risks, and until recently there has been a lack of clear understanding and measurement capabilities to assess the potential impacts on a company's operations and performance. The Climate Financial Risk Forum published in July 2020 an industry guide to addressing climate-related financial risks. It aims to help financial services firms, of all sizes, understand the risks that arise from climate change, and to provide support on how to integrate these risks into their strategy and decision-making processes.

Many UK companies provide information about their risk management processes, although surprisingly not all of them describe their processes for assessing the potential size and scope of risks. While UK law requires a description of "principal risks and uncertainties", TCFD specifically calls for climate-related issues that could have a "material financial impact" on the company. Only 46% of companies described the process used to determine which risks could have a material financial impact on the company. Those which did not either omitted to describe the process itself or else had not made clear how it assessed which risks might have a material financial impact. Informa PLC describe how every principal risk is assessed for financial viability scenarios, to see if they could have a material financial impact, either on their own or if they materialise together. Land Securities Group PLC describe their risk scoring matrix which considers, among other matters, the financial impact to income and capital values.

With regards to identifying climate change in particular:

12% have a separate process for identifying climate-related risks from their general risk management process

20% explicitly stated that the same process for climate-related risk is followed as for other risks

30% did not specify but had referred to climate-related risks within their discussions of principal or emerging risks, so it can be assumed that the same process is followed

12% described the process used to determine climate-related opportunities which could have a material financial impact

J Sainsbury plc identified that climate change risks were subject to a specific risk review for completeness, before the impact on overall risks assessment was considered.

The level of detail of the description of risk assessment processes varied, but five companies stated that they had relied on climate-specific external sources of data. These ranged from "industry and sectoral relevant benchmark data" to other professional advisors. One bank used its customers' responses to a survey to drive its analysis of transition risk.

Climate-related risks are inherently more complex and long-term in nature than most traditional business risks, and until recently there has been a lack of clear understanding and measurement capabilities to assess the potential impacts on a company's operations and performance.

Strategy

TCFD recommendations outline three disclosures in relation to strategy:

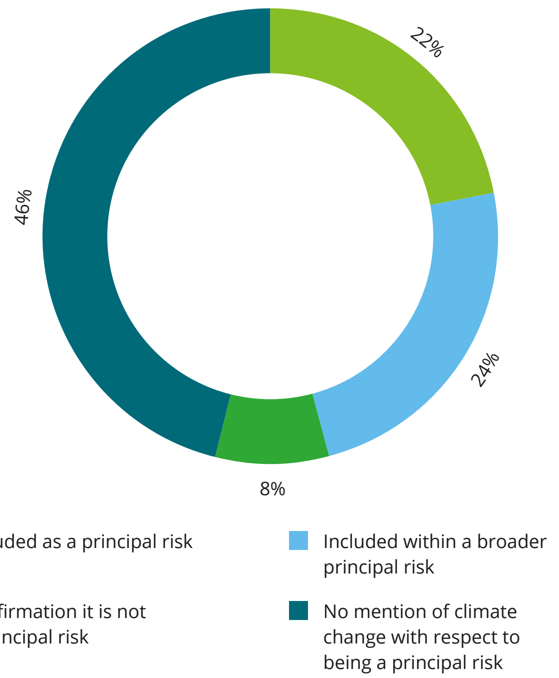
1. Describe the climate-related risks and opportunities identified over the short, medium, and long-term
2. Describe the impact of those risks and opportunities on the company's businesses, strategy, and financial planning
3. Describe the resilience of the company's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario

Beyond the initial identification and description of the risk, this appeared to be an area where companies either struggled to articulate these matters or else had simply not disclosed them.

UK companies are required to describe the principal risks and uncertainties facing the company. Those companies in our sample are also required under the 2018 Code and by law to disclose how they manage and mitigate those risks.

The FRC Guidance confirms that risks and uncertainties included in the strategic report should be limited to those considered by the entity's management to be material to the development, performance, position or future prospects of the entity or where the impact of the entity's activity poses a significant risk.

Figure 8. Is climate change cited as a principal risk?



It specifically calls out risks arising from climate change as being examples of long-term systemic risks which may have a material effect on the entity's ability to generate and preserve value in the long-term. For entities where this is the case the strategic report could explain the potential impact on the entity's strategy and business model if those risks crystallise.

The 2018 Code brought in a new requirement for boards to confirm the procedures in place to identify emerging risks. There is no requirement to identify which risks have been identified as emerging risks, but it appears commonplace for companies to do so. Certain industry groups, such as insurance companies, disclose these as a matter of course already. 28% of companies described climate–related risk as being an emerging risk although unexpectedly 8% had already cited climate change as a principal risk (or part of a broader principal risk) as well. For these, insufficient information was provided to indicate what aspect of climate-related risk was 'emerging'.

TCFD divides climate-related risks into two major categories:

- risks relating to the transition to a lower-carbon economy ("transition risk") and
- risks relating to the physical impacts of climate change ("physical risk").

This terminology has become well established and understood. Of those companies identifying climate-related risks either as principal risks or as an emerging risk, 18% related to transition risk, 18% to physical risk, 55% to both types of risk and for the remaining 9% it was unclear.

Investors and other stakeholders need to understand how climate-related issues may affect a company's businesses, strategy, and financial planning over the short, medium, and long-term. Such information is used to inform expectations about its future performance. Without this clear link to strategy and financial planning, it is easy for additional environmental disclosure to potentially be considered greenwashing.

Only three companies described what they consider to be the relevant short, medium, and long-term time horizons in relation to climate-risk specifically (taking into consideration the useful life of its assets or infrastructure and the fact that climate-related issues often manifest themselves over the medium and longer terms).

Two of these companies then went on to describe the specific climate-related issues for some of these time horizons (short, medium, and long-term) that could have a material financial impact on the company. Persimmon Plc set this out clearly in their TCFD overview:

Strategy	The Board monitors the impact of climate change risk and opportunities on its strategy and business model. It considers the impact over the short (0 to 5 years), medium (6 – 10years) and long (11 – 100 years) term. In the short term (0 – 5 years), we consider the material risk of climate change to be in relation to the transition to a low carbon economy through changing building regulations. On 1 October 2019, the Government set out its plans for the 'Future Homes Standard' including proposed options to increase the energy efficiency requirements for new homes in 2020 as a 'stepping stone' to achieving the new standard. The Future Homes Standard will require new build homes to be future-proofed with low carbon heating and world-leading levels of energy efficiency; it will be introduced by 2025. The industry is currently considering the likely impact of these new regulations. Their implementation may lead to constrained land supply, increased planning delays, increased cost and pressure on materials and require the use of new technology and skills. The physical risks associated with climate change for example, changes in weather patterns and the frequency of extreme weather events, particularly storms and flooding, may increase the likelihood of disruption to the construction process. The availability of mortgages and property insurance may reduce should financial institutions consider the possible impacts relating to climate change. The business considers these risks to be longer term risks. The change in regulations may also in fact be an opportunity resulting from increased demand for low carbon solutions from our customers. Opportunities may also arise from the reduction in operational costs as a result of reducing carbon emissions from our businesses.

More encouragingly, 54% of companies had described the impact of climate-related risks and opportunities on the company's business, strategy, and financial planning (or at least one of these things). This included some companies which were not referring to TCFD within their report, so it is encouraging to see evidence of companies considering some of these matters. The challenge for many of these companies now, having identified risks and opportunities and the potential impact upon their business, is to incorporate the response to these risks into their broader group strategy and decision-making.

Despite the large number of companies identifying the impact of climate change, only four companies described, at least in part, how climate-related issues serve as an input to their financial planning process, the time periods used, and how these risks and opportunities are prioritised.

One financial services company talked of how it looked downwards to the investments it holds and assesses the financial materiality of transition and physical risks across regions, sectors and companies to understand which of these investments will perform well in a low carbon world. This then informs engagement with those investments and, ultimately, the longer term financial planning of the company itself.

In December 2019, the Bank of England issued a discussion paper to standardise climate-related scenario analysis. This aims to test the resilience of the largest banks, insurers and the financial system to different possible climate pathways.

The challenge for many of these companies now, having identified risks and opportunities and the potential impact upon their business, is to incorporate the response to these risks into their broader group strategy and decision-making.

Overall, ten companies (20%) referred to climate-related scenarios used to assess the impact of climate change upon the company, although on occasion it was difficult to see how this exercise had informed the company's strategy and financial planning. Only six of these described what these scenarios were. Some of the descriptions were brief, referring only to the temperature reduction (e.g. 1.5C or 2C). BT Group plc described at a high level the possible risks and impacts under two scenarios.

The 2°C scenario – We looked at the disruptive policies and regulatory changes of moving from today's business-as-usual to a low carbon economy. The main risks for BT of a 2°C scenario include the effect of accelerated and widespread carbon pricing; diesel and petrol vehicle bans; and higher costs for renewable energy if demand outstrips supply.

The 4°C scenario – We considered physical risks, like more regular extreme weather, and big temperature and rainfall changes. In the UK, more storms and floods could lead to more service disruption, damage to our assets (like exchanges) and provide access problems for our engineers. These could all increase our operational costs.

Globally, extreme weather could affect our customers and cause service disruption. It could also make it harder for us to source raw materials from key suppliers who operate in nearly 100 countries.

Under both scenarios we face financial risks by 2030. The most likely impact will be somewhere between the two. But there are also opportunities in a low carbon economy – particularly in how our products, services and infrastructure can help.

Tesco PLC also described two scenarios, based upon those developed by the Intergovernmental Panel on Climate Change (IPCC). After the description they went on to explain their current plans to address risks and opportunities identified in three key areas of their business.

Strategy.

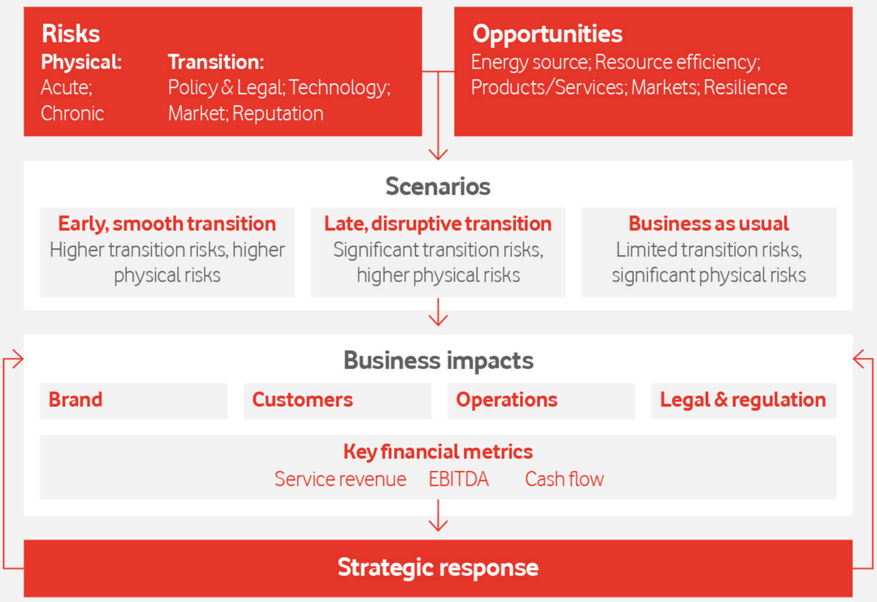
We assessed the risks and opportunities we may face in 2030 under two climate scenarios; a 'Pessimistic' scenario and an 'Optimistic' scenario. The 'Pessimistic' scenario is where the world fails to address climate change, leading to global temperatures continuing to rise well above 2 degrees. This scenario assumes limited policy or regulatory support and looks at physical climate risks. The 'Optimistic' scenario is where the world rises to the challenge of tackling climate change and limits global warming to well below 2 degrees. This low-carbon transition scenario centres on the rapid changes that will be needed by 2030 to cut emissions in line with the Paris Agreement. Our scenarios are based on those developed by the Intergovernmental Panel on Climate Change.

Our scenario analyses assessed Tesco's exposure to physical climate risks such as rising temperatures, changes in rainfall patterns and extreme weather events. Beyond physical risks, we also assessed risks and opportunities arising from a transition to a low-carbon world aligned with the Paris Agreement. These transition risks are a result of market and societal shifts related to agriculture, diets and energy use.

For produce, we focused on agricultural production by country and product. Our assessments indicate some physical risks and opportunities to our produce supply chain. For animal protein, our assessment focused on milk, beef, lamb and chicken. The assessment shows transition risks and opportunities arising from potential policy and societal shifts. To assess climate risks on our property estate, we assessed how our stores and distribution centres might fare under these scenarios.

Vodafone Group Plc used the three scenarios set out by the Bank of England for their analysis, describing each at a high level. They concluded that while the outputs of the scenario analysis will assist in either adjusting existing policies or developing new ones, especially looking at opportunities to improve business resilience and continuity, the overall aim is to provide the board with reasonable assurance of the sustainability of the business in meeting the challenges of an ever-changing global economy.

Our TCFD compliance programme



Bank of England's reference scenarios

Early, smooth transition

- Early, decisive action by society to reduce global emissions
- Coordinated policy action towards low-carbon economy
- Actions sufficient to limit global warming well below 2°C in line with the Paris Agreement

Late, disruptive transition

- Delay in the policy response needed to reduce global emissions
- Severe policy changes required to compensate late start
- Global warming is ultimately limited to well below 2°C

Business as usual

- Governments fail to introduce further policies to address climate change beyond those already known and in place
- Global temperatures increase to above 3°C

4 companies specifically referred to climate change as part of their longer-term viability statement

- one stated that the financial impact of climate change had been assessed and concluded it did not impact viability
- one referred to it as an example of emerging risks considered in the longer-term assessment of the group's prospects
- one called out climate change risk as a specific risk considered as part of stress testing
- one confirmed that uncertainties that may arise from climate change were specifically considered in scenarios modelled to assess the longer-term prospects

The TCFD 2019 Status Report concluded that of those companies using scenarios, the majority do not disclose information on the resilience of their strategies. UK quoted companies are required to disclose their assessment of the longer term viability of their business in a stand-alone statement. This implicitly requires consideration of the resilience of the company's strategy, as recommended in TCFD.

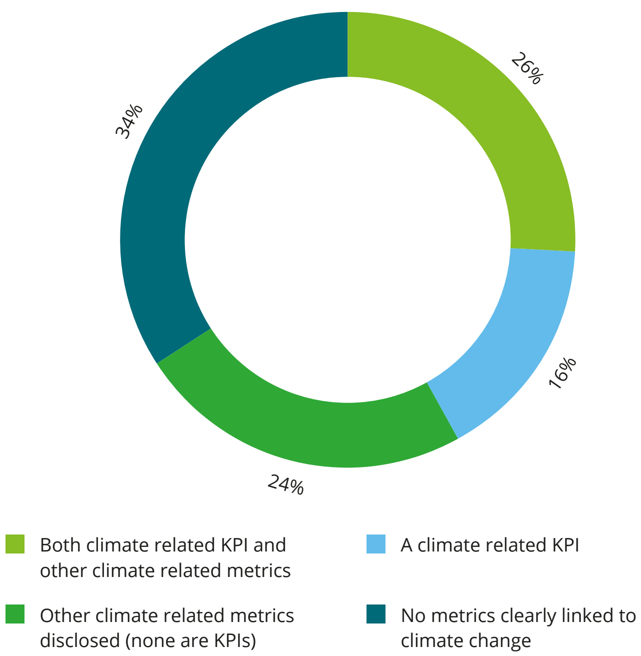
Outside of the longer term viability statement, five companies described the resilience of the company's strategy in the context of climate change, with two of these referring to scenario planning within their description. This mirrors the findings of the TCFD 2019 Status Report, which also acknowledged that companies are still early in the process of using climate-related scenarios internally, evolving their approaches, and learning how to integrate scenarios into corporate strategy formulation processes.

UK quoted companies are required to disclose their assessment of the longer term viability of their business in a stand-alone statement.

Metrics and targets

TCFD recommends disclosure of the metrics used to assess climate-related risks and opportunities in line with the company's strategy and risk management process. When reading the annual reports we looked for a clear link to climate change in relation to these questions, noting that many companies have in previous years stated GHG emissions as a KPI but without any reference to climate change.

Figure 9. Are climate-related metrics disclosed and clearly identified as such?



For the most part, climate-related KPIs related to carbon emissions, either as a quantified value or else as a percentage reduction against a base level. Some companies also stated energy efficiency or reduction and water usage. Climate-related metrics that were not KPIs tended to be more specific to company operations, although scope 3 emissions, waste and energy efficiency were particularly common.

Including a climate-related metric as a KPI, rather than disclosing it only in the depths of a corporate responsibility part of the strategic report, adds more gravitas to the metric, implying – perhaps – that such metrics are subject to higher levels of management scrutiny and regular board review. As mentioned above, the authenticity of climate-related disclosures varied, with some reporters adopting TCFD without clearly linking impact on climate change to broader company strategy. For example, there seemed to be little correlation between including a climate-related metric as a KPI and the adoption of TCFD; half of companies adopting TCFD (or working their way to compliance) had a climate-related KPI and half did not. A quarter of companies with a climate-related KPI had not indicated they had adopted the TCFD recommendations.

Connectivity with principal risks is also important and demonstrates authenticity of disclosures; of the 22% of companies citing climate change as a principal risk, a quarter did not have a KPI clearly linked to climate change, raising the question of whether and how the risk was being measured.

UK companies have long been encouraged by the FRC to disclose relevant targets for performance, and TCFD also recommends disclosing key targets used to manage climate-related risks and opportunities.

The chairman of Hammerson plc stated in his opening statement: "Targets [in respect of climate change] which are set within easy reach miss the scale of what we all have a responsibility to achieve." This echoes the importance of climate change as a key business issue and the significance of work needed to be done to meet key targets identified by the IPCC.

Irrespective of whether they had been clearly linked to the issue of climate change, it was good to see that 64% disclosed a target in relation to GHG emissions. Many of these targets referred to "net zero" by 2030, 2045 or 2050, with some companies aiming higher than that and striving to be carbon negative by 2030.

Similarly, targets for climate-related metrics other than GHG emissions were common. Hammerson plc incorporated both carbon and non-carbon elements (resources and water) within a broader target of being what they term "net positive" by 2030 (reducing carbon emissions, water demand and resource-use to less than zero).

For all of the climate-related metrics and targets identified above, only 39% of those companies explained how they all fit into their strategic approach; 19% did so for at least some of the metrics. Without that link between measurement of performance against strategy, it is unclear why the metrics are important and what the impact upon the company's business is.

64% disclosed a target in relation to GHG emissions, with a further **14%** indicating that they were in the process of establishing a target

46% disclosed targets for climate-related metrics other than GHG emissions, with a further **14%** in the process of establishing a target

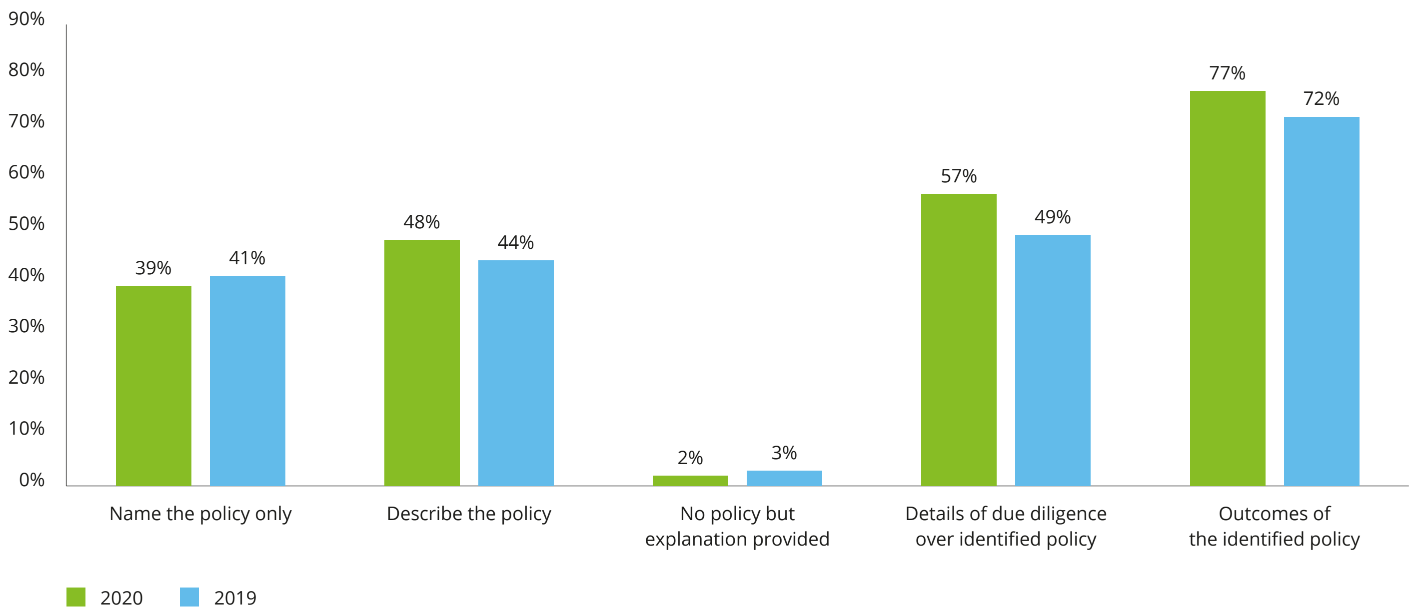
28% did not have any metrics or targets which had clearly been linked to climate change

Non-financial information statement

As noted in the People section, above, the FRC has stated that it will continue to challenge companies whose disclosures in this area appear to fall short of the requirements. It was therefore encouraging to see a marginal increase of identifiable policies relating to the environment (which is broader than simply climate change), whether described or only named, and progress in disclosing due diligence and outcomes. Environmental policies covered a variety of matters although carbon emissions, waste and water were commonly cited. Some companies had combined Safety, Health and Environmental (SHE) policies and systems over which external assurance or accreditation was gained.

Of those companies for which we could not identify relevant policies, there was a handful which had climate-related KPIs or had included climate change within their principal risks. In these instances it appeared to be the lack of clarity and signposting of the non-financial information statement (or even a lack of statement) which hindered communication of relevant policies rather than the company necessarily overlooking the matter of the environment.

Figure 10. Which elements of the NFR Regulations relating to environment were identifiable?



Disclosure of GHG emissions and SECR

All quoted companies are required to disclose scope 1 and 2 GHG emissions within their directors' report. 80% of companies considered the disclosures to be of strategic importance and so located them within the strategic report, instead.

TCFD recommends, and the UK Government strongly encourages, the disclosure of scope 3 emissions as well, being those emissions that arise as a consequence of the activities of the company but occur from sources not owned or controlled by the company. These emissions include employee travel and commuting, and the extraction and production of purchased materials.

40% went further than the legally required disclosures and stated their scope 3 emissions. These were from a variety of industries and included a few which had not made any indication of adopting TCFD.

The new SECR regulations became effective for periods commencing on or after 1 April 2019. For quoted companies SECR extends current GHG reporting by the inclusion of energy consumed (as well as GHG emissions), stating the proportion of total energy consumed and GHG emissions which related to UK activities (as opposed to global activities) and describing the principal actions taken (if any) on increasing energy efficiency.

It was encouraging to see 10% of companies comply with the new requirements, adopting them earlier than required. Of the four companies in our sample in scope of SECR, two had not clearly identified the proportion of emissions and energy consumed relating to the UK and offshore.

A further 30% adopted part of the new requirements voluntarily, either stating the total energy consumed or else outlining some of their actions taken on increasing energy efficiency. The most useful of these were those which demonstrated how the actions fitted into their broader environmental strategies – such as Hammerson plc's boxes scattered among the review of the business, detailing different energy-saving aspects of their "Net Positive" strategy – or else those which demonstrated the link between financial investment (and subsequent savings) and environmental benefit, such as BT Group PLC.

Hammerson plc

Net Positive

Our smart metering roll out is now completed at all but one of our UK flagship destinations . This is giving us live visibility of sub-metered utility demand at each asset, complete with alerts that enable the onsite teams to see and respond to spikes in demand.

This important investment is transforming the use of energy data across the portfolio and is already delivering cost savings for our tenants.

MORE Further information on Sustainability on page 36

Net Positive

We installed a 900kWh photovoltaic (PV) array at Les Terrasses du Port which recently became operational. It is predicted to generate 1,446MWh of electricity annually, approximately 20% of landlord demand at the asset. Costing €1.4 million, the system will save €120,000 p.a. at current electricity prices.

BT Group PLC

Decarbonise our buildings: This year we invested £45.3m in energy management projects in the UK, which cut operating costs and contributed to a global energy reduction of 65GWh. These investments have saved us £343m since 2009/10.

Unite Group PLC also linked their energy efficiency efforts back to financial impact, although without the quantification, explaining that energy consumption constitutes not only one of the most significant sources of carbon emissions but also one of their largest operating costs.

Climate change within the financial statements

An important consideration for climate-related risk upon a company, like many risks, is the impact on the financial statements. Particularly in relation to climate change and the need to transition to the low-carbon economy, there is an inherent potential cost both of action and inaction. Climate-related risks and opportunities and financial performance are interconnected, and there should be consistency between the narrative descriptions around climate change in the strategic report and the impact demonstrated in the financial statements. Investors have increased calls for companies to account for and disclose the impact of climate change in financial statements, arguing that they see this as essential to their analysis of risk and returns over time.

The call for further disclosure in the financial statements

Collective action by investors is well co-ordinated. Climate Action 100 + now has more than 370 investor signatories, representing over 35 trillion dollars of assets under management. They are targeting a list of over 160 companies that they say represent up to 80% of global industrial emissions. This includes action where they believe companies have not appropriately addressed climate change in their reporting. In the letters sent to the chairs of audit committees of the targeted companies, investors are expressing their concerns that material climate considerations may be overlooked. They say this could mean that both performance and capital are potentially overstated. They also emphasise that uncertainty around decarbonisation is not a reason to delay accounting and reporting adjustments today.

The IASB's In Brief article on IFRS Standards and Climate-related Disclosures looks at some of the potential financial reporting implications of climate change and the relevant IFRS Standards which address these, all in the context of applying materiality judgements. In particular, key estimates and judgements and the cash flow forecasts that underpin recognition and measurement of assets and liabilities are impacted by climate change considerations. This is a focus of the FRC's ongoing thematic review around climate change disclosure.[1]

It was disappointing to see the chasm between the communications in the strategic report of climate-related impact and that in the financial statements.

There was little link between narrative commentary and financial statement disclosures, with only two companies referring explicitly to climate change impacts in their financial statements. Both were in respect of impairment testing. One had built in, where it considered appropriate, the impact of climate change into their assumptions used in the value in use calculations. The other company had calculated the fair value less cost of disposal of certain assets, with cash flow forecasts being part of this.

Those cash flow forecasts included long-term price assumptions derived from median curves which included certain data points such as the impact of climate change.

One further company, Drax Group plc, set out clearly their purpose of "enabling a zero carbon, lower cost energy future" and the Group CEO's review referred to a post balance sheet decision to close their coal units. This was also cited in the financial statements as a post balance sheet event, but the main detail of accounting considerations was located in the directors' report:

Post balance sheet events

On 26 February 2020, following a comprehensive review of operations and discussions with National Grid, Ofgem and the UK Government, the Board determined to end commercial coal generation at Drax Power Station in 2021 – ahead of the UK's 2025 deadline. The Group will shortly commence a consultation process with employees and trade unions with a view to ending coal operations in September 2022. Under these proposals, commercial generation from coal will end in March 2021 but the two coal units will remain available to meet Capacity Market obligations until September 2022.

The Group currently anticipates incurring one-off closure costs of between £25 million and £35 million in the period until closure and initially expect to provide in full for these costs during 2020, where appropriate. In assessing the financial impact, the Group will also consider the useful lives, residual values and potential impairment of certain assets at Drax Power Station. The timing for completing this impairment review is uncertain as these assets remain an integral part of the site and a detailed closure plan needs to be finalised. The carrying amount of affected assets was approximately £240 million at 31 December 2019, comprising coal-specific assets with useful lives up to 2025 and other assets with useful lives up to 2039. In addition, the Group held coal inventory at 31 December 2019 with a carrying amount of £103 million, which the Group expects to recover in full over the period to closure.

There was little link between narrative commentary and financial statement disclosures, with only two companies referring explicitly to climate change impacts in their financial statements.

Another impact on the financial statements and, more directly, upon the allocation of capital is the consideration of carbon pricing. TCFD recommends companies disclose their internal carbon prices. Two companies set out their strategy to achieve their climate targets whereby the strategy includes the use of internal carbon pricing, although it was not clear whether such pricing had directly impacted anything in the financial statements in the current period. Land Securities Group PLC noted how using a carbon price can strengthen decision making and capital allocation.

3. Use an internal shadow price of carbon

To support our net zero ambitions, we calculate an internal shadow price of carbon, so we can consider the carbon cost as well as the financial cost when making investment decisions.

We established our internal price of carbon by estimating how much we're spending on carbon reduction projects currently, and how much more we would need to achieve our 2030 goals. We balance this with figures reflecting the fact that making early design decisions with a low cost increase can have significant carbon-saving potential. Our figure is in line with the Commission on Carbon Pricing's recommendation for a carbon price level consistent with the Paris Agreement, and aligned to guidance from the UN Global Compact.

Importantly, our shadow carbon price is not a tax, but a way to strengthen our decision making, and to highlight carbon risks associated with key decisions. The risk may be an increase in the market price of carbon offsets, or the possibility of being forced by regulations to enter a carbon-emissions trading scheme.

What to watch out for

- [ ] The integration of a company's response to climate change risk within its broader strategy and processes, which is fundamental to driving action, should be reflected in the disclosures in the annual report.
- [ ] If the processes in place for identifying, assessing and then managing climate-related risks are separate from the broader risk management process, this should be explained.
- [ ] Where climate-related risk is a principal or emerging risk, the s172(1) statement provides an opportunity for boards to indicate how they have responded to the risk and, where relevant, explain how the risk has influenced their decision-making.
- [ ] When describing climate-related risk and explaining the company's strategic response to it, be sure to outline which issues impact the short, medium, and long-term, as well as the time horizons of each.
- [ ] Where climate-related risks are deemed 'principal' or otherwise significant, the connection between the risk and the metric in place to measure the impact on or the outcomes from the company should be communicated.
- [ ] Under the new SECR regulations, remember to disclose the proportion of total GHG emissions and energy consumed in the UK and offshore area – a few of the early reporters appear to be missing this.

Another impact on the financial statements and, more directly, upon the allocation of capital is the consideration of carbon pricing.

Appendix – Survey methodology

For many years the Annual report insights series has presented the findings of a survey of 100 annual reports of UK companies with a premium listing of their equity on the London Stock Exchange, both within and outside of the FTSE 350. This year we have adopted a different approach to facilitate a deeper look into key areas where regulators and investors are increasing their focus.

Purpose, people, planet and profit chapters

In four key areas – purpose, people, planet and profit – the publication presents the findings of a survey of 50 UK companies with a premium listing of their equity on the London Stock Exchange. The population comprises 21 FTSE 100 companies and 29 FTSE 250 companies across a range of industries. All companies had financial years ending between 31 December 2019 and 31 March 2020 and had more than 500 employees, and were therefore required to disclose both an NFI statement and s172(1) statement and were in scope of the 2018 Code. As many of these companies as possible were included within the sample used in the previous survey.

Pandemic chapter

A large number of the annual reports surveyed for the four previous chapters that were approved in February or early March 2020 made little or no reference to COVID-19. As such, in this section we look at some of the emerging trends in annual reporting regarding COVID-19 for a sample of 20 FTSE 350 March year-ends.

Appendix 1 of consolidated publication – additional findings

This appendix presents various statistics from surveying the larger sample of annual reports that includes 100 UK companies spread across the whole of the FTSE. 91 of the 100 companies are the same as those used in the previous year's survey. The population comprises 20 FTSE 100 companies (2019: 19), 39 FTSE 250 companies (2019: 37) and 41 companies outside the FTSE 350 (2019: 44). Investment trusts, other than real estate investment trusts, are excluded from the sample due to their specialised nature. The reports analysed are for financial years ended between 28 September 2019 and 31 March 2020.

Although our survey data uses only companies from our samples, when selecting examples of good practice we have used material from companies that, in our view, best illustrate a particular requirement or innovation, regardless of whether they are in our sample.

Each chapter also includes a short list of items to watch out for in the reporting season ahead, reflecting areas of changing requirements or practice and areas of regulatory focus.

Glossary of terms and abbreviations

Term	Definition
2018 Code, or the new Code	The 2018 UK Corporate Governance Code
Acc Regs Sch. 7	Schedule 7 of *The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410)*, as amended
the Act	UK Companies Act 2006, as amended
BEIS	The Department for Business, Energy and Industrial Strategy
BEIS Q&As	A set of frequently asked questions published by BEIS regarding *The Companies (Miscellaneous Reporting) Regulations 2018 (SI 2008/860)*
Brydon review	An independent review by Sir Donald Brydon into the quality and effectiveness of audit
Climate Action 100 +	An investor initiative encouraging large corporate greenhouse gas emitters to take necessary action on climate change
ESG	Environment, social and governance matters
ESMA Guidelines	Guidelines on Alternative Performance Measures (APMs) for listed issuers published by the European Securities and Markets Authority (ESMA). Since original publication, ESMA has published several questions and answers on the guidelines to promote common supervisory approaches and practices in the implementation of them
FCA	Financial Conduct Authority
FRC	Financial Reporting Council
FRC Guidance	The FRC's Guidance on the Strategic Report published in July 2018
FRC Lab	The Financial Reporting Lab was launched in 2011 to provide an environment where investors and companies can come together to develop pragmatic solutions to today's reporting needs. Latest reports can be found here.
FRC's Annual Review of the UK Corporate Governance Code	See this link
FRC's Annual Review of Corporate Reporting 2018/2019	See this link
GHG	Greenhouse Gases
IASB	International Accounting Standards Board
IBC	The World Economic Forum's International Business Council
Investment Association	A trade body and industry voice for UK investment managers
IPCC	Intergovernmental Panel on Climate Change, the United Nations body for assessing the science related to climate change
KPI	Key performance indicator
NFI Statement	the Non Financial Information Statement as required by s414CB of the Act
NFR Regulations	*The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016 (SI 2016/1245)* which implement the EU Non Financial Reporting Directive into sections 414CA and 414CB of the Act
Parker Review	An independent review by Sir John Parker into the ethnic diversity of UK boards
R&D	Research and development
s172	Section 172 of the Act which sets out certain directors' duties
s172(1) statement	The statement required by s414CZ of the Act, under which the directors must explain how they have fulfilled their duty under s172(1) of the Act
SASB	Sustainability Accounting Standards Board
SDGs	Sustainable Development Goals, a set of targets set out by the United Nations
SECR	Streamlined Energy and Carbon Reporting, as set out in *The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 (SI 2018/1155)*
TCFD	Task Force on Climate-related Financial Disclosures
TCFD recommendations	Recommendations as set out by the TCFD which promote voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders
TCFD 2019 Status Report	An overview of current disclosure practices as they relate to the TCFD recommendations
WEF	The World Economic Forum

Endnotes

1. https://www.frc.org.uk/news/february-2020-(1)/frc-assesses-company-and-auditor-responses-to-clim

To find out more annual report insights visit:

www.deloitte.co.uk/annualreportinsights

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Designed and produced by 368 at Deloitte. J20038