Financial Reporting Council

Business Energy Use
Department of Business, Energy & Industrial Strategy
6th Floor
1 Victoria Street
London
SW1H 0ET

4 January 2018

Dear Sir / Madam

Streamlined Energy & Carbon Reporting

This letter sets out the comments of the UK Financial Reporting Council (FRC) on the above consultation. Our detailed comments on the questions in the consultation are set out in the attached appendix.

The FRC supports the aim of encouraging boards to better consider the impact of a company's activities on wider society, including environmental matters and climate related risks, and the role transparency can play in achieving this. The FRC recognises the importance of carbon reporting and we support initiatives to improve reporting in this area, particularly in respect of providing information that will allow an assessment of climate change risk posed by a company's activities and its risk to the company's business model. We do, however, ask government to exercise caution in implementing a single policy that simultaneously attempts to increase transparency, change behaviours and inform government policy, as these policy goals may be in conflict with each other.

The purpose of the consultation is to streamline the energy and carbon reporting framework. The FRC is aware of a number of initiatives that aim to improve reporting on environmental matters including climate related risks, both from within different parts of government, and the EU (e.g. Environmental Audit Select Committee inquiry into Green Finance, DEFRA climate change adaptation reporting). We urge government to adopt a joined up approach to proposals that may be introduced, including aligning disclosures and thresholds.

How should information be reported?

Investors' and other stakeholders' interest in environmental matters has grown significantly in recent years and the strategic report already requires information relating to such matters.

For some entities, however, we believe that reporting through mechanisms alongside the annual report may, where such risks are not material to the long term success of the company, be appropriate. We encourage the government to explore the use of different channels for reporting information that is aimed at a wider stakeholder group or which provides detailed data on specific areas. We consider that technology could be used to enable reporting of this type of information. We encourage the government to explore the use of a central digital location and/or the need for a separate report for wider stakeholders covering CSR matters.

8th Floor, 125 London Wall, London EC2Y 5AS Tel: +44 (0)20 7492 2300 Fax: +44 (0)20 7492 2301 www.frc.org.uk

Who should report?

The consultation document notes the desire of the UK government not to impose unnecessary reporting burdens on business.

The recently implemented requirements from the EU Directive on disclosure of non-financial and diversity information ('NFR Directive') and the pre-existing non-financial reporting requirements in the strategic report mainly apply to quoted companies. At the time of implementing NFR Directive, the scope was specifically limited to largest public interest companies so that the regulatory burden of reporting was proportionate. Therefore, it is unclear why this more detailed disclosure which relates to a specific aspect of non-financial reporting should apply to a broader range of companies, including non-quoted entities. We consider that there is a need for more evidence on the effectiveness of the existing requirements before extending those requirements in scope and disclosures.

Should the government introduce new requirements, we encourage the use of an existing Companies Act threshold for determining the scope of the entities to which a new energy and carbon reporting regime would apply. This would limit creating further complexity in the reporting framework which arises from the use of multiple thresholds.

What should be reported?

The consultation seeks views on whether, over the longer-term, any of the TCFD recommended voluntary disclosures should become mandatory. The FRC supports the aims of the TCFD recommendations, but we have reservations as to whether mandating the recommendations for all companies would result in relevant, proportionate and material disclosures for all within scope. We recommend that BEIS should let practice evolve in this area before mandating as in our experience non-mandatory guidance can also be an effective method for changing behaviour.

If you would like to discuss our comments, please contact me or Debbie Crawshawe on 020 7492 2461.

Yours sincerely

Paul George

Paul George
Executive Director of Corporate Governance & Reporting
DDI: 020 7492 2340
Email: p.george@frc.org.uk

Q1. Do you agree that the proposed energy and carbon reporting policy should apply across the UK?

Yes. The FRC supports a policy that applies consistently across UK entities. However, we encourage the government to consider the practicalities of measuring and reporting by UK entities that operate internationally.

Q2. Do you have any comments on the analysis set out in the Impact Assessment?

We would welcome any additional evidence on costs and benefits to support a final assessment of impacts.

The impact assessment sets out the policy objectives of these proposals as being to:

- Reduce the administrative burdens of complying with business reporting policies;
- Simplify the policy landscape to increase coherence of policy levers for organisations;
- Increase the effectiveness of the policy framework in addressing the barriers to energy efficiency; and
- Contribute to the Government's carbon budgets by reducing energy use, and developing markets for energy efficiency products.

We note that the Ministerial foreword also refers to the importance of reporting in informing government policy.

The FRC supports the policy objectives that the proposal is setting out to achieve, but would ask government to exercise caution in implementing a single policy that simultaneously attempts to increase transparency, change behaviour of companies as well as inform government policy. The FRC has concerns that the same vehicle may not be appropriate for each of these policy goals.

In particular, the FRC notes the tension between the need for relevant company specific information with clear linkages to other areas of the annual report to increase transparency for investors, and the need for standardised data to inform public policy. We have reservations as to whether the same regulations can effectively satisfy each goal.

The FRC also notes the significant number of initiatives in this area, from several branches of government and also from EU initiatives. We urge a joined up approach to proposals that may be introduced, including aligning disclosures and thresholds in order to help companies with the burden of compliance and to help users of the annual report to better understand the information presented.

Q3. Do you agree that reporting should be done through annual reports? Please explain your answer. If yes, would any of the following, forming part of companies' annual reports, be better suited? (a) Directors' reports, (b) strategic reports, or (c) a new, bespoke report. Please explain your answer, note any issues you see with using these reports and provide any comments on how proposals might best fit within the annual reports regime.

Under the Companies Act 2006, the annual report is a report primarily for shareholders and the corporate governance code requires the annual report as whole to be fair, balanced and understandable. Within the annual report, the strategic report must be fair, balanced and comprehensive. The FRC encourages reporting that is clear and concise.

The FRC recognises the importance of carbon reporting and we support initiatives to improve reporting in this area, particularly in respect of providing information that will allow an assessment of climate change risk posed by a company's activities and its risk to the company's business model. Reporting on matters which could affect the long term success of a company are of particular importance, not just in relation to climate change, but also in respect of reporting on non-financial matters more broadly.

The FRC also supports the aim of encouraging boards to better consider the impact of a company's activities on wider society, including environmental and climate related risks, and the role transparency can play. While information in the annual report should be primarily for shareholders, the FRC believes that companies need to recognise that investors' and other stakeholders' interest in environmental matters has grown significantly in recent years and therefore the scope of information required by the existing legislative framework has broadened.

To the extent that the carbon reporting and climate change reporting is material to shareholders, the FRC supports the inclusion of that information in the strategic report. For some entities, however, we believe that reporting through mechanisms alongside the annual report may be more appropriate. We also question whether the endorsement of, for instance, the TCFD recommendations, would result in an appropriate level of disclosure in the strategic report for all companies to which the regime would apply.

The FRC notes that the existing GHG disclosures are currently in the directors' report and this is the natural place for expanded disclosures to be located. However, we have reservations that the existing requirements result, in many instances, in non-contextual boilerplate. We have concerns that an extension of the existing disclosure requirements may result in a greater amount of boilerplate, rather than in meaningful disclosures that could affect board and investor decision making.

Whilst information material to the long term success of the company should always be in the annual report the FRC sees merit in BEIS exploring a variation on option (c), being a new, bespoke report outside the annual report, published on the company's website and filed with Companies House. If such a report were to be introduced, the FRC would encourage BEIS to consider using that report as a placement for information for wider stakeholders on other CSR initiatives.

The FRC would also encourage BEIS to consider a change in legislation to allow the directors' report to be placed on the company's website only, and not included in the published annual report.

The FRC has previously expressed concern at the fragmented nature of the disclosures required in the annual report and the gaps in the FRC's monitoring powers in relation to the annual report as a whole. We encourage BEIS to take this opportunity to review this situation. We also encourage BEIS to consider consolidating all existing CSR disclosures into a single regulatory framework, outside of the annual report, with consistent reporting thresholds.

Q4. Do you agree that from 2019 energy and carbon reporting to Companies House should be electronic? If yes, please specify any digital formats, such as XBRL / iXBRL, that may be suited to this purpose, and any opportunities and challenges these may present.

The FRC supports the use of digital reporting to HMRC and Companies House, and with our ownership of the FRC taxonomies we enable digital reporting in inline XBRL. We note, however, that digital reporting to Companies House is not mandatory. We would further note that the private companies that do (voluntary) report in electronic form to Companies House do so most often at an entity level rather than a consolidated accounts level. In our view, for carbon reporting to be meaningful, it should be at a consolidated accounts level, not an individual entity level.

In order to create a taxonomy for carbon reporting, detailed disclosure requirements must first exist. Our experience with creating taxonomies has been that entities also need experience of how they will apply those disclosure requirements in practice, in order for the taxonomy to accommodate different disclosure approaches. Our experience also shows that creating taxonomies is a lengthy and complex process.

We consider the 2019 timing for adoption of electronic reporting on energy and carbon reporting could be problematic for listed companies. From 2020, companies with transferable securities admitted to trading on a regulated market will be required to adopt the European Single Electronic Format (ESEF) for filing to the national storage mechanisms. The ESEF will require the annual report (including the Directors Report) be produced in an XHTML format (with certain elements in tagged in XBRL); aligning the requirements to the same timetable would likely reduce complexity and cost for companies in implementing the reporting requirements. We also note that the ESEF is designed to be filed to the national storage mechanism; as such additional work may be required in order to also file at Companies House.

Your consultation asks if XBRL/iXBRL is an appropriate format. We would highlight that ESMA recently provided the European Commission with a draft technical standard on the ESEF. Within this standard it states that where the laws of Member States in which issuers are incorporated permit or require the marking up of parts of annual financial reports other than the IFRS consolidated financial statements, issuers should use XBRL for the marking up of those parts. This would therefore suggest that XBRL (or iXBRL) would be the only appropriate format for listed companies.

As part of the same ESEF requirements there is currently a lack of clarity if the resultant document and tagging would be subject to audit or other form of assurance. As such, until resolved, the proposals could have the unintended consequence of bringing the carbon reporting data within the scope of the statutory audit and we advise caution in this area.

We also recommend a coordinated approach to reporting in digital formats such as XBRL and iXBRL. To this end, the FRC has recommended that a single UK committee be established to promote the use of digital reporting. This committee could consider electronic energy and carbon reporting as part of their scope.

Q5. Do you agree that the government should seek to establish a mechanism for collating published energy and carbon data for example via a central published report or tool? Please explain your answer.

Yes. We believe that the government should explore the use of a central digital location for reporting of information to achieve specific aims. We note that the government first explored this idea as part of the development of its disclosures on late payment. Over the last few years we have seen an increase in the introduction of disclosures aimed at a wider group of stakeholders or to achieve specific policy aims (e.g. gender pay gap reporting, modern slavery). In our view, there would be merit in providing a central location for the disclosure of this type of information not just for energy and carbon data.

The FRC's work, through its Financial Reporting Lab, has shown that freely accessible sets of data, in a usable and timely format is what the market wants.

Q6. Do you think that the policy should apply to:

- **A) All 'large' companies based on employee numbers and financial tests:**
- **B) Companies who meet the 6GWh ex-CRC annual electricity use threshold described; or**
- **C) Another threshold?**

Please explain your answer. Please state if you have any views on whether reporting should be required to operate at the group or individual company level.

For the purposes of transparency and influencing decision making, the FRC supports a scope definition that uses one of the existing threshold levels set out in the Companies Act 2006. Companies are facing an ever increasing number of reporting requirements, each with different thresholds at which reporting is required. The FRC recognises that sometimes different threshold levels are appropriate, but would strongly discourage government from creating another reporting threshold for the proposed disclosures when one of the existing thresholds could be applied.

To influence their decision making, we believe that investors and stakeholders should be provided with information to help them to understand an entity's energy usage, whether that usage is high or low. Therefore the FRC would discourage the use of an electricity usage threshold for reporting as low usage information is potentially as relevant for shareholders and stakeholders as high usage reporting.

If, however, the information is being collected to inform government policy, the FRC would support a threshold based on energy usage.

The consultation identifies the FRC as the body which will have responsibility for enforcement in relation to compliance with this regime. We note that a threshold based on usage presents significant challenge to an enforcer as it is not always obvious whether the absence of disclosure is as a result of being outside of scope or is a breach of the requirements. At present, the FRC brings the lack of GHG disclosures to a company's attention if it appears to have overlooked the requirements. It is then a matter for the company to determine whether they fall within scope and the corrective action necessary.

Q7. If you prefer Population Approach A (all 'large' companies) which of the proposed company size definitions seems the most appropriate to you, (i) Companies Act 2006, or (ii) ESOS or (iii) any others?

As explained above, the FRC supports an approach using a pre-existing Companies Act 2006 threshold.

Q8. If you prefer Population approach C, which energy use threshold is most appropriate? Please explain your answer, and state who you think should be required to report, describing any other energy threshold(s) you may favour (with options including but not limited to 6GWh per year across all energy products, and 500MWh per year for each of electricity , gas and transport).

No response

Q9. Should reporting requirements within the Companies Act regime also apply to Limited Liability Partnerships (LLPs) [Yes or No]. Please explain your answer.

Yes. The FRC believes that application of these reporting requirements should be based on the economic importance of the entity, rather than the legal vehicle within which it operates. For the same reason, the FRC also believes that consideration should be given to extending this disclosure to public bodies.

We would, however, advise caution when considering how this extension of scope could be implemented within the current legislative reporting framework. Creating further complexity in the framework would be unwelcome.

Q10. Please state where you agree that UK quoted companies should continue, or start to report, on one or more of the following a) global Scope 1 and 2 GHG emissions b) an intensity metric, and start to report on c) global energy use?

Please also provide any views and evidence on the effectiveness of the current mandatory GHG reporting regime improving corporate transparency, reducing energy use, and reducing emissions.

We support the government's objectives in mandating implementing policies to help tackle climate change. We do, however, continue to question whether the current GHG reporting is more than simply a disclosure compliance exercise, resulting in non-contextual boilerplate rather than in meaningful disclosures that can affect board and investor decision making.

We also believe that an education gap exists and that there is a lack of understanding by some companies and some investors as to what the information means and its relevance to them. This lack of understanding also encourages boilerplate disclosures.

Q11. Do you agree that UK unquoted companies in scope should report on a) total UK energy use; b) Scope 1 and 2 GHG emissions associated with UK use; c) an intensity metric. Please explain your answer.

Do you agree that only electricity, gas and transport energy should be in scope for unquoted companies? Please explain your answer and if no, please set out what you think the scope should be.

No response

Q12. Should be government a) mandate the use of specific intensity metrics by sector; b) propose best practice in any guidance; or c) leave the matter to sectors, and to existing best practice and guidance.

The FRC believes that the policy decision in this area should be shaped by the primary outcome that government is trying to achieve.

If the primary objective of this disclosure is to allow the collection of data to inform public policy, then mandating specific intensity metrics would appear to the FRC to be the most appropriate policy.

If the primary objective is transparency and influencing decision making within boards, then the FRC supports the use of metrics that are relevant to the company's business and how it is managed. In our experience, pressure from investors and other market participants does result in a convergence of disclosure, but the FRC believes that giving companies the ability to tell their own coherent story, in a manner that reflects how the business is managed, is critical to providing relevant, decision-useful information.

The FRC also notes the ongoing work of the SASB to identify common industry metrics. We expect that this work may also influence best practice in the UK.

Q13. A) Do you think it should be mandatory for UK quoted and unquoted companies in scope to include information from the most recent audit (including energy management systems such as ISO50001) on i) any identified energy savings opportunities and ii) any energy efficiency action taken.

No response

B) Building on the energy and carbon disclosures proposed here, please provide views on whether in the long term any of the TCFD voluntary disclosures should become mandatory disclosures within companies' annual reports.

The FRC supports the aim of the TCFD recommendations; to enable companies to disclose clear, comparable and consistent information about the risks and opportunities presented by climate change.

The four overarching recommendations of the TCFD relating to governance, strategy, risk management, and metrics and targets, are similar in nature to the requirements of the strategic report. The FRC recognises that investors' interest in environmental matters has grown significantly and therefore the scope of information required by the existing legislative framework has broadened. However, we continue to have concerns that the disclosures at the level of detail set out in the TCFD recommendations within the annual report, will result, for some companies, in a report that lacks balance and understandability and is neither clear nor concise.

The FRC notes that the TCFD recommendations refer to materiality in the implementation guidelines, but, in our view, this materiality filter is given insufficient prominence in relation to the individual disclosures and does not appear to be reflected in the principles for effective disclosure set out within the recommendations.

For the reasons set out above, we are not persuaded that mandatory compliance with TCFD recommendations will result an appropriate level of disclosure within the annual report for all companies within scope, but we would encourage BEIS to explore reporting through mechanisms alongside the annual report.

C) Please specify what support government could provide to support uptake of TCFD disclosures by companies from all sectors.

No response.

D) Reporting of what other complementary information would add most value for business, the market and other stakeholders?

The FRC supports the disclosure of information relevant to assessing the long term success of a company within the annual report. While the annual report may provide information that is also of relevance to wider stakeholders, the FRC believes that information of importance to other stakeholders which is not material to a companies' long term success is best achieved via reporting outside of the annual report.

Q14. Please explain what guidance, tools and data companies might need: i) for financial and risk managers to understand climate risks and their implications for their business and ii) for companies to implement the TCFD recommendations in financial disclosures.

As noted above, the FRC believes that an approach whereby all companies within scope are required to report against all of the TCFD recommendations within their annual reports and accounts may result in documents which, taken as a whole, are not fair, balanced or understandable. Therefore a critical factor in increasing the disclosures relating to climate change risk within the annual report is the application of materiality. The FRC believes that any application guidance should have a strong focus on materiality and how to assess it in relation to climate change disclosures.

Q15. What other policy approaches can work with reporting to drive energy efficiency, reduce bills, reduce emissions, and improve transparency for investors so they are more able to hold companies to account? We are particularly interested to hear about any implications of potential complementary policy approaches for the design of an energy and carbon reporting scheme.

No response

Q16 Please provide views and any information you may have on the relative costs and benefits of:

(A)(1) Central digital reporting and publication of energy and carbon data, including specifically how these costs and benefits compare to reporting through the Companies Act regime on paper that is scanned to images by Companies House to make it available

(2) Please outline the different costs and benefits of:

(i) mandating electronic energy and carbon reporting via Companies House, with complementary activity by government to collate public data and make a single central data set available

(ii) replacing reporting to Companies House with a new dedicated central IT portal, the data from which could be published

(iii) placing such a dedicated central IT portal alongside the current proposals.

(B)(1) Dedicated administrator(s) and regulator(s), including specifically how these costs and benefits compare to administration and regulation of energy and carbon reporting as described in the Companies Act regime

(2) Please outline the different costs and benefits of administration and regulation in relation to both replacing the current proposed scheme and placing such a scheme alongside the current proposals.

No response

Q17 If replacing the proposed regime in future, please set out how a dedicated central energy and carbon reporting regime could continue to meet the needs of investors and others in relation to GHG reporting by UK quoted companies, currently required to be alongside financial information in annual reports

Please see comment to question 4 above.

Q18 Do you have any other comments on the description of how potential future enhancements to energy and carbon reporting might function under any of the possible approaches, have other suggestions for future enhancements, or consider that any aspects of energy and carbon reporting proposed for 2019 might be better deferred. Please explain your answer.

No response.