

New Zealand climate-related disclosure framework

August 2022

Introduction

The Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021 (the Act) establishes a climate-related disclosure framework for New Zealand and makes climate-related disclosures mandatory for climate reporting entities (CRE). The Act was passed and received royal assent on 27 October 2021, and it provides a mandate for the External Reporting Board (XRB) to issue a climate-related disclosure framework.

In July 2022, the XRB, after initial consultation in October 2021 and March 2022, has issued its Exposure Drafts of Aotearoa New Zealand Climate Standards (the EDs). The XRB intends to issue final climate standards and guidance documents in December 2022. If this deadline is met, it is anticipated that CREs will be required to make climate-related disclosures in their annual reports for accounting periods commencing on or after 1 January 2023.

This publication provides an overview of the EDs issued in July 2022, highlighting the proposed structure of the XRB's framework, disclosure requirements and timeline for application.

Scope - Who is captured by the Act

New Zealand has introduced a mandatory climate-related disclosure regime for CREs. The regime captures the following entities as CREs:

- ▶ Listed issuers with a total market value of equity securities or total face value of quoted debt securities exceeding \$60 million
- ▶ Registered banks, credit unions and building societies with total assets exceeding \$1 billion
- ▶ Licensed insurers with total assets exceeding \$1 billion or annual gross premium revenue exceeding \$250 million
- ▶ Managers of registered investment schemes with total assets under management exceeding \$1 billion

Listed issuers that have securities quoted only on growth markets or no quoted securities are excluded from the CRE definition. Large, privately held organisations are unlikely to be included based on the criteria outlined above.

Overseas incorporated organisations will be required to make disclosures if their New Zealand business meets the requirements outlined above.

Although not captured under the Act, an Enduring Letter of Expectations from the Minister of Finance and Minister of ACC states that Crown financial institutions with greater than \$1 billion in total assets under management should provide transparent climate reporting. The letter noted reporting should align with the TCFD recommendations, until the XRB's climate-related disclosure framework has been issued, at which point the XRB requirements should apply.

A CRE will be required to

- ▶ Keep proper records relating to their obligations to make climate-related disclosures
- ▶ Prepare climate statements as at the balance date, that comply with the climate-related disclosure framework
- ▶ Lodge its climate statement with the Registrar of Financial Service Providers

Climate statements or group climate statements (referred to as climate statements in this document) must be prepared within four months of an entity's balance date. A CRE that is required to prepare an annual report must include, in its annual report,

- ▶ A statement that the entity is a CRE
- ▶ A copy of its climate statement, or a link to the website where a copy of the climate statement can be accessed

The Act establishes a number of offences that may be committed. For example, a CRE, and every director of the entity, commits an offence if the entity or the director knowingly fails to comply with an applicable climate standard. An individual is liable on conviction to imprisonments for up to five years, a fine of up to \$500,000, or both. Any entity can be fined on conviction up to \$2.5 million.

Key impact

Large listed entities, banks, insurers and managers of registered investments schemes will be captured by the new disclosures. CREs are expected to be required to prepare climate statements for reporting periods beginning on or after 1 January 2023. A copy of an entity's climate statement, or link to website where it can be accessed, must be provided in its annual report.

The climate-related disclosure framework

The XRB has issued the following EDs as part of its climate-related disclosure framework

- ▶ Exposure Draft Aotearoa New Zealand Climate Standard (ED NZ CS) 1: *Climate-related Disclosures* (ED NZ CS 1)
- ▶ ED NZ CS 2: *First-time adoption of Aotearoa New Zealand Climate Standards* (ED NZ CS 2)
- ▶ ED NZ CS 3: *General Requirements for Climate-related Disclosures* (ED NZ CS 3)

ED NZ CS 1 consists of four sections: Governance, Strategy, Risk Management, and Metrics and Targets based on the TCFD's recommendations. Each section requires specific disclosures and are discussed further below.

ED NZ CS 2 provides entities with a limited number of exemptions on first-time adoption. It provides first-time adoption provisions for some disclosures required under the Strategy and Metrics and Targets sections. It also provides exemptions from providing comparative information and an analysis of trends. If a CRE elects to use any of the transitional provisions, it must include a description of those used in its statement of compliance with the climate standards.

ED NZ CS 3 establishes general requirements for entities to follow when making disclosures under Aotearoa New Zealand Climate Standards. It provides a set of information principles and presentation principles to achieve fair presentation. It also includes materiality considerations and the disclosure requirements for comparatives, methodologies, assumptions and estimation uncertainty.

Materiality is one of the key sections proposed in ED NZ CS 3. An entity must disclose all material information about its climate-related risks and opportunities. Information is material if omitting,

misstating, or obscuring it could reasonably be expected to influence decisions that primary users make on the basis of their assessments of an entity's enterprise value. An entity should consider the requirements in NZ CS 1 and its primary users' information needs to identify information it needs to disclose.

Guidance documents

As part of the EDs, the XRB issued the following staff guidance:

- ▶ Draft NZ CS 1: Guidance for all sectors - providing general application guidance for all sectors
- ▶ Draft Guidance for MIS Managers - providing specific guidance for managers of registered managed investment schemes

The guidance is non-mandatory. These documents are in draft format and will be issued and updated over time. It is expected the XRB will add to this guidance for other industries as practice evolves.

ED NZ CS 1 - Specific disclosures

ED NZ CS 1 includes specific disclosures, including, at a high level:

- ▶ Governance - disclosure of the governance body responsible for climate-related risks and opportunities and its oversight. Disclosure is also required of managements role in assessing and managing climate-related risks and opportunities.
- ▶ Strategy - disclosure of climate-related impacts, scenario analysis undertaken and the climate-related risks and opportunities identified in the short, medium and long term and their impact. Disclosure is also required of how a CRE will transition towards a low-emissions, climate-resilient future state.
- ▶ Risk Management - information around transition risks and physical risks including processes for identifying, assessing and managing that risk and how they are integrated into the CRE's overall risk management processes.
- ▶ Metrics and Targets - cross-industry metrics for greenhouse gas (GHG) emissions for scope 1, 2 and 3 emissions which are relevant to the entity regardless of the industry. Disclosure is also required of industry-based metrics relevant to the CRE and any other performance indicators and targets used to measure and manage climate-related risks and opportunities.

The Strategy section of ED NZ CS 1 requires disclosure of a CRE's scenario analysis undertaken to help identify its climate related risks and opportunities. This includes three scenarios, at a minimum. Specifically, a 1.5 degrees Celsius climate-related scenario, a 3 degrees Celsius or greater climate-related scenario, and a third climate-related scenario.

An entity can use the six-step approach set out in XRB staff guidance for all sectors to start their scenario analysis. The Task Force on Climate-related Financial Disclosures (TCFD) also provides guidance on employing scenario analysis in strategic management¹.

XRB staff recommend that an entity takes a relatively high-level approach in their first year of scenario analysis, touching on a broad range of different aspects of physical and transition risk and opportunity, to provide an overview of the climate-related risks and opportunity landscape, from which more detailed work can be planned. In subsequent years, an entity might then undertake a narrower, deeper dive into climate-related factors of greatest importance to the resilience of their business model and strategy, conducting a more thorough analysis of specific categories of physical or transition risk or opportunity.

Assurance

ED NZ CS 1 requires CREs to ensure that climate statements that disclose GHG emissions are the subject of an assurance engagement. ED NZ CS 1 proposes the assurance requirements become applicable for reporting periods ending on or after 27 October 2024 (likely to be an entity's second climate statement).

The intended scope of the assurance engagement includes:

- ▶ Scope 1, 2 and 3 GHG emissions
- ▶ Additional requirements for the disclosure of GHG emissions under ED NZ CS 1 which include (a) a statement describing the recognised standard or standards that its GHG emissions have been measured in accordance with, (b) the GHG emissions consolidation approach used: equity share, financial control, or operational control, and (c) a summary of specific exclusions of sources, facilities and/or operations with a justification for their exclusion
- ▶ The disclosure requirements of GHG emissions methodologies, assumptions and estimation uncertainty under ED NZ CS 3

Assurance engagements can be either 'reasonable' or 'limited' assurance. ED NZ CS 1 proposes limited assurance. Entities may choose to obtain reasonable assurance over some of all of their GHG emissions disclosures and voluntarily obtain assurance over other disclosures beyond GHG emissions.

Timeline

Submissions on the three EDs close 26 September 2022 and the XRB expects to issue the final standards and any guidance documents in December 2022. The EDs propose an effective date of 1 January 2023.

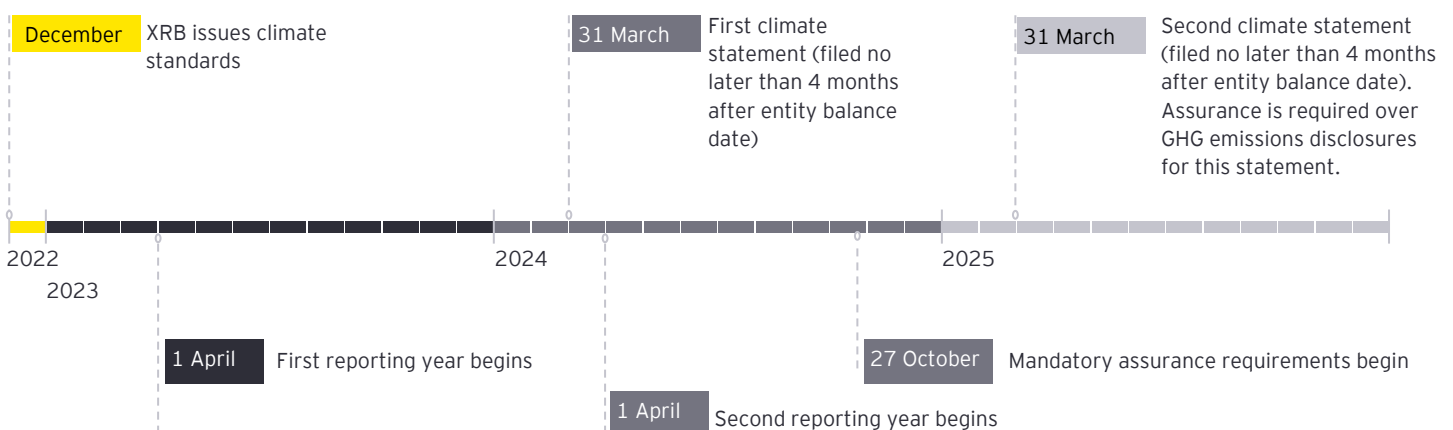
Key impact

- ▶ Climate reporting entities will be required to disclose climate statements in respect of accounting periods of the entity that commence on or after 1 January 2023.
- ▶ Climate reporting entities will be required to get GHG emissions disclosures assured for any accounting period (including open accounting periods) that end on or after 27 October 2024.

International Sustainability Standards Board

The International Sustainability Standards Board (ISSB) has also been active in its program to produce climate-related disclosure standards. In March 2022, it issued two exposure drafts on general requirements and specific climate-related disclosures. Both the XRB and the ISSB have used the TCFD framework for developing climate-related disclosures. The XRB has issued an alignment document comparing the EDs to the ISSB's exposure drafts. There is reasonable alignment although some disclosures do differ.

Figure 1: Example timeline for an entity with a 31 March balance sheet



¹ TCFD Guidance on Scenario Analysis for Non-Financial Companies 2020 issued in October 2020

Next steps

Climate-related disclosure is not just about transparency. It is about transformation. The following recommendations suggest how entities can navigate and prepare for the requirements.

1. Don't wait until climate standards become effective

Climate reporting is mandated in New Zealand. ED NZ CS1 significantly increases the requirements on mandatory disclosures beyond current leading practice. Entities need to take this opportunity to progress current climate-related work, in order to prepare themselves for the step up in disclosure requirements from next year.

To begin, entities need to consider how climate change fits into their governance, strategy and risk management functions, and should start scenario analysis in advance of the standard becoming effective. Once key climate-related risks and opportunities are identified, measurement and reporting processes need to be implemented to disclosure on these.

2. Put climate reporting on the board's agenda

Board oversight of an entity's climate reporting is critical for establishing and maintaining good governance, policies and controls over the climate-related process. An entity will need to:

- ▶ Incorporate or make available relevant experience and expertise at the board level
- ▶ Clearly define climate-related roles and responsibilities of the board and/or its other committees
- ▶ Make sure there is board oversight of most climate-related matters
- ▶ Develop climate-related policies and implement regular monitoring of climate-related performance

Boards will need to be across the requirements of the XRB's climate standards and how the FMA will monitor and enforce the framework. In addition, Boards will need to oversee a materiality assessment and gain comfort over how climate change is integrated into current risk management processes.

3. Seek assurance to build trust in climate reporting

To build trust in the depth and reliability of climate-related disclosures, entities should ensure that their climate reporting has robust processes and controls with a supporting audit trail. This should ideally be done before mandatory disclosure requirements are instigated to identify and resolve any significant measurement, control and reporting issues.

The XRB's current proposals will require limited assurance over GHG emissions. This can be provided by either their statutory auditor or an independent assurance service provider. Entities should focus on audit preparedness as a means of building stakeholder confidence and complying with regulatory obligations.

4. Contribute to the standard setting process

The XRB has just issued its exposure drafts on the three proposed climate standards and guidance documents. Entities can participate in the discussions and embed climate issues into their strategy for long-term value creation by being a part of the process. Read the proposals and consider responding to the EDs with a submission to the XRB.

To discuss further, please contact your local EY Advisor.

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