

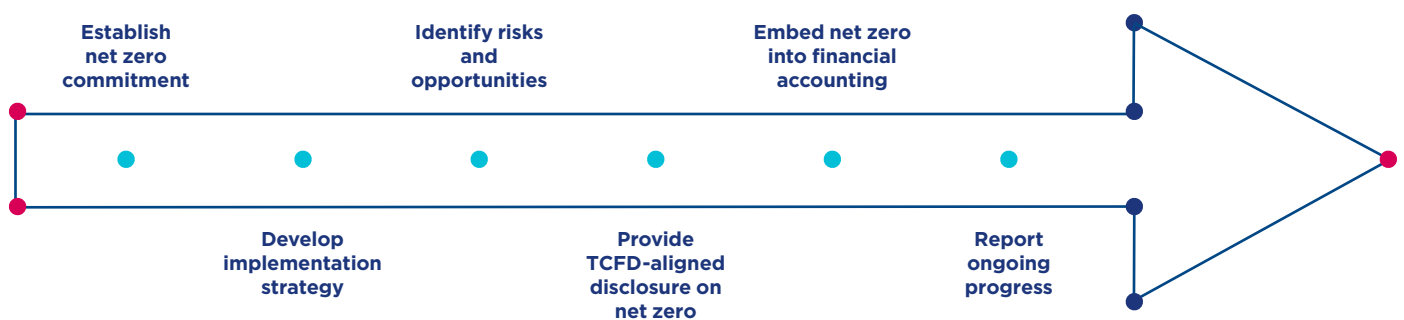
Net Zero: walking the talk



Practical steps for a connected Net Zero and TCFD aligned mainstream financial report

Practical steps for reporting net zero

- ✓ Report the scope, baseline and methodology for your net zero target;
- ✓ Develop an implementation plan to show the actions you expect to take to achieve net zero;
- ✓ Break the ambition down into interim targets and strategies over the short and medium-term;
- ✓ Identify the potential risks and opportunities of achieving net zero for your business;
- ✓ Develop an estimate for the capital expenditure required to deliver your net zero strategy; and
- ✓ Start to plan for how your net zero commitments can be integrated into your financial reporting.



Introduction

An increasing number of companies have signalled their intention to transition towards net zero, however current corporate disclosure provides little to no information to help investors and other stakeholders properly understand these commitments. A study of the world's 250 largest companies highlighted that 46% reported a net zero or science-based target, but only 17% provided information on their strategy to achieve carbon reduction targets¹. When it comes to embedding climate risks into financial reporting, recent analysis suggests over 70% of carbon-intensive firms are failing to include material climate-related matters in their financial statements².

Calls for companies to expand upon net zero ambitions with fully substantiated transition plans are growing. For example, in January 2021, leading asset manager Schroders [called upon all companies in the FTSE 350](#) to publish detailed, costed, transition plans to achieve net zero. The [potential legal liabilities](#) for companies in making poorly substantiated net zero claims are also increasingly becoming apparent. Unless businesses

quickly move from commitments towards clarity in their disclosures, net zero ambitions risk appearing as a deliberate attempt to greenwash corporate strategies. To provide investors with the information they need to finance the net zero transition, it is imperative that company disclosures move beyond high-level commitments to comprehensive reporting upon their action plans and progress towards net zero.

Defining net zero

Net zero refers to the state reached when an organisation's greenhouse gas emissions are reduced in line with a science-based pathway, and any remaining emissions that cannot be further reduced are fully neutralised by like-for-like permanent removals.

These removals can be undertaken by the organisation directly, within its value chain, or through the purchase of valid offset credits.

Source: [Race to Zero](#)

1 KPMG (2020) Towards net zero: How the world's largest companies report on climate risk and net zero transition. [Online]. Available from: <https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/11/towards-net-zero.pdf>

2 Carbon Tracker (2021) Flying blind: The glaring absence of climate risks in financial reporting [Online]. Available from: <https://carbontracker.org/reports/flying-blind-the-glaring-absence-of-climate-risks-in-financial-reporting/>

Good practice net zero strategies

- Activities to remove emissions from the atmosphere (e.g. afforestation, or carbon capture and storage) are only pursued once all opportunities to reduce absolute emissions have been exhausted;
- Actions are prioritised in the near-term, over relying on the use of emissions removal technologies in the future;
- All relevant and material emissions sources, including Scope 3 emissions, are included within the net zero commitment; and
- Where offsets are used, they are properly measured, verifiably delivered, and represent permanent removals of carbon from the atmosphere.

Sources: [SBTi](#), [Race to Zero](#)

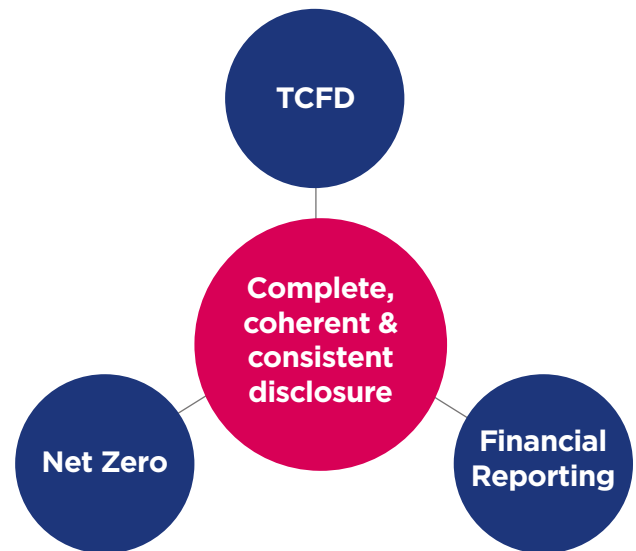


Figure 1: Connected mainstream financial report

Disclosing net zero

Companies must urgently move beyond net zero ambition statements towards providing a complete, coherent, and consistent disclosure on their net zero strategies and progress. Information on net zero can be disclosed in a complementary manner to existing climate-related financial reporting and aligned to the [Task Force on Climate-related Financial Disclosures](#) (TCFD) recommendations via a company's mainstream financial report. Additionally, as detailed in Figure 1, both TCFD disclosures and net zero reporting must be connected to information disclosed in companies' financial statements, to provide a coherent and connected view on how climate mitigation and adaptation are being factored into finance.

Note: Mainstream financial reports are the annual reporting packages in which organisations are required to deliver their audited financial results under the corporate, compliance or securities laws of the country in which they operate, sometimes referred to as a general-purpose financial report

Connecting TCFD and net zero

A net zero emissions reduction strategy can be viewed as an important means of mitigating climate-related risks, as well as a way to best capitalise on climate-related opportunities. For example, by reducing its emissions, a business can also reduce its exposure to the risks of future carbon emissions taxation, whilst achieving cost reductions through improved energy and resource efficiency. Equally, providing transparent disclosure of progress towards net zero can help mitigate regulatory and reputational transition risks, and provide clarity and confidence to investors looking to manage their exposure to climate-related risk.

Adopting a net zero strategy may also introduce potential risks for an organisation. Careful assessment, disclosure and ongoing management of these risks, aligned to the TCFD's framing of physical and transition risks, is therefore an important accompaniment to a net zero commitment. Aligning disclosure on net zero commitments to the recommended disclosures of the TCFD can help ensure that the climate-related financial risks associated with this emissions reduction pathway are appropriately identified, assessed and reported to investors.

The concept of net zero has grown in prominence since the original release of the TCFD recommendations, and recent additions to the TCFD's guidance incorporate guidelines for companies looking to disclose on net zero. The TCFD's Proposed Guidance on Metrics, Targets and Transition Plans³ introduced the concept of transition plans into the TCFD's framing. A transition plan describes an organisation's strategy to minimise risks and increase opportunities as the world transitions to a low carbon economy. The TCFD's additional guidance for transition plans address the associated aspects of the strategic transformation necessary for a business to achieve net zero. This can therefore be readily applied to reporting upon progress towards this target.

³ TCFD (2021) Proposed Guidance on Climate-related Metrics, Targets and Transition Plans. [Online]. Available from: https://assets.bbhub.io/company/sites/60/2021/05/2021-TCFD-Metrics_Targets_Guidance.pdf

Net zero and scenario analysis

There is an important distinction between developing a net zero strategy (aligned to limiting global temperature rise to 1.5°C), and assessing the implications of potential alternative climate scenarios to consider your strategic resilience to a range of plausible alternative outcomes. A net zero strategy sets out an organisation's emissions reduction pathway to mitigate its own climate-related impacts. Scenario analysis refers to a method for assessing the risks and opportunities that a range of potential climate futures may pose to your business. It can be used to develop forward-looking plans, which are more flexible and robust, both under the desirable outcome of limiting warming to 1.5°C, and also to potential alternative outcomes which could see much higher levels of warming.

Whilst net zero is therefore an important consideration in developing climate mitigation strategies, a sole focus on this singular outcome would not necessarily enable an organisation to adequately prepare for the

uncertainties that the physical and transitional impacts of climate change may bring. It's therefore important to be clear when building a net zero strategy that both developing a plan to align your emissions to this trajectory, and also conducting scenario analysis to assess your resilience to a range of scenarios, are of equal importance. These should be treated as interconnected, yet distinct, exercises.

Narrative reporting

A key starting point for many organisations in reporting upon their net zero commitments will be its inclusion within the narrative disclosure provided in the 'front half' of the mainstream financial report. Much of the information that companies should seek to disclose to move from commitment to clarity on net zero are addressed by existing climate-related reporting standards (i.e., TCFD). For example, the key aspects of a net zero strategy which an organisation should seek to include in its mainstream financial report can be mapped to the TCFD core elements as follows:

Governance

- The organisation's overall commitment to net zero;
- The oversight provided by board in establishing the net zero implementation strategy;
- Management-level accountability for delivering the strategy; and
- How leadership will monitor ongoing progress towards net zero and related interim milestones.

Strategy

- The organisation's implementation plan to deliver upon its net zero ambition over the short, medium and long-term;
- How the net zero goal will be integrated with strategic and financial planning processes, including identifying forward-looking capital expenditure plans to finance the commitment;
- Ongoing progress against actions being implemented to achieve the net zero goal; and
- Testing the robustness of the plan to achieve net zero through scenario analysis, whilst using wider exploratory scenarios to prepare for other possible futures.

Risk Management

- How risks and opportunities connected to achieving the net zero commitment are identified, assessed and managed; and
- How the risks associated with net zero are integrated within the organisation's wider risk management processes.

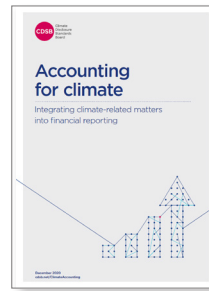
Metrics and Targets

- The net zero target year, its baseline year, and the scope of greenhouse gas emissions (i.e., scope 1, 2 and 3) included within the target;
- The net zero emissions reduction pathway, including the relative contribution of absolute emissions reductions and emissions removals to achievement of the target, as well as the methodologies used to develop the pathway;
- Interim targets to ensure sufficient near-term progress towards the long-term net zero commitment;
- Additional metrics used to monitor progress in implementing the net zero strategy, e.g. proportions of R&D investment, revenues and capital allocations that are aligned to net zero; and
- Confirmation that the net zero target and/or interim targets align to a science-based pathway for absolute emissions reductions.

Financial statements and net zero

As well as providing narrative disclosure on net zero in the 'front half' of the mainstream financial report, it is vital that organisations commence reporting on net zero in their 'back half' financial statements, in order to provide a complete, coherent and consistent story of its commitment to net zero. This can help to evidence that they are 'putting their money where their mouth is' to finance their net zero commitments, demonstrating to their investors that they are taking action near-term steps to deliver upon their ambition statements. In order to achieve this, it's critical that net zero commitments are embedded with financial processes, including strategic planning and budgeting. A key emphasis of the TCFD recommended disclosures was also in driving greater connection between climate and financial information in mainstream financial reports.

Whilst financial statements are backward looking, providing clear accounting for net zero, using existing financial reporting standards such as the International Financial Reporting Standards (IFRS), helps to demonstrate how business activities in the financial reporting year have contributed towards delivery of the long-term commitments. This can serve to complement the forward-looking narrative disclosure included elsewhere within the mainstream financial report, providing a connected view of both future plans and the current status of their implementation. It is also vital that forward-looking capital allocation plans disclosed within the net zero transition plan remain aligned to the information provided within the financial statements.



To support the inclusion of climate-related information into financial accounts, CDSB published its Accounting for Climate guidance⁴ in 2020.

The guidance identifies how material information on climate-related financial risks can, and should, be integrated within financial statements, under existing IFRS

Standards. The guidance clearly identifies the relevant aspects of IFRS Standards which already support the provision of climate-related financial disclosure. These provisions could also be used to specifically account for net zero within the financial statements. For example, IAS 1 – Presentation of Financial Statements – provides for the disaggregation of line items within financial statements, 'when such presentation is relevant to an understanding of the entity's financial position'. Therefore, to provide investors with connected information, which reflects its net zero commitment, disaggregation of line items pertaining to delivery of net zero could be specifically provided within financial statements. The guidance sets out clear next steps for companies to enable them to start out in integrating material climate-related factors in their financial reporting, including worked examples to help a preparer to understand how to implement such matters into financial reporting. For instance, Example B in the aforementioned guidance details a company announcing its intention to achieve net zero emissions by 2050 and the financial reporting implications that followed.

⁴ CDSB (2020) Accounting for climate: Integrating climate-related matters into financial reporting. [Online]. Available from: <https://www.cdsb.net/climateaccounting>

Resources to support financially-connected net zero disclosure

A4S (2021) Net zero: A practical guide for finance teams [Online]. Available from: <https://www.accountingforsustainability.org/content/dam/a4s/corporate/home/KnowledgeHub/Guide-pdf/Net%20Zero%20A%20Practical%20Guide%20for%20Finance%20Teams.pdf.downloadasset.pdf>

CDSB (2019) CDSB Framework for reporting environmental and climate change information. [Online]. Available from: <https://www.cdsb.net/what-we-do/reporting-frameworks/environmental-information-natural-capital>

CDSB (2020) Accounting for climate: Integrating climate-related matters into financial reporting. [Online]. Available from: <https://www.cdsb.net/climateaccounting>

CISL (2020) Targeting net zero: A strategic framework for business action. [Online]. Available from: <https://www.cisl.cam.ac.uk/system/files/documents/net-zero-a-strategic-framework-for-business-action.pdf>

KPMG (2020) Towards net zero: How the world's largest companies report on climate risk and the net zero transition. [Online]. Available from: <https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/11/towards-net-zero.pdf>

Race to Zero (2021) Race to Zero Lexicon. [Online]. Available from: <https://racetozero.unfccc.int/wp-content/uploads/2021/04/Race-to-Zero-Lexicon.pdf>

Race to Zero (2021) Starting Line and Leadership Practices 2.0. [Online]. Available from: <https://racetozero.unfccc.int/wp-content/uploads/2021/04/Race-to-Zero-Criteria-2.0.pdf>

Science-Based Targets Initiative (2021) Net-zero [Online]. Available from: <https://sciencebasedtargets.org/net-zero>

TCFD (2021) Guidance on Metrics, Targets and Transition Plans [Online]. Available from: https://assets.bbhub.io/company/sites/60/2021/07/2021-Metrics_Targets_Guidance-1.pdf

WWF (2021) Net zero: An introductory guide for financial institutions. [Online]. Available from: https://wwfint.awsassets.panda.org/downloads/net_zero__an_introduutory_guide_for_financial_institutions__june_2021.pdf



CDSB
60 Great Tower Street
EC3R 5AZ
London
United Kingdom

+44 (0) 203 818 3939
www.cdsb.net
info@cdsb.net
[@CDSBglobal](https://twitter.com/CDSBglobal)