HFMA response
September 2024

HM Treasury's TCFD-aligned disclosure exposure draft for phase 3

Introduction

HM Treasury has published an exposure draft[1] to consult on new climate-related financial disclosures covering phase 3 of the Task Force on Climate-related Financial Disclosures (TCFD) recommendations. Expanding on the TCFD-aligned disclosure application guidance for phase 1 and phase 2[2], this exposure draft addresses the recommended disclosures for the strategy pillars of the TCFD framework. This covers the whole of the UK public sector.

Phase 3 of this application guidance sets out the disclosure requirements for the third year of implementation. In addition to phase 1 and phase 2 disclosure requirements, phase 3 includes the TCFD strategy recommended disclosures that are descriptions of the:

- climate-related risks and opportunities the organisation has identified over the short, medium, and long term
- impact of climate-related risks and opportunities on the organisation's operations', strategy, and financial planning
- resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or 4°C scenario.

This guidance does not automatically apply to local government, NHS bodies (trusts, foundation trusts and integrated care boards), public corporations, and entities in the devolved administrations. Those bodies should follow the direction from their respective relevant authority and may choose to voluntarily apply this guidance. In the NHS, the *Foundation trust annual reporting manual* (FT ARM) and the *Group accounting manual* (GAM) incorporated phase 1 requirements in 2023/24 and phase 2 disclosures for 2024/25.

[1] HM Treasury *TCFD-aligned disclosure exposure draft phase 3*, July 2024
[2] HM Treasury, *TCFD-aligned disclosure application guidance – phase 1 and phase 2,* updated July 2024

Key messages

The HFMA's response to the consultation is based on discussions with members of the HFMA's Environmental Sustainability Special Interest Group and Accounting and Standards Committee.

The HFMA is broadly in support of the draft exposure and recognises the importance of the TCFD's aims to improve the quality and breadth of climate-related information in public sector annual reports and use disclosures to promote the management of climate-related financial risks and opportunities. Recognising the wide range of pressures currently faced in the NHS, it is key that we do not lose sight of the importance of the impact of the climate crisis.

However, we do note the following key areas for consideration in our response:

- the guidance could be more concise and easy to understand, recognising feedback from the 2023/24 annual report and accounts preparation and audit process that a number of new annual reporting requirements, in particular TCFD, were not well understood
- the need to consider value for the taxpayer, recognising the capacity and capability requirements of multi-disciplinary teams to provide the disclosures and ensuring proportionality is built into the requirements.
- there needs to be stronger links to the board assurance framework and individual risk registers
- the proposals should be more future focused to avoid the need to be rewritten almost as soon as agreed and implemented
- the guidance refers to climate relates risks and opportunities, yet there are few to no opportunities arising from climate change

Responses

Q1: Is the Principal, new and emerging risk section sufficiently clear? Does the guidance on risk assessments, risk reporting and risk prioritisation adequately set out the expectation and disclosure requirements, and support preparers? If not, what further detail should be added?

This section does clearly set out the different definitions of the types of risk and the summary in paragraph 3.27 is particularly helpful. However, as the guidance says, climate related risks are just one of the risks that an organisation is facing.

NHS bodies will include their principal risks in the board assurance framework (BAF) – our concern is that climate related risks may be too nebulous to be included in the framework when compared to the other risks they are facing around managing demand and the financial position. There is a variable approach across NHS organisations to how and where climate change risks are recorded. A particular challenge is how to measure climate risk proportionally to financial and operational risks.

To this end, it would be helpful if the disclosure requirements were clearer. The table on page 40 seems to summarise the requirements which effectively ask the body to either disclose the risk or explain why climate is not considered a principal risk. However, paragraph 3.29 onwards imply that climate related risks should always be disclosed.

We support paragraphs 3.1 that set out the role of the strategy, but our concern is that the specific requirements in paragraph 3.2 to disclose climate related issues could mean that reporting of other risks are overlooked. Hopefully, the materiality assessment will mean that climate related risks will not be reported if they are not deemed to be material. The FReM requires annual reports to be fair, balanced and understandable. Our concern is that this exposure draft is almost as long as the FReM itself and, while climate related risks are important, could result in reports that are unbalanced simply because of the focus of the guidance that bodies must follow.

We note that climate related risks will be the responsibility of multi-disciplinary teams including finance but not exclusively finance professionals. The guidance needs to be written in plain English without any assumptions about understanding the wider requirements for the annual report and accounts.

Recognising feedback from the 2023/24 annual report and accounts preparation and audit process that a number of new annual reporting requirements, in particular TCFD, were not well understood, we would recommend a clear and easy to understand summary of requirements.

Q2a: Do you support our approach to not adapt Strategy recommended disclosure a) or the Supporting Guidance from TCFD? If not, why not?

We support the decision not to adapt. We welcome the comply or explain approach, particularly recognising the difficulty in quantifying climate risk over the medium- and longer-term timeframe meaning that disclosures are likely to be high level and qualitative for many public sector bodies.

Q2b: Is the additional detail on time horizons, impacts with respect to broader public sector considerations, and climate-related opportunities sufficiently clear? Do you support this public sector interpretation? If not, why not?

The guidance in paragraphs 3.31 to 3.38 is helpful and the reference to organisations using this to input into their financial planning process (p41 and 42) is important, recognising how these disclosures can be used.

While the guidance refers to climate relates risks and opportunities, we note there are few to no opportunities arising from climate change

Q3a: Do you support our approach to not adapt Strategy recommended disclosure b) or the Supporting Guidance from TCFD? Do you support the interpretations for Strategy recommended disclosure b) and the Supporting Guidance from TCFD? If not, why not

We support the approach and particularly support paragraph 3.42 that talks about the balanced annual report.

Q3b: Is the additional clarification and guidance on impacts with respect to broader public sector considerations sufficiently clear? If not, why not? Do you believe further guidance is required in this sub-section? If so, what?

We welcome the recognition of the wider influence beyond operations and assets in the public sector. For example, the NHS has a target date of 2045 for reducing emissions it indirectly controls.

We support paragraph 3.50 that states, 'High-quality disclosure should be open with users on the level of uncertainty behind any quantitative information and assumptions included in estimates.'

Q3c: Are the disclosure requirements and guidance for quantification sufficiently clear? Do they strike the appropriate balance, considering the utility of the information for decision-makers and annual report users, as well as the ability of reporting entities to adequately make a quantified assessment? If not, why not?

The comply and explain approach is helpful and it is important to recognise the challenge organisations will face quantifying climate related risks. In the NHS financial and operational pressures are impacting on already limited capacity in respect of both dealing with demand and workforce availability. Data collection is a key challenge, requiring often new and more comprehensive mechanisms to collate data in order to measure and manage these risks. As we have said before, there needs to be a balance both in reporting on and managing all of the risks bodies face.

Q4: Are you supportive of the adaptation to Strategy recommended disclosure c) to remove the revenue size thresholds consideration for robust scenario analysis; and instead apply this guidance in deciding the level of detail for climate scenario analysis? Do you believe further guidance is needed in this section? If so, what?

The supporting guidance on page 47 is helpful, particularly the list of areas for provider organisations to consider discussing how climate-related risks and opportunities are integrated into their:

- current decision-making and
- strategy formulation, including planning assumptions and objectives around climate change mitigation, adaptation, or opportunities.

Paragraph 3.56 refers to where climate is identified as a principal risk (or a significant component of another principal risk), the organisation must apply climate scenario analysis to test the strategic resilience of the organisation to different future plausible climate states - or explain non-compliance. This is not an area that many in the NHS will have expertise or experience, and it is likely to be new for many. The additional reference to climate scenario analysis on page 49 is welcome as well as the link at 3.59 to TCFDs guidance on scenario analysis.

It is also worth noting that climate change is likely to have an impact on patterns of disease, such as respiratory diseases, which will in turn influence what organisations might be asked to do to adapt to these changes. Scenario analysis should include consideration of both how climate change might impact on current activities as well as how it might change the activities themselves.

Q5: Are you supportive of the application guidance setting a common reference periods of mid-century (2050s)? If not, why not? Which alternative reference period (or anchor point) would you suggest, if any?

Yes, we are supportive. We welcome paragraph 3.61 that allows deviation from these dates because the NHS has specific target dates of reducing the NHS carbon footprint to net zero by 2040 and the NHS carbon footprint plus emissions over which there is influence by 2045.

Q6a: Are you supportive of the application guidance setting a common reference period of the end of the century (2080-2100)?

Yes.

Q6b: Are you supportive of this reference period, only being required where reporting entities: 1. own, manage or regulate significant long-life assets or infrastructure; or, 2. deliver essential public goods and services which are likely to be significantly impacted by climate change; or, 3. set longer term policy which is, or regulate industries/sectors that are, likely to be significantly impacted by climate change. Do you support the chosen test characteristics? If not, why not? What alternative text characteristics would you suggest? Is this guidance sufficiently clear for reporting entities? If not, why not?

We support this reference period - although paragraph 3.64 could be made clearer by simply indenting the criteria 1, 2 and 3 so it is clear that the final bullet (the reference period to the end of the century) only applies to organisations meeting that fall within these criteria.

Q7: Are you supportive of mandating a total of three reference periods (or points)? Are you supportive of near-term reference periods (or points) being selected by the organisation? Is this guidance sufficiently clear? If not, why not?

It would be helpful if there was some guidance as to what near-term referenced in paragraph 3.66 actually means. The reference to the 2030s implies that it means 5-10 years but this should be more explicit.

Q8: Are you supportive of aligning climate scenario analysis with the global warming level/temperature pathways set out by the Climate Change Committee? If not, why not? Do you believe further guidance is needed in this section - including on alternative physical and socio-economic pathways? If so, what?

We are supportive of using the CCC as a recognised expert body

Q9: Is the guidance on transition pathways and shadow carbon pricing sufficiently clear? Does this support preparers with this type of analysis and disclosure? If not, what further detail should be added? Are there any other potential or perceived risks which have not been addressed in this guidance?

We do not have any comments on this area.

Q10: Do you support the approach that scenario analysis is conducted every 3 to 5 years, or more frequently where the assumptions used no longer apply? Is the associated guidance sufficiently clear? If not, why not? Do you believe further guidance is needed in this section? If so, what

Yes, this seems reasonable, thought the accelerating rate of climate change suggests that organisations should be encouraged to re-analyse sooner rather than latter, whenever possible.

The guidance could be more future focused to avoid the need to be rewritten regularly.

Q11: Is the Climate Scenario Analysis section sufficiently clear? Does the guidance on transition driven pathways, and support preparers with this type of disclosure? If not, what further detail should be added? Do you believe further guidance is needed in this section?

Yes, the guidance on climate scenario analysis provides support an area that will be new to many. As set out in 3.1, it is helpful to recognise that while quantitative climate scenario analysis is useful, qualitative analysis may be appropriate. We agree that a cost benefit analysis should be undertaken taking into account the high level of uncertainty in this area.

About the HFMA

The Healthcare Financial Management Association (HFMA) is the professional body for finance staff in healthcare. For over 70 years, it has provided independent and objective advice to its members and the wider healthcare community. It is a charitable organisation that promotes best practice and innovation in financial management and governance across the UK health economy through its local and national networks.

The association also analyses and responds to national policy and aims to exert influence in shaping the wider healthcare agenda. It has particular interest in promoting the highest professional standards in financial management and governance and is keen to work with other organisations to promote approaches that really are 'fit for purpose' and effective.

The HFMA offers a range of qualifications in healthcare business and finance at undergraduate and postgraduate level and can provide a route to an MBA in healthcare finance. The qualifications are delivered through HFMA's Academy which was launched in 2017 and has already established strong learner and alumni networks.

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