Developing Malaysia's Roadmap to Net Zero

State of play on net zero reporting and inherent risks of not meeting net zero targets

May 2022

Contents

Foreword

By Datuk Johan Idris | Managing Partner, KPMG in Malaysia

In February 2022, the United Nation's Intergovernmental Panel on Climate Change (IPCC) released its Sixth Assessment Report, which warned that any further delay in global action to slow climate change and adapt to its impacts "will miss a brief and rapidly closing window of opportunity to secure a livable and sustainable future for all"[1].

The report detailed how climate change is being felt across our planet including one notation stating, "approximately 3.3 to 3.6 billion people live in contexts that are highly vulnerable to climate change". But perhaps the most shiver-inducing statement came in this finding that if global warming continues unchecked, it is likely that the proportion of all terrestrial and freshwater species "at very high risk of extinction" will reach 9% (maximum 14%) at 1.5°C. This rises to 10% (18%) at 2°C and 12% (29%) at 3°C.

The enduring results of climate change will have consequences far beyond the environment to further impact the broader social and economic landscape. We see proof of this in the debilitating floods across multiple states in Malaysia that began in December 2021 and continues until today.

Corporate Malaysia must take a proactive role in the face of the climate crisis and collaborate with governments and other institutions for better. Fortunately, we observe many companies are already making valiant efforts to include Environmental, Social and Governance (ESG) and net zero commitments in their boardroom agendas. Investors are also increasing pressure for businesses to disclose their exposure to climate-related risks and explain their strategies to ensure long-term resilience and competitive advantage.

Setting net zero ambitions are well and good, but the challenge lies in achieving them. This difficulty to transform ambition into action is a common experience; in fact, KPMG's latest survey found that most CEOs reported the complexity of decarbonizing supply chains to be the greatest barrier to achieving their net zero/ESG ambitions[2].

This thought leadership sheds light on net zero and how to achieve that end. Corporate reporting is a step towards taking greater accountability and a more transparent approach towards measuring these efforts. There is always more to be done as new technology, policies and consumer behaviors emerge every day towards enabling a more sustainable ecosystem.

By working together, I am optimistic that Corporate Malaysia will make great strides forward in helping to achieve a more sustainable future for everyone.

1. United Nation's Intergovernmental Panel on Climate Change (IPCC), 28 February 2022. "Climate Change 2022: Impacts, Adaptation and Vulnerability. Working Group II Contribution to the IPCC Sixth Assessment Report"
2. KPMG International, CEO Outlook Pulse Survey 2022

Foreword

By Dr. Veerinderjeet Singh | President of MICPA

The rising global temperatures have become alarming and have caught the attention of global forums. Our Government has also called on organisations and individuals to tackle global warming – all of us play a part in acquiring and enhancing our knowledge of this phenomenon and contributing to the healing of what is already a worldwide crisis. In light of this development, Bursa Malaysia has proposed amendments to the Listing Requirements aimed at enhancing disclosures on sustainability material matters and indicators for listed issuers across all sectors. Such proposals align with the climate change related disclosures of the Task Force on Climate-Related Financial Disclosures (TCFD) Recommendations for listed issuers. This alignment will help Malaysia's reporting on climate-related disclosures to be globally comparable.

With a new found pressure around the demands to disclose an organisation's climate-related risks and opportunities, organisations are expected to develop their strategies so as to maintain their edge in the market, including taking steps to reduce carbon dioxide emissions through various initiatives and approaches. Professional accountants, as trustworthy advisers to organisations they work with and for, are also expected to be cognisant of climate-related risks and net zero emission targets of organisations, consider cost-benefit perspectives of this issue, assess its implications to the finance function of organisations and advise employers diligently. In short, professional accountants and finance functions play a role in navigating the way to achieve organisational net zero emission targets, including:

- raising and allocating funds needed for adaptation;
- providing information and data to drive the agenda on the reduction of carbon dioxide emission;
- embedding the reduction of carbon dioxide emission in the decision-making process;
- devising strategies to achieve the committed targets;
- interacting with capital markets to meet the committed targets;
- ensuring compliance with regulatory requirements; and
- reporting performance against the committed targets.

As part of MICPA's efforts to prepare professional accountants in dealing with climate-related risk and net zero targets, we hope that this thought leadership publication can help you to commence efforts to tackle the issue of climate-related risk. The ultimate aim is to prevent a worsening climate crisis and to seize the opportunities that will arise in the process of transitioning to cleaner and greener energy.

Pressure is building

Climate change is recognised by central banks and supervisors worldwide as presenting significant risks to the global economy and financial system. These risks are complex and uncertain in their scale, geographic scope, and timing. Future conditions and their severity are dependent on current drivers such as policy settings, domestic and global markets, and atmospheric emissions.

Climate Action 100+ (an investor group comprising 615 firms with over US$65 trillion in assets under management) had demanded that the world's 160 largest companies publish strategies to reduce emissions by 45 percent by 2030 and to reach net zero by 2050. This is only the latest in a long list of investor initiatives to encourage the reporting of what is widely viewed as a material risk and will increasingly be a major opportunity.

The Taskforce for Climate-related Financial Disclosures (TCFD) has gathered huge and rapidly growing international support since it was first established in 2015. Supporters control balance sheets totalling over US$150 trillion and include all the world's systemically important banks, its largest asset managers, insurers, and pension funds. Additionally, an alliance of the leading climate disclosure standard setters – which are already interoperable with the overarching TCFD framework – facilitated by the Impact Management Project, have come together to build the technical underpinning for a single global sustainability reporting architecture.

The IAASB guidance sets out how auditors should consider climate risks and the adequacy of companies' climate disclosures under existing published standards, necessitating professional services firms adapt and support the rapid and broad adoption of corporate climate disclosure.

Climate-related financial disclosures must be made mandatory and designed around a core framework –ideally the TCFD – to ensure comparability. Heralding the first steps towards this goal, the International Financial Reporting Standards (IFRS) Foundation trustees recently published a consultation with proposals for a new Sustainability Standards Board, which could build on the work of TCFD and the alliance of voluntary standard-setters to issue global climate reporting standards.

In Malaysia, Bank Negara Malaysia (BNM)[1] has indicated that 11.7% of assets held by financial players are in sectors potentially at risk from climate change. BNM has determined that Malaysian financial institutions need to manage climate risk to ensure that their ability to provide financial intermediation services are not significantly impacted by climate change. As such, BNM has put in place mechanisms to:

- Ensure appropriate regulations are in place and that supervision to ensure financial institutions are adequately measuring, mitigating, and buffered against climate risks.
- Increase the capacity of financial institutions to be the catalyst in the transition to a low-carbon economy. This includes increasing their offering of green financial solutions that can help their customers to transition to greener practices and to better cope with climate-related events.

1. https://www.bnm.gov.my/climatechange

The economic implications of delayed transition to net zero emissions

KPMG in conjunction with the CSIRO of Australia[2] recently reported that the exposure of Australia's key economic exports, which derive from emissions-intensive industries with hard-to-abate emissions sources (mining, manufacturing, and agriculture) and in the case of agriculture and mining, are also highly exposed to physical risk, in the event of a delayed transition to a low carbon economy.

The study showed that fossil fuel intensive industries (fossil fuel sourced electricity, coal, and gas production) decline the most, as expected, in the emission-constrained delayed transition scenario. This is driven by the delayed and then rapid transition to renewable energy sources, electrification, and negative emission technologies.

The study also found that higher short-term decarbonisation targets coupled with domestic policy certainty could assist to smoothen the transition, avoid shocks, allow coordinated transition plans to be developed for the most vulnerable industries, and enable higher confidence to attract investment in emerging low emissions industries and technologies.

Given the fact that the Malaysian economy is highly dependent upon fossil fuel production and processes coupled with our strong agricultural activities, means Malaysia could face similar impacts should there remain a lack of real government policies to mitigate and manage climate change impacts.

The Malaysian government's commitment towards net zero at COP26 is a step in the right direction; however, the lack of real policy and a climate mitigation regulatory framework is a concern. Hence, it is imperative for Corporate Malaysia to take the helm in leading Malaysia's charge towards net zero.

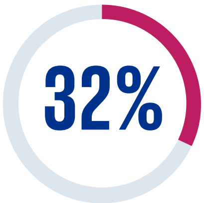
The Malaysian government's commitment towards net zero at COP26 is a step in the right direction; however, the lack of real policy and a climate mitigation regulatory framework is a concern.

2. Exploring climate risk in Australia: The economic implications of a delayed transition to net zero emissions, 2022

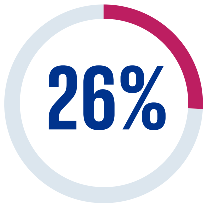
ESG at the top of mind

KPMG's CEO Outlook surveys found that ESG concerns have risen to the top of mind for CEOs worldwide.

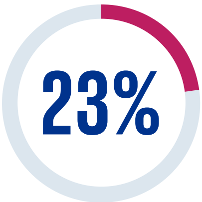
Key drivers accelerating their company's ESG strategy



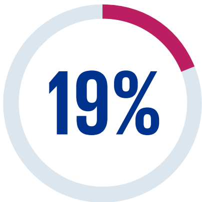
of CEOs are taking a more proactive approach to societal issues, such as increased investment in a living wage, human rights and a just transition



are increasing measurement and governance to build a more robust and transparent approach to ESG

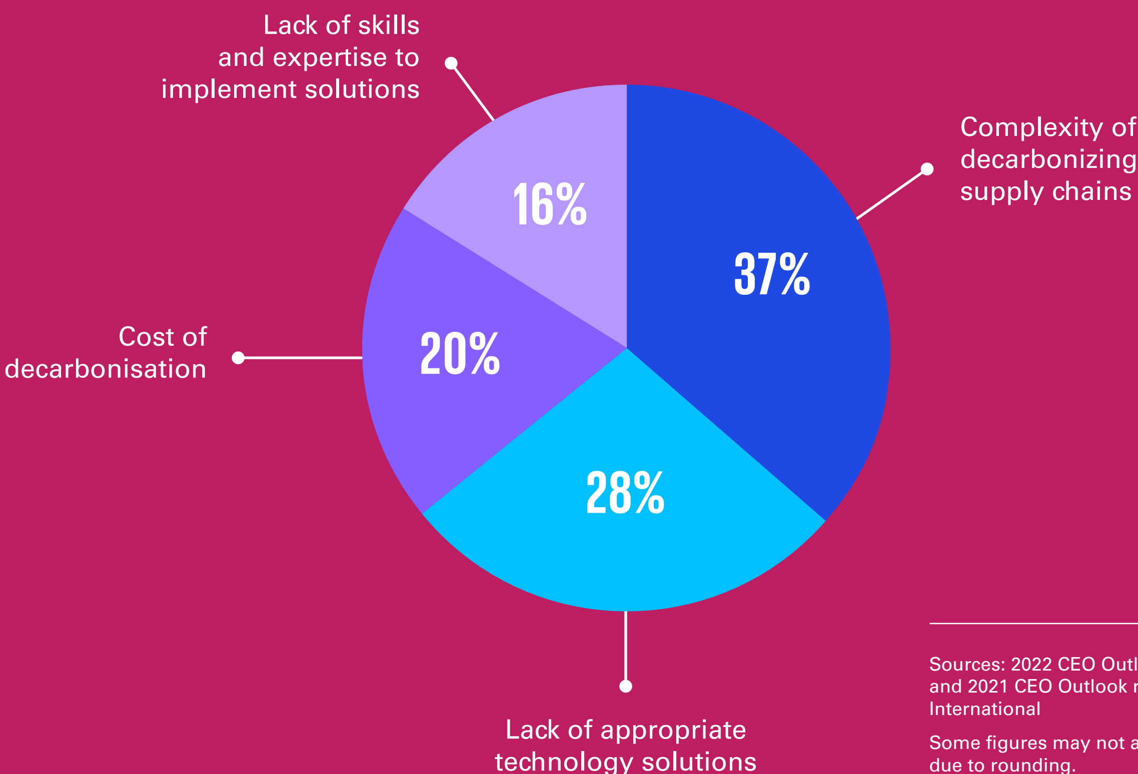


will be delivering greater gender equity in leadership and addressing historic gender issues including pay gaps



will implement a net zero strategy and/or measuring and acting on your company's carbon footprint

Greatest barrier to achieving net zero or similar climate ambitions



Sources: 2022 CEO Outlook Pulse Survey and 2021 CEO Outlook report by KPMG International

Some figures may not add up to 100 percent due to rounding.

Biggest challenge to deliver their ESG strategy

23%
Increasing or frequently changing regulations

19%
Identifying and measuring agreed metrics

14%
Failing to create value from ESG investments

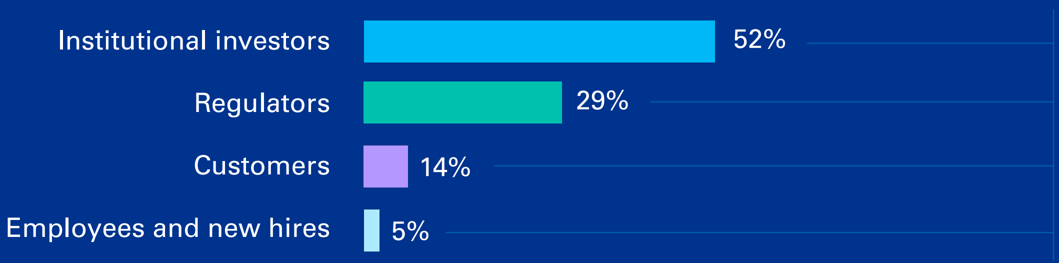
Heightened focus towards ESG reporting

15% considered integrating ESG reporting into their measurement and reporting processes as a top operational priority towards achieving their growth objectives over the next 3 years.

23% said that struggling to meet the ESG reporting needs of different investors and other stakeholders was a key challenge when communicating their ESG performance to stakeholders.

58% saw significant demand from stakeholders for increased reporting and transparency on ESG issues.

Pressures are coming from:



Sources: 2022 CEO Outlook Pulse Survey and 2021 CEO Outlook report by KPMG International

Some figures may not add up to 100 percent due to rounding.

How are corporations doing?

KPMG's 12 quality criteria for climate risk and net zero reporting comprise of:

Source: Towards net zero, November 2020, KPMG International

A study conducted by KPMG in 2020 analysed how the world's 250 largest companies (as defined in the 2019 Fortune 500 list)[3] measured up against a set of quality criteria for climate disclosures on climate risk and net zero transition.

At first glance, KPMG's research suggests that the world's largest companies, henceforth referred to as the G250, are still some ways from demonstrating good practice in reporting on climate risk and net zero transition. However, closer observation of the data shows a complex and mixed picture – these companies are doing better at some aspects of reporting than others, and there are notable variations in reporting quality between companies based in different geographies and operating in different sectors.

For example, Japanese companies perform particularly well in demonstrating good governance of climate risk in their reporting and delivering high quality scenario analysis, but they do not do so well at reporting their decarbonisation strategies clearly. German companies lead the world in setting net zero decarbonisation targets, but lags when it comes to transparent reporting of their progress toward meeting such targets.

On a sectoral level, companies in the technology, media, and telecommunications sector, for example, are out in front for acknowledging the financial risk of climate change in their reporting. Few of them, however, are using scenario analysis to model and disclose those risks.

Overall, the data paints a picture in which most large companies in most countries have the basics of climate risk reporting in place. They have acknowledged climate change as a financial risk and are reporting, to some extent, on both the physical and transitional climate risks their businesses face. However, only one in five are following the TCFD recommendation to apply scenario analysis to assess and disclose the potential impacts of these risks, and even fewer are doing a good job of it.

Regarding reporting on decarbonisation and net zero transition, an encouraging number of companies have set carbon reduction targets aligned with what climate science tells us is needed. This is a significant

3. https://fortune.com/global500/2019/

improvement from the situation five years ago when KPMG research showed that the carbon reduction targets being set by the world's biggest businesses were largely arbitrary and unexplained.

On the other hand, the G250 as a group still have a lot of work to do to improve the way they report their decarbonisation strategies and progress.

Details of findings from KPMG's research are presented in the following subsequent sections.

Governance of climate-related risks

Board responsibility for climate change

Out of the G250 companies, 44 percent confirmed that the company has assigned board responsibility for overseeing the company's response to climate change. This is encouraging as it suggests a growing trend for large companies to assign responsibility for climate change at the highest levels of the organization. However, this statistic disguises wide disparity between countries. All 28 Japanese companies in the G250 sample have assigned board responsibility for climate change but the practice is less common in other locations.

The Chair or CEO's message

Leaders of companies based in Germany, France and Japan are far more likely to reference climate change or climate risk in their messages than their counterparts in the US or China. This may be driven in part by regulatory factors, such as mandatory climate reporting in France. This is concerning, given that China and the US together are responsible for almost 40 percent of global emissions. While a large majority (80 percent) of oil and gas company leaders acknowledge climate change as a core issue for their businesses, the trend is not yet seen in other high carbon sectors: automotive and industrials, metals & manufacturing.

Acknowledging climate change as a financial risk

This data point refers to acknowledging climate change as a potential risk in the company's financial reporting i.e., making it clear to financial stakeholders that the company considers climate change to be a financial issue rather than a sustainability or 'non-financial' issue. A majority of the G250 now acknowledge climate risk in their financial reporting – a notable, if not dramatic, increase since 2017 when less than half did so (48 percent), according to KPMG's survey.

French and Japanese companies take the lead in several other quality criteria. Surprisingly, a significant number of German companies are still only discussing in non-financial reporting. Public scrutiny of the role of fossil fuels in climate change is reflected in the high numbers of oil and gas companies that acknowledge climate risk in their financial reporting. Conversely, numbers are surprisingly low in the automotive sector.

Identifying climate-related risks

Clear reporting of climate-related financial risk

French companies lead when it comes to providing investors with information on climate risk. Almost all 18 French companies (94 percent) in the G250 published a clearly defined climate-risk section in their annual financial or integrated report and/or a separate report on climate risk.

Higher rates among the financial services and oil and gas sectors may be due to their close involvement in the TCFD. Financial services companies played a critical role in developing the TCFD recommendations, and the oil and gas sector was highlighted by the TCFD as a sector with particular exposure to climate risk.

Reporting both physical and transitional risks

Globally, less than half of G250 companies reported on both physical and transitional climate-related risk. However, the figures are well above this level in France, Germany, Japan, and the US. In these countries, a significant majority of large companies (two thirds or more) have understood the concept of the two different types of climate-related risk and have accepted the need to report on both.

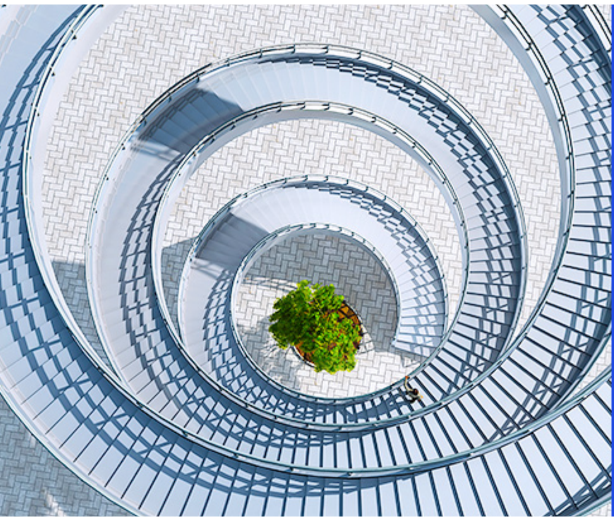
Marginally more companies worldwide report on physical risks than transitional risks. This suggests that some companies are less comfortable with discussing transitional risk. The same trend is largely reflected on a sector level. There are only three sectors in which more companies report on transitional than physical risks. These are financial services, oil and gas, and automotive. The latter two are historically high carbon industries and may be more threatened than others by net zero transition.

Globally, less than half of G250 companies reported on both physical and transitional climate-related risk.

Impact of climate-related risks

Conducting scenario analysis of climate-related risk

Just over one-fifth of the G250 companies now include climate-risk scenario analysis in their corporate reporting. Rates are especially high in Japan. On a sectoral level, financial services companies lead. This may be due to the sector's close involvement in developing the TCFD recommendations and pressure from many central banks exercising oversight of the sector in their countries.



One in ten (or 26) G250 companies has developed a sophisticated approach to climate scenario analysis by reporting under two or more global warming scenarios.

Using multiple climate scenarios and clear timelines

One in ten (or 26) G250 companies has developed a sophisticated approach to climate scenario analysis by reporting under two or more global warming scenarios. This does not mean that others are not working on it. Based on observations by KPMG professionals, companies commonly spend two years or more developing scenario analysis before disclosure. A further 24 reported just under one warming scenario, while only three companies reported under three separate global warming scenarios.

Even fewer companies are taking a long-term view of climate-related risks and opportunities. Less than 10 percent (20 companies) of the G250 reported under scenarios to 2050 or beyond. All but one of the companies that are taking a long-term view of climate change to 2050 or beyond are based in the US, Japan, France, or Germany. Almost half are in the financial services sector.

Using reputable sources for climate scenarios

Around one-fifth of G250 companies include climate scenario analysis in their reporting. Of these, almost 90 percent have referenced climate scenarios developed by reputable sources. This suggests that although reporting of climate scenario analysis is still in the minority, the companies that are doing it are, for the most part, basing their analyses on sound scenarios. The most used scenarios among this group were the IPCC physical climate scenarios (used by around two-thirds of G250 companies reporting scenario analysis) and the IEA transitional scenarios (used by just over half).

Slightly more companies reported scenario analysis of physical risks than transitional risk. This may be because physical risk is arguably less complex to model under established climate science projections than transitional risks which must be modelled to a large extent on forecasts of geopolitical factors, such as global treaties and policy responses.

Reporting on net zero transition

Setting net zero or science-based targets

KPMG's survey found 46 percent of G250 companies' reporting states the company's ambition to achieve net zero carbon emissions at or before 2050 or explains another target – this is a significant progress since 2017 when our survey found less than one-third of the G250 linked their corporate carbon reduction targets to greater climate goals.

The automotive sector, and technology, media and telecommunications sector, are currently leading when it comes to setting net zero targets. This is likely related to the progress made by these sectors in electric vehicles and renewably powered data centres respectively.

Germany leads with over three-quarters of its G250 companies setting net zero goals. According to Christian Hell, Leader of KPMG in Germany's

Sustainability Services practice, this is because German companies in the sample are historically seen as sustainability leaders. For them, pursuing new technologies and other innovations to make the leap towards net zero emissions is the logical next step to stay ahead in their market.

Reporting decarbonisation strategy

The previous section paints a positive picture of large companies setting robust decarbonisation targets linked to climate science. However, far fewer companies explain how they will achieve these targets in their reporting. German companies are leading in reporting their decarbonisation strategies, while automotive is the leading sector. This is largely because the sector's decarbonisation strategy is well established, namely a shift towards electric vehicles, driven partly by regulation in some countries to end the manufacture and sale of new fossil-fuelled vehicles.

Communicating progress towards decarbonisation

Less than one-quarter of G250 companies perform well when it comes to clearly reporting progress toward decarbonisation targets, with the technology, media and telecommunications sector performing best. This may be because decarbonisation strategies in this sector can be more straightforward, focusing on product energy efficiency and clean energy for data centres. Decarbonisation in oil & gas or industrials, metals & manufacturing, for example, is arguably more complex. Slow progress may result in reluctance to be transparent. A strong performance by French companies may be due to the 2018 transposition of the EU Non-financial Reporting Directive into French law.

Using an internal carbon price

Few large global companies report the use of an internal carbon price in their annual financial, integrated or sustainability reporting. Some companies may report the use of internal carbon pricing in other reporting, such as CDP submissions, which were not covered by this survey. For maximum investor visibility, KPMG professionals recommend inclusion in primary reporting channels. French companies are an exception – almost half of French G250 companies report the use of an internal carbon price.

National challenges

Barriers faced by corporations in Malaysia involve:

1. Energy supply currently under existing Power Purchase Agreements (PPA) is binding with regards to the fuel types used and costs. A PPA will contain all the necessary information such as the technical parameters and commercial arrangements required for the development, procurement, financing, fuel supply, and operations and maintenance of plants developed by Independent Power Producer (IPP). With these agreements in place, the ability of our electricity producers to pivot towards renewable energy use is limited, unless there is a change in the agreements and continued transformation of our national electricity sector to encourage and enhance the mobilisation of renewable energy.

2. The lack of infrastructure hindering the deployment of large-scale renewable energy. Distributors must think of ways to mobilise large buyers of electricity as well as smaller households. Tapping on technology to strengthen transmission and distribution networks can play a key role in optimising operations as well.

3. The enhancement of local renewable energy producer. There is a need to encourage both localised energy and community energy producers to ensure continuity of energy supply.

Our take on the findings

Upon further review, it would be easy to conclude that the world's largest companies are underperforming when it comes to reporting their climate risks and decarbonisation activities. The G250 report card seems to show that less than half of these companies currently satisfy the bulk of KPMG's quality criteria for good reporting.

Yet, it is important to view this data in its context. Corporate disclosure of climate-related risks, as we currently understand it, did not exist five years ago. It was at the UN Climate Conference of 2015 (known as COP21 and which spawned the Paris Agreement) that Mark Carney, then Chair of the Financial Stability Board, and Michael Bloomberg launched the TCFD. The reason they did so was precisely because they saw the lack of corporate disclosure of climate-related risk as a threat, not only to individual investors, lenders, and insurers, but also to the stability of the global financial system in its entirety.

Almost half have assigned board level responsibility for the company's response to climate change.

When we consider this, we can see how swift and significant the progress has been. Less than five years later, more than half of the G250 publicly acknowledge climate change as a financial risk. Almost half have assigned board level responsibility for the company's response to climate change. As noted in the previous section, these rates are considerably higher in some countries and industry sectors.

Similarly, the concept of net zero emissions is new to the mainstream political and business worlds. It first appeared in the text of the Paris Agreement of 2015, although the Agreement's deadline for achieving global net zero emissions was vaguely expressed as "in the second half of this century." It is only very recently that 2050 has begun to emerge as a widely adopted target date. In 2019, the UK, France, Denmark, and New Zealand enshrined achievement of net zero by 2050 into national law. A net zero target at or around the same year is now either in law or on its way to becoming law in approximately 20 countries and territories.

In this context, it is remarkable that one in five of the world's largest 250 companies already have a net zero emissions target in place. In some locations, such as Germany and Japan, the rates are even higher.

So, while there is much yet to be done and we must always guard against complacency, there is cause for some optimism. Even though performance is patchy, rapid progress over the last few years is clearly evident. It is our hope that this report, by providing insight into the current state of play, may help to close some of the gaps and contribute to further progress.

What's next?

It is important to remember that it can take a large company two years or more to prepare before it is ready to publicly disclose its climate risk information. The process can be time consuming and complex, especially for companies doing it for the first time. Organisations that are already making public disclosures can be considered true global leaders. They started the journey early with recognition that climate risk disclosure would likely not only become standard practice, but ultimately a mandatory requirement for businesses. They should be applauded, even if most disclosures are not yet complete nor satisfying all the quality criteria set out in this report. We can also see further progress taking place behind the scenes. Corporate experience is growing, and innovative, new ways of analysing climate risks and improved data are emerging. We are confident that more and deeper disclosures are on the way and that we will see a ratcheting-up of both the volume and quality of information being disclosed.

It is worth noting, in Malaysia, 11 companies have already committed to Science-based Targets[4], however, only four have provided firm targets for reductions. Of these two were small-medium enterprises.

For companies starting out on the journey, we offer the following:

1

First, reporting should be aligned and keeping pace with the development of the business itself. Even the world's largest 250 companies are on a journey and don't get everything right straight away. For those starting with reporting, our advice would be to take a business lens and let the reporting follow from that. Don't be too concerned about 'ticking all the boxes.' The TCFD recommendations are not intended as a box-ticking exercise, but as a framework to inform business and investment decisions alike.

2

Second, the disclosure landscape is evolving rapidly and the pressure to disclose is growing. The policy and regulatory tide in an increasing number of jurisdictions is turning towards mandatory climate risk disclosure and 2050 net zero targets. Companies that have not yet started out on their climate risk disclosure and net zero planning should begin without delay.

3

Finally, be careful about misreading the recommendations of the TCFD as flexible and easy to meet. Serious implementation of them requires genuine and ongoing commitment not only from the leadership but right across the business, and the appropriate resources to be made available. A light touch approach will not provide financial stakeholders with the decision-useful information they need and could result in substantial risk management issues if the company fails to fully understand and act on the impacts of climate change on its business.

4. https://sciencebasedtargets.org/companies-taking-action

Contact Us

KPMG in Malaysia

Datuk Johan Idris
Managing Partner
E: jidris@kpmg.com.my

Chan Siew Mei
Head of Advisory
E: siewmeichan@kpmg.com.my

Adrian Lee
Deputy Head of Advisory
E: allee@kpmg.com.my

Phang Oy Cheng
Head of Sustainability Advisory Services
E: oychengphang@kpmg.com.my

The Malaysian Institute of Certified Public Accountants (MICPA)

Dr. Veerinderjeet Singh
President
E: micpa@micpa.com.my

Novie Tajuddin
Chief Executive Officer
E: novie@micpa.com.my

Chiam Pei Pei
Executive Director, Technical
E: peipei@micpa.com.my

kpmg.com.my

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

micpa.com.my